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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 singular standard to define fair value, establish a framework for measuring fair value and to address disclosures about fair value measurements. In order to implement a single standard for fair value guidance, with the adoption of the final standard the following corresponding modifications will be incorporated within existing statutory accounting guidance: (Appendix A illustrates these statutory accounting modifications.)

- a. *SSAP No. 2—Cash, Drafts, and Short-Term Investments* (SSAP No. 2) – Reference to SSAP No. 27 in paragraph 13.a. will be deleted, and replaced with reference to the SSAP on fair value measurements.
- b. *SSAP No. 13—Stock Options and Stock Purchase Plans* (SSAP No. 13) – Paragraph 8 will be deleted with the issuance of the fair value measurements SSAP. (FAS 157 does not apply under any pronouncements that address share-based payment transactions. Thus deleting paragraph 8 may be considered inconsistent with GAAP as references to fair value in this standard would inherently follow the guidance in the new SSAP. However, the determination of fair value currently included within paragraph 8 of SSAP No. 13 does not appear to contradict with the fair value definition proposed within this issue paper.) Reference to market price in paragraphs 3.d., 6 and 14 will be revised to reflect fair value.
- c. *SSAP No. 26—Bonds, Excluding Loan-Backed and Structured Securities* (SSAP No. 26) - Reference to SSAP No. 27 in paragraph 17.a. will be replaced with reference to the new SSAP on fair value measurements. Paragraph 4 will be revised to remove the phrase “which cannot exceed the fair value at the date of acquisition”. Retention of this phrase would result with a difference between GAAP and SAP if FAS 157 is adopted, as proposed within this issue paper, for statutory accounting.
- d. *SSAP No. 27—Disclosure of Information about Financial Instruments with Off-Balance Sheet Risk, Financial Instruments with Concentrations of Credit Risk and Disclosures about Fair Value of Financial Instruments* (SSAP No. 27) – Paragraphs 8-10 and 13-14 will be deleted with the issuance of the fair value measurements standard. Furthermore, all references to fair value disclosures included throughout the standard (including the title) and the reference to adopted FAS 107 GAAP guidance will be deleted. All fair

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.

- e. *SSAP No. 30—Investments in Common Stock (excluding investments in common stock of 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 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. 32, paragraph 10 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.
- g. *SSAP No. 36—Troubled Debt Restructuring* (SSAP No. 36) – Revisions are incorporated to paragraphs 10 and 11 to clarify the determination of fair value in accordance with the new SSAP on fair value measurements.
- h. *SSAP No. 37—Mortgage Loans* (SSAP No. 37) - Reference to SSAP No. 27 in paragraph 20.a. will be revised to reference the new SSAP on fair value measurements.
- i. *SSAP No. 40—Real Estate Investments* (SSAP No. 40) – Guidance in paragraph 11 for the regarding the definition of fair value will be deleted, but the requirement to obtain an

- 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”.
- j. *SSAP No. 43R—Loan-Backed and Structured Securities-Revised* (SSAP No. 43R) – Reference to SSAP No. 27 in paragraph 48 will be revised to reference the new SSAP on fair value measurements. Paragraph 7 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. 43, paragraph 6 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.
- k. *SSAP No. 51—Life Contracts* (SSAP No. 51) – The term “market value” included within paragraphs 38.a.iii. and 38.a.iv. will be revised to refer to “fair value”.
- l. *SSAP No. 52—Deposit-Type Contracts* (SSAP No. 52) – The term “market value” included within paragraphs 17.a.iii. and 17.a.iv. will be revised to refer to “fair value”.
- m. *SSAP No. 56—Separate Accounts* (SSAP No. 56) – The term “market value” included within paragraphs 17, 18, 18.a., 20, 22, 26, 31.b., 32 and 41 will be revised to refer to “fair value”. The use of the term “market value adjusted contracted” as illustrated in paragraphs 20 and 29.c. will be retained.
- n. *SSAP No. 61—Life, Deposit-Type and Accident and Health Reinsurance* (SSAP No. 61) – The term “market value” included within paragraphs 55, 59.a.iii. and 59.a.iv. will be revised to refer to “fair value”. The term “market-value adjustments” included within paragraph 59.a. will be retained.
- o. *SSAP No. 73—Health Care Delivery Assets – Supplies, Pharmaceuticals and Surgical Supplies, Durable Medical Equipment, Furniture, Medical Equipment and Fixtures, and Leasehold Improvement in Health Care Facilities* (SSAP No. 73) - The reference to “market” in paragraph 5 will be revised to refer to “fair value”.
- p. *SSAP No. 74—Accounting for the Issuance of Insurance-Linked Securities Issued by a Property and Casualty Insurer Through a Protected Cell* (SSAP No. 74) – In the glossary to this statement, the term “fair value” will be redefined to reference the new SSAP on fair value measurements.
- q. *SSAP No. 86—Accounting for Derivatives, Instruments and Hedging Activities* (SSAP No. 86) – Reference to SSAP No. 27 in paragraph 14 will be revised to reflect the new SSAP No. 27 title (as modified pursuant to the inclusion of all fair value disclosures within the new SSAP on fair value measurements). Throughout SSAP No. 86, Exhibit C, the term “marked-to-market” will be deleted.
- r. *SSAP No. 90—Accounting for the Impairment or Disposal of Real Estate Investments* (SSAP No. 90) – Reference to the definition of fair value included within the Glossary to

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”.

- s. *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SSAP No. 91R) – Paragraph 7.e. will be revised to eliminate the reference to the glossary and instead reference the new SSAP on fair value measurements. Paragraphs 8 and 12 will be revised to remove the parenthetical definition of fair value “presumably, the price paid”. Paragraphs 95.f.i. and 95.g.i. will be revised to remove the parenthetical instruction on determining fair value and be revised to reference the new SSAP on fair value measurements. The Glossary to SSAP No. 91R will revise the definition of “Derivative Financial Instrument” to update the title of SSAP No. 27 pursuant to the revisions adopted by the new SSAP on fair value measurements.
- t. *SSAP No. 93—Accounting for Low Income Housing Tax Credit Property Investments* (SSAP No. 93) – References to “market value” in paragraphs 1.c., 1.d., 5 and 20.b. will be revised to refer to “fair value”
- u. *SSAP No. 95—Exchanges of Nonmonetary Assets, A Replacement of SSAP No. 28—Nonmonetary Transactions* (SSAP No. 95) – Revisions will be incorporated to paragraph 14 to define fair value in accordance with the new SSAP on fair value measurements. (No revisions will be incorporated to paragraph 7, as the ‘fair value’ is based on the measurement method used for each type of asset pursuant to SSAP that provides guidance for that asset type. If the SSAP was to prescribe a fair value measurement, then the new SSAP on fair value measurements would be utilized.)
- v. *SSAP No. 97—Insurance in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP No. 88* (SSAP No. 97) – Reference to “market ” in 31a will be revised to refer to “fair value”. Reference to “quoted market price” in 31b, will be revised to refer to “quoted price”.
- w. *Glossary to the Statements of the Statutory Accounting Principles* (Glossary) – The definition of fair value will be revised to refer to the new SSAP on fair value measurements.
- x. *INT 99-17: EITF 97-12: Accounting for Increased Share Authorizations in an IRS Section 423 Employee Stock Purchase Plan Under APB Opinion No. 25* (INT 99-17) – Consistent with the proposed revisions to SSAP No. 13, the term “market” in paragraph 2 will be revised to reflect “fair value.”
- y. *INT 99-29: Classification of Step-Up Preferred Stock* (INT 99-29) – The reference to “market” in paragraph 4 will be revised to reflect “fair value”
- z. *INT 01-14: EITF 00-16: Recognition and Measurement of Employer Payroll Taxes on Employee Stock-Based Compensation* (INT 01-14) – The reference to “market value” in paragraph 1 will be revised to reflect “fair value”. (The reference to “market sectors” within that paragraph will be retained.)
- aa. *INT 01-31: Assets Pledged as Collateral* (INT 01-31) – The reference to “market value” in paragraph 6 will be revised to reflect “fair value”.
- bb. *INT 02-05: Accounting for Zero Coupon Convertible Bonds* (INT 02-05) – The reference to “marked to market” within paragraph 3 will be revised to reflect “fair value”. Also in

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) 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. Quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement, if available. If a quoted market price is available, the fair value is the product of the number of trading units times market price.

If quoted market prices are not available, the estimate of fair value shall be based on the best information available. The estimate of fair value shall consider prices for similar assets and liabilities and the results of valuation techniques to the extent available in the circumstances. Examples of valuation techniques include the present value of estimated expected future cash flows using a discount rate commensurate with the risks involved, option-pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis. Valuation techniques for measuring financial assets and liabilities and servicing assets and liabilities shall be consistent with the objective of measuring fair value. Those techniques shall incorporate assumptions that market participants would use in their estimates of values, future revenues, and future expenses, including assumptions about interest rates, default, prepayment, and volatility. In measuring financial liabilities and servicing liabilities at fair value by discounting estimated future cash flows, an objective is to use discount rates at which those liabilities could be settled in an arm's-length transaction.

Estimates of expected future cash flows, if used to estimate fair value, shall be the best estimate based 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 to which the evidence can be verified

objectively. If a range is estimated for either the amount or timing of possible cash flows, the likelihood of possible outcomes shall be considered in determining the best estimate of future cash flows.

64. The guidance incorporated within the Glossary was previously established from GAAP guidance in paragraph 13 of *FAS 15, Accounting for Debtors* (FAS 15). (This guidance has been superseded by FAS 157):

13 ...The fair value of the assets transferred is the amount that the debtor could reasonably expect to receive for them in a current sale between a willing buyer and a willing seller, that is, other than in a forced or liquidation sale. Fair value of assets shall be measured by their market value if an active market for them exists. If no active market exists for the assets transferred but exists for similar assets, the selling prices in that market may be helpful in estimating the fair value of the assets transferred. If no market price is available, a forecast of expected cash flows may aid in estimating the fair value of assets transferred, provided the expected cash flows are discounted at a rate commensurate with the risk involved.

65. The adoption of a new SSAP, that adopts, with modification, FAS 157 to define fair value, establish a framework for measuring fair value in generally accepted accounting principles (GAAP) and to expand disclosures about fair value measurements will result with continued fair value measurements that are essentially identical for statutory and GAAP purposes. Furthermore, developing a specific statement to address fair value will address the need to have consistent and comparable guidance throughout the SSAPs.

66. The adoption, with modification, of FAS 157 will change the statutory approach to determining fair value. With the guidance proposed under this issue paper, the transaction to sell an asset or liability, and determine fair value, is a hypothetical transaction at the measurement date considered from the perspective of a market participant that holds the asset or owes the liability. Thus, the definition focuses on the price that would be received to sell the asset or paid to transfer the liability (an exit price), not the price that would be paid to acquire the asset or received to assume the liability (an entry price).

67. By adopting, with modification, FAS 157, statutory accounting principles will incorporate the following key aspects of FAS 157:

- a. Fair value is a market-based measurement, not an entity-specific measurement. Thus, fair value measurements shall be determined based on the assumptions that market participants would use in pricing the asset or liability.
- b. The fair value hierarchy distinguishes between (1) market participant assumptions developed based on market data obtained from sources independent of the reporting entity (observable inputs) and (2) the reporting entity's own assumptions about market participant assumptions based on the best information available in the circumstances (unobservable inputs).
- c. Market participant assumptions include assumptions about risk. A fair value measurement should include an adjustment for risk if market participants would include one in pricing the related asset or liability, even if the adjustment is difficult to determine. Therefore, a measurement that does not include an adjustment for risk would not represent a fair value measurement if market participants would include one in pricing the related asset or liability.

## 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 the practicability exceptions to fair value measurements in accounting pronouncements within the scope of this Statement.
- c. This Statement does not apply under *FASB Statement No. 13, Accounting for Leases*, and other accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under Statement 13. This scope exception does not apply to assets acquired and liabilities assumed in a business combination that are required to be measured at fair value under Statement 141 or Statement 141(R), regardless of whether those assets and liabilities are related to leases.

3. This Statement does not apply under accounting pronouncements that require or permit measurements that are similar to fair value but that are not intended to measure fair value, including the following:

- a. Accounting pronouncements that permit measurements that are based on, or otherwise use, vendor-specific objective evidence of fair value
- b. ARB No. 43, Chapter 4, "Inventory Pricing."

4. Appendix D lists pronouncements of the Accounting Principles Board (APB) and the FASB existing at the date of this Statement that are within the scope of this Statement. Appendix E lists those APB and FASB pronouncements that are amended by this Statement.

### Measurement

#### *Definition of Fair Value*

5. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

*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 considered from the perspective of the reporting entity, thereby allowing for differences between and among entities with different activities. If there is a principal market for the asset or liability, the fair value measurement shall represent the price in that market (whether that price is directly observable or otherwise determined using a valuation technique), even if the price in a different market is potentially more advantageous at the measurement date.

9. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. 5 Transaction costs represent the incremental direct costs to sell the asset or transfer the liability in the principal (or most advantageous) market for the asset or liability. 6 Transaction costs are not an attribute of the asset or liability; rather, they are specific to the transaction and will differ depending on how the reporting entity transacts. However, transaction costs do not include the costs that would be incurred to transport the asset or liability to (or from) its principal (or most advantageous) market. If location is an attribute of the asset or liability (as might be the case for a commodity), the price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall be adjusted for the costs, if any, that would be incurred to transport the asset or liability to (or from) its principal (or most advantageous) market.

*Market Participants*

10. Market participants are buyers and sellers in the principal (or most advantageous) market for the asset or liability that are:

- 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 includes transaction costs.
- d. The market in which the transaction occurs is different from the market in which the reporting entity would sell the asset or transfer the liability, that is, the principal or most advantageous market. For example, those markets might be different if the reporting entity is a securities dealer that transacts in different markets, depending on whether the counterparty is a retail customer (retail market) or another securities dealer (inter-dealer market).

#### *Valuation Techniques*

18. Valuation techniques consistent with the market approach, income approach, and/or cost approach shall be used to measure fair value. Key aspects of those approaches are summarized below:

- a. **Market approach.** The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business). For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might lie in ranges with a different multiple for each comparable. The selection of where within the range the appropriate multiple falls requires judgment, considering factors specific to the measurement

(qualitative and quantitative). Valuation techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique used principally to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities.

- b. **Income approach.** The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts. Those valuation techniques include present value techniques; option-pricing models, such as the Black-Scholes-Merton formula (a closed-form model) and a binomial model (a lattice model), which incorporate present value techniques; 9 and the multiperiod excess earnings method, which is used to measure the fair value of certain intangible assets.
- c. **Cost approach.** The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (often referred to as current replacement cost). From the perspective of a market participant (seller), the price that would be received for the asset is determined based on the cost to a market participant (buyer) to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence. Obsolescence encompasses physical deterioration, functional (technological) obsolescence, and economic (external) obsolescence and is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (based on specified service lives).

19. Valuation techniques that are appropriate in the circumstances and for which sufficient data are available shall be used to measure fair value. In some cases, a single valuation technique will be appropriate (for example, when valuing an asset or liability using quoted prices in an active market for identical assets or liabilities). In other cases, multiple valuation techniques will be appropriate (for example, as might be the case when valuing a reporting unit). If multiple valuation techniques are used to measure fair value, the results (respective indications of fair value) shall be evaluated and weighted, as appropriate, considering the reasonableness of the range indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances.

20. Valuation techniques used to measure fair value shall be consistently applied. However, a change in a valuation technique or its application (for example, a change in its weighting when multiple valuation techniques are used) is appropriate if the change results in a measurement that is equally or more representative of fair value in the circumstances. That might be the case if, for example, new markets develop, new information becomes available, information previously used is no longer available, or valuation techniques improve. Revisions resulting from a change in the valuation technique or its application shall be accounted for as a change in accounting estimate (FASB Statement No. 154, Accounting Changes and Error Corrections, paragraph 19). The disclosure provisions of Statement 154 for a change in accounting estimate are not required for revisions resulting from a change in a valuation technique or its application.

#### *Inputs to Valuation Techniques*

21. In this Statement, inputs refer broadly to the assumptions that market participants would use in pricing the asset or liability, including assumptions about risk, for example, the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) and/or the risk inherent in the inputs to the valuation technique. Inputs may be observable or unobservable:

- a. **Observable inputs** are inputs that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the reporting entity.

- b. Unobservable inputs are inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

Valuation techniques used to measure fair value shall maximize the use of relevant observable inputs (that is Level 1 and Level 2 inputs that do not require significant adjustment) and minimize the use of unobservable inputs.

#### *Fair Value Hierarchy*

22. To increase consistency and comparability in fair value measurements and related disclosures, the fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). In some cases, the inputs used to measure fair value might fall in different levels of the fair value hierarchy. The level in the fair value hierarchy within which the fair value measurement in its entirety falls shall be determined based on the lowest level input that is significant to the fair value measurement in its entirety. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability.

23. The availability of inputs relevant to the asset or liability and the relative reliability of the inputs might affect the selection of appropriate valuation techniques. However, the fair value hierarchy prioritizes the inputs to valuation techniques, not the valuation techniques. For example, a fair value measurement using a present value technique might fall within Level 2 or Level 3, depending on the inputs that are significant to the measurement in its entirety and the level in the fair value hierarchy within which those inputs fall.

#### *Level 1 Inputs*

24. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available, except as discussed in paragraphs 25 and 26.

25. If the reporting entity holds a large number of similar assets or liabilities (for example, debt securities) that are required to be measured at fair value, a quoted price in an active market might be available but not readily accessible for each of those assets or liabilities individually. In that case, fair value may be measured using an alternative pricing method that does not rely exclusively on quoted prices (for example, matrix pricing) as a practical expedient. However, the use of an alternative pricing method renders the fair value measurement a lower level measurement.

26. In some situations, a quoted price in an active market might not represent fair value at the measurement date. That might be the case if, for example, significant events (principal-to-principal transactions, brokered trades, or announcements) occur after the close of a market but before the measurement date. The reporting entity should establish and consistently apply a policy for identifying those events that might affect fair value measurements. However, if the quoted price is adjusted for new information, the adjustment renders the fair value measurement a lower level measurement.

27. If the reporting entity holds a position in a single financial instrument (including a block) and the instrument is traded in an active market, the fair value of the position shall be measured within Level 1 as the product of the quoted price for the individual instrument times the quantity held. The quoted price shall not be adjusted because of the size of the position relative to trading volume (blockage factor). The use of a blockage factor is prohibited, even if a market's normal

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 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 weighting indications of fair value resulting from the use of multiple valuation techniques, the 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.

29D. Even in circumstances where there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. 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, the reporting entity's intention to hold the asset or liability is not relevant in estimating fair value. Fair value is a market-based measurement, not an entity-specific measurement.

29E. 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 not orderly (that is, distressed or forced). Circumstances that may indicate that a transaction is not orderly include, but are not limited to:

- 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, 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.
- 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.

29G. Regardless of the valuation technique(s) used, the reporting entity shall include appropriate risk adjustments. Paragraph B5 of this Statement indicates that “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.

29H. When estimating fair value, this Statement 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 Statement. 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 orderly transactions or a valuation technique that

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 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*

31. 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 Statement 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*

32. For assets and liabilities that are measured at fair value on a recurring basis in periods subsequent to initial recognition (for example, trading securities), 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 category type* as described in paragraph 19 of *FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities* even if the equity securities or debt securities are not within the scope of Statement 115):

- a. The fair value measurements at the reporting date
- 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.

33. 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 category type* as described in paragraph 19 of Statement 115 even if the equity securities or debt securities are not within the scope of Statement 115):

- 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.

34. The quantitative disclosures required by this Statement shall be presented using a tabular format.

35. The reporting entity is encouraged, but not required, to combine the fair value information disclosed under this Statement with the fair value information disclosed under other accounting pronouncements (for example, *FASB Statement No. 107, 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 (for example, inventories measured at market value under ARB 43, Chapter 4), if practicable.

#### Effective Date and Transition

36. Except as provided in subparagraphs 36.a. and 36.b. below, this Statement shall be effective for financial statements issued for fiscal years beginning after November 15, 2007, and

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.

- a. Delayed application of this Statement is permitted for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until fiscal years beginning after November 15, 2008, and interim periods within those fiscal years.
- b. An entity that has issued interim or annual financial statements reflecting the application of the measurement and disclosure provisions of this Statement prior to the issuance of *FSP FAS 157-2, Effective Date of FASB Statement No. 157*, must continue to apply all of the provisions of this Statement.

37. This Statement shall be applied prospectively as of the beginning of the fiscal year in which this Statement is initially applied, except as follows. This Statement shall be applied retrospectively to the following financial instruments as of the beginning of the fiscal year in which this Statement is initially applied (a limited form of retrospective application):

- a. A position in a financial instrument that trades in an active market held by a broker-dealer or investment company within the scope of the AICPA Audit and Accounting Guides for those industries that was measured at fair value using a blockage factor prior to initial application of this Statement
- b. A financial instrument that was measured at fair value at initial recognition under Statement 133 using the transaction price in accordance with the guidance in footnote 3 of EITF Issue No. 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities," prior to initial application of this Statement
- c. A hybrid financial instrument that was measured at fair value at initial recognition under Statement 133 using the transaction price in accordance with the guidance in Statement 133 (added by FASB Statement No. 155, Accounting for Certain Hybrid Financial Instruments) prior to initial application of this Statement.

38. At the date this Statement is initially applied to the financial instruments in paragraph 37.a.-37.c., a difference between the carrying amounts and the fair values of those instruments shall be recognized as a cumulative-effect adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that fiscal year, presented separately. The disclosure requirements of Statement 154 for a change in accounting principle do not apply.

39. The disclosure requirements of this Statement (paragraphs 32-35), including those disclosures that are required in annual periods only, shall be applied in the first interim period of the fiscal year in which this Statement is initially applied. The disclosure requirements of this Statement need not be applied for financial statements for periods presented prior to initial application of this Statement.

**Appendix A - Illustrations of Modifications to Statutory Accounting Guidance:***SSAP No. 2—Cash, Drafts and Short-Term Investments:*

13. The following disclosures shall be made for short-term investments 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 Fair Value of Financial Instruments~~ (SSAP No. 27);

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

3. A reporting entity recognizes no compensation expense for services received in return for stock issued through noncompensatory plans. The following four characteristics are essential in a noncompensatory plan:
  - d. The discount from the ~~market price~~ fair value of the stock is no greater than would be reasonable in an offer of stock to stockholders or others.

6. The measurement date for determining compensation cost in stock option, purchase, and award plans is the first date on which are known both (a) the number of shares that an individual employee is entitled to receive and (b) the option or purchase price, if any. That date for many or most plans is the date an option or purchase right is granted or stock is awarded to an individual employee. However, the measurement date may be later than the date of grant or award in plans with variable terms that depend on events after the date of grant or award. Thus, a reporting entity recognizes compensation cost for stock issued through compensatory plans unless the employee pays an amount that is at least equal to the quoted ~~market price~~ fair value of the stock at the measurement date.

~~8. Quoted market prices in active markets are the best evidence of fair value and shall be used as fair value, if available. If quoted market prices are not available, the estimate of fair value shall be based on the best information available in the circumstances.~~

14. Compensation expense related to stock appreciation rights and other variable stock option or award plans shall be measured at the end of each period as the amount by which the quoted ~~market price~~ fair value or value of the shares of the enterprise's stock covered by a grant exceeds the option price or value specified under the plan and should be accrued as a charge to expense over the periods the employee performs the related services. Changes in the quoted ~~market price or value~~ fair value should be reflected as an adjustment of accrued compensation and compensation expense in the periods in which the changes occur until the date the number of shares and purchase price, if any, are both known.

*SSAP No. 26—Bonds, Excluding Loan-Backed and Structured Securities:*

4. A bond acquisition or disposal shall be recorded on the trade date, not the settlement date, except for the acquisition of private placement bonds which shall be recorded on the funding date. At acquisition, bonds shall be reported at their cost, including brokerage and other related fees, ~~which cannot exceed the fair value at the date of acquisition.~~

17. The financial statements shall include the following disclosures:
  - a. Fair values disclosures 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 Fair Value of Financial Instruments~~ (SSAP No. 27);

*SSAP No. 27—Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk, Financial Instruments with Concentrations of Credit Risk and Disclosures about Fair Value of Financial Instruments*

- ~~8. A reporting entity shall disclose in the notes to the financial statements the aggregate fair value of all financial instruments, summarized by type of financial instrument, for which it is practicable to estimate fair value, except for certain financial instruments named in paragraph 8 of FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments* (FAS 107). Fair value disclosed in the notes shall be presented together with the related admitted values in a form that makes it clear whether the fair values and admitted values represent assets or liabilities and to which line items in the Statement of Assets, Liabilities, Surplus and Other Funds they relate. Separate disclosure of this information in the notes is required even if such information is presented elsewhere in the financial statements. Unless specified otherwise in another SSAP, the disclosures may be made net of encumbrances, if the asset or liability is so reported. A reporting entity shall also disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments.~~
- ~~9. For purposes of this statement, the fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. If quoted market prices are not available, management's best estimate of fair value shall be based on the quoted market price of a financial instrument with similar characteristics, or on industry recognized valuation techniques (for example, the present value of estimated future cash flows using a discount rate commensurate with the risks involved).~~
- ~~10. If it is not practicable for an entity to estimate the fair value of a financial instrument or a class of financial instruments, the following shall be disclosed:~~
- ~~a. Information pertinent to estimating the fair value of that financial instrument or class of financial instruments, such as the carrying amount, effective interest rate, and maturity; and~~
  - ~~b. The reasons why it is not practicable to estimate fair value.~~
- ~~13. This statement adopts FAS 107 as amended by FASB Statement No. 119, *Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments* (FAS 119), except that paragraph 15(c) of FAS 119 relating to disclosure of financial instruments held or issued for trading is rejected and FASB Emerging Issues Task Force No. 85-20, *Recognition of Fees for Guaranteeing a Loan*. In addition, this statement rejects FASB Statement No. 126, *Exemptions from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities*, an amendment of FAS 107. FAS 119 is addressed in SSAP No. 31.~~
- ~~14. Paragraph 8 of FAS 107 discusses financial instruments which are exempt from fair value disclosure. Included as exempt instruments are insurance contracts, except for financial guaranty contracts.~~

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

5. At acquisition, common stocks shall be reported at their cost, including brokerage and other related fees. ~~Cost shall not exceed fair value.~~ Common stock acquisitions and dispositions shall be recorded on the trade date. Private placement stock transactions shall be recorded on the funding date.
13. The following disclosures regarding common stocks shall be made in the financial statements:

- 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 Fair Value of Financial Instruments (SSAP No. 27);~~
- f. The disclosures in (i) and (ii) above should be segregated by those preferred 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.
- h. 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:
  - i. The aggregate carrying value of the investments not evaluated for impairment, and
  - ii. The circumstances that may have a significant adverse effect on the fair value.

*SSAP No. 36—Troubled Debt Restructuring*

10. A creditor shall account for a troubled debt restructuring according to the type of the restructuring (receipt of assets in full satisfaction, modification of terms, combination of types). Generally, troubled debt restructuring involving the transfer of assets shall be accounted for at the fair value of the assets received. Troubled debt restructuring involving modification of terms shall be accounted for at fair value (as determined by acceptable appraisal methodologies ~~or, if applicable, the value determined in accordance with the NAIC Purposes and Procedures of the Securities Valuation Office (SVO Purposes and Procedures)~~ in accordance with SSAP No. 100—Fair Value Measurements). If the restructured loan is collateral dependent, fair value shall be the fair value of the collateral. If the restructured loan is not collateral dependent, fair value shall be determined in accordance ~~with the SVO Purposes and Procedures, if applicable, or at the present value of expected future cash flows~~ with SSAP No. 100 (reference new SSAP). If the

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 loss in the statement of operations. After the troubled debt restructuring, a creditor shall account for the assets consistent with the statutory guidance for such assets.

11. A creditor shall account for assets, including foreclosed property and equity interests in corporations, joint ventures, or partnerships, received in satisfaction of the loan at their fair value (as determined by acceptable appraisal methodologies ~~or, if applicable, the value determined in accordance with the SVO Purposes and Procedures~~) at the time of restructuring or at the book value of the loan if lower. If the fair value is less than the book value, the required writedown shall be recognized as a realized capital loss. The creditor shall reclassify the asset from loans to the appropriate asset account, such as real estate or other invested assets, at the time that the creditor obtains clear title to the asset except for mortgage loans which shall be reclassified at the beginning of the redemption period unless it is probable that the mortgage loan will be redeemed. After the troubled debt restructuring, a creditor shall account for the assets received in satisfaction of the loan consistent with the statutory guidance for similar assets.

*SSAP No. 37—Mortgage Loans*

20. The following disclosures shall be made in the financial statements:

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

*SSAP No. 40—Real Estate Investments*

11. The current fair value of real estate shall be determined on a property by property basis (i.e., increases in the fair value of one property shall not be used to offset declines in fair value of another) ~~and shall be defined as the price that a property would bring in a competitive and open market under all conditions requisite to a fair sale (i.e., the buyer and seller acting prudently and knowledgeably with the price not affected by any undue stimulus)~~. If market quotes are unavailable, estimates of fair value shall be determined by an appraisal (internal or third party), which is based upon an evaluation of all relevant data about the market, considering the following:

- a. A physical inspection of the premises;
- b. The present value of future cash flows generated by the property (Discounted Cash Flows), or capitalization of stabilized net operating income (Direct Capitalization);
- c. Current sales prices of similar properties with adjustments for differences in the properties (Sales Comparison Approach);
- d. Costs to sell the property if the reporting entity does not have the intent or ability to hold the real estate as an investment; and
- e. Replacement costs of the improvements, less depreciation, plus the value of the land (Cost Approach).

19. A participating mortgage loan is established when the lender is entitled to participate in appreciation of the ~~market value~~ fair value of mortgaged real estate, the results of operations of the mortgaged real estate project, or in both. Mortgage loan participation features should be recorded at fair value at inception of the loan. The borrower should recognize a participation liability for the determined fair valued amount, with a corresponding debit to a debt discount

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.
- b. Terms of participations by the lender in either the appreciation in the ~~market value~~fair value of the mortgaged real estate project or the results of operations of the mortgaged real estate project, or both.

*SSAP No. 43R—Loan-Backed and Structured Securities - Revised*

6. At acquisition, loan-backed securities, except for loan-backed or structured securities that are beneficial interests that are not of high credit quality or can contractually be prepaid or otherwise settled in such a way that the reporting entity would not recover substantially all of its recorded amount<sup>1</sup> (see paragraphs 20-24), shall be reported at cost, including brokerage and related fees. ~~Cost shall not exceed fair value.~~ Acquisitions and dispositions shall be recorded on the trade date, not the settlement date, except for the acquisition of private placement loan-backed securities which shall be recorded on the funding date. For securities where all information is not known as of the trade date (e.g., actual payment factors and specific pools), a reporting entity shall make its best estimate based on known facts.

48. In addition to the disclosures required for invested assets in general, the following disclosures regarding loan-backed securities 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 Fair Value of Financial Instruments (SSAP No. 27);~~
- i. The disclosures in (i) and (ii) above should be segregated by those securities 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.
- k. 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:
  - i. The aggregate carrying value of the investments not evaluated for impairment, and

<sup>1</sup> As referenced in the Relevant Literature section, this Statement adopts EITF 99-20, including the scope requirements of that guidance.

- ii. The circumstances that may have a significant adverse effect on the fair value.

*SSAP No. 51—Life Contracts*

38. Disclose the amount of annuity actuarial reserves and deposit liabilities by withdrawal characteristics as follows:

- a. Subject to discretionary withdrawal:
  - iii. At ~~market-fair~~ fair value, where the withdrawal of funds is payable at current ~~market value~~ fair value of the assets supporting the liabilities, the assets are stated at current ~~market-fair~~ fair value, and the liabilities are stated at the current ~~market-fair~~ fair value or per unit value of the assets supporting the liabilities. These liabilities are for contracts where the customer bears the entire investment risk;
  - iv. Total with adjustment or at ~~market-fair~~ fair value;

*SSAP No. 52—Deposit-Type Contracts*

17. Disclose the amount of annuity actuarial reserves and deposit liabilities by withdrawal characteristics as follows:

- a. Subject to discretionary withdrawal:
  - iii. At ~~market-fair~~ fair value, where the withdrawal of funds is payable at current ~~market-fair~~ fair value of the assets supporting the liabilities, the assets are stated at current ~~market-fair~~ fair value, and the liabilities are stated at the current ~~market-fair~~ fair value or per unit value of the assets supporting the liabilities. These liabilities are for contracts where the customer bears the entire investment risk;
  - iv. Total with adjustment or at ~~market-fair~~ fair value;

*SSAP No. 56—Separate Accounts*

17. Assets supporting fund accumulation contracts (GICs), which do not participate in underlying portfolio experience, with a fixed interest rate guarantee, purchased under a retirement plan or plan of deferred compensation, established or maintained by an employer, will be recorded as if the assets were held in the general account. Assets supporting all other contractual benefits shall be recorded at ~~market-fair~~ fair value on the date of valuation, or if there is no readily available market, then in accordance with the valuation procedures in the applicable contract.

18. An AVR is generally required for separate accounts when the insurer, rather than the policyholder/contractholder, suffers the loss in the event of asset default or ~~market-fair~~ fair value loss. An AVR is required unless:

- a. The asset default or ~~market-fair~~ fair value risk is borne directly by the policyholders; or

20. Assets supporting typical modified guaranteed contracts, market value adjusted contracts, and contracts with book value guarantees similar to contracts generally found in the general account do require an AVR because the insurer is responsible for credit related asset or ~~market-fair~~ fair value loss.

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.e., both assets and liabilities are recorded either as if in the general account ("book value") or as at ~~market-fair~~ value (current interest rates based on market rates shall be used for liabilities when assets are recorded at ~~market-fair~~ value), shall continue to be recorded using such basis until such time as the applicable contract terms or provisions are substantially changed, such as by a contract amendment modifying interest rate or withdrawal provisions. State laws and regulations shall be understood to include anything considered authoritative by the domiciliary state under the individual state's statutory authority and due process procedures. Changes that do not require change in the basis of recording would include: address changes, continued deposits, and other non-substantive changes such as these. For example, additional funds received after January 1, 2001 under contracts issued prior to January 1, 2001 may continue to be recorded using the basis in effect prior to January 1, 2001 until such time as a triggering change is made. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—*Accounting Changes and Corrections of Errors*.

*SSAP No. 61—Life, Deposit-Type and Accident and Health Reinsurance*

55. The assuming entity is to value the assets acquired at the date of acquisition at their ~~market-fair~~ values, and the reserves are to be established according to statutory requirements based on the benefits in the individual policies reinsured. If the liabilities exceed the assets, the difference represents goodwill that must be amortized into operations using the interest method

over the life of the policies, but for a period not to exceed 10 years. Goodwill resulting from assumption reinsurance transactions shall be included in the total goodwill of an entity when calculating the amount of goodwill that is a nonadmitted asset pursuant to SSAP No. 68—Business Combinations and Goodwill. If the assets exceed the liabilities, the assuming entity shall record a deferred liability and amortize the amount into operations using the interest method over the expected life of the business but not to exceed ten years.

59. Disclose the amount of annuity actuarial reserves and deposit liabilities by withdrawal characteristics as follows:

- a. Subject to discretionary withdrawal:
  - iii. At ~~market-fair value~~, where the withdrawal of funds is payable at current market value of the assets supporting the liabilities, the assets are stated at current ~~market-fair value~~, and the liabilities are stated at the current ~~market-fair value~~ or per unit value of the assets supporting the liabilities. These liabilities are for contracts where the customer bears the entire investment risk;
  - iv. Total with adjustment or at ~~market-fair value~~;

*SSAP No. 73—Health Care Delivery Assets – Supplies, Pharmaceuticals and Surgical Supplies, Durable Medical Equipment, Furniture, Medical Equipment and Fixtures, and Leasehold Improvements in Health Care Facilities*

5. The reporting entity shall maintain a control system that provides for identification of quantities on hand and appropriate valuation (lower of cost or ~~market-fair value~~) of supplies, pharmaceuticals and surgical supplies, and durable medical equipment.

*SSAP No. 74—Accounting for Issuance of Insurance-Linked Securities Issued by a Property and Casualty Insurer through a Protected Cell*

Glossary:

Fair value - See ~~GLOSSARY to the Statements of Statutory Accounting Principles~~ SSAP No. 100—Fair Value Measurements.

*SSAP No. 86—Accounting for Derivative Instruments and Hedging, Income Generation, and Replication (Synthetic Asset) Transactions (Note – 106 hits of ‘fair’ and 15 hits of ‘market’)*

14. ~~Derivative instruments represent rights or obligations that meet the definitions of assets (SSAP No. 4—Assets and Nonadmitted Assets) or liabilities (SSAP No. 5) and shall be reported in financial statements. In addition, derivative instruments also meet the definition of financial instruments as defined in SSAP No. 27—Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk, and Disclosures about Fair Value of Financial Instruments—(SSAP No. 27). Should the cost basis of the derivative instrument be undefined (i.e., no premium is paid), the instrument shall be disclosed in accordance with paragraphs 8-10 of SSAP No. 27. Derivative instruments are admitted assets to the extent they conform to the requirements of this statement.~~

Exhibit C – SSAP No. 86

1.b.i.(e) - 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 the designated portion of the derivative shall be valued at its current fair value (~~marked to market~~) with gains and losses recognized in unrealized gains or unrealized losses to the extent it ceased to be an effective hedge.

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 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);

2.b.iv. - Open derivatives hedging items recorded at fair value, where gains and losses on the hedged item are recognized currently in earnings: swaps, collars and forwards 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.

(a) 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 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.

iv. Open futures hedging items recorded at fair value, where gains and losses on the hedging item are recognized currently in earnings shall be valued at current fair value ~~(marked to market)~~ with changes in fair value recognized currently in earnings.

*SSAP No. 90—Accounting for the Impairment of Disposal of Real Estate Investments*

5. A long-lived asset shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. The following are examples of such events or changes in circumstances:

a. A significant decrease in the ~~market price~~ fair value of a long-lived asset

Fair Value

16. A discussion of fair value is contained in ~~the Glossary to the Statements of Statutory Accounting Principles~~ SSAP No. 100—Fair Value Measurement. This statement requires properties occupied by the company, that are determined to be subject to recoverability testing as discussed in paragraphs 6 and 7, to follow the guidance in SSAP No. 40, paragraph 11.

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 Principles. In addition, this statement allows a modification to use for determining the fair value of properties occupied by company.~~

*SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*

7. Upon completion of a transfer of assets that satisfies the conditions to be accounted for as a sale (see paragraph 5), the transferor (seller) shall:

- e. Initially measure such additional assets obtained and liabilities incurred in the sale at fair value (see ~~Glossary to the Statements of Statutory Accounting Principles~~ SSAP No. 100—Fair Value Measurements), or if it is not practicable to estimate the fair value of an asset or a liability, apply alternative measures (paragraph 49); and

8. The transferee shall recognize all assets obtained and any liabilities incurred, and initially measure them at fair value ~~(in aggregate, presumptively the price paid).~~

12. If distinct servicing rights exist in accordance with the above guidelines, the reporting entity shall recognize a servicing asset or liability. When the servicing fees to be received exceed the cost of servicing the transferred assets, a servicing asset is recognized and nonadmitted. When the cost of servicing the transferred assets is greater than the servicing fees to be received, a liability shall be recorded for the excess to recognize this obligation. A corresponding loss shall be recorded through the Summary of Operations in other income. Servicing assets and servicing liabilities shall be measured initially at fair value, ~~presumptively the price paid.~~ Servicing assets or liabilities shall be measured subsequently at fair value at each reporting date with fluctuations in fair value reported as unrealized gains and losses. Declines in fair value which are determined to be other than temporary shall be recorded as realized losses. shall be amortized into income in proportion to, and over the period of estimated servicing income

95. A reporting entity shall disclose the following:

- f. If the entity has securitized financial assets during any period presented and accounts for that transfer as a sale, for each major asset type (for example, mortgage loans):
  - i. Its accounting policies for initially measuring the interests that continue to be held by a transferor, if any, ~~including the methodology (whether quoted market price, prices based on sales of similar assets and liabilities, or prices based on valuation techniques) used in determining 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); and~~
- g. If the entity has interests that continue to be held by a transferor in securitized financial assets at the date of the latest statement of financial position presented, for each major asset type (for example, mortgage loans):
  - i. Its accounting policies for subsequently measuring those interests that continue to be held by a transferor, including the methodology ~~(whether quoted market price, prices based on sales of similar assets and liabilities, or prices based on valuation techniques)~~ used in determining

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 Hedging, Income Generation, and Replication (Synthetic Asset) Transactions) that is a financial instrument (refer to SSAP No. 27—Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk, and Financial Instruments with Concentrations of Credit Risk and Disclosures about Fair Value of Financial Instruments, paragraph 2).

*SSAP No. 93—Accounting for Low Income Housing Tax Credit Property Investments*

1. This statement establishes statutory accounting principles for investments in federal and certain state sponsored Low Income Housing Tax Credit (LIHTC) properties. State sponsored LIHTC programs that have the following characteristics are within the scope of and shall be accounted for in accordance with this statement:

- c. Resale value of the investment is not based upon the ~~market value~~fair value of the underlying real estate.
- d. ~~Market value~~Fair value of the investment is directly tied to the remaining stream of tax credits and deductible losses

5. Resale valuation of these investments is based on the present value of the future stream of tax credits and deductible losses, and not the ~~market value~~fair value of the underlying real estate.

20. The significance of an investment to the reporting entity's financial position and results of operations shall be considered in evaluating the extent of disclosures of the financial position and results of operations of an investment in a LIHTC. If in the aggregate the LIHTC investments exceed 10% of the total admitted assets of the reporting entity the following disclosures shall be made:

- b. For partnerships, and limited liability companies for which a quoted ~~market price~~fair value is available, the aggregate value of each partnership, or limited liability company investment based on the quoted ~~market price~~fair value; and

*SSAP No. 95—Exchanges of Nonmonetary Assets, A Replacement of SSAP No. 28—Nonmonetary Transactions*

14. Fair value of a nonmonetary asset transferred to or from a reporting entity in a nonmonetary transaction should be determined in accordance with SSAP No. 100—Fair Value Measurements. ~~by referring to estimated realizable values in cash transactions of the same or similar assets, quoted market prices, independent appraisals, estimated fair values of assets or services received in exchange, and other available evidence.~~ If one of the parties in a nonmonetary transaction could have elected to receive cash instead of the nonmonetary asset, the amount of cash that could have been received may be evidence of the fair value of the nonmonetary assets exchanged.

*SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP No. 88*

31. The significance of an investment to the reporting entity's financial position and results of operations shall be considered in evaluating the extent of disclosures of the financial position and results of operations of an investee. The following disclosures shall be made for all investments in SCA entities that exceed 10% of the total admitted assets of the reporting entity:

- a. Financial statements of a reporting entity shall disclose (i) the name of each SCA entity and percentage of ownership of common stock, (ii) the accounting policies of the reporting entity with respect to investments in SCA entities, and (iii) the difference, if any, between the amount at which the investment is carried and the amount of underlying equity in net assets (i.e., goodwill, other nonadmitted assets, ~~market fair value~~ or discounted ~~market fair value~~ adjustments) and the accounting treatment of the difference;
- b. For those SCA entities for which a quoted market price is available, the aggregate value of each SCA investment based on the quoted ~~market price~~ price and the difference, if any, between the amount at which the investment is carried and the quoted ~~market price~~ price shall be disclosed;

*Glossary to the Statements of Statutory Accounting Principles*

~~Fair Value — Fair value is defined in SSAP No. 100—Fair Value Measurements. 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. Quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement, if available. If a quoted market price is available, the fair value is the product of the number of trading units times market price.~~

~~If quoted market prices are not available, the estimate of fair value shall be based on the best information available. The estimate of fair value shall consider prices for similar assets and liabilities and the results of valuation techniques to the extent available in the circumstances. Examples of valuation techniques include the present value of estimated expected future cash flows using a discount rate commensurate with the risks involved, option pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis. Valuation techniques for measuring financial assets and liabilities and servicing assets and liabilities shall be consistent with the objective of measuring fair value. Those techniques shall incorporate assumptions that market participants would use in their estimates of values, future revenues, and future expenses, including assumptions about interest rates, default, prepayment, and volatility. In measuring financial liabilities and servicing liabilities at fair value by discounting estimated future cash flows, an objective is to use discount rates at which those liabilities could be settled in an arm's-length transaction.~~

~~Estimates of expected future cash flows, if used to estimate fair value, shall be the best estimate based 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 to which the evidence can be verified objectively. If a range is estimated for either the amount or timing of possible cash flows, the likelihood of possible outcomes shall be considered in determining the best estimate of future cash flows.~~

~~Market Value — Market value is equivalent to fair value.~~

*INT 99-17: EITF 97-12: Accounting for Increased Share Authorizations in an IRS Section 423 Employee Stock Purchase Plan under APB Opinion No. 25.*

2. The working group reached a consensus that EITF 97-12 should be adopted to require that additional shares granted in a stock purchase plan be classified as compensatory or noncompensatory at the grant date of the additional shares. If the discount at that date does not meet the ~~market fair value~~ discount criterion in paragraph 3.d. of SSAP No. 13, then the new grant would be treated as a compensatory award under SSAP No. 13, which would result in compensation cost.

*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 expense recognition. Costs incurred by companies for employer payroll taxes on employee stock-based compensation have become more significant for U.S. companies as a result of the increased use of options as a form of employee compensation and the rapid growth in the ~~market-fair~~ value of underlying stocks in certain market sectors. Consequently, the predominant current practice of recognizing those costs when the event that triggers payment to the taxing authority occurs (for an option, that event is employee exercise), has been called into question.

*INT 01-31: Assets Pledged as Collateral*

6. The working group reached a consensus that if the collateral had not been pledged in the examples described above, it is assumed the underlying asset would be recorded as an admitted asset under SSAP No. 4 (e.g. they are readily marketable assets available to meet both current and future policyholder obligations). In addition, it is assumed that the asset would not be considered impaired under SSAP No. 5 due to a default, ~~market~~fair value decline, or other loss contingency.

*INT 02-05: Accounting for Zero Coupon Convertible Bonds*

3. A convertible bond really consists of a bond and an embedded derivative in the form of a warrant. Under GAAP, the holder accounts for the two components separately. The bond and warrants are fair valued at date of purchase. The bond is typically classified as available for sale (AFS) or held to maturity (HTM) and the scientific method of amortization is used on any premium or discount. This amortization of the premium or discount produces a market yield when combined with the coupon rate. In addition, the available for sale is ~~marked-to-market~~recorded at fair value with the unrealized gains and losses recorded as a component of equity in other comprehensive income. The warrant is fair valued at each reporting date and classified as trading with ~~the~~ adjustments to ~~market-fair value~~ recorded through the income statement, as it is considered a derivative (no hedge).
4. For GAAP, assuming a purchase price was \$900,000 at 1/1/x1 and the fair value of the warrants was \$150,000 at 1/1/x1, the following entries would be recorded during the year:

At 1/1/X1:	
Purchase Price	\$900,000
Bond Fair Value	\$750,000
Yield	8.87%
Warrant Fair Value	\$150,000

At 12/31/X1:	
Bond Fair Value	\$780,000
Warrant Fair Value	\$200,000

Entries 1/1/X1:	
Bonds-AFS	\$750,000
Warrants-Trading	\$150,000
Cash	(\$900,000)

Entries 12/31/X1:	
Cash (coupon rate)	\$50,000
Bonds-AFS (amortization)	\$16,554
Investment income	(\$66,554)
Record discount accretion and cash from coupon rate	

Bonds-AFS	13,446
Warrants-Trading	50,000
Unrealized gains-OCI	(13,446)
Realized gains	(50,000)

Mark AFS and Trading to ~~market~~ fair value

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

2. Certain situations may exist in which a qualified opinion is provided due to a GAAP departure, while information is available to determine the appropriate balances under a GAAP basis of accounting. For example, a qualified opinion would be given if a cost sharing agreement requires the cost basis of accounting to be used to value investments in a limited partnership in which the reporting entity owned more than a 5% interest, as GAAP requires such investments to be recorded based upon the GAAP equity method. Since the notes to the financial statements disclose the ~~market fair~~ value of investments held by the limited partnership, information is readily available to allocate the unrealized appreciation on investments to determine what the appropriate GAAP equity balance would be. A qualified opinion could also result if the unrealized appreciation on investments is not allocated in accordance with a partnership agreement. Another example occurs when a qualified opinion is issued due to a departure from GAAP and the departure is related to the valuation of an U.S. insurance entity on the basis of U.S. statutory accounting principles.

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

3. The following is excerpted from EITF 02-15:

3. Statement 84 was issued to amend Opinion 26, to exclude from its scope convertible debt that is converted to equity securities of the debtor pursuant to conversion privileges different from those included in the terms of the debt at issuance, and the change in conversion privileges is effective for a limited period of time, involves additional consideration, and is made to induce conversion. That Statement applies only to conversions that both (a) occur pursuant to changed conversion privileges that are exercisable only for a limited period of time and (b) include the issuance of all of the equity securities issuable pursuant to conversion privileges included in the terms of the debt at issuance for each debt instrument that is converted. When convertible debt is converted to equity securities of the debtor pursuant to an inducement offer (described above), the debtor shall recognize an expense equal to the excess of the fair value of all securities and other consideration transferred in the transaction over the fair value of securities issuable pursuant to the original conversion terms.

4. A question has arisen as to whether Statement 84 applies to conversions of convertible debt when the "offer" for consideration in excess of the original conversion terms was made by the debt holder rather than the debtor. In certain circumstances, for

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 that approached the debtor. The following example is provided:

Company A issued publicly traded convertible bonds (the Bonds) during a prior period. Currently, the Bonds are trading at a price that is significantly less than the carrying value (possibly due to a decline in Company A's stock price or credit rating or both). The original conversion price of the Bonds is \$50 (20 shares of common stock per bond), and Company A's common stock is currently trading at \$25 per share. On an individual basis, bondholders approach Company A with an offer for Company A to purchase the Bonds by providing consideration in excess of the conversion terms. Assume that on the date of the exchange, each Bond has the following values:

Company A's carrying value of the Bonds	\$1,000
Current fair market-value of the Bonds	\$ 750

A bondholder approaches Company A with the following two independent offers that are exercisable by Company A for a limited period of time:

1. Company A may purchase the Bonds in exchange for the Bonds' original conversion of 20 shares of Company A common stock (\$500 fair market-value) and \$300 cash.
2. Company A may purchase the Bonds in exchange for 32 shares of Company A common stock (\$800 fair market-value).

*INT 06-07: Definition of Phrase "Other Than Temporary"*

2. The decision for determining when an investment is considered impaired is dictated by the applicable SSAP and the respective impairment indicators included in each of the SSAPs. If an impairment indicator is present, the determination of an impairment shall be assessed at the individual security or investment level as reported in the annual statement and supporting schedules. For those SSAPs that require the reporting entity to use the fair value to determine if an impairment has occurred, the determination of that value shall be consistent with how the term fair value is defined within ~~the Glossary of the Accounting Practices and Procedures Manual~~ SSAP No. 100—Fair Value Measurements. Once a reporting entity has determined that an impairment indicator is present, the reporting entity shall continue to evaluate whether the investment is impaired each subsequent reporting period until either (a) the investment experiences a recovery of the fair value up to (or beyond) its carrying value or (b) the investor recognizes an other-than-temporary impairment loss.