

Components of the Fair Value Definition

Asset/Liability

Price

Principal (or Most Advantageous) Market -

Application to Assets -

Fair Value Hierarchy



Disclosures

Relevant Literature

FAS 157, Fair Value Measurements *FSP*
FAS 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement Under Statement 13
FSP FAS 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

Payment *FASB Statement No. 123, Share-Based*

Stock Options and Stock Purchase Plans *SSAP No. 13—*

FAS 107, Disclosures about Fair Value of Financial Instruments
FSP FAS 107-1 and APB-1, Interim Disclosures about Fair Value of Financial Instruments

Exhibit A - Disclosure Illustrations:

Assets Measured at Fair Value on a Recurring Basis:

<i>(In millions)</i>	Level 1	Level 2	Level 3	Total

Assets Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3):

	Equity Securities	Separate Account Assets	Derivative Assets	Derivative Liabilities	Total
	\$	\$	\$	\$	\$

Total Gains or Losses (realized/unrealized)

Balance at 12/31/0X

Total gains (losses) included in income attributable to instruments held at the reporting date

\$ \$ \$ \$

Assets Measured at Fair Value on a Nonrecurring Basis:

DISCUSSION:

Modifications to Generally Accepted Accounting Principles

FASB Statement No. 123R, Share-Based Payment

Options and Stock Purchase Plans

SSAP No. 13—Stock

EITF 08-05, Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement

*Disclosures about Fair Value of Financial Instruments
107-1 and APB-1, Interim Disclosures about Fair Value of Financial Instruments*

*FAS 107,
FSP FAS*

Modifications to Statutory Accounting Principles

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

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

INT 03-03: Admissibility of Investments Recorded Based on the Audited GAAP Equity of the Investee when a Qualified Opinion is Provided

INT 04-07: EITF 02-15: Determining Whether Certain Conversations of Convertible Debt to Equity Securities Are Within the Scope of FASB Statement No. 84

INT 06-07: Definition of Phrase “Other Than Temporary”

INT 09-04, Application of the Fair Value Definition

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

Fair Value - The fair value of an asset (or liability) is the amount at which that asset (or liability)

Fair Value Measurements

The Asset or Liability

6. A fair value measurement is for a particular asset or liability. Therefore, the measurement should consider attributes specific to the asset or liability, for example, the condition and/or location of the asset or liability and restrictions, if any, on the sale or use of the asset at the measurement date. The asset or liability might be a standalone asset or liability (for example, a financial instrument or an operating asset) or a group of assets and/or liabilities (for example, an asset group, a reporting unit, or a business). Whether the asset or liability is a standalone asset or liability or a group of assets and/or liabilities depends on its unit of account. The unit of account determines what is being measured by reference to the level at which the asset or liability is aggregated (or disaggregated) for purposes of applying other accounting pronouncements. The unit of account for the asset or liability should be determined in accordance with the provisions of other accounting pronouncements, except as provided in paragraph 27.

The Price

7. A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale). The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. Therefore, the objective of a fair value measurement is to determine the price that would be received to sell the asset or paid to transfer the liability at the measurement date (an exit price).

The Principal (or Most Advantageous) Market

8. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The principal market is the market in which the reporting entity would sell the asset or transfer the liability with the greatest volume and level of activity for the asset or liability. The most advantageous market is the market in which the reporting entity would sell the asset or transfer the liability with the price that maximizes the amount that would be received for the asset or minimizes the amount that would be paid to transfer the liability, considering transaction costs in the respective market(s). In either case, the principal (or most advantageous) market (and thus, market participants) should be considered from the perspective of the reporting entity, with the principal market(s) for the asset or liability being the market(s) in which the reporting entity would sell the asset or transfer the liability (or, in the absence of a principal market, the market(s) in which the reporting entity would sell the asset or transfer the liability with the price that maximizes the amount that would be received for the asset or minimizes the amount that would be paid to transfer the liability, considering transaction costs in the respective market(s)).

- a. Independent of the reporting entity; that is, they are not related parties
- b. Knowledgeable, having a reasonable understanding about the asset or liability and the transaction based on all available information, including information that might be obtained through due diligence efforts that are usual and customary
- c. Able to transact for the asset or liability
- d. Willing to transact for the asset or liability; that is, they are motivated but not forced or otherwise compelled to do so.

11. The fair value of the asset or liability shall be determined based on the assumptions that market participants would use in pricing the asset or liability. In developing those assumptions, the reporting entity need not identify specific market participants. Rather, the reporting entity should identify characteristics that distinguish market participants generally, considering factors specific to (a) the asset or liability, (b) the principal (or most advantageous) market for the asset or liability, and (c) market participants with whom the reporting entity would transact in that market.

Application to Assets

12. A fair value measurement assumes the highest and best use of the asset by market participants, considering the use of the asset that is physically possible, legally permissible, and financially feasible at the measurement date. In broad terms, highest and best use refers to the use of an asset by market participants that would maximize the value of the asset or the group of assets within which the asset would be used. Highest and best use is determined based on the use of the asset by market participants, even if the intended use of the asset by the reporting entity is different.

13. The highest and best use of the asset establishes the valuation premise used to measure the fair value of the asset. Specifically:

- a. **In-use.** The highest and best use of the asset is in-use if the asset would provide maximum value to market participants principally through its use in combination with other assets as a group (as installed or otherwise configured for use). For example, that might be the case for certain nonfinancial assets. If the highest and best use of the asset is in-use, the fair value of the asset shall be measured using an in-use valuation premise. When using an in-use valuation premise, the fair value of the asset is determined based on the price that would be received in a current transaction to sell the asset assuming that the asset would be used with other assets as a group and that those assets would be available to market participants. Generally, assumptions about the highest and best use of the asset should be consistent for all of the assets of the group within which it would be used.
- b. **In-exchange.** The highest and best use of the asset is in-exchange if the asset would provide maximum value to market participants principally on a standalone basis. For example, that might be the case for a financial asset. If the highest and best use of the asset is in-exchange, the fair value of the asset shall be measured using an in-exchange valuation premise. When using an in-exchange valuation premise, the fair value of the asset is determined based on the price that would be received in a current transaction to sell the asset standalone.

14. Because the highest and best use of the asset is determined based on its use by market participants, the fair value measurement considers the assumptions that market participants would use in pricing the asset, whether using an in-use or an in-exchange valuation premise.

Application to Liabilities

15. A fair value measurement assumes that the liability is transferred to a market participant at the measurement date (the liability to the counterparty continues; it is not settled) and that the nonperformance risk relating to that liability is the same before and after its transfer. Nonperformance risk refers to the risk that the obligation will not be fulfilled and affects the value at which the liability is transferred. Therefore, the fair value of the liability shall reflect the nonperformance risk relating to that liability. Nonperformance risk includes but may not be limited to the reporting entity's own credit risk. The reporting entity shall consider the effect of its credit risk (credit standing) on the fair value of the liability in all periods in which the liability is measured at fair value. That effect may differ depending on the liability, for example, whether the liability is an obligation to deliver cash (a financial liability) or an obligation to deliver goods or services (a nonfinancial liability), and the terms of credit enhancements related to the liability, if any.

Fair Value at Initial Recognition

16. When an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price represents the price paid to acquire the asset or received to assume the liability (an entry price). In contrast, the fair value of the asset or liability represents the price that would be received to sell the asset or paid to transfer the liability (an exit price). Conceptually, entry prices and exit prices are different. Entities do not necessarily sell assets at the prices paid to acquire them. Similarly, entities do not necessarily transfer liabilities at the prices received to assume them.

17. In many cases, the transaction price will equal the exit price and, therefore, represent the fair value of the asset or liability at initial recognition. In determining whether a transaction price represents the fair value of the asset or liability at initial recognition, the reporting entity shall consider factors specific to the transaction and the asset or liability. For example, a transaction price might not represent the fair value of an asset or liability at initial recognition if:

- a. The transaction is between related parties.
- b. The transaction occurs under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty.
- c. The unit of account represented by the transaction price is different from the unit of account for the asset or liability measured at fair value. For example, that might be the case if the asset or liability measured at fair value is only one of the elements in the transaction, the transaction includes unstated rights and privileges that should be separately measured, or the transaction price also delivers goods or services that should be separately measured.

daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

Level 2 Inputs

28. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

- a. Quoted prices for similar assets or liabilities in active markets
- b. Quoted prices for identical or similar assets or liabilities in markets that are not active. (Paragraph 29A includes example factors that may indicate that a market is not active or that there has been a significant decrease in the volume and level of activity for the asset or liability when compared to normal market activity for the asset or liability (or similar assets or liabilities), depending on the degree to which the factors exist.)
- c. Inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates)
- d. Inputs that are derived principally from or corroborated by observable market data by correlation or other means (market-corroborated inputs).

29. Adjustments to Level 2 inputs will vary depending on factors specific to the asset or liability. Those factors include the condition and/or location of the asset or liability, the extent to which the inputs relate to items that are comparable to the asset or liability, and the volume and level of activity in the markets within which the inputs are observed. An adjustment that is significant to the fair value measurement in its entirety might render the measurement a Level 3 measurement, depending on the level in the fair value hierarchy within which the inputs used to determine the adjustment fall.

29A. The reporting entity should evaluate the following factors to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability when compared with normal market activity for the asset or liability (or similar assets or liabilities). The factors include, but are not limited to:

- a. There are few recent transactions.
- b. Price quotations are not based on current information.
- c. Price quotations vary substantially either over time or among market makers (for example, some brokered markets).
- d. Indexes that previously were highly correlated with the fair values of the asset or liability are demonstrably uncorrelated with recent indications of fair value for that asset or liability.
- e. There is a significant increase in implied liquidity risk premiums, yields, or performance indicators (such as delinquency rates or loss severities) for observed transactions or quoted prices when compared with the reporting entity's estimate of expected cash flows, considering all available market data about credit and other nonperformance risk for the asset or liability.
- f. There is a wide bid-ask spread or significant increase in the bid-ask spread.

- g. There is a significant decline or absence of a market for new issuances (that is, a primary market) for the asset or liability or similar assets or liabilities.
- h. Little information is released publicly (for example, a principal-to-principal market).

The reporting entity shall evaluate the significance and relevance of the factors to determine whether, based on the weight of the evidence, there has been a significant decrease in the volume and level of activity for the asset or liability.

29B. If the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), transactions or quoted prices may not be determinative of fair value (for example, there may be increased instances of transactions that are not orderly). Further analysis of the transactions or quoted prices is needed, and a significant adjustment to the transactions or quoted prices may be necessary to estimate fair value in accordance with this Statement. Significant adjustments also may be necessary in other circumstances (for example, when a price for a similar asset requires significant adjustment to make it more comparable to the asset being measured or when the price is stale).

29C. This Statement does not prescribe a methodology for making significant adjustments to transactions or quoted prices when estimating fair value. Paragraphs 18-20 discuss the use of valuation techniques in estimating fair value. If there has been a significant decrease in the volume and level of activity for the asset or liab

- c. The seller is in or near bankruptcy or receivership (that is, distressed), or the seller was required to sell to meet regulatory or legal requirements (that is, forced).
- d. The transaction price is an outlier when compared with other recent transactions for the same or similar asset or liability.

The reporting entity shall evaluate the circumstances to determine whether the transaction is orderly based on the weight of the evidence.

29F. The determination of whether a transaction is orderly (or not orderly) is more difficult if there has been a significant decrease in the volume and level of activity for the asset or liability. Accordingly, the reporting entity shall consider the following guidance:

- a. If the weight of the evidence indicates the transaction is not orderly, the reporting entity shall place little, if any, weight (compared with other indications of fair value) on that transaction price when estimating fair value or market risk premiums.
- b. If the weight of the evidence indicates the transaction is orderly, the reporting entity shall consider that transaction price when estimating fair value or market risk premiums. The amount of weight placed on that transaction price when compared with other indications of fair value will depend on the facts and circumstances such as the volume of the transaction, the comparability of the transaction to the asset or liability being measured at fair value, and the proximity of the transaction to the measurement date.

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reflects market participant assumptions (including assumptions about risks). In weighting a quoted price as an input to a fair value measurement, the reporting entity should place less weight (when compared with other indications of fair value that are based on transactions) on quotes that do not reflect the result of transactions. Furthermore, the nature of the quote (for example, whether the quote is an indicative price or a binding offer) should be considered when weighting the available evidence, with more weight given to quotes based on binding offers.

Level 3 Inputs

30. Level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, that is, an exit price from the perspective of a mark

changes in net assets), and a description of where those gains or losses included in earnings (or changes in net assets) are reported in the statement of income (or activities)

- (2) Purchases, sales, issuances, and settlements (net)
- (3) Transfers in and/or out of Level 3 (for example, transfers due to changes in the observability of significant inputs)

- d. The amount of the total gains or losses for the period in subparagraph (c)(1) above included in earnings (or changes in net assets) that are attributable to the change in unrealized gains or losses relating to those assets and liabilities still

interim periods within those fiscal years. Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including any financial statements for an interim period within that fiscal year.

*SSAP No. 27—Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk,
Financial Instruments with Concentrations of C*

- d. The disclosures in (i) and (ii) above should be segregated by those common stocks that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer using fair values determined in accordance with ~~SSAP No. 27~~ SSAP No. 100—Fair Value Measurements.
- f. When it is not practicable to estimate fair value in accordance with ~~SSAP No. 27~~, the investor should disclose the following additional information, if applicable, as of each date for which a statement of financial position is presented in its annual financial statements:

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

10. At acquisition, preferred stock shall be reported at cost, including brokerage and other related fees. ~~Cost shall not exceed fair value.~~ PIK stock received as dividends shall be recorded at fair value. Acquisitions and dispositions shall be recorded on the trade date. Private placement stock transactions shall be recorded on the funding date.

29. The following disclosures regarding preferred stocks shall be made in the financial statements:

- a. ~~Fair values in accordance with SSAP No. 100—Fair Value Measurements~~ SSAP No. 27—Disclosure of Information about Financial Instruments with Off-Balance Sheet Risk, Financial Instruments with Concentrations of Credit Risk and Disclosures about Financial Instruments

determined fair value of the loan is less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs, and unamortized premium or discount), a new cost basis shall be established at the fair value with the difference being recorded as a realized

account. The debt discount should be amortized by the interest method, using the effective interest rate. After inception, adjustment of the participation liability should occur at each reporting date to current fair value. The corresponding debit or credit should be to the related debt discount account. The revised debt discount should be amortized prospectively, using the effective interest rate method.

20. The real estate investment with the participating mortgage loan should be reported in accordance with paragraph 4, with no adjustment for appreciation of ~~market value~~fair value.

24. An entity that holds real estate investments with participating mortgage loan features should disclose:

- a. Aggregate amount of participating mortgage obligations at the balance-sheet date, with separate disclosure of the aggregate participation liabilities and related debt discounts.

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22. An IMR is required for separate accounts with assets recorded at book value, but is not required for separate accounts with assets recorded at ~~market-fair~~ value. For example, separate accounts for traditional variable annuities or variable life insurance do not require an IMR because assets and liabilities are valued at ~~market-fair~~ value.

26. Where separate account contracts have guaranteed elements, the basis for determining the value of the liability shall be consistent with the basis used for asset values (i.e., valuation interest rates as defined in Appendix A-820 shall be used when assets are recorded as if held in the general account and current interest rates based on market rates shall be used when assets are recorded at ~~market-fair value~~). Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

31. For each risk-based capital grouping (as detailed in paragraph 32), the following shall be disclosed:

- a. Premiums, considerations or deposits received during the year;
- b. Reserves by the valuation basis of the investments supporting the reserves at the financial statement date. List reserves for separate accounts whose assets are carried at ~~market-fair value~~ separately from those whose assets are carried at amortized cost/book value;
- c. Reserves by withdrawal characteristics, i.e., whether or not the separate account is subject to discretionary withdrawal or market value adjustment, or to withdrawal at book value with or without surrender charge;

32. For the disclosures required in paragraph 31, separate accounts shall be addressed in the following groupings (which are the same as those used for risk-based capital):

- b. Nonguaranteed Separate Accounts-Variable separate accounts, where the benefit is determined by the performance and/or ~~market-fair~~ value of the investments held in the separate account. Include variable accounts with incidental risks, nominal expense, and minimum death benefit guarantees.

41. This statement is effective for years beginning January 1, 2001. Contracts with assets held in a Separate Account that were issued in accordance with applicable state laws and regulations and issued prior to that effective date, for which assets and liabilities have been recorded using a consistent basis since issue, i.

1.b.ii(a) - Options, warrants, caps, or floors purchased or written shall be valued at current fair value ~~(marked to market)~~ with changes in fair value recognized currently consistent with the hedged item; this will result in unrealized gain/loss treatment with adjustment to unassigned funds (surplus).

1.b.iii. - Open derivatives hedging items recorded at fair value, where gains and losses on the hedged item are recognized currently in earnings: options, warrants, caps, or floors purchased or written shall be valued at current fair value ~~(marked to market)~~ with changes in fair value recognized currently in earnings together with the gains and losses on the hedged item.

1.b.iii.(b) - If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, recognition of changes in fair value through earnings ceases. The derivative or the designated portion of the derivative shall continue to be valued at its current fair value ~~(marked to market)~~, but thereafter gains or losses shall be recognized in unrealized gains or unrealized losses to the extent it ceased to be an effective hedge.

2.b.i.(5) - If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, valuation at amortized cost ceases and the derivative or a designated portion of the derivative shall be valued at its current fair value ~~(marked to market)~~ with gains and losses recorded in unrealized gains or unrealized losses to the extent that it ceased to be an effective hedge. Upon redesignation into an effective hedging relationship, the derivative's mark to fair value through unrealized gain or loss shall be reversed.

2.b.ii(a) - Swaps, collars, or forwards shall be valued at current fair value ~~(marked to market)~~ with

41. The modifications to FAS 144 were made in order to maintain consistency with current statutory accounting principles and the Statement of Concepts:

- d. Paragraphs 22-24 which discuss fair value, are rejected. The definition of fair value is in SSAP No. 100—Fair Value Measurements, ~~the glossary to the~~ Statement of Statutory Accounting Principi

their fair value. (Fair value shall be determined in accordance with SSAP No. 100—Fair Value Measurements (Glossary to the Statements of Statutory Accounting Principles);

Glossary: Derivative financial instrument - A derivative instrument (as defined in SSAP No. 86—*Accounting for Derivative Instruments and H*

INT 99-29: Classification of Step-up Preferred Stock

4. A strict reading of the perpetual preferred stock definition further complicates the issue in that step-ups do not have redemption features: thus, they meet the definition of perpetual preferred stock. The valuation of step-up preferred stock would not be consistent with the economic substance of the security if it were valued at ~~market~~fair value.

INT 01-14: EITF 00-16: Recognition and Measurement of Employer Payroll Taxes on Employee Stock-Based Compensation

1. *Topic No. D-83, Accounting for Payroll Taxes Associated with Stock Option Exercises* requires that payroll taxes incurred in connection with stock-based compensation be recognized as an expense, but it does not address the timing of that -6(but Tw 3.5Th1 noTd()Tj0.00027f-184434 16.677 0 T sed

example, a bondholder may be a third party that purchased the bonds in the open market (often at a significant discount from face value) and approached the debtor to increase the conversion terms of the notes. In many of those circumstances, the offer to induce conversion is not extended to all debt holders; rather, the conversion involves only the specific debt holder.