



Insurance Investment Management

April 24, 2009

Investment Accounting Update GAAP and SSAP

There has been a flurry of activity in the investment accounting world this past month related to fair value accounting and OTTI. All of which could have an impact on your first quarter reporting. We had been waiting for the dust to settle before we summarized the new guidance as outlined below:

GAAP

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

Effective Date: Reporting periods ending after June 15, 2009; early adoption (along with FSP FAS 115-2 and 124-2 and FSP FAS 107-1 and APB 28-1) is permitted for periods ending after March 15, 2009.

This FSP stresses that the objective of fair value measurement has not changed. It still should represent the Company's best estimate of the consideration that would be exchanged in an orderly transaction. It is noted that the emphasis on using quoted prices for fair value measurement "has resulted in a misapplication of Statement 157 when estimating the fair value of certain financial assets." Therefore, the purpose of this FSP is to clarify situations in which a Company should deviate from using quoted prices for fair value measurement. These situations exist when the volume and level of trading activity for a security have significantly decreased and the quotes generated from these transactions are not "orderly" (distressed or liquidation sales). Below are the factors noted in the FSP that indicate that a market is abnormal/inactive and the related price quotes are not from orderly transactions.

Abnormal/Inactive Market

- 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 brokers.
- d. Indexes that previously were highly correlated with the fair values are demonstrably uncorrelated with recent indications of fair value.

- 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 Company's estimate of expected cash flows, considering all available market data about credit and other nonperformance risk.
- 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.
- h. Little information is released publicly (for example, a principal-to-principal market).

Price Quote is Not Orderly

- 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 marketing conditions.
- b. There was a usual and customary marketing period, but the seller marketed only to a single market participant.
- c. The seller is in or near bankruptcy or receivership (distressed), or the seller was required to sell to meet regulatory or legal requirements (forced).
- d. The transaction price is an outlier when compared with other recent transactions for the same or similar security.

If it is evident that the quotes are not a result of an orderly transaction, little or no weight shall be placed on the quote when estimating the fair value of the security. If the Company can not conclude that a quote is from an orderly transaction, the company should obtain sufficient collaborative evidence to support the Company's fair value estimate.

FSP FAS 115-2 and 124-2: Recognition and Presentation of Other-Than-Temporary Impairments

Effective Date: Reporting periods ending after June 15, 2009; early adoption (along with FSP FAS 157-4 and FSP FAS 107-1 and APB 28-1) is permitted for periods ending after March 15, 2009

This FSP has significantly changed the GAAP Other Than Temporary Impairment (OTTI) model. In the previous model, a company needed to assert that it had the ability to hold an impaired security for a period of time sufficient to allow for a recovery in its fair value to its amortized cost basis. This requirement has changed to a) the company asserting that it does not intend to sell the debt security or b) that it is more likely than not the company will not be required to sell the debt security before its anticipated recovery. The new model also includes the concept of bifurcating an impairment loss between the credit related portion of the loss and the non-credit related portion of the loss. Additionally, the new model includes a comparison of the present value of expected cash flows of a security to its amortized cost basis and to its fair value to determine how an OTTI write-down shall be recorded. Before we go into detail on the methodology behind

- Upon recording the OTTI write-down, the cost basis of the security will equal the present value of the expected cash flows. Using the effective interest rate method, the security shall then be accreted over its remaining life to the undiscounted estimate of principal recovery. If the security is classified as available-for-sale, the accretion shall be recognized in earnings. If the security is classified as held-to-maturity, the accretion is recognized in accumulated other comprehensive income.

Company does not intend to sell a security that was written down in a prior period and it is more likely than not that the Company will not be required to sell the security before recovery of its amortized cost.

- The Company shall reclassify a portion of the previously recorded impairment from retained earnings to accumulated other comprehensive income.
- The amount of the reclassification shall equal the difference between the amortized cost of the security and the present value of the expected cash flows. The security's yield, prior to the impairment write-down, shall be used as the discount rate to calculate the present value.
- Using the effective interest rate method, the security shall then be accreted over its remaining life to the undiscounted estimate of principal recovery. If the security is classified as available-for-sale, the accretion shall be recognized in earnings. If the security is classified as held-to-maturity, the accretion is recognized in accumulated other comprehensive income.

The FSP also requires additional disclosures and a specific presentation related to OTTI write-downs. Please refer to the pronouncement for details.

FSP FAS 107-1 and APB 28-1: Interim Disclosures about Fair Value of Financial Instruments

Effective Date: Reporting periods ending after June 15, 2009; early adoption (along with FSP FAS 157-4) is permitted for periods ending after March 15, 2009

This FSP requires companies to include FAS 107 disclosures in the quarterly reporting. It also requires disclosure of the methods and significant assumptions used to estimate the fair values and a description of any changes in these methods and assumptions during the period.

SSAP

INT 09-04: Application of the Fair Value Definition – EXPOSURE DRAFT

Comment period: Ending April 30, 2009

Tentative Effective Date: Periods ending on or after March 31, 2009

The current version of this exposure draft reiterates the guidance in 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. Refer to the paragraphs above for details regarding this FSP.

SSAP No. 98: Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments, an Amendment of SSAP No. 43 – Loan-Backed and Structured Securities

The NAIC has delayed the effective date of SSAP 98 until September 30, 2009, with early adoption permitted. Previously, it was effective January 1, 2009. SSAP 98 requires insurers to write down other-than-temporarily impaired loan-backed securities to fair value. With its delay, insurers can continue to apply guidance in SSAP 43, which requires other-than-temporarily impaired loan-backed securities to be written down to the undiscounted estimate of future cash flows.

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