

Relating SVO Unit Prices to the NAIC Fair Value Hierarchy

A. Background - This document provides guidance on how the Securities Valuation Office (SVO) determines Unit Prices. It is intended to guide insurance companies who need to assign appropriate fair value hierarchy levels to Unit Prices reported in the NAIC's Automated Valuation Service+ (AVS).

B. Unit Prices and the NAIC Fair Value Hierarchy - SSAP No. 100 *Fair Value Measurements* defines fair value 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." The Price Origin, Classification, and NAIC Designation fields in the AVS security records will assist you to determine where a Unit Price fits in the fair value hierarchy.

- **Price Origin** is available for all security types provided a Unit Price is reported for the security in the AVS.
 - Unit Prices (valuations) with Price Origin symbol 'E' (meaning an external source)¹ can be generally categorized in either Level 1 or Level 2 of the fair value hierarchy because they are obtained from acceptable third-party vendors whose primary sources for the prices or related inputs are markets or exchanges. However, the decision of whether a Unit Price should be categorized in Level 1, Level 2, or Level 3 of the fair value hierarchy must be left to the discretion of the insurers.
 - Unit Prices with Price Origin symbol 'I' (meaning an internal source) should be considered Level 3 in the fair value hierarchy framework unless the insurers can justify another level of fair value hierarchy. The great majority of the Unit Prices with Price Origin symbol 'I' are analytically determined. While reflecting some market observable inputs, those analytically determined Unit Prices are commonly derived from material Level 3 inputs and/or relevant adjustments.
 - This guidance pursuant to the Fair Value Hierarchy does not consider any Unit Prices for securities with a (blank) or null value in the Price Origin field as such securities do not have SVO prices assigned.
- **Classification** symbols supplement the Price Origin symbol 'E'. For the Unit Prices with the Price Origin symbol 'E':
 - Unit Prices for securities classified with symbol 'C' (for Common Stock) or 'P' (for Preferred Stock) can generally be considered Level 1 as the primary sources for the prices are exchanges.
 - Unit Prices for securities classified with symbol 'B' (for Bond) generally qualifies for either Level 1 or Level 2 in the fair value hierarchy.
 - This guidance pursuant to the Fair Value Hierarchy does not consider any Unit Prices for securities with a (blank) or null value in the classification field as there is insufficient information about such instruments for Fair Value Hierarchy purpose.

The decision of whether a Unit Price should be categorized in Level 1, Level 2, or Level 3 of the fair value hierarchy must be left to the discretion of the insurer.

¹ Excluding RMBS and CMBS assigned Administrative Symbols FMR and FMC

- **RMBS and CMBS** – Unit Prices², provided by a third-party pricing vendor and assigned to RMBS and CMBS in the NAIC’s Valuation of Securities (VOS) Database should be considered Level 3 for purposes of the fair value hierarchy unless the insurer can justify a different determination. While many of the Unit Prices reflect market observable inputs, generalization of the level in the fair value hierarchy for the RMBS and CMBS is difficult. These securities are identified by the NAIC Administrative Symbols, FMR for RMBS and FMC for CMBS, in the NAIC Designation field, indicating they are subject to financial modeling methodology described in Part Three Section 3(c) of the SVO Purposes and Procedures Manual.

C. Guidance on SVO Analytical Valuation Methodologies³ - Where available, the SVO will assign market prices for insurer-owned securities. When a market value is not available, the SVO may accept a valuation determined by an independent organization approved by the SVO. If either of these two approaches cannot be applied, the SVO will determine a Unit Price using analytical methodologies. The followings securities are typically the subject of an analytically determined Unit Price.

- Privately Issued Common Stock and Warrants - In the absence of two valid price quotes from financial institutions acceptable to the SVO, the SVO will typically determine a fair value by assessing issuer’s audited financial statement. The assessment is an estimate of the residual claim of common stock and warrants holders based on financial information contained in the audited financials. Other analytical valuation methods may be used as appropriate.
- Privately Issued Preferred Stock – In the absence of two valid price quotes from financial institutions acceptable to the SVO, the SVO most typically determines a fair value using the present value of cash flows method discounted by internally determined, applicable yields or estimating the residual claim allocable to the preferred stock. Other analytical valuation methods may be used as appropriate.
- Privately Issued, Fixed-Rate Bonds Denominated in US\$ – The valuation, currently measured semi-annually in June and December, is determined by calculating the present value of future cash flows. A stream of future cash flows are discounted at an appropriate yield that, in the opinion of the SVO, reflects equivalent fair market yield curves and general private placement market conditions. Primary factors affecting the valuation are the credit quality, the terms of the bond, and applicable yield-to-maturity. Bonds with embedded options that have the potential for meaningful impact on the fair value are not within the scope of this valuation practice.
- Privately Issued Bond with NAIC-6 Designation – Determining a Unit Price for securities that are in or near default requires the exercise of judgment and security specific adjustments. The primary goal of the analysis is to estimate the bond’s adjusted dollar value incorporating specific underlying factual circumstances.

² RMBS and CMBS securities are one of the instruments classified as ‘B’ (for Bond). The Unit Prices for the RMBS and CMBS securities reported in the NAIC’s VOS Database are provided by a third-party pricing vendor. These Unit Prices are not to be confused with the modeled data for RMBS and CMBS prepared for the purpose of the risk-based capital (RBC).

³ For more detailed SVO Valuation Methodologies, refer to Part 5 Section 1 (c) of the SVO Purposes and Procedures Manual.

Flow Chart: SVO Price in Fair Value Hierarchy

