

Interpretation of the Emerging Accounting Issues Working Group

INT 09-04: Application of the Fair Value Definition

ISSUE NULLIFIED BY SSAP NO. 100

INT 09-04 Dates Discussed

March 26, 2009; April 7, 2009; April 16, 2009; June 13, 2009

INT 09-04 References

Fair Value Definition in the Glossary to the *Accounting Practices and Procedures Manual*

INT 09-04 Issue

1. The accounting issue is application of the current definition of “fair value” within the Glossary to the Statutory Accounting Principles in situations when the volume and level or activity for the asset or liability have significantly decreased and to transactions which are forced or liquidation sales.

INT 09-04 Discussion

2. The working group reached a consensus that the following guidance shall be followed in determining fair value when the volume and level or activity for the asset or liability have significantly decreased and to transactions which are forced or liquidation sales:

3. Consistent with the current fair value definition, a quoted market price in an active market is the best evidence of fair value and shall be used as the basis of measurements when an active market exists.

4. Even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation techniques used, the objective of the fair value definition remains the same:

The fair value of an asset (or liability) is the amount at which that asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale.

5. Markets where the volume and level of activity for the asset or liability have significantly decreased do not require use of quoted prices as representations of fair value. Although the volume and level of activity for an asset or liability may significantly decrease, transactions for the asset or liability may still occur with sufficient frequency and volume to provide pricing information on an ongoing basis. The estimate of fair value under such market conditions shall be based on the best information available as described in the definition of “fair value” within the Glossary to the Accounting Practices and Procedures Manual. Consistent with the Glossary, in determining the best information available, consideration must be given to the assumptions that market participants would use in the estimates of values, future revenues, and future expenses, including assumptions about interest rates, default, prepayment and volatility. If estimates of expected future cash flows are used to estimate fair value, such information shall be the best estimate on reasonable and supportable assumptions and projections. All available evidence shall be considered in developing estimates of expected future cash flows. The weight given to the evidence shall be commensurate with the extent the evidence can be verified objectively.

6. Each reporting entity shall use its judgment in determining 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. This list of example factors is not considered all-inclusive, and any or all of these factors could provide the evidence necessary to determine whether a decrease in the volume and level of activity has occurred:

- 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).

7. If the reporting entity concludes that 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 a result of a forced or liquidation sale). 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. 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.)

8. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate (for example, the use of a market approach and a present value technique.). When weighing indications of fair value resulting from the use of multiple valuation techniques, a reporting entity shall consider the reasonableness of the range of fair value estimates. The objective is to determine the point within that range that is most representative of fair value under current market conditions. A wide range of fair value estimates may be an indication that further analysis is needed.

9. Determining the price at which willing market participants would transact at the measurement date under current market conditions if there has been a significant decrease in the volume and level of activity for the asset or liability depends on the facts and circumstances and requires the use of significant judgment. However, a reporting entity's intention to hold or

dispose of the asset or liability is not relevant in estimating fair value. Fair value is a market-based measurement, not an entity-specific measurement.

10. Even if there has been a significant decrease in the volume and level of activity for the asset or liability, it is not appropriate to conclude that all transactions are part of a forced or liquidation sale. Circumstances that may indicate that a transaction was part of a forced or liquidation sale:

- a. There was not adequate exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities under current market conditions.
- b. There was a usual and customary marketing period, but the seller marketed the asset or liability to a single market participant.
- c. The seller is in or near bankruptcy or receivership (that is, liquidation), 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.

A reporting entity shall evaluate the circumstances to determine whether the transaction is or is not part of a forced or liquidation sale based on the weight of the evidence.

11. The determination of whether a transaction is part of a forced or liquidation sale 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 part of a forced or liquidation sale, a reporting entity shall place little, if any, weight on that transaction price when estimating fair value or market risk premiums.
- b. If the weight of the evidence indicates that the transaction is not part of a forced or liquidation sale, a 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 not part of a forced or liquidation sale, 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). A reporting entity shall place less weight on transactions on which a reporting entity does not have sufficient information to conclude whether the transaction is part of a forced or liquidation sale when compared with other transactions that are known not to be part of a forced or liquidation sale.

12. In its determinations, a reporting entity need not undertake all possible efforts, but shall not ignore information that is available without undue cost and effort. A reporting entity would be expected to have sufficient information to conclude whether a transaction is part of a forced or liquidation sale when it is party to the transaction.

13. Regardless of the valuation techniques used, a reporting entity shall include appropriate risk adjustments. 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 a transaction, other than a forced or liquidation sale, between market participants at the measurement date under current market conditions.

14. When estimating fair value, the fair value definition does not preclude the use of quoted prices provided by third parties, such as pricing services or brokers, when a reporting entity has determined that the quoted prices provided by those parties are determined pursuant to the fair value definition. However, when there has been a significant decrease in the volume or level of activity for the asset or liability, a reporting entity shall evaluate whether those quoted prices are based on current information that does not reflect forced or liquidation sales or a valuation technique that reflects market participant assumptions (including assumptions about risks). In weighing a quoted price as an input to a fair value measurement, a 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 weighing the available evidence, with more weight given to quotes based on binding offers.

15. This consensus has an effective date for interim and annual financial reporting periods ending on or after June 30, 2009. The effective date is restricted to prospective application and prohibits retrospective application to a prior interim or annual reporting period.

INT 09-04 Status

16. No further discussion planned.