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Fair Value Adoption – An Update

Developments and observations from the widespread adoption of SFAS 157 and SFAS 159

Overview

In September 2006, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 157, *Fair Value Measurements* (SFAS 157), and in February 2007 issued FASB Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115 (SFAS 159). Both statements became effective for fiscal years beginning after November 15, 2007, with early adoption permitted.[1] Therefore, unless adopted early, calendar year companies were required to adopt these fair value accounting standards beginning January 1, 2008.

[1] On February 12, 2008, the FASB issued FASB Staff Position FAS157-2: *Effective Date of FASB Statement No. 157* (FSP157-2), which deferred the effective date of SFAS 157 until fiscal years beginning after November 15, 2008, (e.g., a one-year deferral) for nonfinancial assets and nonfinancial liabilities not measured or disclosed in the financial statements on a recurring basis. Early adoption of the requirements deferred by FSP157-2 is encouraged, and the deferral is not applicable to entities that already issued financial statements inclusive of the deferred requirements (i.e., early adopters of SFAS 157 are not within the scope of this deferral).

SFAS 157 is aimed at increasing the consistency, comparability, and transparency of fair value measurements used in financial reporting by (1) establishing a single authoritative definition of fair value ("exit-price"), (2) establishing a framework for measuring fair value, and (3) expanding fair value financial statement disclosure requirements. SFAS 157 does not introduce any new fair value measurement requirements; rather, it codifies the meaning of fair value used under other U.S. generally accepted accounting principles (U.S. GAAP).

SFAS 159 affords companies the option to measure certain financial assets and financial liabilities at fair value not previously available under U.S. GAAP. Under SFAS 159, companies have the irrevocable option ("the fair value option" or FVO) to measure most financial assets and financial liabilities at fair value, with changes in fair value recognized in current-period earnings. The fair value option provides companies with the opportunity to mitigate the

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potential for mismatches that may occur in financial reporting (e.g., an entity could elect the fair value option and report both the underlying debt and an interest rate swap at fair value, thus avoiding the application of hedge accounting).

Since the FASB's issuance of these fair value standards, aided by the turmoil in the credit markets, fair value measurements have gained notoriety and been atop many headlines. This issue of our fair value accounting newsletter summarizes several updates and interpretations related to fair value, reviews how companies have applied the standards, including the new disclosures required by SFAS 157, as well as various industry trends and developments related to fair value measurement and the fair value option.

The discussion herein revolves around an examination of 50 Securities and Exchange Commission (SEC) registrants representing the banking, insurance, investment, and energy industries, and other corporate filers, based upon information obtained from their respective 10-Q filings for the first quarter of 2008.[2] See Appendix A for a listing of those entities we evaluated, and details of how we developed our grouping of companies.

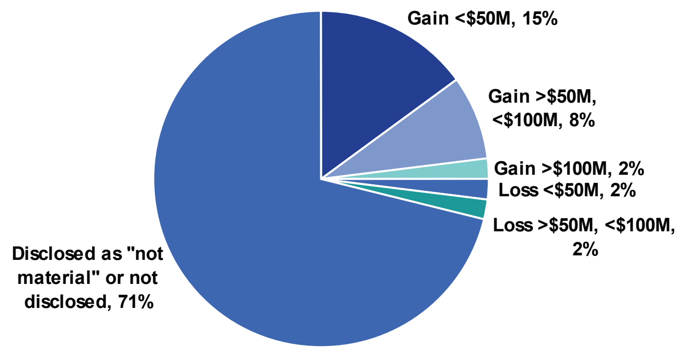
The analysis of our group of issuers included a review of the initial impact of adoption, via the disclosed transition adjustments for both SFAS 157 and SFAS 159; an examination of the composition of the leveling disclosures required by SFAS 157, an assessment of the application of the additional disclosure requirements for Level 3 assets and liabilities measured at fair value on a recurring basis; and various other disclosures related to fair value measurements. In summary, our review found that the majority of companies in our sample did not report significant[3] transition adjustments to retained earnings for either SFAS 157 or SFAS 159, and that the composition of companies' fair value measurements within the fair value hierarchy varied greatly by industry. Additionally, there was diversity within our sample related to the application of certain disclosure requirements of each standard.

SFAS 157: Adoption Impact

As SFAS 157 became effective for financial statements issued for fiscal years beginning after November 15, 2007, most companies adopted the requirements of SFAS 157 while preparing first quarter financial statements for calendar year 2008.

In general, the measurement requirements of SFAS 157 are required to be applied prospectively, except in the following three instances: (1) positions previously recorded at fair value using a "blockage factor" in accordance with certain AICPA Audit and Accounting Guides; (2) instruments previously recorded at their transaction price (as opposed to fair value) pursuant to EITF Issue No. 02-3[4]; and (3) hybrid financial instruments previously recorded at their transaction prices (as opposed to fair value) pursuant to SFAS 155[5] — therefore, there are limited circumstances for which a transition adjustment would be required related to the adoption of SFAS 157.

The graph below shows the transition adjustments disclosed by the entities within our sample.[6]



Given the limited circumstances for which recognition of a transition adjustment is appropriate (as previously described), the majority of the entities we examined (71%) either did not disclose a transition adjustment, or disclosed the transition adjustment as "not material."

The following table provides a summary of the transition adjustments to retained earnings we observed by industry, as a percentage of equity.

	High*	Low*	Median*	ND/NM**
Banking	0.24%	-0.16%	0.09%	0 of 10
Insurance	0.01%	-0.02%	0.01%	8 of 11
Investment	-	-	-	9 of 9
Energy	0.02%	0.02%	0.02%	9 of 10
Other	-1.32%	-1.32%	-1.32%	9 of 10

Note:
* Calculations based on Q1 2008 disclosed equity balances (Q1 2007 for early adopters);
** NM/MD means the entities either did not disclose a transition adjustment, or disclosed the adjustment as "not material"

[2] Transition adjustment information for those companies that early adopted SFAS 157 and SFAS 159 were obtained from their respective Form 10-Q filings for the first quarter of 2007; see Appendix A for a listing of companies within our sample, industry classification, and identification of those companies within our population that early adopted.

[3] Most disclosed transition adjustments to retained earnings were less than $50 million gains or losses

[4] 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* (EITF Issue No. 02-3)

[5] FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments* (SFAS 155)

[6] Transition adjustments are presented net of tax and includes "early adopters" as identified in Appendix A. Further, Abbott Laboratories disclosed one transition adjustment amount related to their adoption of both SFAS 157 and SFAS 159, of $(189)M, and therefore, was excluded from this graph.

The majority of the transition adjustments noted in our population were recorded by entities in the banking industry; each of the 10 entities in this category of our sample reported a transition adjustment. The vast majority of the transition adjustments in our banking sample related to recognition of gains and losses previously deferred under EITF Issue No. 02-3, followed by derecognition of block discounts.

Further, five nonbanking entities within our sample (insurance: 3; energy: 1; and other: 1) reported transition adjustments related to their respective adoptions of SFAS 157. Similarly, these transition adjustments related to the recognition of gains and losses previously deferred under EITF Issue No. 02-3. No transition adjustments were disclosed by those entities within our investment company grouping.

EITF Issue No. 02-3 deferred inception gains and losses related to derivative instruments for which there was no observable market information. Companies within the banking, insurance, and energy industries often transact in such instruments. Therefore, these entities are likely to recognize transition adjustments related to EITF Issue No. 02-3.

Prospective effects of adoption

SFAS 157 led to several changes in practice related to certain fair value measurements. With the adoption of SFAS 157 companies are required to measure fair value using assumptions expected to be used by other market participants, including assumptions about risk, and requires the maximization of observable inputs (and minimization of unobservable inputs).[7] Prior to the adoption of SFAS 157 entities may have used internal assumptions that management believed to be better than available observable inputs. Similarly, with the adoption of SFAS 157 consideration for appropriate risks (i.e., model, liquidity, nonperformance, etc.) that may not have previously been contemplated in valuation methodologies are now being considered when appropriate — most notably, the inclusion of nonperformance risk in the valuation of derivative liabilities. In accordance with SFAS 157, such changes in practice were required to be applied prospectively.

Therefore, in addition to the disclosures required by SFAS 157 related to transition adjustments recorded in retained earnings, certain companies within our sample (10 companies, or 20% of our sample — insurance: 5; banking: 4; energy: 1; and no companies in the investment or other industries) provided additional disclosures related to the prospective impacts of adopting the measurement provisions of SFAS 157.

Insurance: The prospective effects of SFAS 157 disclosed by those entities within our sample in the insurance industry related to the maximization of observable inputs and the inclusion of credit considerations in derivative valuation. For example, prior to the adoption of SFAS 157, certain insurance companies within our sample valued certain guaranteed benefit contracts, and other complex insurance contracts, using internal assumptions, or limited observable inputs, as opposed to including all observable information. Therefore, such companies within our sample disclosed the effects of using all available observable inputs as of the date of adoption. Additionally, certain insurance companies within our sample did not include their own credit when valuing derivative liabilities prior to adoption. Likewise, these companies disclosed the impact of including such credit considerations as of the day of adoption of SFAS 157. For the five insurance companies that disclosed any prospective effects of adoption, the average amount disclosed was a net post-tax loss of $72 million recognized in current period earnings (high: $28 million gain; low: $220 million loss; and median: $19 million loss).

Banking: The prospective effects of adoption disclosed by those companies within our sample in the banking industry generally related to the recognition of changes in fair value of their "principal investments." These investments reflect the respective entities' direct investments in private enterprises. Prior to the adoption of SFAS 157, such investments were usually carried at historical cost, given their illiquidity. Under SFAS 157, based on either observable market information, their expectations of market participants' assumptions, or some combination thereof, these companies were required to change their fair value estimates for these investments. For the four banking companies that made such disclosures, the average amount disclosed was a net post-tax gain of $415 million recognized in current period earnings (high: $517 million gain; low: $250 million gain; median: $446 million gain).

Energy: The one energy company that provided disclosures related to the prospective effect of adopting SFAS 157 disclosed the effect of including their own credit in the valuation of derivative liabilities. The company disclosed a $10 million pretax increase to accumulated other comprehensive income (derivative liabilities in qualifying cash flow hedging relationships pursuant to SFAS 133[8]), and a $3 million pretax increase to current period earnings (derivative liabilities other than those in qualifying hedging relationships) during the quarter of adoption of SFAS 157.

[7] Paragraph 21(a) defines observable inputs as, "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."

[8] FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133)

SFAS 159: Adoption Impact

Unless adopted early, calendar year companies were able to apply the fair value option afforded by SFAS 159 as of January 1, 2008, with initial disclosures included in 2008 first quarter filings.

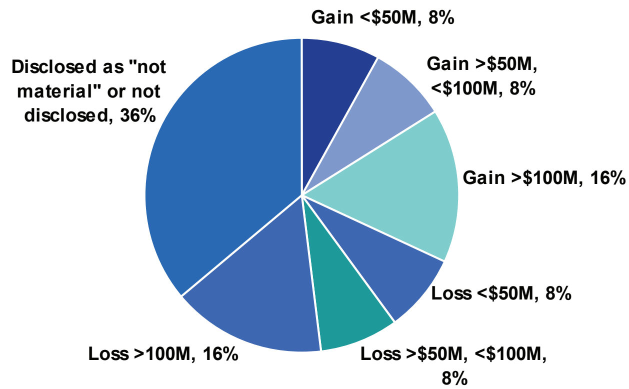
In general, companies within our sample that exercised the fair value option under SFAS 159[9] elected to carry certain loans, loan commitments, liabilities (bonds, notes, deposits, etc.), and available-for-sale securities at fair value on a recurring basis, with changes in fair value recognized in current period earnings.

Entities that apply the fair value option must make certain disclosures at the time of adoption; notably, the entity must disclose its reason(s) for electing an instrument (or group of instruments) under SFAS 159. Avoiding the requirements of hedge accounting under SFAS 133 was a common reason for electing the fair value option for many companies within our sample. Similarly, some companies applied the fair value option to certain assets and liabilities for which hedge accounting could not be achieved, in order to reduce income statement volatility due to accounting mismatches related to economic hedges.

Some entities made only prospective elections for instruments to be originated (i.e., newly originated residential mortgages). However, certain companies that made such prospective elections also disclosed the discontinuance of such elections during the same quarter (i.e., the companies discontinued making new elections, however, original elections could not be revoked). The discontinuances of new prospective elections were generally due to the increased income statement volatility due to the fluctuations in credit spreads, liquidity discounts, and other valuation inputs, experienced during the wide-spread market disruptions during the first quarter of calendar 2008.

For example, under SFAS 133 certain risks could be hedged (i.e., interest rate risk), whereas under SFAS 159 all changes in fair value must be recognized. Therefore, certain entities that chose to apply the fair value option prospectively to avoid the application of fair value hedge accounting under SFAS 133, have ceased such election in favor of once again applying hedge accounting, to mitigate income statement volatility experienced during the market disruption and the election of the fair value option.

The following graph summarizes the transition adjustment disclosed by those entities in our sample.[10]



Similar to the SFAS 157 transition adjustments noted previously, many of the entities within our sample did not record a significant transition adjustment related to their adoption of SFAS 159.

Recurring Fair Value Measurements

SFAS 157 requires tabular disclosure by level within the fair value hierarchy for all assets and liabilities measured at fair value on a recurring basis. SFAS 157 provides that 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," and also notes that this determination may be subjective.[11] Therefore, entities need to first evaluate their valuation techniques and determine the hierarchy level of each input. Then, entities should aggregate all inputs by level, and determine the lowest level input that is significant to the overall valuation.

The overall level of a measurement is dependent on the nature of the inputs used by the company to determine fair value. For example, SFAS 157 defines Level 1 inputs, as quoted prices from an active market, and defines an active market in the following manner: "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."[12] Further, SFAS 157 provides example characteristics of inactive markets, such as, few transactions, stale prices, diversity in quotes from market makers, and little publicly

[9] Only 25 entities within our sample (banking: 9; insurance: 5; investment: 3; energy: 3; and other: 5) elected the fair value option under SFAS 159 for certain of their financial assets or financial liabilities that existed at the date of their adoption; therefore, our analysis and commentary herein only relates to those entities, and not our entire population.

[10] SFAS 159 transition adjustments are disclosed net of tax, and herein, are presented in millions of USD (see also footnote 9)

[11] SFAS 157, paragraph 22

[12] SFAS 157, paragraph 24

available market information.[13] This requires entities to determine policies related to the determination of active markets, and requires entities to consistently apply such policies to each of its fair value measurements.

Most notably, an active market debate has centered on U.S. Treasury securities. Market participants have generally agreed that "on-the-run"[14] treasuries trade in an active market; however, there appears to be more diversity related to more seasoned "off-the-run" issuances (see table on next page). Similarly, exchange-traded derivatives were not always disclosed as Level 1 fair value measurements, highlighting the need to evaluate trading activity levels related to a given asset or liability, and not simply the market in which an instrument trades. These observations further highlight the need for companies to develop and consistently apply their definition of an active market.

As noted above, after determining the nature of the inputs used in a given valuation technique, a company must determine the disclosure level for the overall measurement. The disclosure level for a given fair value measurement represents the hierarchy level of the lowest level (1 to 3, highest to lowest) input(s) that are significant to the measurement in its entirety. Therefore, a company's determination of disclosure levels will be subjective in many circumstances based upon a company's definition, or process, for determining significance. Other than references to "significance testing" or "stress-testing," the companies we evaluated generally did not disclose their respective methodologies or thresholds for determining significance.

The table on the following page shows the classification of certain financial instruments within the fair value hierarchy. Some of the assets and liabilities that were generally disclosed as Level 1 include treasury bills, G7 government securities, actively traded corporate debt and equity securities, and exchange-traded derivative assets and liabilities.

As demonstrated by the significant overlap of various products between different levels (i.e., certain equities may be Level 1, Level 2, or Level 3), classification within the hierarchy is dependent on the specific nature of the instrument and the market information available to an entity, and requires professional judgment. Generally, the only "consensus" Level 1 measurements are "on-the-run" U.S. Treasuries, and actively traded listed equities and listed derivatives.

Further, most of the entities within our sample broadly defined instruments within each level. For example, "ABS measured with observable market inputs are classified within Level 2..." The specific nature of the instruments (i.e., collateral, terms, etc.) was generally not provided. Exchange-traded derivatives (e.g., futures and options) were generally disclosed as Level 1 measurements and "vanilla" OTC derivatives were generally disclosed as Level 2 measurements. More structured derivatives, including long-dated options were disclosed as Level 3 fair value measurements.

In response to the subjectivity related to fair value measurements, in the interest of financial statement users the SEC sought additional disclosures related to fair value measurements, as well as publicly commented on fair value measurements and disclosures.[15]

First, in late March, the SEC's Division of Corporation Finance sent a letter (e.g., the "Dear CFO" letter) to a number of public companies on MD&A disclosure regarding the application of SFAS 157. Although the letter was sent to financial institutions, SEC staff representatives have indicated that it "can be applicable to any company." The letter specifies several MD&A disclosure and discussion points that would apply when, for example, a registrant concludes that its use of unobservable inputs is material and when additional information would add greater insight into the application of SFAS 157.

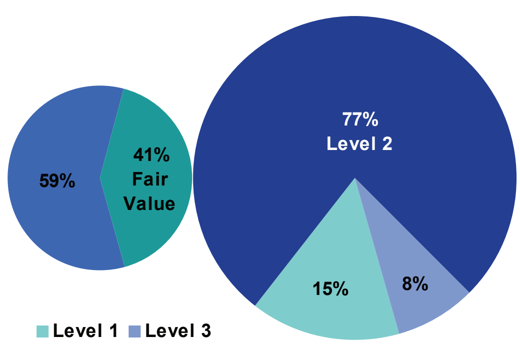
Further, in July 2008, the SEC hosted a "Roundtable on Fair Value Accounting Standards" to discuss the benefits and potential challenges associated with existing fair value accounting and auditing standards. The roundtable was organized in two panels, and included investors, preparers, auditors, regulators, and other interested parties. The panel discussions focused on the usefulness of fair value accounting to investors, potential market behavior effects from fair value accounting, practical experience, and potential challenges in applying fair value accounting standards, aspects of the current standards, if any, that can be improved, and experience with auditors providing assurance regarding fair value accounting. Any resulting guidance or standard setting has yet to be seen.

[13] SFAS 157, paragraph 28
[14] "On-the-run" Treasuries refer to the most recently issued U.S. Treasury bond or note of a particular maturity
[15] An example of the "Dear CFO" letter, as well as press releases related to the roundtable can be found at www.sec.gov

Industry	Level 1	Level 2	Level 3
Insurance	U.S. Treasury Securities G7 Government Securities Equity Securities Derivatives (Futures & Options) Separate Accounts	U.S. & Foreign Equities Mortgage-backed Securities Derivatives Commercial Paper Separate Accounts	U.S. & Foreign Securities Mortgage-backed Securities Foreign Government Securities Derivatives CDOs/CMOs Separate Accounts
Investment	U.S. Treasury Securities G7 Government Securities Foreign Government Securities Equity Securities Cash Equivalents	Senior Debt Mutual Fund Investments Equity Securities Cash Equivalents	Subordinated Debt Structured Products Mutual Fund Investments Equity Securities Private Equity Investments Equity Warrants Derivatives
Banking	U.S. Treasury Securities G7 Government Securities Foreign Government Securities Equity Securities Cash Equivalents Derivatives (Futures & Options)	U.S. & Foreign Equities Foreign Government Securities Agency Securities Derivatives Money Market Instruments Mortgage CDOs Commercial CDOs Private Equity Investments	U.S. & Foreign Equities Foreign Government Securities Agency Securities Derivatives Money Market Instruments Mortgage CDOs Commercial CDOs Private Equity Investments Retained Interests
Energy	Derivatives (Futures) Nuclear Decommissioning Trusts	Derivatives Debt & Equity Securities Nuclear Decommissioning Trusts	Derivatives Nuclear Decommissioning Trusts
Other	U.S. Treasury Securities Derivatives (Futures & Options) Corporate Debt	Derivatives Debt & Equity Securities Agency Securities Commercial Paper	Derivatives Debt & Equity Securities Agency Securities Commercial Paper Retained Interests

Recurring Asset Disclosures

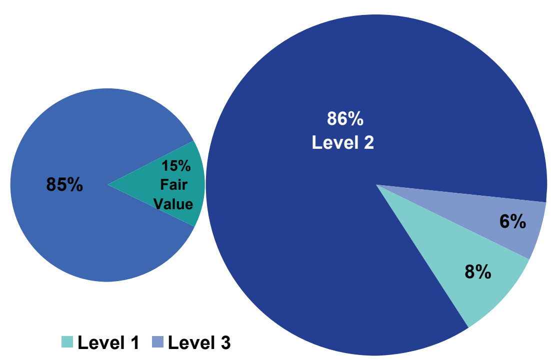
The following graph provides a breakdown of assets measured at fair value on a recurring basis, versus total assets for the 50 entities within our sample. Additionally, the graph provides the relative percentage of assets measured at fair value on a recurring basis by level within the fair value hierarchy.



The significance of the percentage of assets measured at fair value on a recurring basis, as compared to total assets (41% of total assets were measured at fair value on a recurring basis), was driven primarily by those entities within the financial services sector (i.e., banking, insurance, and investment companies within our sample; see industry breakdown herein).

Recurring Liability Disclosures

Similar to assets recorded at fair value on a recurring basis, the following graph shows that the overwhelming majority of liabilities measured at fair value on a recurring basis are also disclosed as Level 2 measurements within the SFAS 157 hierarchy.

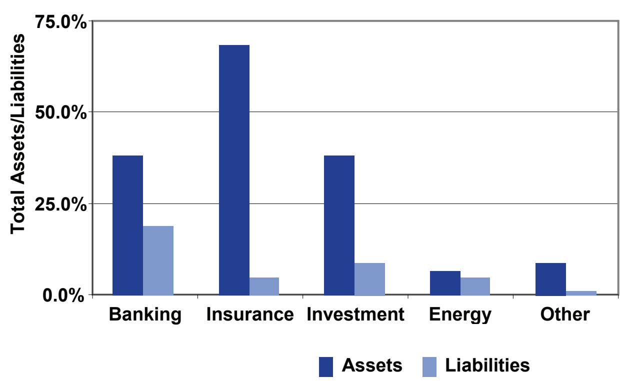


The greater percentage of assets carried at fair value is attributable to the greater prevalence of accounting standards under U.S. GAAP that call for fair value measurements of assets as opposed to relatively fewer for liabilities. For example, derivative assets (SFAS 133), many investments in debt and equity securities (SFAS 115[16]), investments held by investment companies and broker/dealers (AICPA Audit and Accounting Guides), must be measured at fair value on a recurring basis. Further, companies have the option to measure mortgage servicing rights (SFAS 156[17]), hybrid financial instruments (SFAS 155), and most other financial assets (SFAS 159) at fair value. With regard to liabilities, generally only derivative liabilities (SFAS 133) must be measured at fair value on a recurring basis, with the option to carry most other financial liabilities and mortgage servicing obligations at fair value on a recurring basis (SFAS 159 and SFAS 156, respectively). Furthermore, as noted in our SFAS 159 adoption section above, only half of the entities in our population elected the fair value option under SFAS 159 (see footnote 9), and within this portion of our sample, we observed more FVO elections related to assets, than to liabilities. This observation helps to further explain the relatively lower percentage of liabilities measured at fair value, as compared to assets.

The significance of recurring liabilities disclosed at Level 2 may also be explained by the accounting guidance noted above. Without a company exercising its option to measure liabilities at fair value on a recurring basis, generally only derivative liabilities would be measured at fair value on a recurring basis. As most vanilla derivative instruments have been disclosed as Level 2 measurements, the noted concentration may be expected.

Recurring Fair Value Measurements by Industry

The graph below shows by industry, for our sample, the relative assets and liabilities carried at fair value as a percentage of total assets and total liabilities, respectively.



[16] FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115)
[17] FASB Statement No. 156, *Accounting for Servicing of Financial Assets* (SFAS 156)

As mentioned previously, and demonstrated in the graph, those companies within the financial services industries measure a greater percentage of their total assets and total liabilities at fair value on a recurring basis. As U.S. GAAP generally does not provide for fair value accounting for nonfinancial assets and liabilities on a recurring basis, the skewed dispersion of recurring fair value measurements between those companies in financial services industries versus other industries is to be expected.

However, it should be noted that the fair value disclosures (and percentages in the graph above) of eight of the entities in our insurance grouping include separate account assets.[18] When separate account assets are removed (from both assets at fair value and total assets), only 61% of insurance company assets in our population are carried at fair value, versus 70% when such assets are included. The table below details the separate account disclosures made by those eight entities.

	Separate Accounts	% of FV Assets	% of Total Assets	Level 1	Level 2	Level 3
PRU	$ 181.9	46.8%	38.0%	45%	43%	12%
MET	180.0	43.8%	32.3%	65%	19%	16%
HIG	169.6	58.3%	49.3%	81%	19%	0%
LNC	84.7	57.6%	45.7%	0%	100%	0%
AIG	73.0	10.4%	6.9%	94%	4%	1%
ALL	13.1	11.7%	8.6%	100%	0%	0%
CI	6.6	34.1%	16.1%	29%	64%	6%
AET	6.3	29.2%	16.0%	39%	42%	19%
	$ 715.1	34%	25%	59%	33%	8%

Note: PRE, UNH, and BRK did not disclose any separate account assets.

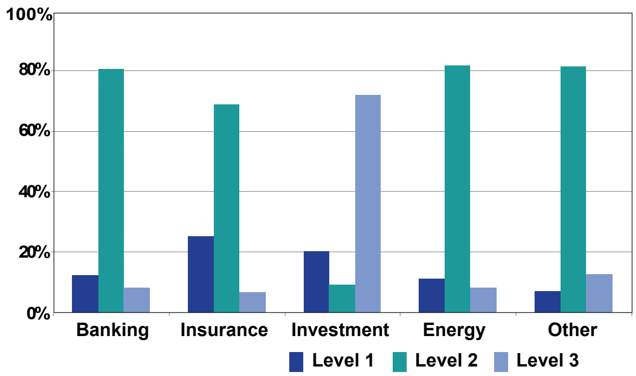
[18] Relates to separate account assets within the scope of AICPA SOP 03-1, *Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts*, for which the entity is not exposed to the risks and rewards of changes in fair value of the underlying holdings; additionally, it should be noted that separate account liabilities were not included in the hierarchy disclosures of those entities within our insurance grouping.

Disclosure Levels by Industry

The graph below presents the breakdown of the fair value measurement disclosures for assets measured at fair value on a recurring basis across five industry groupings.[19]

The graphical presentation shows that generally, with the exception of investment companies, most assets carried at fair value on a recurring basis across all industries presented represent Level 2 measurements. As discussed above, the dominance of Level 2 measurements may not be unforeseen.

Assets Measured at Fair Value (Recurring)



Of further note, is the prevalence of assets disclosed as Level 3 measurements within the investment industry, and the relatively greater percentage of fair value measurements disclosed as Level 3 by companies within the "other" category. While likely not surprising for the companies within the investment industry, given the requirements to carry investments at fair value pursuant to the AICPA Audit and Accounting Guide for that industry (i.e., all investments regardless of nature are carried at fair value on a recurring basis), it may be startling for those companies within the "other" grouping.

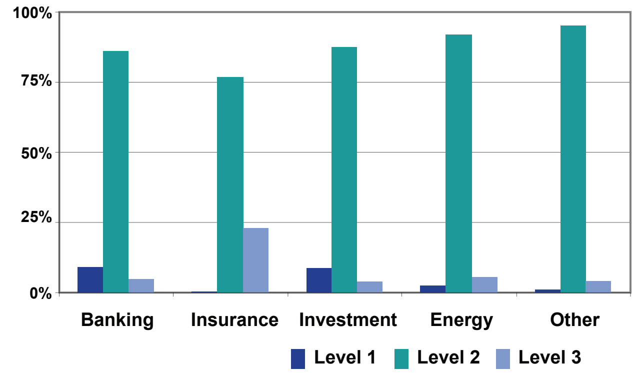
However, when consideration is given for the automotive companies within the "other" grouping, and the prevalence of securitization of auto loans and other assets within the industry, thus creating residual interests in securitizations, the relative size of the measurements disclosed as Level 3 may not seem unusual.

Similar to assets, as shown in the following graph, the majority of liabilities carried at fair value represent Level 2 measurements.[20] As discussed previously, these results may be intuitive as well.

[19] Percentages determined based upon gross amounts disclosed by the respective entities in each of our groupings. Furthermore, 17 entities in our sample disclosed netting adjustments to reconcile the gross totals within the footnote disclosures to amounts recorded on the balance sheet; such netting adjustments were not disclosed by fair value hierarchy level, and accounted for 46%, 3%, 0%, 56% and 3%, of the gross assets disclosed at fair value on a recurring basis in the banking, insurance, investment, energy and other groupings, respectively.

[20] Percentages determined based upon gross amounts disclosed by the respective entities in each of our groupings. Furthermore, 17 entities in our sample disclosed netting adjustments to reconcile the gross totals within the footnote disclosures to amounts recorded on the balance sheet; such netting adjustments were not disclosed by fair value hierarchy level, and accounted for 64%, 29%, 0%, 73% and 18%, of the gross liabilities disclosed at fair value on a recurring basis in the banking, insurance, investment, energy and other groupings, respectively.

Liabilities Measured at Fair Value (Recurring)



Of note, is the relatively greater percentage of Level 3 measurements by those entities within our insurance grouping. Based upon the disclosures by these entities, these Level 3 measurements generally relate to derivatives embedded in certain insurance contracts. For example, the guaranteed benefit portion of certain annuity contracts.

Level 3 Recurring Measurements

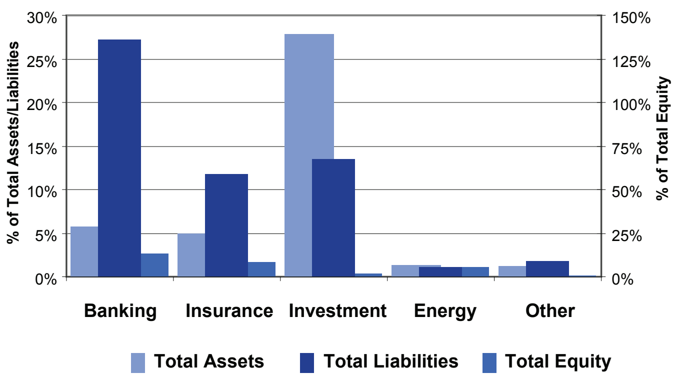
Perhaps the most onerous and most scrutinized disclosures required under SFAS 157 are the additional disclosures required for recurring measurements disclosed as Level 3 within the fair value hierarchy. SFAS 157 requires companies to disclose a "Level 3 Rollforward." The rollforward provides a reconciliation of beginning and ending Level 3 balances, and must separately disclose (1) gains and losses for the period, identifying those gains, and losses included in current period earnings; (2) purchases, sales, issuances, and settlements (net); and (3) transfers into or out of Level 3. In addition to the reconciliation, entities are also required to disclose the unrealized gains or losses included in earnings for the period attributable to assets and liabilities still held at the reporting date.

Certain items in the Level 3 Rollforward have received much attention from preparers. For example, SFAS 157 does not provide prescriptive guidance surrounding how transfers into and out of Level 3 should be calculated and disclosed. Different views may exist among market participants, such as, the beginning of period, the end of the period, a specific point in time, or some combination thereof (e.g. transfers in at the beginning, and transfers out at the end of a period). Despite the varying views, only three companies within our sample disclosed how transfers in/out of Level 3 were treated.

Similarly, varying views may exist related to the determination of unrealized gains and losses. For example, for a security with no intermittent cash settlements, the determination is rather straightforward. For example, unless such an instrument is sold, the unrealized gain or loss is the difference between the fair value of the instrument at the beginning of the period and the end of the period. However, the determination can be more complicated for instruments with intermittent and/or uncertain cash settlements; for example, related to mortgage servicing rights, where the timing and amounts of cash flows are uncertain and periodic. Despite the potential for varying calculation methodologies, none of the entities within our sample provided disclosure as to how their Level 3 unrealized gains and losses were determined.

As noted above, the Level 3 disclosures have garnered the most media attention, especially for those entities with relatively significant Level 3 holdings. Since the adoption of SFAS 157 several media publications have periodically compared companies disclosed Level 3 measurements to total assets, or total equity, and suggested that higher proportions of Level 3 measurements were indicative of increased risk.

The following graph presents Level 3 assets as a percentage of total assets, Level 3 liabilities as a percentage of total liabilities, and aggregate Level 3 measurements (i.e., assets and liabilities) as a percentage of equity.[21]



When evaluating fair value measurements it is important to remember that no observable market information may be ignored when developing estimates of fair value (even for Level 3 measurements), and all fair value estimates may fluctuate period to period as a result of changing economic conditions. This notion of considering all available market information was emphasized in a white paper issued by the Center for Audit Quality (CAQ) in October 2007.[22] The white paper specifically reminded issuers and auditors of the importance of considering market observable information, even in illiquid markets, or markets with activity levels below historic norms.

Additionally, several entities in our sample disclosed that certain assets and liabilities disclosed as Level 3 measurements were hedged by instruments disclosed as Level 1 or Level 2, or visa versa. As changes in fair value of instruments disclosed as Level 3 measurements are specifically broken out in the required rollforward, the issuers may have wanted to point out that such instruments may be part of a holistic risk management approach, and emphasize that the gains and losses disclosed in the rollforward may be offset by changes in fair value of instruments disclosed in other fair value hierarchy levels.

As noted previously, the recent market disruptions have caused increased volatility in inputs used in valuation methodologies. Additionally, the market disruptions have caused certain valuation inputs to no longer be observable. For example, as transaction volumes decreased for certain instruments, pricing such assets may have become less transparent.

As a result, as observable market inputs become less available, management must use internal assumptions in their valuation methodologies. To the extent such internal (unobservable) assumptions are significant to an overall valuation methodology, the fair value measurement must be disclosed as a Level 3 fair value measurement.

The following table shows the change in assets disclosed as Level 3 measurements as a percentage of total assets measured at fair value on a recurring basis between Q1 2007 and Q1 2008, related to the nine entities in our population that early adopted SFAS 157.

The table clearly depicts the increases in Level 3 fair value measurements between Q1 2007 and Q1 2008, especially for those entities in the financial services industry.

	Level 3 at Q1 2007	Level 3 at Q1 2008	Q1 2007 to Q1 2008
KFN	8%	100%	1102%
MER	4%	16%	299%
JPM	6%	14%	143%
C	8%	19%	135%
BAC	5%	8%	70%
GS	8%	13%	51%
MS	14%	15%	4%
SRE	8%	6%	-19%
ABT	-	-	-

As discussed above, given the increase in fair value measurements based on significant unobservable inputs, the SEC has urged issuers to provide additional clarity in their footnote disclosures and MD&A related to their

[21] The calculations presented in this graph were based upon gross amounts disclosed as Level 3 fair value measurements by the entities within our respective groupings; certain amounts may be subject to netting in the issuers financial statements, however, such amounts could not be determined based upon disclosures. See footnotes 19 and 20 for additional information regarding disclosed netting adjustments and amounts.

[22] The CAQ developed the paper to serve as an aid in completing audits and quarterly reviews of public companies. The CAQ shared an earlier draft of the paper with various organizations for comment. It shared the final paper with the staffs of the Securities and Exchange Commission, the Financial Accounting Standards Board, the Public Company Accounting Oversight Board, and various banking regulatory agencies.

fair value measurements. These recommendations were discussed in the aforementioned "Dear CFO" letter sent to various entities.

Nonrecurring Measurements

Nonrecurring fair value measurements represent fair value measurements of assets and liabilities that are not measured at fair value each reporting period. For example, impairment measurements related to loans held for sale carried at the lower of cost or market (LOCOM) pursuant to SFAS 65,[23] where the carrying value of a loan is written down to the then current market value. Such a measurement represents a nonrecurring fair value measurement as the loan is only remeasured at fair value if determined to be impaired, as opposed to being remeasured at least annually.

Initially, all nonrecurring fair value measurements required disclosure under SFAS 157. However, the issuance of FSP 157-2, deferred the requirements of SFAS 157 until fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities valued on a nonrecurring basis. Although entities that adopted SFAS 157 prior to the issuance of the FSP must continue to apply SFAS 157 in its entirety; entities may apply the full provisions of SFAS 157 early at their option. In addition to those entities in our population that were required to make such disclosures because of their early adoption of SFAS 157, certain entities in our population applied the full requirements of SFAS 157 at their option. Such issuers were generally in the financial services industry, where their nonrecurring nonfinancial measurements generally related to real estate owned and other property obtained in foreclosure.

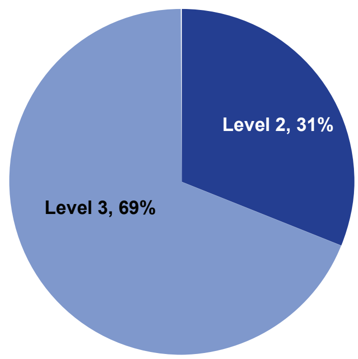
As a requirement of FSP 157-2, entities not applying the full requirements of SFAS 157 pursuant to the FSP must disclose the fact that the requirements of SFAS 157 have not been applied in its entirety, and the fair value measurements for which the entity has not applied the provisions of SFAS 157. The entities within our sample that did not apply the full provisions of SFAS 157, pursuant to FSP 157-2, made the required disclosures.

The following table provides a summary of the nonrecurring measurements disclosed by our sample. Only entities within two groupings made such disclosures (see additional details in the following sections).

Industry		Level 2	Level 3
Banking	Asset	Loans (commercial and residential), Other receivables	Loans (commercial and residential), Other receivables, Other assets (REO, foreclosed assets)
	Liabilities	Certain leveraged loan commitments	Certain leveraged loan commitments, Master servicing liabilities
Other	Assets	Accounts receivable	Equity method investments, Assets held for sale

Assets Measured on a Nonrecurring Basis

Not astonishingly, as depicted in the following graph,[24] in our sample, no nonrecurring measurements were disclosed as Level 1 fair value measurements, and the majority of measurements were disclosed as Level 3.



As Level 1 instruments generally represent items carried at fair value on a recurring basis, and impaired assets are generally illiquid, this distribution among the hierarchy levels makes sense.

Most nonrecurring asset disclosures in our sample related to impairment calculations for financial assets. For example, some nonrecurring measurements included impairment calculations related to various loans and other receivables, and certain other assets held for sale. Further, 90% of the nonrecurring fair value measurements disclosed by our sample were disclosed by companies in the financial

[23] FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities* (SFAS 65)

[24] This graph shows the nonrecurring asset fair value measurements disclosed by companies within our sample as of the first quarter of calendar 2008; 12 entities made disclosures related to the measurement of nonrecurring assets.

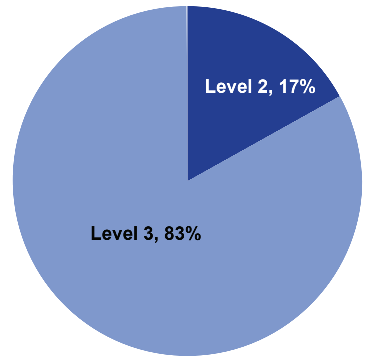
services industry, with the remaining 10% from the "other corporate filers" category.

Additionally, going forward, as nonfinancial nonrecurring measurements require disclosure, such disclosures will also likely be skewed towards Level 3, as pricing information for fixed assets, goodwill, etc. is generally less transparent.

Liabilities Measured on a Nonrecurring Basis

Only three entities within our sample disclosed liabilities measured at fair value on a nonrecurring basis for the first quarter of calendar 2008 — all of which were in the financial services industry. These measurements related to certain loan commitments, and certain master servicing liabilities, and comprised only 1% of total nonrecurring measurements disclosed by our sample.

The following graph shows the breakdown of hierarchy disclosure level for the liabilities measured on a nonrecurring basis disclosed by those entities in our sample.



The Level 2 measurements represent certain loan commitments valued without significant unobservable inputs.

Appendix A

Obtained from the respective Form 10-Q filings with the SEC for the first quarter of 2008 * Identifies entities that adopted fair value accounting prior to Q1 2008			Total assets (millions of USD)	Assets carried at fair value (millions of USD)	% of total assets	Total liabilities (millions of USD)	Liabilities carried at fair value (millions of USD)	% of total liabilities
FINANCIAL SERVICES								
BANKING								
*	BANK OF AMERICA CORP	BAC	$1,736,502	$486,285	28	$1,580,193	$108,110	7
*	CITIGROUP INC	C	2,199,848	865,000	39	2,071,629	468,283	23
	FEDERAL NATIONAL MORTGAGE ASSOCIATION	FNM	843,227	341,461	40	804,233	24,739	3
	GMAC	GMA	243,354	27,532	11	228,590	4,310	2
*	GOLDMAN SACHS GROUP INC	GS	1,189,006	770,942	65	1,146,377	493,439	43
*	J P MORGAN CHASE & CO	JPM	1,642,862	646,031	39	1,517,235	253,386	17
*	MERRILL LYNCH & CO INC	MER	1,042,054	449,817	43	1,005,512	333,745	33
*	MORGAN STANLEY	MS	1,090,896	523,116	48	1,057,616	302,029	29
	WACHOVIA CORP	WB	808,575	194,063	24	727,515	25,949	4
	WASHINGTON MUTUAL, INC	WM	319,668	37,281	12	297,219	825	0
		TOTALS	11,115,992	4,341,528	39	10,436,119	2,014,815	19
INSURANCE								
	AETNA INC	AET	39,159	21,457	55	29,277	-	-
	ALLSTATE CORP	ALL	152,210	111,809	73	131,907	524	0
	AMERICAN INTERNATIONAL GROUP INC	AIG	1,051,086	701,623	67	971,283	112,382	12
	BERKSHIRE HATHAWAY	BRK	281,047	111,708	40	157,401	9,471	6
	CIGNA CORP	CI	40,988	19,319	47	36,174	998	3
	HARTFORD FINANCIAL SERVICES GROUP INC	HIG	344,168	291,002	85	326,332	2,404	1
	LINCOLN NATIONAL CORP	LNC	185,349	147,053	79	174,263	1,061	1
	METLIFE INC	MET	557,132	410,835	74	524,133	5,071	1
	PARTNERRE, LTD	PRE	17,291	11,632	67	12,818	-	-
	PRUDENTIAL FINANCIAL INC	PRU	478,320	388,550	81	455,623	1,867	0
	UNITEDHEALTH GROUP INC	UNH	53,543	20,732	39	33,784	12,493	37
		TOTALS	3,200,293	2,235,720	70	2,852,995	146,271	5
INVESTMENT								
	ALLIANCEBERNSTEIN HOLDING L.P.	AB	9,184	3,366	37	4,680	336	7
	ALLIED CAPITAL CORP	AFC	5,082	4,756	94	2,254	-	-
	AMERICAN CAPITAL STRATEGIES LTD	ACAS	10,219	9,635	94	4,500	146	3
	ARES CAPITAL	ARCC	1,996	1,959	98	890	-	-
	BLACKROCK, INC.	BLK	21,816	1,885	9	9,423	-	-
	BLACKSTONE GROUP L.P.	BX	13,216	5,048	38	3,185	-	-
	COHEN & STEERS INC	CNS	295	79	27	23	-	-
	FIDELITY NATIONAL FINANCIAL, INC.	FNF	7,475	2,680	36	4,192	-	-
*	KKR FINANCIAL CORP	KFN	15,436	3,727	24	13,928	3,410	24
		TOTALS	84,719	33,135	39	43,075	3,892	9
	FINANCIAL SERVICES TOTALS		14,401,004	6,610,383	46	13,332,189	2,164,978	16
NONFINANCIAL SERVICES								
ENERGY								
	ALLEGHENY ENERGY, INC	AYE	9,920	57	1	7,302	99	1
	AMERICAN ELECTRIC POWER CO INC	AEP	41,317	2,787	7	30,767	951	3
	CHEVRON CORP	CVX	152,847	669	0	73,641	619	1
	CONSTELLATION ENERGY GROUP INC	CEG	23,185	4,413	19	17,089	3,328	19
	DYNEGY	DYN	14,823	1,861	13	4,350	2,250	52
	EXELON CORP	EXC	45,848	6,511	14	35,928	942	3
	FPL GROUP INC	FPL	41,330	3,637	9	30,616	217	1
	MIRANT CORP	MIR	10,892	1,540	14	6,142	1,973	32
*	SEMPRA ENERGY	SRE	29,854	5,819	19	21,277	2,396	11
	SOUTHERN CO	SO	46,596	1,366	3	32,951	83	0
		TOTALS	416,612	28,660	7	260,063	12,858	5
OTHER								
*	ABBOTT LABORATORIES	ABT	41,178	251	1	23,198	2,647	11
	BOEING CO	BA	60,360	5,193	9	51,294	23	0
	BRISTOL MYERS SQUIBB CO	BMY	26,325	2,553	10	15,764	217	1
	DOW CHEMICAL CO	DOW	50,657	2,221	4	30,478	103	0
	DUPONT	DPT	36,228	113	0	23,663	138	1
	FORD MOTOR CO	F	288,869	36,091	12	282,520	2,297	1
	GENERAL ELECTRIC CO	GE	833,890	52,425	6	709,656	7,771	1
	GENERAL MOTORS CORP	GM	145,741	15,390	11	185,415	1,810	1
	PEPSI BOTTLING GROUP INC	PBG	13,192	445	3	10,748	614	6
	PFIZER INC	PFE	118,550	30,104	25	50,990	1,537	3
		TOTALS	1,614,990	144,786	9	1,383,726	17,157	1
	NONFINANCIAL SERVICES TOTALS		2,031,602	173,446	9	1,643,789	30,015	2
	GRAND TOTALS		**$16,432,606**	**$6,783,829**	**41**	**$14,975,978**	**$2,194,993**	**15**

Note: This selection of companies was compiled based upon a number of criteria in order to create a selection of SEC registrants that included early adopters of SFAS 157 and/of 159, across a diverse population of industries. However, our selections focused on the financial services industries (e.g., banking, insurance, and investment industries), as such entities would be more likely to have more fair value measurements, and therefore, more readily available disclosure information. The selection was also focused on relatively larger registrants, however, entities of varying size were also included for comparative purposes. No statistical methods were utilized to compile this “grouping” or “sample” as used throughout this publication, and by including herein we by no means express any opinion or commentary on the quality of the disclosures by these registrants.

Other Resources

Technical Library: The Deloitte Accounting Research Tool

Deloitte makes available, on a subscription basis, access to its online library of accounting and financial disclosure literature called Technical Library: The Deloitte Accounting Research Tool. The library includes material from the FASB, the EITF, the AICPA, the PCAOB, the IASB, and the SEC, in addition to Deloitte's own accounting and SEC manuals and other interpretive accounting and SEC guidance.

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FASB Statement No. 157 Implementation and Application Tool

The Statement 157 Implementation and Application Tool (the "Fair Value Tool") is designed to help you understand how FASB Statement No. 157, *Fair Value Measurements*, interacts with existing accounting standards. The Fair Value Tool will enable you to quickly identify fair value measurements affected by Statement 157 and understand the overall impact the new standard has on fair value measurement.

For each fair value measurement identified, the Fair Value Tool summarizes the following considerations: (1) application of Statement 157 to initial and subsequent measurements; (2) use of a practical expedient (i.e., an exception) to fair value measurements in certain circumstances; (3) applicability of Statement 157 disclosures to the item being measured; (4) applicability of SFAS 159; and (5) other considerations in developing a fair value measurement, as applicable. The Fair Value Tool also includes an Appendix, "Internal Control Considerations," which is a high-level overview of internal control implications of Statement 157.

While this Fair Value Tool covers significant areas affected by Statement 157, it is not all inclusive and is best used in conjunction with the Deloitte U.S. Accounting Manual (available by subscription to Deloitte Technical Library), which includes detailed guidance on Statements 157 and 159.

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