Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue: *ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions***

**Check (applicable entity):**

 P/C Life Health

Modification of Existing SSAP [x]  [x]  [x]

New Issue or SSAP [ ]  [ ]  [ ]

Interpretation [ ]  [ ]  [ ]

Description of Issue:

In June 2022, the Financial Accounting Standards Board (FASB) issued *ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions* to 1) clarify the guidance in Topic 820, Fair Value Measurement, when measuring the fair value of an equity security subject to contractual restrictions that prohibit the sale of an equity security, 2) amend a related illustrative example, and 3) add a new disclosure of the fair value of equity securities subject to contractual sale restrictions, nature and remaining duration of the restrictions, and circumstances that could cause a lapse in the restrictions, in accordance with Topic 820.

These amendments do not change the principles of fair value measurement. They provide clarity in situations involving equity securities that have restrictions related to the sale of the asset. This ASU provides updated guidance for two specific scenarios, one where the restriction is based on the entity holding the equity security and one where the restriction is a characteristic of the equity security.

* First, it clarifies situations where an equity security cannot be sold on the measurement date because of a contractual sale restriction where the entity is not allowed to sell an asset. An example of this would be lock-up periods, where the assets cannot be sold for a set period but can be readily priced based on a public security exchange.
* Second, it provides guidance for situations where the restriction is based on characteristics of the asset that limits if it can be sold in regular markets. An example would be an equity security issued through a private placement and not SEC registered and are legally restricted from being sold on a national securities exchange or an over-the-counter market. These assets would be available to be sold on an existing market (not on the public exchange) but would have a fair value based on the market price of the similar unrestricted equity security adjusted to reflect the effect of the restriction.

Guidance for restricted assets is in *SSAP No. 4—Assets and Nonadmitted Assets*, and additional guidance specific to securities in ASU 2022-03 are included in *SSAP No. 30R—Unaffiliated Common Stock*, *SSAP No. 32R—Preferred Stock*, and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*. Under these SSAPs, restricted securities are generally considered to be admitted assets to the extent that they can be used to cover policyholder obligations.

Existing Authoritative Literature:

The primary guidance for fair value is in *SSAP No. 100R—Fair Value*. *SSAP No. 30R—Unaffiliated Common Stock* and *SSAP No. 32R—Preferred Stock*, include some guidance on restricted investments involving common and preferred stock, but neither goes into detail on the specific guidance discussed in ASU 2022-03. Additionally, *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures* and *SSAP No. 4—Assets and Nonadmitted Assets* include references to restricted assets, primarily related to disclosures.

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):** None

Staff Recommendation:

**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. 100R—Fair Value* to adopt *ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions* with modification to be consistent with statutory language in the respective statutory accounting statements. Proposed revisions are illustrated below.**

Proposed edits to SSAP No. 100R:

### Equity Securities Subject to Contractual Sale Restrictions

1. An equity security that an entity cannot sell on the measurement date because of a contractual sale restriction shall be measured at fair value on the basis of the price in the principal (or most advantageous) marketFN. A contractual sale restriction does not change the market in which that equity security would be sold. A discount applied to the price of an equity security because of a contractual sale restriction is not a characteristic of the equity security. A contractual sale restriction is a characteristic of the reporting entity holding the equity security rather than a characteristic of the asset and, therefore, is not considered in measuring the fair value of an equity security. A contractual sale restriction prohibiting the sale of an equity security is a characteristic of the reporting entity holding the equity security and shall not be separately recognized as its own unit of account.
2. The effect on a fair value measurement arising from a restriction on the sale or use of an asset by a reporting entity will differ depending on whether the restriction would be taken into account by market participants when pricing the asset. When the restriction is a characteristic of the asset, the restriction is a characteristic of the asset and should be considered in measuring the fair value of the asset. For example, an equity security issued through a private placement is not registered and is legally restricted from being sold on a national securities exchange or an over-the-counter market until the shares are registered or the conditions necessary for an exemption from registration have been satisfied. A market participant would sell the private placement equity securities in a different market than the market used for registered equity securities on the measurement date. Because that restriction would be a characteristic of the equity security, a market participant would consider the inability to resell the security on a national securities exchange or an over-the-counter market when pricing the equity security; therefore, the reporting entity that holds the Class A shares acquired through a private placement transaction would consider that restriction a characteristic of the asset, and the reporting entity should measure the fair value of the equity security on the basis of the market price of the similar unrestricted equity security adjusted to reflect the effect of the restrictionFN.

FN—Refer to *SSAP No. 4—Assets and Nonadmitted Assets* for admissibility guidance for restricted equity securities.

60. For equity securities that are subject to contractual sales, disclose the fair value of equity securities subject to contractual sale restrictions.

65. This standard adopts *ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions*, with modification to be consistent with statutory language in the respective statutory accounting statements.

Staff Review Completed by: Jake Stultz– NAIC Staff, November 2022

Status:

On December 13, 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. 100R to adopt *ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions* with modification to be consistent with statutory language in the respective statutory accounting statements, as illustrated above. Note that this agenda item does not recommend incorporating the new proposed GAAP disclosures on sales restrictions, but identifies that items restricted as to sale would be captured as restricted assets per SSAP No. 1 and subject to admittance considerations under SSAP No. 4.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/Fall - December/Exposures/22-16 - ASU 2022-03 - FV.docx