

November 18, 2008

## NAIC Update

### ***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***

Issued: November 5, 2008

Effective: January 1, 2009, with early adoption permitted

This pronouncement requires that when recording an other-than-temporary impairment related to a loan backed security, the security's cost basis should be reduced to its fair value. Prior to the adoption of SSAP No. 98 and 99, the cost basis of an other-than-temporarily impaired loan backed security was written down to its undiscounted estimate of future cash flows.

Loan backed securities that have been previously impaired should be reviewed to determine if an additional write-down is warranted.

### ***SSAP No. 99 – Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment***

Issued: September 23, 2008

Effective: January 1, 2009, with early adoption permitted

This pronouncement requires that after writing down a bond or redeemable preferred stock, whereby the cost basis of the security is reduced to its fair value, the difference between the new cost basis and the estimated recovery value (the new premium or discount) should be amortized or accreted over the remaining life of the security.

SSAP No. 99 also clarifies that any bond premium that is written-off upon recognition of an impairment shall be recorded as a realized loss versus a reduction to investment income.

#### **Other Relevant Statutory Guidance:**

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

One of the key concepts of this OTTI guidance is that there are two types of impairments - interest related impairments and credit related impairments. An interest related impairment is obviously caused by changes in the risk free interest rate, but also includes general credit spread widening due to "supply/demand imbalances" or "perceived higher/lower risk of an entire sector". From a recognition standpoint, an interest related OTTI adjustment should be recorded when the holder has the intent to sell the position.

In contrast, a credit related impairment should be recognized when it is deemed other-than-temporary. Since we are currently experiencing a market where many securities have been trading at severely depressed levels, it is important to assess the issuers' ability to make principal and interest payments when they are due. If the issuer is showing signs that indicate the inability to make these payments, the impairment should be considered credit related. If the issuer remains financially sound, the impairment is most likely interest related.

## **Annual Statement Changes 2008-22BWG**

Effective: 2008 Annual Statement

With the adoption of 2008-22BWG comes a new (electronic) column to the Schedule D Parts 1 and 2, which identifies the source of the fair value/market value used in the statement. Below are the codes that are to be noted in this column:

- a – price is from a pricing service
- b – price is from a stock exchange
- c – price is from a broker or the insurer's custodian \*\*
- d – price is determined by the insurer
- e – price is from the SVO

\*\* Broker must be approved by the insurer as a counterparty for buying and selling securities or be an underwriter of the security being valued and the broker's or custodian's pricing policy must be retained by the insurer.

Similar to AAM's SFAS 157 level one, two, or three reporting, AAM will provide a year-end report to our client's that specify our valuation sources in the format outlined above.

Joseph A. Borgmann, CPA  
Vice President  
Investment Accounting

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