NAIC Winter National Meeting
San Francisco, California

Valuation of Securities (E) Task Force

Sunday, December 6, 2009
10:30 a.m. - 12:00 p.m. Eastern
Hilton San Francisco, Continental 6 Ballroom Level

James J. Wrynn, Chair,	New York	Ralph S. Tyler III	Maryland
Thomas R. Sullivan, Vice Chair,	Connecticut	Glenn Wilson	Minnesota
Steve Poizner	California	Ann Frohman	Nebraska
Karen Weldin - Stewart	Delaware	Roger Sevigny	New Hampshire
Kevin McCarty	Florida	Kim Holland	Oklahoma
Michael McRaith	Illinois	Joel Ario	Pennsylvania
Susan Voss	Iowa	Alfred Gross	Virginia
Sandy Praeger	Kansas	Mike Kreider	Washington
James J. Donelon	Louisiana	Sean Dilweg	Wisconsin

Agenda

1. The RMBS Project

   a. Placing RMBS under Regulatory Review – Interim Instructions for Year End Reporting; Clarifications

   b. Status Report

   c. Extending NAIC method for determining an NAIC designation for RMBS pending a long-term process

2. Hear the Report of the Invested Asset (E) Working Group

3. Adopt 2010 charge for the Invested Asset (E) Working Group

4. Proposal to revise the requirement to file certain 6* securities with the SVO

5. Implementation of RealPoint, LLC credit ratings for CMBS

6. Assigning an NAIC designation to hybrid securities not rated by AROs – Discussion of Issue and Options

   a. Draft regulatory rule

   b. Permit industry to self-rate

   c. Require use of the 5*/6* process

   d. Other alternatives?

7. Referral from the Statutory Accounting Principles (E) Working Group

8. Definition of first lien RMBS or CMBS securities that incorporate mixed collateral

9. Other Matters

VALUATION OF SECURITIES (E) TASK FORCE
WINTER NATIONAL MEETING

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To: Michael Moriarty, Chair of the Valuation of Securities (E) Task Force
Members of the Valuation of Securities (E) Task Force
From: Kevin Fry, Chair of the Invested Asset Working Group
Matti Peltonen, Vice Chair of the Invested Asset (E) Working Group
Bob Carcano, Senior Counsel, SVO
Re: Proposal to Redefine the Mission and Role of the Invested Asset (E) Working Group
Date: September 1, 2009

1. Introduction - The Invested Asset (E) Working Group ("IAWG" or "Working Group") was re-created in 2006[1] to serve as a forum for regulators to address new investment structures and to propose regulatory rules to address them. The IAWG functions as a contact point into the regulatory process for insurance companies and members of the investment advisory community. As we approach the completion of our current charge we are concerned that the operating pattern of the IAWG is inappropriate to its role and function. The IAWG was conceived as an ad hoc group, operating only when convened by the Task Force to respond to a specific assignment and disbanding immediately thereafter.[2] This memorandum proposes an alternative organizational pattern and charge for the IAWG and explains our reasoning.

2. Background – Immediately after its formation, the IAWG was assigned to review Constant Proportion Debt Obligations. This assignment convinced the Working Group that if the NAIC was to attain its transparency objective, the IAWG would have to be able to provide comprehensive, one-stop regulatory guidance in as timely a manner as the complexity of the new instrument permitted. As a result, we requested an expanded charge to consider improvements to the process by which risks in investments are evaluated, regulatory rules are made and guidance is communicated to insurance companies, market participants and the regulatory community.[3] We recognized and articulated that:

- Improving transparency would require insurance companies, their trade representatives, investment advisors and market participants to identify new securities and to work with regulators to highlight actual and potential risks and translate analytical insights into appropriate regulatory rules. Our first priority therefore was to facilitate this interaction by developing the specific procedures that would apply in a technical review of a new security.[4]

- The expression of regulatory concerns about risks in securities that have already been purchased by insurance companies runs a great risk of creating market turmoil. Accordingly, we have focused considerable attention on identifying the kinds of investment risks (other than credit) that are associated with fixed-income securities in order to create a more comprehensive regulatory framework. We are now evaluating the best ways to regulate those risks. The investment risk

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[1] The Invested Asset (E) Working Group was re-formed as part of NAIC transparency initiative, whose components are identified below:

- The SVO should report all of its determinations involving publicly traded securities on the SVO Web site;
- Broker-dealers could have direct access to the SVO to obtain SVO opinions before bringing new securities to the market;
- The SVO would explain its determinations as required through research articles;
- Clarifying amendments could be made to portions of the *Purposes and Procedures Manual;* and
- The Invested Asset Working Group should be reestablished and tasked with reviewing new investment vehicles as and when so directed by the Valuation of Securities (E) Task Force.

[2] Invested Asset (E) Working Group – Charge adopted December 10, 2006. From time to time, the Valuation of Securities (E) Task Force may determine that the technical nature of some matter before it would be best advanced by convening the Invested Asset Working Group and transferring to it a specific regulatory assignment or assignments. The assignment or assignments thus transferred to the Invested Asset Working Group by the Valuation of Securities Task Force shall be within that charge of the Task Force related to development of a regulatory framework for new or evolving investments or the consideration of refinements for an existing regulatory framework applicable to an existing class of securities. The phrase regulatory framework refers collectively to and means the following regulatory mechanisms or processes: statutory accounting guidance, annual statement instructions, blanks reporting instructions, asset valuation reserves, interest maintenance reserves, risk based capital charges, valuation procedures for invested assets, credit assessment procedures for invested assets or any other aspect of the NAIC financial solvency framework within the scope of the charge of the Task Force. The Invested Asset Working Group is charged with the review of matters in the priority established by the Task Force.

[3] The Invested Asset Working Group is charged with considering improvements to the process by which risks in new invested assets are evaluated, communicated and monitored, and how the annual statement investment schedules could be made more transparent to better reflect non-credit risks, such as various structural risks embedded in new and existing securities. (Charge adopted June 3, 2007.)

[4] The role of the IAWG and the process for reviewing securities is explained at http://www.naic.org/committees_e_vos_iawg.htm

framework we are developing provides the primary background against which regulators will develop rules for investments.

- A risk focused approach to regulation requires regulators to understand investment risks and that they and the SVO as their primary advisor have the tools and systems necessary to conduct thorough financial solvency monitoring. Accordingly, we have worked with NAIC staff to identify where changes are necessary to investment schedules and reporting instructions, create a dynamic electronic system to identify risk attributes of securities owned by insurers, identify analytical tools and concepts for development that will assist regulators understand investment issues and expand SVO capabilities.

If the IAWG is disbanded after completing its current charge, the infrastructure we have just described would quickly erode. Our opinion is that the function of the IAWG should be to proactively manage the NAIC transparency objective and the infrastructure described above. The members of the IAWG, supported by the SVO, must develop the background, knowledge, expertise, legitimacy and infrastructure necessary to quickly and efficiently represent the NAIC regulatory community in discussions on investment risk issues with investment professionals representing the insurance industry and other capital market participants. This can only happen if the IAWG evolves into the regulatory partner of the SVO. The IAWG should:

- Ensure that its members develop and maintain expertise about investment risks in general and SVO operations in particular;

- Serve the SVO as a base of knowledge about regulatory practices and procedures;

- Provide the SVO with direction and guidance to assist the SVO identify those market signals and information that have immediate regulatory significance;

- Be the chief representative of the regulatory community to the SVO analytical staff;

- Assist the SVO to identify regulatory needs;

- Ensure proper dissemination of investment know-how to the regulatory community;

- Provide guidance in the completion and implementation of system projects commenced during its current charge; [5] and

- Have a role in identifying technology platform characteristics that would most effectively assist the regulatory mission and assist the management and evolution of these systems.

We believe the recommended charge (Attachment One) would accomplish the objectives identified.

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[5] A summary of these projects and the issues they present for regulators and the staff is set forth below:

A) Database Symmetry
  i. Development of risk attribute granularity and implication for the Investment Schedule project
  ii. Other than credit risks that can be monitored by this process

B) Enhanced SVO Monitoring Process and Role
  i. Priority Coding
  ii. Pricing Information
  iii. Greater Reporting on Exposures

3) Implementation of Phases 1, 2 and 3 of the Investment Schedule Project.

Attachment One
Proposed 2010 Charge for the Invested Asset (E) Working Group

The Invested Asset (E) Working Group (IAWG) is established as a standing NAIC Working Group. The mission of the IAWG is to provide continuity in and manage NAIC processes related to the development of regulatory rules to address new investment structures. The IAWG shall fulfill this charge by:

- Serving as the primary NAIC contact point into the regulatory process for insurance companies, their investment advisors and other market participants;
- Creating and maintaining a framework and the necessary procedures and processes to conduct technical assessments of investment risks in investment products eligible for purchase by insurance companies;
- Developing and maintaining knowledge and expertise about investment risks and issues as well as SVO operations and capabilities;
- Guiding the development of the technology platform of the SVO to ensure the development, implementation and evolution of systems and tools that adequately support NAIC financial solvency objectives;
- Serving as the primary NAIC regulatory resource to alert the NAIC regulatory community of the identification of regulatory issues and concerns in specific investments or in investments generally;
- Ensuring that the process by which risks in invested assets are evaluated, communicated and monitored is updated as necessary to permit a timely and comprehensive response to requests for regulatory guidance;
- Ensuring that the NAIC framework for investment risks in all annual statement investment schedules and reporting instructions capture relevant information of investment risks in insurer owned securities; and
- Performing or conducting such other ancillary or related activity that are consistent with its mission and charge.

In its fulfillment of this charge, the IAWG shall meet with the SVO on a regular basis. in sessions which are either open or closed to the public, in accordance with, and within the parameters of, the requirements of the NAIC Open Meetings Policy. During these sessions the IAWG shall consult on:

- SVO operations;
- Risks in investment or investment trends identified by the SVO;
- Regulatory practices and regulatory sensitivities that should serve as inputs in the conduct of SVO analytical responsibilities; and
- Market signals and information that warrant scrutiny for possible regulatory relevance.

To: Matti Peltonen, Chair of Valuation of Securities (E) Task Force
From: North American Securities Valuation Association (NASVA)
Date: October 20, 2009

As we discussed during the July Interim NASVA meeting in New York, there appears to be a disconnect between the 6* language in Part 4, Section 3 (g) and Part 6 – Valuation of Unaffiliated Investments. The current 6* language in Part 4 requires insurance companies to file a Principal & Interest Certification for a security with the Securities Valuation Office if they intend to carry it on the annual statement with a value greater zero. Part 6 grants insurance companies (in Sec 2(b) the right to use their GAAP price sources or the SVO prices for all securities in their portfolio, regardless of designation. We feel that there is no longer a need for the SVO to continue to assign a price to 6* securities.

The 5*/6* policy was designed to encourage insurance companies' compliance with the requirements outlined in the P&P for filing with the SVO in a timely manner. By requiring companies to carry a 6* on their annual statement, the cost for non-compliance is the highest RBC Charge. The possibility of a lower RBC charge is the strongest motivator for an insurance company during these times of economic uncertainty. Higher RBC charges, as a enterprise overall, put pressure on an insurance company's ability to raise capital and general business. One of the criteria uses to determine an NRSRO's financial strength rating of an insurance company is the risk based capital charges.

The purpose of the 2008 changes to Part 6 was to improve accuracy, to reflect market practices in the pricing process, and to eliminate any discrepancies between a company's statutory and GAAP prices. Pricing a 6* at zero is not a true representation of the fair value of security. The 6* is merely an administrative symbol to indicate that full documentation was not available for the SVO to do a complete review of the security. We propose that insurance companies no longer be required to file a 6* to get a price of greater than zero. Companies should be allowed to use their own GAAP sources as the price would be more indicative of the true inherent value of the security.

Accordingly, here are our proposed amendments to the *Purposes and Procedures Manual* to codify this change:

Current Language

(f) Use of NAIC 6* Designation

An insurer may assign an **NAIC 6*** Designation to corporate and municipal securities and to structured securities that have never been rated by an NAIC ARO.

The insurer shall assign an **NAIC 6*** Designation to a security when:

(i) The documentation necessary to permit a full credit analysis of a security does not exist;

(ii) The insurer cannot certify that the issuer or obligor is current on all required interest and principal payments; and

(iii) The insurer cannot certify that it expects ultimate payment of all interest and principal.

The SVO may assign a security an **NAIC 6*** Designation when the security was assigned an **NAIC 5*** Designation in a previous year but no Subsequent Report has been received by the SVO.

(g) Unit Price of NAIC 6* Securities

An insurer that intends to report a security on its annual or quarterly financial statement (NAIC Financial Statement Blank) with an **NAIC 6*** Designation and a Unit Price not greater than zero is not obligated to file a Principal and Interest Certification Form for the security with the SVO. An insurer that intends to report a security on its annual or quarterly financial statement (NAIC Financial Statement Blank) with an **NAIC 6*** Designation and a Unit Price greater than zero shall file a Principal and Interest Certification Form for the security with the SVO.

<u>Proposed Language</u>

(f) Use of NAIC 6* Designation

An insurer may assign an **NAIC 6*** Designation to corporate and municipal securities and to structured securities that have never been rated by an NAIC ARO.

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(iii) The insurer cannot certify that it expects ultimate payment of all interest and principal.

The SVO may assign a security an **NAIC 6*** Designation when the security was assigned an **NAIC 5*** Designation in a previous year but no Subsequent Report has been received by the SVO.

(f) Unit Price of NAIC 6* Securities
For determining the fair value, the insurer should refer to Part 6 for instructions.

To: Valuation of Securities Task Force
Superintendent James J. Wrynn, Chair

From: Statutory Accounting Principles Working Group
Joe Fritsch, Chair

Date: October 1, 2009

RE: Referral – Information on Valuation Technique Utilized

During the 2009 Fall National Meeting, the Statutory Accounting Principles Working Group adopted *Issue Paper No. 138, Fair Value Measurements* (Issue Paper No. 138) and directed staff to draft and expose a new SSAP on fair value. Issue Paper No. 138 adopts, with modification *FAS 157, Fair Value Measurements* (FAS 157) and defines fair value, establishes a framework for measuring fair value and establishes disclosure requirements about fair value.

Pursuant to the guidance within FAS 157, and adopted within Issue Paper No. 138, fair value is defined as 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. Although the objective of this fair value definition (exit price) remains the same, different techniques can be utilized to determine fair value. Pursuant to the guidance, entities must classify fair value measurements into one of three broad hierarchy levels. The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value and gives the highest priority to quoted prices in active markets and the lowest priority to unobservable inputs. The following provides a summary of the fair value hierarchy levels:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets and liabilities that the entity has the ability to access at the measurement date.
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 – 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. (As noted, the fair value objective remains the same, thus unobservable inputs shall reflect the entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability – including assumptions about risk.)

In 2009, the Financial Accounting Standards Board (FASB) adopted modifications to FAS 157 in the form of *FSP FAS 157-4, Determining the Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP FAS 157-4). The Working Group also adopted this guidance within Issue Paper No. 138. This guidance addressed questions on the use of pricing services or brokers in determining fair value:

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

When discussing the fair value guidance within Issue Paper No. 138, it was identified that the information provided within the current NAIC Securities Valuation Office (SVO) product may not provide the detail necessary for entities to determine whether the pricing information ("fair value") has been determined in accordance with the parameters of Issue Paper No. 138. Although recent SVO revisions allow entities to utilize various sources for determining fair value, it was noted that entities that continue to utilize the NAIC SVO product might not have the means to properly classify valuations within the fair value hierarchy, or assert that the information received has been determined in accordance with Issue Paper No. 138.

Please accept this memorandum as notification from the Statutory Accounting Principles Working Group on anticipated changes to fair value measurements and classifications, as well as to advise of the need to incorporate information on the valuation techniques utilized when the NAIC SVO provides pricing information.

(Although issue papers adopted by the Statutory Accounting Principles Working Group are not considered authoritative statutory accounting guidance, during the Fall National Meeting the Working Group directed staff to proceed with drafting and exposing a new SSAP on fair value measurements, reflecting the guidance adopted within Issue Paper No. 138. It is expected that this SSAP will be discussed and potentially adopted during the 2009 Winter National Meeting. The effective date of this new SSAP is currently proposed for 2010 annual financial statements, with interim and annual financial statement reporting thereafter. Allowance for early adoption within 2009 annual financial statements is also provided within the proposed SSAP.)

Thank you for your consideration of this memorandum. Any of the Statutory Accounting Principles Working Group staff can provide assistance as needed.

cc: Matti Peltonen; Mike Moriarty; Chris Evangel; Richard Newman; Julie Gann; John Tittle; Robin Marcotte

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Statutory Issue Paper No. 138

Fair Value Measurements

STATUS:
Adopted – Sept. 21, 2009

Type of Issue:
Common Area

SUMMARY OF ISSUE:

1. In September 2006, the Financial Accounting Standards Board (FASB) issued *FAS 157, Fair Value Measurements* (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. Since the issuance of FAS 157, the FASB has issued four FASB staff positions (FSPs) and one EITF to provide clarification of the guidance under FAS 157.

a. *FSP FAS 157-1: Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13* (FSP FAS 157-1). This FSP revised FAS 157 to exclude accounting pronouncements that address lease accounting. This FSP identifies that the term fair value will be used differently under *FAS 13, Accounting for Leases*, (FAS 13) than under FAS 157.

b. *FSP FAS 157-2: Effective Date of FASB Statement No. 157* (FSP FAS 157-2). This FSP defers the effective date of FAS 157 for nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008.

c. *FSP FAS 157-3: Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active* (FSP FAS 157-3). This FSP initially clarified the application of FAS 157 for a market that is not active and provided an illustration in determining the fair value of a financial asset when the market for that financial asset is not active. With the issuance of FSP FAS 157-4, FSP FAS 157-3 was superseded, thus all of the amendments to FAS 157 from this FSP were deleted or amended.

d. *FSP FAS 157-4: Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transaction That Are Not Orderly* (FSP FAS 157-4). This FSP provides guidance for estimating fair value in accordance with FAS 157 when the volume and level of activity for the asset and liability have significantly decreased. This FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly.

e. *EITF Issue No. 08-5, Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement* (EITF 08-5). This EITF provides guidance in determining an issuer's unit of accounting for a liability issued with an inseparable third-party credit enhancement when it is measured or disclosed at fair value on a recurring basis. As noted within this EITF, the issuer of a liability with a third-party credit enhancement that is inseparable from the liability shall not include the effect of the credit enhancement in the fair value measurement of the liability. For example, in determining the fair value of debt with a third-party guarantee, the issuer would consider its own credit standing and not that of the third-party guarantor. The issuer should disclose the existence of the third-party credit enhancement.

2. This Issue Paper proposes adoption, with modification, of FAS 157, FSP FAS 157-1 and FSP FAS 157-4. As components of FSP FAS 157-4 have been incorporated within INT 09-04, with the issuance of a final SSAP on fair value measurements INT 09-04 will be nullified. Guidance within FSP FAS 157-2 on the effective date for nonfinancial assets and nonfinancial liabilities is not considered applicable for statutory accounting, as the effective date of a new SSAP on fair value measurements will be after the effective date established by FSP FAS 157-2. FSP FAS 157-3 is considered rejected for statutory accounting purposes as the modifications made to FAS 157 from the issuance of that FSP have been amended or deleted with the issuance of FSP FAS 157-4. EITF 08-5 is considered rejected for statutory accounting purposes as the concept of considering non-performance risk (own credit risk) is inconsistent with the statutory accounting concept of conservatism and the assessment of financial solvency for insurers. Liabilities reported at fair value shall reflect the guidance adopted within FAS 157, as provided within this Issue Paper, without consideration of own-performance risk and without reflection of any third-party guarantee.

3. Current statutory accounting guidance for the definition of 'fair value' is primarily located within the Glossary to the Accounting Practices and Procedures Manual. There are instances throughout the Statements of Statutory Principles (SSAPs) in which guidance on the definition of fair value is located within a specific SSAP. It is intended that all statutory references to "fair value" will be defined in accordance with the provisions established within this Issue Paper, except where specifically excluded.

Summary Conclusion

4. This Issue Paper defines fair value, establishes a framework for measuring fair value in statutory accounting principles, and expands disclosures about fair value measurements. This Issue Paper applies under other accounting pronouncements that require or permit fair value measurements, but this Issue Paper does not require any new fair value amendments. However, the application of this Issue Paper may change current practice. This Issue Paper does not eliminate the practicability exceptions to fair value measurements in accounting pronouncements within the scope of this Issue Paper.

Scope

5. This Issue Paper applies under other statutory accounting pronouncements that require or permit fair value measurements, except as follows

a. This Issue Paper does not eliminate the practicality exceptions to fair value measurements in accounting pronouncements within the scope of this Issue Paper.

b. This Issue Paper does not apply under *SSAP No. 22—Leases* (SSAP No. 22) and other accounting pronouncements that address fair value measurements for purposes of lease classification to measurement under SSAP No. 22. This scope exception does not apply to assets acquired or liabilities assumed in a business combination that are required to be measured at fair value under *SSAP No. 68—Business Combinations and Goodwill* (SSAP No. 68), regardless of whether those assets and liabilities are related to leases.

Definition of Fair Value

6. 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.

Components of the Fair Value Definition

7. *Asset/Liability* - A fair value measurement is for a particular asset or liability. Therefore, the measurement should consider attributes specific to the asset or liability, for example, the condition and/or location of the asset or liability and restrictions, if any, on the sale or use of the asset at the measurement date. The asset or liability might be a standalone asset or liability (for example, a financial instrument or an operating asset) or a group of assets and/or liabilities (for example, an asset group, a reporting unit, or a business).

8. *Price* - A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale). The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. Therefore, the objective of a fair value measurement is to determine the price that would be received to sell the asset or paid to transfer the liability at the measurement date (an exit price).

9. *Principal (or Most Advantageous) Market* - A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The principal market is the market in which the reporting entity would sell the asset or transfer the liability with the greatest volume and level of activity for the asset or liability. The most advantageous market is the market in which the reporting entity would sell the asset or transfer the liability with the price that maximizes the amount that would be received for the asset or minimizes the amount that would be paid to transfer the liability, considering transaction costs in the respective market(s). In either case, the principal (or most advantageous) market (and thus, market participants) should be considered from the perspective of the reporting entity, thereby allowing for differences between and among entities with different 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.

10. 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. 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. 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.

11. *Market Participants* - 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; and

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

12. The fair value of the asset or liability shall be determined based on the assumptions that market participants would use in pricing the asset or liability. In developing those assumptions, the reporting entity need not identify specific market participants. Rather, the reporting entity should identify characteristics that distinguish market participants generally, considering factors specific to (a) the asset or liability, (b) the principal (or most advantageous) market for the asset or liability, and (c) market participants with whom the reporting entity would transact in that market.

13. *Application to Assets* **-** A fair value measurement assumes the highest and best use of the asset by market participants, considering the use of the asset that is physically possible, legally permissible, and financially feasible at the measurement date. In broad terms, highest and best use refers to the use of an asset by market participants that would maximize the value of the asset or the group of assets within which the asset would be used. Highest and best use is determined based on the use of the asset by market participants, even if the intended use of the asset by the reporting entity is different.

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

a. <u>In-use</u> - The highest and best use of the asset is in-use if the asset would provide maximum value to market participants principally through its use in combination with other assets as a group (as installed or otherwise configured for use). For example, that might be the case for certain nonfinancial assets. If the highest and best use of the asset is in-use, the fair value of the asset shall be measured using an in-use valuation premise. When using an in-use valuation premise, the fair value of the asset is determined based on the price that would be received in a current transaction to sell the asset assuming that the asset would be used with other assets as a group and that those assets would be available to market participants. Generally, assumptions about the highest and best use of the asset should be consistent for all of the assets of the group within which it would be used.

b. <u>In-exchange</u> - The highest and best use of the asset is in-exchange if the asset would provide maximum value to market participants principally on a standalone basis. For example, that might be the case for a financial asset. If the highest and best use of the asset is in-exchange, the fair value of the asset shall be measured using an in-exchange valuation premise. When using an in-exchange valuation premise, the fair value of the asset is determined based on the price that would be received in a current transaction to sell the asset standalone.

15. Because the highest and best use of the asset is determined based on its use by market participants, the fair value measurement considers the assumptions that market participants would use in pricing the asset, whether using an in-use or an in-exchange valuation premise.

16. *Application to Liabilities* - Consideration of non-performance risk (own credit-risk) should not be reflected in the fair value calculation for liabilities at subsequent measurement. At initial recognition, it is

perceived that the consideration of own-credit risk may be inherent in the contractual negotiations resulting in the liability. The consideration of non-performance risk for subsequent measurement is inconsistent with the conservatism and recognition concepts as well as the assessment of financial solvency for insurers, as a decrease in credit standing would effectively decrease reported liabilities and thus seemingly increase the appearance of solvency. Furthermore, liabilities reported or disclosed at "fair value" shall not reflect any third-party credit guarantee of debt.

Fair Value at Initial Recognition

17. 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.

18. 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 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).

d. For liabilities, differences may exist as non-performance risk (own credit risk) is not reflected in the fair value (i.e., exit price) determination of all liabilities (including derivatives).

Valuation Techniques

19. 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; 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).

20. 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.

21. 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 pursuant to SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3). The disclosure provisions of SSAP No. 3 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

22. In this Issue Paper, 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 observable inputs and minimize the use of unobservable inputs.

Fair Value Hierarchy

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

24. 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.

<u>Level 1 Inputs</u>

25. 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 26 and 27.

26. 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.

27. 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.

28. 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

29. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

a. Quoted prices for similar assets or liabilities in active markets

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

c. Inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates)

d. Inputs that are derived principally from or corroborated by observable market data by correlation or other means (market-corroborated inputs).

30. 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.

31. 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.

32. 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 Issue Paper. 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).

33. This Issue Paper does not prescribe a methodology for making significant adjustments to transactions or quoted prices when estimating fair value. Paragraphs 19-21 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.

34. 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.

35. 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.

36. The determination of whether a transaction is orderly (or not orderly) is more difficult if there has been a significant decrease in the volume and level of activity for the asset or liability. Accordingly, the reporting entity shall consider the following guidance:

a. If the weight of the evidence indicates the transaction is not orderly, the reporting entity shall place little, if any, weight (compared with other indications of fair value) on that transaction price when estimating fair value or market risk premiums.

b. If the weight of the evidence indicates the transaction is orderly, the reporting entity shall consider that transaction price when estimating fair value or market risk premiums. The amount of weight placed on that transaction price when compared with other indications of fair value will depend on the facts and circumstances such as the volume of the transaction, the comparability of the transaction to the asset or liability being measured at fair value, and the proximity of the transaction to the measurement date.

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

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

37. Regardless of the valuation technique(s) used, the reporting entity shall include appropriate risk adjustments. Risk-averse market participants generally seek compensation for bearing the uncertainty inherent in the cash flows of an asset or liability (risk premium). A fair value measurement should include a risk premium reflecting the amount market participants would demand because of the risk (uncertainty)

in the cash flows. Otherwise, the measurement would not faithfully represent fair value. In some cases, determining the appropriate risk premium might be difficult. However, the degree of difficulty alone is not a sufficient basis on which to exclude a risk adjustment. Risk premiums should be reflective of an orderly transaction (that is, not a forced or distressed sale) between market participants at the measurement date under current market conditions.

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

39. Level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, that is, an exit price from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs shall reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). Unobservable inputs shall be developed based on the best information available in the circumstances, which might include the reporting entity's own data. In developing unobservable inputs, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. However, the reporting entity shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the reporting entity's own data used to develop unobservable inputs shall be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions.

Inputs Based on Bid and Ask Prices

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

Disclosures

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

major category of assets and liabilities (for equity and debt securities), major category shall be defined as major security type:

a. The fair value measurements at the reporting date and the source of the fair value measurement.

b. The level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3)

c. For fair value measurements using significant unobservable inputs (Level 3), a reconciliation of the beginning and ending balances, separately presenting changes during the period attributable to the following:

(1) Total gains or losses for the period (realized and unrealized), segregating those gains or losses included in earnings (or changes in net assets), and a description of where those gains or losses included in earnings (or changes in net assets) are reported in the statement of income (or activities)

(2) Purchases, sales, issuances, and settlements (net)

(3) Transfers in and/or out of Level 3 (for example, transfers due to changes in the observability of significant inputs)

d. The amount of the total gains or losses for the period in subparagraph (c) (1) above included in earnings (or changes in net assets) that are attributable to the change in unrealized gains or losses relating to those assets and liabilities still held at the reporting date and a description of where those unrealized gains or losses are reported in the statement of income (or activities)

e. The inputs and valuation technique(s) used to measure fair value and a discussion of changes in valuation techniques and related inputs, if any, during the period.

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

a. The fair value measurements recorded during the period and the reasons for the measurements

b. The level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3)

c. For fair value measurements using significant unobservable inputs (Level 3), a description of the inputs and the information used to develop the inputs

d. The inputs and valuation technique(s) used to measure fair value and a discussion of changes, if any, in the valuation technique(s) and related inputs used to measure similar assets and/or liabilities in prior periods.

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

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

Disclosures about Fair Value of Financial Instruments *(Copied from SSAP No. 27 and modified to reflect adoption of FSP FAS 107-1 and APB 28-1. This modification would require disclosures for annual and quarter financial statements.)*

45. A reporting entity shall disclose in the notes to the financial statements, as of each date for which a statement of financial position is presented in the quarterly or annual 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 identified in paragraph 46. 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. 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.

46. The disclosures about fair value prescribed in paragraph 45 are not required for the following:

a. Employers' and plans' obligations for pension benefits, other postretirement benefits including health care and life insurance benefits, postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements, as defined in *SSAP No. 12—Employee Stock Ownership Plans* (SSAP No. 12), *Stock Options and Stock Purchase Plans* (SSAP No. 13), *SSAP No. 14—Postretirement Benefits Other Than Pensions* (SSAP No. 14), and *SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8* (SSAP No. 89).)

b. Substantively extinguished debt subject to the disclosure requirements of *SSAP No. 91R—Accounting for Transfer and Servicing of Financial Assets and Extinguishments of Liabilities* (SSAP No. 91R).

c. Insurance contracts, other than financial guarantees and deposit-type contracts

d. Lease contracts as defined in *SSAP No. 22—Leases* (SSAP No. 22).

e. Warranty obligations and rights.

f. Investments accounted for under the equity method.

g. Equity instruments issued by the entity.

47. 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.

48. In the context of this Issue Paper, practicable means that an estimate of fair value can be made without incurring excessive costs. It is a dynamic concept: what is practicable for one entity might not be for another; what is not practicable in one year might be in another. For example, it might not be practicable for an entity to estimate the fair value of a class of financial instruments for which a quoted market price is not available because it has not yet obtained or developed the valuation model necessary to make the estimate, and the cost of obtaining an independent valuation appears excessive considering the materiality of the instruments to the entity. Practicability, that is, cost considerations, also may affect the required precision of the estimate; for example, while in many cases it might seem impracticable to estimate fair value on an individual instrument basis, it may be practicable for a class of financial instruments in a portfolio or on a portfolio basis. In those cases, the fair value of that class or of the portfolio should be disclosed. Finally, it might be practicable for an entity to estimate the fair value only of a subset of a class of financial instruments; the fair value of that subset should be disclosed.

Relevant Literature

49. This Issue Paper adopts with modification *FAS 157, Fair Value Measurements*; (FAS 157) *FSP FAS 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement Under Statement 13*, (FSP FAS 157-1) and *FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP FAS 157-4). Modifications from FAS 157, FSP FAS 157-1 and FSP FAS 157-4 include:

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

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

c. This Issue Paper does not adopt guidance from FAS 157 regarding the consideration of non-performance risk (own credit risk) in determining the fair value measurement of liabilities. The consideration of own credit-risk in the measurement of fair value liabilities is inconsistent with the statutory accounting concept of conservatism and the assessment of financial solvency for insurers. The fair value determination for liabilities should follow the guidance adopted from FAS 157, with the exception of the consideration of own-performance risk.

d. This Issue Paper includes revisions to reference statutory standards or terms instead of GAAP standards or terms.

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

50. Paragraphs 42-44 adopt FAS 107 as amended by *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*. Financial instruments named within paragraph 8 of FAS 107 that are exempt from disclosure are adopted to the extent applicable for statutory accounting and are reflected in paragraph 46. This Issue Paper also adopts revisions to FAS 107 reflected in *FSP FAS 107-1 and APB-1, Interim Disclosures about Fair Value of Financial Instruments* (FSP FAS 107-1 and APB-1), and thus requires disclosure in both annual and quarterly financial statements. In addition, this Issue Paper 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.

Effective Date and Transition

51. This Issue Paper shall be effective for December 31, 2010 annual financial statements, with interim and annual financial statement reporting thereafter. Early adoption is permitted for December 31, 2009 annual financial statements, with interim and annual reporting thereafter.

Exhibit A - Disclosure Illustrations:

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

(In millions)	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets at fair value:				
Preferred stock	$	$	$	$
Common stock	-			-
Sub-total				
	-			
Derivative assets	-	-		
Separate account assets	-			-
Total assets at fair value	**$**	**$**	**$**	**$**
Liabilities at fair value:				
Derivatives liabilities	$ -	$	$ -	$
Total liabilities at fair value	**$ -**	**$**	**$**	**$**

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

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

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

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

DISCUSSION:

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

Modifications to Generally Accepted Accounting Principles

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

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

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

59. This Issue Paper does not adopt guidance from FAS 157 regarding the consideration of non-performance risk (own credit risk) in determining the fair value measurement of liabilities. The consideration of own credit-risk in the measurement of fair value liabilities is inconsistent with the statutory accounting concept of conservatism and the assessment of financial solvency for insurers. The

fair value determination for liabilities should follow the guidance adopted from FAS 157, with the exception of the consideration of own-performance risk. This Issue Paper also rejects guidance within *EITF 08-05, Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement* (EITF 08-05). Thus, under statutory accounting, liabilities measured at fair value shall not include the issuer's own credit risk, or reflect any third-party guarantee of debt. The consideration of non-performance risk is considered inconsistent with the recognition concept as protection of the policyholders can only be maintained through continued monitoring of the financial condition of the insurance enterprise. If statutory liabilities reflected the reporting entity's non-performance risk, the balance sheet would ineffectively illustrate the financial condition of the insurer.

60. This Issue Paper includes revisions to reference statutory standards or terms instead of GAAP standards or terms.

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

Modifications to Statutory Accounting Principles

62. This Issue Paper proposes the establishment of a 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 13a 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 3d, 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 17a 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 13d and 13f 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 29a and 29f 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 11to 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 20a 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 24b 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 38a.iii and 38a.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 17a.iii and 17a.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, 18a, 20, 22, 26, 31b, 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 29c 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, 59a.iii and 59 a.iv will be revised to refer to “fair value”. The term “market-value adjustments” included within paragraph 59a 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 41d will be revised to refer to the new SSAP on fair value measurements. Additionally, the term "market price" in paragraph 5a 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 7e 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 95f.i and 95g.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 1c, 1d, 5 and 20b 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. 98) – 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 t 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)–(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. __—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 value~~s~~ disclosures in accordance with SSAP No, ___—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. ___—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. ___—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. ___—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. ___—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. ____ (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. __—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:

<u>a.</u> Aggregate amount of participating mortgage obligations at the balance-sheet date, with separate disclosure of the aggregate participation liabilities and related debt discounts.

<u>b.</u> Terms of participations by the lender in either the appreciation in the ~~market value~~<u>fair value</u> 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[1] (see paragraphs 20 through 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 <u>SSAP No. __—Fair Value Measurements.</u> ~~*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~~<u>SSAP No. __</u>.~~.~~

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
   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~~ <u>fair</u> value, where the withdrawal of funds is payable at current ~~market value~~<u>fair value</u> of the assets supporting the liabilities, the assets are stated at current ~~market~~ <u>fair</u> value, and the liabilities are stated at the current ~~market~~ <u>fair</u> value or per unit value of the assets supporting the liabilities. These liabilities are for contracts where the customer bears the entire investment risk;

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[1] As referenced in the Relevant Literature section, this Statement adopts EITF 99-20, including the scope requirements of that guidance.

iv. Total with adjustment or at ~~market~~ 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 value, where the withdrawal of funds is payable at current ~~market~~ fair 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. 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 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 value loss. An AVR is required unless:

    a. The asset default or ~~market~~ 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 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. ____—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 through 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. ___—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 through 24 which discuss fair value, are rejected. The definition of fair value is in SSAP No. ___—Fair Value Measurements. ~~the glossary to the Statement of Statutory Accounting Principles. In addition, his statement allows a modification to use for determining the fair value of properties occupied by company.~~

SSAP No. 91—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. __—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. ___—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. ___—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. ___—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. ___—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 sell (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. ___—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.

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To: Industry and Interested Persons
From: Mike Moriarty, Chair of the Valuation of Securities (E) Task Force
Members of the Valuation of Securities Task Force
Re: References to the Purposes and Procedures Manual in SSAP No 43
Date: November 18, 2009

1. **Revised Statutory Accounting Guidance for RMBS -** The Statutory Accounting Principles (E) Working Group recently released a revision to Statement of Statutory Accounting Principle (SSAP) No. 43R for a comment period ending Thursday, November 19, 2009. The revisions to SSAP No. 43R relate to an NAIC regulatory decision initiated by the Valuation of Securities (E) Task Force that for year end 2009 reporting purposes, risk based capital (RBC) for residential mortgage backed securities (RMBS)[1] would be determined using a financial model instead of NAIC ARO credit ratings.

2. **The Financial Model Output -** The financial model will calculate 10 prices for every RMBS (5 for Life and 5 for P&C/Health, reflecting the difference in RBC). Each price represents the point at which the expected loss for any given RMBS equals the midpoint between the RBC charges for each NAIC designation; i.e., each price point, if exceeded by the insurer's carrying value, changes the NAIC designation. An insurance company will compare its carrying value for an RMBS to the list of price points to obtain the appropriate NAIC Designation for the RMBS. The procedure is fully discussed below.

3. **Statutory Guidance Refers to the P&P Manual -** Paragraph 26 of the exposure draft refers insurance companies to the *Purposes & Procedures Manual of the NAIC Securities Valuation Office* (the "P&P Manual) as the source for the method to be used to determine an NAIC Designation for loan-backed securities for 2009 year end reporting.

4. **Clarification -** For purposes of <u>reporting loan backed securities other than RMBS</u> references in SSAP No. 43R to the P&P Manual is to the filing exemption discussed in Part Four, Section 2 (d). Loan-backed securities *other than RMBS* are not affected by the NAIC decision to determine RBC for RMBS using a financial model instead of NAIC ARO ratings. For purposes of <u>reporting RMBS</u>, references in SSAP No. 43R to the P&P Manual is to Part Two, Section 3 (e), i.e., the NAIC procedure for placing a security or asset class under regulatory review. Because the regulatory review process contemplates the need to develop new regulatory policy or new methodology to drive regulatory objectives it envisions that the NAIC would provide interim reporting instructions to insurance companies. The applicable interim instructions for year end reporting of RMBS are attached to this Statement and have also been posted to the NAIC website. All insurers that maintain non-agency, private label RMBS must comply with the interim instructions for the 2009 statutory annual statement filing.

[1] For purposes of these instructions, RMBS refers to and includes non-agency residential mortgage-backed securities, where the collateral consists of loans pertaining to non-multi-family homes. That includes prime, subprime, Alt-A mortgages, as well as home equity loans, home equity lines of credit and loans against manufactured or mobile homes. Excluded from these instructions are agency RMBS where the mortgages are guaranteed by federal and federally sponsored agencies such as GNMA (Government National Mortgage Association, FNMA (Federal National Mortgage Association), or FHLMC (Federal Home Loan Mortgage Corporation). The exclusion covers both bonds issued and guaranteed by, or only guaranteed by the agency. Also not included are loans guaranteed by the United States Department of Veteran Affairs or the Rural Housing Services.

Interim Reporting Instructions for the Year Ending December 31, 2009

For Use in Reporting
Residential Mortgage Backed Securities

Valuation of Securities (E) Task Force
Of the
Financial Conditions (E) Committee
Of the

National Association of Insurance Commissioners

1. Background

This document contains instructions on the process to be used by insurers to determine an NAIC Designation and the reporting for residential mortgage backed securities (RMBS)[2] for the 12/31/2009 annual statement filing.

RMBS securities were placed under regulatory review by the NAIC on December 6, 2009. The regulatory review process is discussed in Part Two, Section 3 (e) of the Purposes and Procedures of the NAIC Securities Valuation Office (SVO) (referred to in this document as the Purposes and Procedures Manual). For your convenience, the text of Section 3 (e) is attached.

The NAIC procedure to place a security or asset class under regulatory review was developed to enable the NAIC to publicly communicate to industry and interested capital market participants a possible change in: regulatory policy for a specific security or asset class, analytical methodology used to determine regulatory treatment, or both. The NAIC began to discuss the possibility of a change in policy and methodology for RMBS in May of this year. The decision to place RMBS under regulatory review formally acknowledges and observes an established NAIC procedure.

The decision to place RMBS under regulatory review means:

- That for year end 2009 reporting purposes the NAIC will not use NAIC ARO credit ratings to determine risk based capital (RBC) for RMBS but instead will utilize a financial model for that purpose.

- Under the regulatory review procedure, insurers are now required to identify RMBS on their financial statements by appending the suffix **Z***. This permits identification of insurer holdings of this asset class and also facilitates necessary changes to NAIC computer systems used to track insurer holdings.

- That the filing exemption applicable to RMBS securities rated by NAIC AROs is suspended for this asset class for 2009 reporting purposes and until further notice. The exception to this is a small number of RMBS which cannot be modeled. Instructions for determining an NAIC Designation for that small population of securities is provided in this document.

- Because NAIC Designations for RMBS will be determined by a vendor run model, and not directly by the SVO, the normal process by which an insurer appeals decisions of the SVO will not apply for RMBS for 2009 reporting purposes and until further notice.

[2] For purposes of these instructions, RMBS refers to and includes non-agency residential mortgage-backed securities, where the collateral consists of loans pertaining to non-multi-family homes. That includes prime, subprime, Alt-A mortgages, as well as home equity loans, home equity lines of credit and loans against manufactured or mobile homes. Excluded from these instructions are agency RMBS where the mortgages are guaranteed by federal and federally sponsored agencies such as GNMA (Government National Mortgage Association, FNMA (Federal National Mortgage Association), or FHLMC (Federal Home Loan Mortgage Corporation). The exclusion covers both bonds issued and guaranteed by, or only guaranteed by the agency. Also not included are loans guaranteed by the United States Department of Veteran Affairs or the Rural Housing Services.

2. Overview of the Modeling Process

a. What the Model Does - The decision to use a model reflects regulatory concern that credit ratings for RMBS do not properly reflect the expected total loss from the securities. Accordingly, the NAIC decided to engage an independent third party firm to model losses of RMBS securities held by the insurance industry.

The modeling is to be conducted on a security level basis and use assumptions generally accepted by market participants for prepayments, home price levels, expected defaults, severities of loss, and performance of loans in good standing, along with other assumptions, including interest rates.

b. The Model Output - For each RMBS, the model determines the price at which the expected loss[3] equals the midpoint between the RBC charges for each NAIC designation, i.e. each price point, if exceeded, changes the NAIC designation. Because of the difference in RBC charge, the deliverable is 5 prices for Life and 5 for P&C (and Health, as RBC is the same for P&C and Health) for each RMBS.

RBC charge / NAIC designation (pre-tax)

P&C	RBC	Midpoint
1	0.3%	0.65%
2	1.0%	1.50%
3	2.0%	3.25%
4	4.5%	7.25%
5	10.0%	20.00%
6	30.0%	
Life	**RBC**	**Midpoint**
1	0.4%	0.85%
2	1.3%	2.95%
3	4.6%	7.30%
4	10.0%	16.50%
5	23.0%	26.50%
6	30.0%	

c. How to Use the Model Output – The NAIC Designation depends on the insurer's carrying value of each RMBS, whether that carrying value, in accordance with SSAP 43R paragraphs 25-26 is the amortized cost or fair value, and where the carrying value matches the price ranges provided in the model output for each NAIC designation.

This is discussed in greater detail and examples are given below.

Some RMBS owned by insurers will not be subject to modeling because the data is not available for modeling (e.g. private placements). Of these, many will be subject to utilization of the existing ARO ratings along with the carrying value to determine the NAIC designation and the resulting RBC factor more accurately.

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[3] Expected Loss is defined as the net present value of principal losses, discounted using the security's Coupon rate. Security (adjusted in case of original issue discount securities to book yield at original issue, and in case of floating rate securities, discounted using LIBOR curve + Origination spread).

The remaining RMBS with no ARO ratings and which cannot be modeled will follow the existing ‘Not Rated’ or ‘NR’ process, requiring subsequent filing with the NAIC’s Securities Valuation Office, or be subjected to the ‘5*/6* process’ (‘five-star/six-star process’).

Re-securitization of Real Estate Mortgage Investment Conduits(Re-REMIC) are also subject to be analyzed by the model.

3. Example

a. Intrinsic Price calculation

In order to calculate the desired output, it will be necessary to calculate a price that reflects the credit loss expectations for each CUSIP. This price is different from the market price and is termed as the Intrinsic Price.

Intrinsic price is defined as difference between Remaining Par Value and Expected Loss
The example below works through the steps and calculations for a single RMBS: Subprime RMBS security BSABS 2007-AQ1, class A2 (CUSIP 07389VAB3) modeled using market observer assumptions on Conditional Default Rate, Prepayment rates, Severity and other parameters applied to the securitization waterfall structure. In this example the Discounted Expected Loss is equal to 24%.

Discounted Expected Loss (% of Remaining Par)	24%
Intrinsic Price	**76**

b. Carrying Price ranges for NAIC ratings

Carrying Price is defined as the insurer's Carrying Value divided by the security's remaining Par Value, multiplied by 100. To translate the Expected Loss ranges into Carrying Price breakpoint, divide the Intrinsic Price by 1 minus the Expected Loss at each breakpoint:

$$Carrying\ Price = \frac{Intrinsic\ Price}{(1 - Expected\ Loss)}$$

"Expected Loss" refers to the Midpoint loss for a given NAIC RBC category.

The example below works through the steps and calculation of break points for the Intrinsic Price calculated in the previous section

Calculate Carrying Price break point for each NAIC designation based on expected loss at break point, e.g.

$$\text{Minimum Carrying Price (NAIC Designation 4 Life)} = \frac{\text{Intrinsic Price}}{(1 - \text{Expected Loss})} = \frac{76}{(1 - 7.30\%)} = 81.98$$

For NAIC desi

The following tables expand this calculation to all NAIC designations

Example Carrying Price range calculations - Life
Intrinsic Price = 76

NAIC designation	RBC charge	Midpoint	Break point
1	0.40%	0.85%	0.00
2	1.30%	2.95%	76.65
3	4.60%	7.30%	78.31
4	10.00%	16.50%	81.98
5	23.00%	26.50%	91.02
6	30.00%		103.40

Example calculated above

Example Carrying Price range calculations – P&C and Health
Intrinsic Price = 76

NAIC designation	RBC charge	Midpoint	Break point
1	0.30%	0.65%	0.00
2	1.00%	1.50%	76.50
3	2.00%	3.25%	77.16
4	4.50%	7.25%	78.55
5	10.00%	20.00%	81.94
6	30.00%		95.00

4. Illustration of How To Use the Model Output

Overview of the process:

- I. Determine initial NAIC designation based on break points using Amortized Cost
- II. Determine whether security is to be held at Amortized Cost or Fair Value
  - A. For Life companies
    - 1. Securities with NAIC designation 1-5 are held at Amortized Cost
    - 2. Securities with NAIC designation 6 are held at Fair Value
  - B. For P&C and Health companies
    - 1. Securities with NAIC designation 1-2 are held at Amortized Cost
    - 2. Securities with NAIC designation 3-6 are held at Fair Value
- III. Determine the final NAIC designation
  - A. For securities held at Amortized Cost, keep the initial designation
  - B. For securities held at Fair Value, determine final NAIC designation based on break points using Fair Value

Illustrative Price Table using the example security above.

	Maximum price for each NAIC designation				
	1	2	3	4	5
Life	76.65	78.31	81.98	91.02	103.40
P&C	76.50	77.16	78.55	81.94	95.00

<u>Step I</u>: Determine, using the company's Amortized Cost (divided by remaining part value), and the Price Table, what the <u>Initial</u> Designation is at Amortized Cost. A user would determine the correct Initial Designation by comparing the Amortized Cost with the maximum price for each NAIC category. The relevant Initial Designation is the designation where the <u>Amortized Cost is **less than** the Maximum Price</u> for such category. For the example security, a Life company that has an Amortized Cost of 79 would net an Initial Designation of 3. For a P&C company, the relevant designation would be 4 for the same security.

<u>Step II</u>: Determine whether, in accordance with SSAP43, Paragraphs 25-26, the company should carry the security at Amortized Cost or Fair Value.

<u>Step III</u>: If under Step 2 it is determined that Amortized Cost is used, the process is complete and the initial designation is used as the final designation. If under Step 2 it is determined that Fair Value is used, the process used to determine the final designation is the same as Step I, except Fair Values are used in place of Amortized Cost.

5. <u>Accounting (SSAP43R)</u>

Based upon the following accounting guidance in SSAP No. 43R, the company will need to follow the steps below in determining the value it would report in its financial statements.

25. Loan-backed securities shall be valued and reported in accordance with this statement, the *NAIC Purposes and Procedures of the Securities Valuation Office* manual, and the designation assigned in the NAIC Valuations of Securities product prepared by the NAIC Securities Valuation Office. For reporting entities that maintain an Asset Valuation Reserve (AVR), loan-backed securities shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value. For reporting entities that do not maintain an AVR, loan-backed securities designated highest-quality and high-quality (NAIC designations 1 and 2, respectively) shall be reported at amortized cost; loan-backed securities that are designated medium quality, low quality, lowest quality and in or near default (NAIC designations 3 to 6, respectively) shall be reported at the lower of amortized cost or fair value.

26. The *NAIC Purposes and Procedures of the Securities Valuation Office manual* identifies which method loan-backed securities are subject to in determining NAIC designation. Securities within the scope of this statement will determine the NAIC designation as follows:

i. a. For loan-backed securities subject to a single designation:

ii. The NAIC designation is the single designation assigned to a particular CUSIP in the Valuation of Securities product (either assigned by the NAIC Securities Valuation Office, or determined by the Filing Exempt process). This designation establishes the carrying value method as described in paragraph 25 and is reported in Schedule D. or

iii.

b. For loan-backed securities subject to multiple designations:

iv. Securities subject to multiple designations shall use a two-step process for determining the carrying value method and final NAIC designation;

v.

vi. Step 1: The current amortized cost of a loan-backed security is compared to the range of values assigned to the six (6) NAIC designations for each CUSIP to establish the **<u>initial</u>** NAIC designation. The carrying value method, either the amortized cost or the lower of amortized cost or fair value, is then determined as described in paragraph 25 based upon the **<u>initial</u>** NAIC designation.

vii.

viii. Step 2: The final NAIC designation that shall be used for reporting is determined by comparing the carrying value of a security (based on paragraph 26 b.i.) to the range of values assigned to the six (6) NAIC designations for each CUSIP. This final NAIC designation shall be applicable for all statutory accounting and reporting purposes (including establishing the AVR charges), except for establishing the appropriate carrying value method in Step 1(paragraph 26 b.i.).

27. For reporting entities required to maintain an AVR, the accounting for unrealized gains and losses shall be in accordance with SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve (SSAP No. 7). For reporting entities not required to maintain an AVR, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus).

6. Further Detailed Illustrations

For Entities that DO NOT maintain an AVR (e.g. P&C and Health companies)

The following is information available from company records.

CUSIP	Amortized Cost	Fair Value
55265KWV7	95.47	27.32
12669GL33	90.64	93.04

The following illustrative Price Table will be made available to the user:

CUSIP	1	2	PC & Health 3	4	5
55265KWV7	92.99	93.83	95.56	99.52	112.14
12669GL33	90.30	91.14	92.88	96.84	109.46

1. Compare the current Amortized Cost to the range of values from the Price Table and determine the <u>Initial</u> Designation that will indicate what valuation method will be used for the current reporting period.

So, for CUSIP 55265KWV7, the Amortized Cost is 95.47, which is greater than 93.83 but less than 95.56, therefore an <u>Initial Designation</u> of 3 should be used for valuation purposes only.

For CUSIP 12669GL33, the amortized cost is 90.64, which is greater than 90.30 but less than 91.14, therefore an <u>initial NAIC designation</u> of 2 should be used for valuation purposes only.

2. Compare the Initial Designation used to indicate the valuation method with the new SSAP 43R paragraph for securities indentified as available to use the new SVO filing criteria.

a. **If the current Amortized Cost indicates a designation 1-2 (Non-AVR) then Amortized cost is the carrying value method for the current reporting period.**

i. **The current amortized cost will be reported in the Book/Adjusted Carrying Value column of Schedule D; and**

For CUSIP 12669GL33, the Initial Designation calculated above is 2, and the entity would report the current amortized cost of 90.64 in the book/adjusted carrying value column of Schedule D.

ii. **The designation associated with the current amortized cost is reported in Schedule D (in this case it will be the same as the initial designation used to indicate the valuation method).**

For CUSIP 12669GL33, the Initial Designation is final and a NAIC designation of 2 would be reported in Schedule D.

The reporting entity would now need to determine the designation associated with the current fair value that is reporting in Schedule D.

b. If the current Amortized Cost indicates a designation 3-6 (Non-AVR), then Fair Value is the carrying value method for the current reporting period.

i. **The current Fair Value will be reported in the Book/Adjusted Carrying Value column of Schedule D; and**

For CUSIP 55265KWV7, Initial Designation is 3 and Fair Value must be used for reporting purposes. For CUSIP 55265KWV7, the entity would report the current fair value of 27.32 in the book/adjusted carrying value column of Schedule D.

ii. **The designation associated with the current Fair Value is reported in Schedule D (NOT the Initial Designation established by the Amortized Cost comparison that generates the valuation method for the current reporting period).**

The procedure for determining the NAIC designation for Fair Values is the same as the Amortized Cost. The Fair Value is compares with the Maximum Prices from the Price Table. The best designation where the Fair Value is less than the Maximum Price is used.

For CUSIP 55265KWV7, Initial Designation is 3 and Fair Value must be used to calculate the Final Designation. The fair value is 27.32, which is less than 92.99, and is therefore a Final NAIC Designation of 1, which would be reported in Schedule D.

<u>For Entities that DO maintain an AVR (e.g. Life or Fraternal entity)</u>

The following is information available from company records.

CUSIP	Amortized Cost	Fair Value
65535YAA0	100.78	58.57
126671F84	89.48	21.53

The following illustrative Price Table will be made available to the user:

	LIFE				
CUSIP	**1**	**2**	**3**	**4**	**5**
65535YAA0	70.96	73.04	77.35	86.45	96.35
126671F84	98.43	100.51	104.81	113.92	123.82

1. Compare the current Amortized Cost to the range of values from the Price Table and determine the <u>Initial</u> Designation that will indicate what valuation method will be used for the current reporting period.

So, for CUSIP 65535YAA0, the Amortized Cost is 100.78, which is greater than 96.35, an <u>Initial Designation</u> of 6 should be used for valuation purposes only.

For CUSIP 126671F84, the Amortized Cost is 89.48, which is less than 98.43, an <u>Initial Designation</u> of 1 should be used for valuation purposes only.

2. Compare the initial designation used to indicate the valuation method with the new SSAP 43R paragraph for securities indentified as available to use the new SVO filing criteria.

a. If the current Amortized Cost indicates a designation 1-5 (AVR), then Amortized Cost is the carrying value method for the current reporting period.

i. **The current amortized cost will be reported in the Book/Adjusted Carrying Value column of Schedule D; and**

For CUSIP 126671F84, Initial Designation is 1 and the entity would report the current amortized cost of 89.48 in the book/adjusted carrying value column of Schedule D.

ii. The designation associated with the current amortized cost is reported in Schedule D (in this case it will be the same as the initial designation used to indicate the valuation method).

For CUSIP 126671F84, the amortized cost is 89.48, the Initial Designation is final and a NAIC designation of 1 would be reported in Schedule D.

The reporting entity would now need to determine the designation associated with the current Fair Value that is reporting in Schedule D.

b. If the current Amortized Cost indicates a designation 6 (AVR), then Fair Value is the carrying value method for the current reporting period.

i. The current Fair Value will be reported in the Book/Adjusted Carrying Value column of Schedule D; and

For CUSIP 65535YAA0, Initial Designation is 6 and Fair Value must be used for reporting purposes. The entity would report the current fair value of 58.57 in the book/adjusted carrying value column of Schedule D.

iii. **The designation associated with the current Fair Value is reported in Schedule D (NOT the Initial Designation established by the Amortized Cost comparison that generates the valuation method for the current reporting period).**

The procedure for determining the NAIC designation for Fair Values is the same as the Amortized Cost. The Fair Value is compares with the Maximum Prices from the Price Table. The best designation where the Fair Value is less than the Maximum Price is used.

For CUSIP 65535YAA0, the Initial Designation is 6 and Fair Value must be used to calculate the Final Designation. The Fair Value is 58.57, which is less than 70.96, and is therefore an Final NAIC Designation 1, which would be reported in Schedule D.

7. Schedule D Reporting

<u>For Entities that DO NOT maintain an AVR (e.g. property and casualty or health entity)</u>

SCHEDULE D – PART 1
Showing All Long-Term **BONDS** Owned December 31 of Current Year

1	6	Fair Value		10	11
		8	9		
CUSIP Identification	NAIC Designation	Rate Used To Obtain Fair Value	Fair Value	Par Value	Book / Adjusted Carrying Value
55265KWV7	1Z*	27.32	27,320	100,000	27,320
12669GL33	2Z*	93.04	93,040	100,000	90,640

<u>For Entities that DO maintain an AVR (e.g. Life or Fraternal entity)</u>

SCHEDULE D – PART 1
Showing All Long-Term **BONDS** Owned December 31 of Current Year

1	6	Fair Value		10	11
		8	9		
CUSIP Identification	NAIC Designation	Rate Used To Obtain Fair Value	Fair Value	Par Value	Book / Adjusted Carrying Value
65535YAA0	1Z*	58.57	58,570	100,000	58,570
126671F84	1Z*	21.53	21,530	100,000	89,480

8. AVR and IMR Reporting

The final NAIC designation reported in Schedule D as determined in the guidance above would be used in determining whether a realized gain or loss for an RMBS security is interest-related or credit-related. The determination is completed just as any other security; with the rating at purchase being compared to the rating at sale.

If the rating changed by more than one NAIC designation from purchase, the realized gain or loss would be considered credit-related and go into the AVR. Otherwise the realized gain or loss would be considered interest-related and go into the IMR if the rating did not change by more than one NAIC rating class when comparing the ratings at purchase and sale. All unrealized gains or losses as the result of valuing the securities at fair value would go into the AVR.

The AVR or IMR treatment for RMBS realized losses for other-than-temporary impairments would be determined according to the provisions of paragraph 27 of SSAP No. 43R. The book-adjusted carrying value of RMBS securities that is used in the AVR calculation would be the same as that calculated for Schedule D reporting as determined in the guidance above.

9. Risk-Based Capital Reporting

No special guidance for RMBS securities is needed for RBC reporting. The book-adjusted carrying value and final NAIC designation of RMBS securities as reported in Schedule D of the annual statement and as calculated in the guidance above would be used for Risk-Based Capital calculation. The above process must be used by all insurers, even if the insurer is not subject to RBC.