

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: ASU 2021-07, Compensation – Stock Compensation

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue: In October 2021, the Financial Accounting Standards Board (FASB) issued *Accounting Standards Update (ASU) 2021-07, Compensation – Stock Compensation (Topic 718), Determining the Current Price of an Underlying Share for Equity-Classified Share-Based Awards* to offer nonpublic companies a practical expedient to one of the several inputs necessary for option-priced modeling. When equity share options or similar instruments are granted in a share-based payment transaction, the fair value (which is used to determine expense recognition at inception and during any subsequent award modification) is estimated using an option-pricing model valuation technique.

In terms of option-priced models, the Black-Scholes-Merton model is considered to be one of the most widely used as it has less complexity than other pricing models. However, despite its reduced complexity, it (and various other pricing models) requires numerous inputs which typically include exercise price, expected dividend rate, risk-free interest rate, expected term, expected share price volatility, and current share price. For public entities, the determination of these values is generally readily available, however for nonpublic entities, many of these inputs are not easily determinable.

Of these inputs, private company stakeholders have indicated that three of these inputs (exercise price, expected dividend rate, and risk-free interest rate) are easy to obtain. However, stakeholders indicated that the remaining three inputs (expected share price volatility, expected term, and current share price) can be costly and difficult to estimate. Topic 718 already provides nonpublic entities with practical expedients for expected share price volatility and expected term. However, prior to ASU 2021-07, a practical expedient was not available for estimating the current price input. The current price input is often considered the most costly and complex input to determine and audit for nonpublic entities, primarily because an active market for those entities' shares does not exist and therefore a readily determinable market price is not available.

ASU 2021-07 provides a practical expedient for nonpublic entities to determine the current price by utilizing a "reasonable application of a reasonable valuation method." The practical expedient describes several characteristics of a reasonable valuation method and will include 1) consideration of the value of all tangible and intangible assets, 2) the present value of future anticipated cash flows, 3) the market value of similar entities, 4) recent arm's-length transactions involving the sale or transfer of stock/equity interests, and 5) other relevant factors that affect the valuation or have a material economic effect on the entity. The calculation of share price must be timely in it cannot be more than 12 months stale, and all available information after the date of calculation that may materially affect the valuation of the entity must be considered for any value updates.

One final note - this ASU provides a practical expedient (not an accounting alternative) to one of the inputs used for nonpublic companies in their option-pricing modeling. Also, as mentioned previously, this is the third such practical expedient permitted in Topic 718, of which the previous two (expected share price volatility and expected term) have previously been adopted and are currently permissible for use in *SSAP No. 104R—Share-Based Payments* (further detailed in the "Existing Authoritative Literature" section).

Existing Authoritative Literature: ASU 2021-07 offers a third practical expedient for the inputs utilized in option-pricing models. As previously mentioned, the prior two practical expedients are permissible in SSAP No. 104R and are included herein for reference:

Practical Expedient Regarding Volatility: Topic 718 (paragraph 718-10-30-20) recognizes nonpublic entities may not be able to reasonably estimate the fair value as it is not practicable to estimate share volatility, a component of the fair value calculation. Adoption of this first practical expedient to address this circumstance occurred through the Working Group's adoption of *FAS 123R, Share-Based Payment*. The applicable paragraph in SSAP No. 104R has been included with relevant guidance bolded.

52. **A reporting entity may not be able to reasonably estimate the fair value of its equity share options, nonemployee awards and similar instruments because it is not practicable for the reporting entity to estimate the expected volatility of its share price. In that situation, the entity shall account for its equity share options, nonemployee awards and similar instruments based on a value calculated using the historical volatility of an appropriate industry sector index instead of the expected volatility of the entity's share price (the calculated value).** A reporting entity's use of calculated value shall be consistent between employee share-based payment transactions and nonemployee share-based payment transactions. Throughout the remainder of this statement, provisions that apply to accounting for share options, nonemployee awards and similar instruments at fair value also apply to calculated value.

Practical Expedient Regarding Expected Term: Topic 718 (paragraph 718-10-30-20A) recognizes nonpublic entities may not be able to reasonably account for the expected term of a share-based payment. Adoption of a second practical expedient to address this circumstance occurred through the Working Group's adoption, with modification, of *ASU 2016-09, Improvements to Employee Share-Based Payment Accounting*. The applicable paragraphs from SSAP No. 104R have been included below:

53. For an award that meets the conditions in paragraph 54, a reporting entity may make an entity-wide accounting policy election to estimate the expected term using the following practical expedient:

- a. If vesting is only dependent upon a service condition, a reporting entity shall estimate the expected term as the midpoint between the employee's requisite service period or the nonemployee's vesting period and the contractual term of the award.
- b. If vesting is dependent upon satisfying a performance condition, an entity first would determine whether the performance condition is probable of being achieved.
 - i. If the reporting entity concludes that the performance condition is probable of being achieved, the entity shall estimate the expected term as the midpoint between the employee's requisite service period or the nonemployee's vesting period and the contractual term.
 - ii. If the reporting entity concludes that the performance condition is not probable of being achieved, the reporting entity shall estimate the expected term as either:
 - (a) The contractual term if the service period is implied (that is, the requisite service period or the nonemployee's vesting period is not explicitly stated but inferred based on the achievement of the performance condition at some undetermined point in the future).
 - (b) The midpoint between the employee's requisite service period or the nonemployee's vesting period and the contractual term if the requisite service period is stated explicitly.

54. A reporting entity that elects to apply the practical expedient in paragraph 53 shall apply the practical expedient to a share option or similar award that has all of the following characteristics:

- a. The share option or similar award is granted at the money.
- b. The grantee has only a limited time to exercise the award (typically 30-90 days) if the grantee no longer provides goods or terminates service after vesting.
- c. The grantee can only exercise the award. The grantee cannot sell or hedge the award.
- d. The award does not include a market condition.

A reporting entity that elects to apply the practical expedient in paragraph 53 may always elect to use the contractual term as the expected term when estimating the fair value of a nonemployee award as described in paragraph 42. However, a reporting entity must apply the practical expedient in paragraph 53 for all nonemployee awards that have all the characteristics listed in this paragraph if that reporting entity does not elect to use the contractual term as the expected term and that reporting entity elects the accounting policy election to apply the practical expedient in paragraph 53.

ASU 2021-07 also supplements existing disclosure requiring that if this new practical expedient is utilized, its use shall be disclosed. NAIC staff have determined that additional disclosures in SSAP No. 104R are likely not necessary as existing SAP disclosures reference the disclosures in FASB Codification 718-10-50-2 as required – which is the location for FASB’s new disclosure regarding use of this practical expedient.

Disclosures

113. An entity with one or more share-based payment arrangements shall disclose information that enables users of the financial statements to understand all of the following:

- a. The nature and terms of such arrangements that existed during the period and the potential effects of those arrangements on shareholders;
- b. The effect of compensation costs arising from share-based payment arrangements on the income statement;
- c. The method of estimating the fair value of the goods or services received, or the fair value of the equity instruments granted (or offered to grant), during the period; and
- d. The cash flow effects resulting from share-based payment arrangements.

114. The disclosures in paragraph 113 are for annual audited statutory financial statements only. **This statement adopts FASB Codification 718-10-50-2 for the minimum disclosure information needed to achieve the objective in paragraph 113 of this statement, noting that a reporting entity may need to disclose additional information to achieve the objectives.**

As final reference, SSAP No. 104R has predominantly adopted, with modification from U.S. GAAP guidance regarding share-based payment guidance, as detailed below.

126. This statement adopts with modification the U.S. GAAP guidance for share-based payment transactions reflected in FASB *Accounting Standards Codification (ASC) Topic 718, Compensation – Stock Compensation*, as modified by the ASUs listed in paragraphs 126.a through 126.e, excluding the guidance in *ASC Subtopic 718-40, Employee Stock Ownership Plans (ESOPs)*. Statutory accounting guidance for ESOPs is addressed in *SSAP No. 12—Employee Stock Ownership Plans*. This adoption with modification includes the related implementation guidance reflected within the FASB Codification Topic 718 not reflected within this standard. The U.S. GAAP guidance adopted with modification reflects the adoption with modification of the following ASUs:

- a. *ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting.* The revisions from ASU 2018-07 expand the scope of ASC 718 to include share-based payment transactions for acquiring goods and services from nonemployees. With ASU 2018-17, *ASC 505-50, Equity – Equity Payments to Nonemployees* was superseded.
- b. *ASU 2017-09, Scope of Modification Accounting*
- c. *ASU 2016-09, Improvements to Employee Share-Based Payment Accounting*
- d. *ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period*
- e. *ASU 2010-13, Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Current of the Market in Which the Underlying Equity Security Trades*

127. The statutory accounting guidance for share-based payments is intended to be consistent with U.S. GAAP. Adopted modifications to U.S. GAAP guidance are as follows:

- a. GAAP references to “public and nonpublic” guidance have been eliminated. However, entities that report share-payment transactions under U.S. GAAP as “public” entities shall not report different amounts between U.S. GAAP and SAP. (For example, if a reporting entity reports “fair value” under U.S. GAAP, that entity shall not utilize a “calculated or intrinsic” amount under statutory accounting.
- b. Prepaid assets are nonadmitted.
- c. GAAP references are revised to reference applicable statutory accounting guidance.
- d. GAAP reporting line items (either explicitly provided in the statement or adopted by reference – such as the GAAP implementation guidance) shall be replaced to reference applicable statutory annual statement line items. (For example, GAAP references to “other comprehensive income” shall be reflected within “Surplus - Unassigned Funds”).
- e. GAAP guidance to calculate earnings per share is not applicable to statutory accounting and has not been included within the statement.
- f. GAAP effective date and transition, and transition disclosures have not been incorporated. Reporting entities shall follow the effective date and transition elements provided within this statement.
- g. Inclusion of guidance specific to statutory for consolidated/holding company plans.

128. The adoption with modification of FASB Codification Topic 718 detailed in paragraph 126 of this statement reflects adoption with modification of the following pre-codification GAAP standards:

- a. *FAS 123R, Share-Based Payment (FAS 123R);*
- b. *FAS 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (FAS 150) – (Adopted only to the extent referenced in FAS 123R for classifying instruments as equity or liability for application in this statement. Adopted guidance is reflected in Exhibit A);*
- c. *FASB Staff Position FAS 123(R)-1: Classification and Measurement of Freestanding Financial Instruments Originally issued in Exchange for Employee Services under FASB Statement No. 123(R) (FAS 123R-1);*
- d. *FASB Staff Position (FSP) FAS 123(R)-2: Practical Accommodation to the Application of Grant Date as Defined in FASB Statement No. 123(R) (FSP FAS 123R-2);*

- e. *FASB Staff Position (FSP) FAS123(R)-4: Classification of Options and Similar Instruments Issued as Employee Compensation That Allow for Cash Settlement upon the Occurrence of a Contingent Event (FSP FAS 123R-4);*
- f. *FASB Staff Position (FSP) FAS 123(R)-5: Amendment of FASB Staff Position FAS 123R-1 (FSP FAS 123R-5);*
- g. *FASB Staff Position (FSP) FAS 123(R)-6: Technical Corrections of FASB Statement No. 123(R) (FSP FAS 123R-6);*
- h. *FASB Emerging Issues Task Force 97-14: Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested (EITF 97-14);*
- i. *FASB Emerging Issues Task Force 00-16: Recognition and Measurement of Employer Payroll Taxes on Employee Stock-Based Compensation (EITF 00-16);*
- j. *FASB Technical Bulletin 97-01, Accounting under Statement 123 for Certain Employee Stock Purchase Plans with a Look-Back Option (TB 97-01)*

129. The adoption with modification of FASB Codification Topic 718 in this statement reflects rejection of the following pre-codification GAAP standards:

- a. *FASB Staff Position (FSP) FAS 123(R)-3: Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards (FSP FAS 123R-3); and*
- b. *FASB Staff Position (FSP) EITF 03-6-1; Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities (FSP EITF 03-6-1).*

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group: None

Convergence with International Financial Reporting Standards (IFRS): N/A

NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to SSAP No. 104R—Share-Based Payments to incorporate the practical expedient for the current price input, a required component for the option-pricing models – models in which are utilized in the determination of fair value for share-based payments. Integration of this third practical expedient is consistent with previous decisions by the Working Group to adopt the prior two practical expedients regarding option-pricing modeling input permitted by FASB. The language proposed by NAIC staff directs that the practical expedient is only available when a reporting entity is not able to reasonably estimate the current fair value. While this language is technically broader than what was adopted by FASB (as ASU 2021-07 directly references non-public companies), the proposed language is consistent with prior Working Group adoptions and by default, should not be utilized by public entities – as they would be able to reasonably estimate fair value, which is likely the publicly traded share price.

Proposed Revisions to SSAP No. 104R

52. A reporting entity may not be able to reasonably estimate the fair value of its equity share options, nonemployee awards and similar instruments because it is not practicable for the reporting entity to estimate the expected volatility of its share price. In that situation, the entity shall account for its equity share options, nonemployee awards and similar instruments based on a value calculated using the historical volatility of an appropriate industry sector index instead of the expected volatility of the entity's share price (the calculated value). A reporting entity's use of calculated value shall be consistent between employee share-based payment transactions and nonemployee share-based payment transactions. Throughout the

remainder of this statement, provisions that apply to accounting for share options, nonemployee awards and similar instruments at fair value also apply to calculated value.

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55. If a reporting entity is not able to reasonably estimate the current share price (fair value), as a practical expedient, a reporting entity may use a value determined by the reasonable application of a reasonable valuation method as the current price of its underlying share for purposes of determining the fair value of an award that is classified as equity at grant date or upon a modification. The determination of whether a valuation method is reasonable, or whether an application of a valuation method is reasonable, shall be made on the facts and circumstances as of the measurement date. Factors to be considered under a reasonable valuation method include, as applicable:

- a. The value of tangible and intangible assets
- b. The present value of anticipated future cash flows
- c. The market value of stock or equity interests in similar corporations and other entities engaged in trades or businesses substantially similar to those engaged by the entity for which the stock is to be valued, the value of which can be readily determined through nondiscretionary, objective means (such as through trading prices on an established securities market or an amount in an arm's length transaction)
- d. Recent arm's length transactions involving the sale or transfer of stock or equity interest
- e. Other relevant factors such as control premiums or discounts for lack of marketability and whether the valuation method is used for other purposes that have a material economic effect on the entity, its stockholders, or its creditors
- f. The entity's consistent use of a valuation method to determine the value of its stock or assets for other purposes, including for purposes unrelated to compensation of service providers.

Effective Date and Transition

130. This statement was effective January 1, 2013, with interim and annual financial reporting thereafter. Early adoption was permitted for December 31, 2012, financial statements with interim and annual reporting thereafter. At the time of initial adoption of this statement, reporting entities with existing share-based payment instruments that applied the guidance in *SSAP No. 13—Stock Options and Stock Purchase Plans* were to apply the requirements of SSAP No. 104 prospectively to new awards and to awards modified, repurchased or cancelled after the required effective date. Those reporting entities were to continue to account for any portion of awards outstanding at the date of initial application using the statutory accounting principles originally applied to those awards (e.g., SSAP No. 13).

131. Since the initial adoption of SSAP No. 104, subsequent revisions were effective as follows:

- a. *ASU 2021-07, Compensation – Stock Compensation, Determining the Current Price of an Underlying Share for Equity-Classified Share-Based Awards.* This SAP clarification is effective.
- ~~a.~~b. *ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting:* Nonsubstantive revisions effective January 1, 2020, with early application permitted.
- ~~b.~~c. *ASU 2017-09, Scope of Modification Accounting:* Nonsubstantive revisions effective January 1, 2018, applicable to modifications that occur on or after the effective date, with early application permitted.
- ~~c.~~d. *ASU 2016-09, Improvements to Employee Share-Based Payment Accounting:* Nonsubstantive revisions effective December 31, 2017, with early adoption permitted. The adoption included the transition provisions from ASU 2016-19, although not duplicated within this statement.
- ~~d.~~e. *ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period:* Nonsubstantive revisions effective January 1, 2016, with early adoption permitted.
- ~~e.~~f. *ASU 2010-13, Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Current of the Market in Which the Underlying Equity Security Trades:* Captured in the original adoption of SSAP No. 104, effective January 1, 2013.

Staff Review Completed by: Jim Pinegar– NAIC Staff, February 2022

Status:

On April 4, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to *SSAP No. 104R—Share-Based Payments* to incorporate a practical expedient for the current price input, a required component for option-pricing models which are utilized in the determination of fair value for share-based payments.

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