

2007 AICPA National Banks & Savings Institutions Conference

Fair Value Measurements & Fair Value Option

Randy Shearer, Bank of America

Shannon Warren, JPMorganChase

November, 2007

SFAS 157 –Fair Value Measurements

Fair Value Measurements

- Determine the asset or liability subject to measurement
- Determine the valuation premise that is appropriate
- Identify the principal or most advantageous market for the item
- Apply a valuation technique consistent with that which a market participant would apply

SFAS 157 –Fair Value Measurements

Valuation Premise

- In Exchange- generally financial instruments, rebuttable presumption
- In Use- generally nonfinancial assets, rebuttable presumption
- Items to consider
 - Loan Warehouses- whole loan versus securitization prices adjusted
 - Mortgage Servicing Rights
 - Structured Notes

SFAS 157 –Fair Value Measurements

Principal Market

- Transaction price- when does transaction price equal fair value
- Determination of market participants (strategic buyer, financial buyer)
- Most advantageous market
 - Where an entity can access multiple markets
 - Where an entity cannot access the most advantageous market

SFAS 157 –Fair Value Measurements

Valuation Techniques

- Assess valuation adjustments
- Ensure risk premium for uncertainty is evaluated
- Factoring liquidity into fair value measurements

SFAS 157 –Fair Value Measurements

Own Credit

- Methodology
 - CDS versus Cash spreads
 - Derivatives
 - Structured notes
- Consistency with counterparty credit valuations
- Market perception and disclosure

SFAS 157 –Fair Value Measurements

Transaction Costs

- Exclude from valuation
- Presentation in Income Statement – Gross versus Net
- Costs embedded within the Bid/Ask spread
- Transportation Costs

SFAS 157 –Fair Value Measurements

Disclosures

- **Balance sheet, by hierarchy level**
 - **Definition of an active market**
 - **Definition of significance**
 - Balance sheet perspective
 - Income statement perspective
 - Effectiveness of explicit thresholds
 - **Incorporation of FIN 39 netting and cash collateral**
 - **Allocation of portfolio level adjustments**

- **Level 3 disclosures**
 - **Rollforward – Supplemental disclosure**
 - Actual versus expected view
 - Balance sheet view
 - Income statement view
 - **External focus on level 3 disclosures**

SFAS 157 –Fair Value Measurements

Day 2 Issues

- Impact of SFAS 142 impairment tests
- Day 2 Accounting for valuations in Business Combinations

SFAS 157 –Fair Value Measurements

Nonrecurring Fair Value Measurements

- Scope
- Methodology – Balance sheet approach
- Other considerations
 - Costs to sell

SFAS 157 –Fair Value Measurements

Other Considerations

- Valuation Resource Group
- Client valuations
 - Principal markets
- Pensions
- Business combinations

SFAS 157 –Fair Value Measurements

Lessons Learned

- Time and resource commitment- do not underestimate the scope of this effort
- Education of the masses
- Dry runs (many, many dry runs)

SFAS 159- Fair Value Option

Benefits

- Elimination of complex hedge accounting
- Elimination of accounting mismatches
- Interaction with the Investment company SOP

SFAS 159- Fair Value Option

Election Considerations

- Assess population that is eligible
- Document basis for elections
- Ensure all disclosure requirements have been considered
- Other Reporting Considerations
 - GP interests with a servicing element
 - FAS 91

SFAS 159- Fair Value Option

Disclosure

- Detailed balance sheet disclosure
- Detailed income statement disclosure
- Loans and Long Term Debt
 - Instrument specific credit risk
 - Principal versus carrying value

SFAS 159- Fair Value Option

Lessons Learned

- Infrastructure and tracking of "new" GL accounts
- Dry runs