Components of the Fair Value Definition

7. Asset/Liability - 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).

8. *Price* - 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).

9. Principal (or Most Advantageous) Market - 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, thereby allowing for differences between and among entities with different

- c. Able to transact for the asset or liability; and
- d. Willing to transact for the asset or liability; that is, they are motivated but not forced or otherwise compelled to do so.

12. 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.

13. Application to Assets - 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.

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

- a. <u>In-use</u> 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 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. <u>In-exchange</u> 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 price that would be received in a current transaction to sell the asset standalone.

15. 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, wheally

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decrease reported liabilities and thus seemingly incr

Valuation techniques used to measure fair value shall maximize the use of observable inputs and minimize the use of unobservable inputs.

Fair Value Hierarchy

23. To increase consistency and comparability in fair value measurements and related disclosures, the

Level 2 Inputs

29. 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, that is, markets in which there are few transactions for the asset or liability, the prices are not current, or price quotations vary substantially either over time or among market makers (for example, some brokered markets), or in which little information is released publicly (for example, a principal-to-principal market)
- 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

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g. There is a significant decline or absence of

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.

36. 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.
- c. If the reporting entity does not have sufficient information to conclude that the transaction is orderly or that the transaction is not orderly, it shall consider that transaction price when estimating fair value or market risk premiums. However, that transaction price may not be determinative of fair value (that is, that transaction price may not be the sole or primary basis for estimating fair value or market risk premiums). The reporting entity shall place less weight on transactions on which the reporting entity does not have sufficient information to conclude whether the transaction is orderly when compared with other transactions that are known to be orderly.

In its determinations, the reporting entity need not undertake all possible efforts, but shall not ignore information that is available without undue cost and effort. The reporting entity would be expected to have sufficient information to conclude whether a transaction is orderly when it is party to the transaction.

37. Regardless of the valuation technique(s) used, the reporting entity shall include appropriate risk adjustments. Risk-averse market participants generally seek compensation for bearing the uncertainty inherent in the cash flows of an asset or liability (risk premium). A fair value measurement should include a risk premium reflecting the amount market participants would demand because of the risk (uncertainty) in the cash flows. Otherwise, the measurement would not faithfully represent fair value. In some cases, determining the appropriate risk premium might be difficult. However, the degree of difficulty alone is not a sufficient basis on which to exclude a risk adjustment. Risk premiums should be reflective of an orderly transaction (that is, not a forced or distressed sale) between market participants at the measurement date under current market conditions.

38. When estimating fair value, this issue paper does not preclude the use of quoted prices provided by third parties, such as pricing services or brokers, when the reporting entity has determined that the quoted prices provided by those parties are determined in accordance with this issue paper. However, when there has been a significant decrease in the Volume or level of activity for the asset or liability, the reporting entity should evaluate whether those quoted prices are based on current information that reflects

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

39. 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 market participant that holds the asset or owes the liability. Therefore, unobservable inputs shall reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). Unobservable inputs shall be developed based on the best information available in the circumstances, which might include the reporting entity's own data. In developing unobservable inputs, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. However, the reporting entity shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the reporting entity's own data used to develop unobservable inputs shall be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions.

Inputs Based on Bid and Ask Prices

40. If an input used to measure fair value is based on bid and ask prices (for example, in a dealer market), the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value, regardless of where in the fair value hierarchy the input falls (Level 1, 2, or 3). This issue paper does not preclude the use of mid-market pricing or other pricing conventions as a practical expedient for fair value measurements within a bid-ask spread.

Disclosures

41. For assets and liabilities that are measured at fair value on a recurring basis in periods subsequent to initial recognition (for example, common stock), the reporting entity shall disclose information that enables users of its financial statements to assess the inputs used to develop those measurements and for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on earnings (or changes in net assets) for the period. To meet that objective, the reporting entity shall disclose the following information for each interim and annual period separately for each major category of assets and liabilities (for equity and debt securities), major category shall be defined as major security type:

- a. The fair value measurements at the reporting date and the source of the fair value measurement. (Source of fair value measurement is only required in annual audited reporting periods.)
- b. The level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3)
- c. For fair value measurements using significant unobservable inputs (Level 3), a reconciliation of the beginning and ending balances, separately presenting changes during the period attributable to the following:

- (1) Total gains or losses for the period (realized and unrealized), segregating those gains or losses included in earnings (or 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 held at the reporting date and a description of where those unrealized gains or losses are reported in the statement of income (or activities)
- e. The inputs and valuation technique(s) used to measure fair value and a discussion of changes in valuation techniques and related inputs, if any, during the period.

42. For assets and liabilities that are measured at fair value on a nonrecurring basis in periods subsequent to initial recognition (for example, impaired assets), the reporting entity shall disclose information that enables users of its financial statements to assess the inputs used to develop those measurements. To meet that objective, the reporting entity shall disclose the following information for each interim and annual period separately for each major category of assets and liabilities (for equity and debt securities major category shall be defined as major security type):

- a. The fair value measurements recorded during the period and the reasons for the measurements
- b. The level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3)
- c. For fair value measurements using significant unobservable inputs (Level 3), a description of the inputs and the information used to develop the inputs
- d. The inputs and valuation technique(s) used to measure fair value and a discussion of changes, if any, in the valuation technique(s) and related inputs used to measure similar assets and/or liabilities in prior periods.

43. The quantitative disclosures required by this issue paper shall be presented using a tabular format. (See Exhibit A.)

44. The reporting entity is encouraged, but not required, to combine the fair value information disclosed under this issue paper with the fair value information disclosed under other accounting pronouncements (for example, disclosures about fair value of financial instruments) in the periods in which those disclosures are required, if practicable. The reporting entity also is encouraged, but not required, to disclose information about other similar measurements, if practicable.

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. Finally, it might be practicable for an entity to estimate the fair value only of a subset of a class of financial instruments; the fair value of that subset should be disclosed.

Relevant Literature

49. This issue paper adopts with modification FAS 157, Fair Value Measurements; (FAS 157) 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 157-1) and 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 (FSP FAS 157-4). Modifications from FAS 157, FSP FAS 157-1 and FSP FAS 157-4 include:

- a. This issue paper does not adopt the scope exclusion within paragraph 2.a. of FAS 157 regarding share-based payment transactions. *FASB Statement No. 123, Share-Based Payment,* and its related interpretive accounting pronouncements that address share-based payment transactions are still being considered for statutory accounting. If these GAAP standards are adopted for statutory accounting, consideration will be given to incorporating an exclusion for determining fair value in accordance with the guidance under this issue paper. This issue paper is considered applicable under *SSAP No. 13—Stock Options and Stock Purchase Plans* (SSAP No. 13)
- b. This issue paper does not adopt the scope exclusions within paragraph 3 of FAS 157 for accounting pronouncements that require or permit measurements that are similar to fair value but that are not intended to measure fair value, including (a) accounting pronouncements that permit measurements that are based on, or otherwise use, vendor-specific objective evidence of fair value and (b) inventory pricing. These items are excluded as they are not prevalent within statutory accounting.
- c. This issue paper does not adopt guidance from FAS 157 regarding the consideration of non-performance risk (own credit risk) in determining the fair value measurement of liabilities. The consideration of own credit-risk in the measurement of fair value liabilities is inconsistent with the statutory accounting concept of conservatism and the assessment of financial solvency for insurers. The fair value determination for liabilities should follow the guidance adopted from FAS 157, with the exception of the consideration of own-performance risk.
- d. This issue paper includes revisions to reference statutory standards or terms instead of GAAP standards or terms.
- e. This issue paper incorporates the guidance from SSAP No. 27 regarding disclosures about fair value of financial instruments. This incorporated SSAP No. 27 guidance was adopted from FAS 107, Disclosures about Fair Value of Financial Instruments (FAS 107) and was revised to adopt FSP FAS 107-1 and APB-1, Interim Disclosures about Fair Value of Financial Instruments (FSP FAS 107-1 and APB-1). For statutory purposes, the incorporation of this guidance within one standard results in having one comprehensive standard addressing fair value measurements and disclosures.

50. Paragraphs 42-44 adopt FAS 107 as amended by

Exhibit A - Disclosure Illustrations:

52. Assets Measured at Fair Value on a Recurring Basis:

| (In millions) | Level 1 | Level 2 | Level 3 | Total |
|--|---------|----------|---------|-------|
| Assets at fair value: | \$ | \$ | \$ | \$ |
| Preferred Stock Common Stock Sub Tatal | \$ | <u>ф</u> | \$ | \$ |
| Sub-Total | Φ | \$ | Φ | Φ |
| Derivative Assets Separate Account Assets | | | | |
| Total Assets at Fair Value | \$ | \$ | \$ | \$ |
| Liabilities at Fair Value: | | | | |
| Derivatives Liabilities Total Liabilities at Fair Value | \$ | \$ | \$ | \$ |
| I Ulai Liaunnies al Pari Value | Φ | Φ | Φ | φ |

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

| | Separate Equity Account | | Derivative Derivative | | |
|---|----------------------------|--------|-----------------------|-------------|-------|
| (In millions) | Securities | Assets | Assets | Liabilities | Total |
| Balance at 1/1/0X: | \$ | \$ | \$ | \$ | \$ |
| Total Gains or Losses (realized/unrealized) | | | | | |
| Included in net income | | | | | |
| Included in surplus | | | | | |
| Purchases, issuances and settlements | | | | | |
| Transfers in (out) of Level 3 | | | | | |
| Balance at 12/31/0X | | | | | |
| Total gains (losses) included in income | | | | | |
| attributable to instruments held at the | | | | | |
| reporting date | \$ | \$ | \$ | \$ | |

| Description | 12/31/0X | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Gains (Losses) |
|--------------------|----------|--|---|---|-------------------------|
| Bonds | | | | | |
| Preferred Stock | | | | | |

54. Assets Measured at Fair Value on a Nonrecurring Basis:

DISCUSSION:

55. In considering FAS 157 for statutory accounting, the Statutory Accounting Principles Working Group agreed that a consistent definition of fair value should be established to address inconsistencies that may exist on the definition and application of fair value within individual statements of statutory accounting principles. Furthermore, the Working Group agreed that the statutory definition and application of fair value should be similar to the GAAP definition of fair value to minimize situations in which "fair value" is calculated differently between GAAP and SAP. By having similar fair value definitions, it is presumed that assets reported at fair value will not vary between GAAP and SAP financial statements. As illustrated within this issue paper, for determining the fair value of liabilities, the concept of considering own credit risk has been rejected for statutory accounting. Thus, it is presumed that in some instances fair value measurements under GAAP and SAP for liabilities will differ.

Modifications to Generally Accepted Accounting Principles

56. This issue paper does not incorporate the GAAP concept of "unit of account". This GAAP concept reflects the application of the fair value measurement guidance to assets or liabilities that are based in groups or lots. Statutory accounting has not previously endorsed the concept of "unit of account" as the statutory measurement of financial instruments is calculated in accordance with single securities. Thus, this term has not been reflected within the statutory accounting fair value measurement guidance.

57. This issue paper does not adopt the scope exclusion within paragraph 2.a. of FAS 157 regarding share-based payment transactions. *FASB Statement No. 123R, Share-Based Payment,* and its related interpretive accounting pronouncements that address share-based payment transactions are still being considered for statutory accounting. If these GAAP standards are adopted for statutory accounting, consideration will be given to incorporating an exclusion for determining fair value in accordance with the guidance under this issue paper. This issue paper is considered applicable under *SSAP No. 13—Stock Options and Stock Purchase Plans* (SSAP No. 13).

58. This issue paper does not adopt the scope exclusions within paragraph 3 of FAS 157 for accounting pronouncements that require or permit measurements that are similar to fair value but that are not intended to measure fair value, including (a) accounting pronouncements that permit measurements that are based on, or otherwise use, vendor-specific objective evidence of fair value and (b) inventory pricing. These items are excluded as they are o. 1entory

EITF 08-05, Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement (EITF 08-05). Thus, under statutory accounting, liabilities measured at fair value shall not include the issuer's own credit risk, or reflect any third-party guarantee of debt. The consideration of non-performance risk is considered inconsistent with the recognition concept as protection of the policyholders can only be maintained through continued monitoring of the financial condition of the insurance enterprise. If statutory liabilities reflected the reporting entity's non-performance risk, the balance sheet would ineffectively illustrate the financial condition of the insurer.

60. This issue paper includes revisions to reference statutory standards or terms instead of GAAP standards or terms.

61. This issue paper incorporates the guidance from SSAP No. 27 regarding disclosures about fair value of financial instruments. This incorporated SSAP No. 27 guidance was adopted from *FAS 107*, *Disclosures about Fair Value of Financial Instruments* (FAS 107) and was revised to adopt *FSP FAS 107-1 and APB-1*, *Interim Disclosures about Fair Value of Financial Instruments* (FSP FAS 107-1 and APB-1). For statutory purposes, the incorporation of this guidance within one standard results in having one comprehensive standard addressing fair value measurements and disclosures.

Modifications to Statutory Accounting Principles

62. This issue paper proposes the establishment of a singul

value disclosure requirements, including financial instruments disclosures, and references to adopted GAAP guidance pertaining to fair value will be incorporated within the new SSAP on fair value measurements. (SSAP No. 27 will be retained for the other items addressed within this standard.) The modification proposed is a variation from GAAP as FAS 107 still includes fair value disclosure requirements for financial instruments. However, this issue paper concludes that the paragraphs currently included within SSAP No. 27 for statutory financial instrument disclosures would be more appropriately placed, and improve the ease of application, if included in the new SSAP on fair value measurements.

- SSAP No. 30—Investments in Common Stock (excluding investments in common stock of e. subsidiary, controlled or affiliated entities) (SSAP No. 30) – Reference to SSAP No. 27 in paragraphs 13.d. and 13.f. will be revised to reference the new SSAP on fair value measurements. Paragraph 5 will be revised to remove the sentence "Cost shall not exceed fair value." Retention of this sentence would result with a difference between GAAP and SAP if FAS 157 is adopted, as proposed within this issue paper, for statutory accounting. In accordance with FAS 157, transaction costs would be initially included in 'cost' at acquisition. For subsequent reporting, unrealized gains/losses would be reflected to illustrate the difference between the acquisition cost and fair value. If the existing SSAP No. 30, paragraph 5 guidance was retained for statutory accounting, the initial recognition of the asset would have an immediate unrecognized loss (assumed to represent transaction costs if purchased at fair value). As at subsequent reporting, the GAAP and SAP valuation of the asset would both reflect fair value, and as transaction costs are typically immaterial, the existing variation from GAAP seems to generate an operational difference between GAAP and SAP that would not provide a significant impact to capital and surplus for statutory purposes.
- f. SSAP No. 32—Investments in Preferred Stock (including investments in preferred stock of subsidiary, controlled or affiliated entities) (SSAP No. 32) Reference to SSAP No. 27 in paragraphs 29.a. and 29.f. will be revised to reference the new SSAP on fair value measurements. Paragraph 10 will be revised to remove the sentence "Cost shall not exceed fair value." Retention of this sentence would result with a difference between GAAP and SAP if FAS 157 is 0.0004 Tc 0.1321 Tw -20.399 -1.159 Td[cost Reference tetween)Thu

appraisal if market quotes are unavailable will be retained. Reference to "market value" in paragraphs 19, 20 and 24.b. will be deleted and replaced with the term "fair value".

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the AP& P manual in paragraphs 16 and 41.d. will be revised to refer to the new SSAP on fair value measurements. Additionally, the term "market price" in paragraph 5.a. will be replaced with the term "fair value".

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paragraph 3, the term "market" in the last paragraph will be revised to reflect "fair value". In paragraph 4, the statement "Mark AFS and Trading to market" will be revised to read "Mark AFS and Trading to fair value".

- cc. INT 03-03: Admissibility of Investments Recorded Based on the Audited GAAP Equity of the Investee when a Qualified Opinion is Provided (INT 03-03) Reference to "market value" in paragraph 2 will be revised to reflect "fair value".
- dd. 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 04-07) – The term "fair market value" throughout paragraph 4 will be revised to reflect "fair value".
- ee. *INT 06-07: Definition of Phrase "Other Than Temporary"* (INT 06-07) The reference to the definition of fair value within the Glossary will be revised to reflect the new SSAP on fair value measurements.
- ff. *INT 09-04, Application of the Fair Value Definition* (INT 09-04) This interpretation will be nullified with the issuance of this standard. (As this item will be completely nullified, this item has not been included within Appendix A.)

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

63. Statutory accounting guidance for the definition of fair value is primarily included within the Glossary to Statutory Accounting Principles. In limited situations the definition of fair value is further defined within individual SSAPs, but the guidance within the Glossary is the underlying guidance for the previous definition of fair value within statutory accounting statements:

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

Fair Value Measurements

Generally Accepted Accounting Principles

68. The GAAP guidance for the fair value measurements is included within FAS 157, as modified by FSP FAS 157-1, FSP FAS 157-2 and FSP FAS 157-4: (Note: FSP FAS 157-3 is not reflected in the amended FAS 157, as the modifications included within FSP FAS 157-4 deleted all revisions originally incorporated by FSP FAS 157-3.)

1. This Statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Where applicable, this Statement simplifies and codifies related guidance within generally accepted accounting principles (GAAP).

Scope

2. This Statement applies under other accounting pronouncements 1 that require or permit fair value measurements, except as follows:

a. This Statement does not apply under accounting pronouncements that address share-based payment transactions: *FASB Statement No. 123 (revised 2004), Share-Based Payment*, and its related interpretive accounting pronouncements that address share-based payment transactions.

b. This Statement does not eliminate terrets Stavielminentheboeisstoepreferatif trahisD TA(b.)-o 10.980.0168aed Statement.

c. This Statement does not apply under FASB Statement No. 13, Accounting for L.01es

The Asset or Liability

6. A fair value measurement is for a particular asset or liability. 4 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 seeside ind, fitbat the divergence integes until principal suntil principal fortbid ferrences while for the assumementice).

- 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 ao deliver goNsacti mightset t6(f accernit)TJ03Tj0 T290.080720ww 8.79 0 te

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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Fair Value Measurements

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 <u>SSAP No.</u> 27SSAP 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 <u>SSAP No. 100—Fair Value Measurements</u> <u>SSAP</u> <u>No. 27—Disclosure of Information about Financial Instruments with Off-Balance-Sheet</u> <u>Risk, Financial Instruments with Concentrations of Credit Risk and Disclosures about</u> <u>Financial Instruments</u> <u>with Concentrations</u> <u>of Credit Risk and Disclosures</u> <u>about</u> <u>Financial Instruments</u> <u>with Concentrations</u> <u>of States</u> <u>is a state of the states</u> <u>is a states <u>is a states</u> <u>is a states <u>is a states</u> <u>is a states <u>is a sta</u></u></u></u></u></u></u></u></u></u></u></u></u></u>

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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Issue Paper

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 <u>market-fair</u> 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 <u>market-fair</u> 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 marketfair 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;
- 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 <u>market fair</u> 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 <u>SSAP No. 100—Fair Value Measurements.</u> the glossary to the Statement of Statutory Accounting Principl

their fair value. (Fair value shall be determined in accordance with SSAP <u>No. 100—Fair Value Measurements</u> (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 marketfair 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 specificll debt holy the