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Accounting Standards Update No. 2011-04

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Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs



- Amendments classified in two broad categories:
 - Clarification of the Board's intent about the application of existing FVM and disclosure requirements
 - Changing a particular principle or requirement for measuring FV or for disclosing information about FVM

- Clarifications (Bold means anticipated to have an impact on BDCs)
 1. **Application of the highest and best use and "in-use valuation premise"**
 2. Measuring the fair value of an instrument classified in a reporting entity's shareholders' equity
 3. **Disclosures about FVM**

- Changes
 1. Measuring the fair value of financial instruments that are managed within a portfolio
 2. **Application of premiums and discounts in FVM**
 3. **Additional disclosures about FVM**

- **FASB and IASB acknowledge that differences remain between Topic 820 and IFRS 13. The U.S. guidance is effective for interim and annual periods beginning after December 15, 2011**

ASU No. 2011-04 – What is Relevant to BDCs?



- Clarifications

1. H&BU and “in-use valuation premise” are only relevant when measuring the fair value of nonfinancial assets. They can no longer be applied to financial assets.
 - a. Some might interpret the new guidance as precluding an investor from considering its controlling equity ownership when valuing a debt investment in the same company
2. Measuring FV of an instrument classified in shareholders’ equity – No anticipated impact on BDCs.
3. Disclosures about FVM – Reporting entity should disclose quantitative information about the unobservable inputs used in a FVM that is categorized within Level 3 of the fair value hierarchy.
 - a. “Measurement uncertainty” analysis for Level 3 has been tabled for the moment.

ASU No. 2011-04 – What is Relevant to BDCs?



- Changes

1. FV of financial instruments managed within a portfolio – No anticipated impact on BDCs.
2. Application of premiums and discounts in FVM – The prohibition on the use of block discounts is now extended to all levels of the hierarchy (previously limited to Level 1)
 - a. Does not disallow the application of other discounts (or premiums) as long as that is consistent with the relevant unit of account in U.S. GAAP, or, absent such guidance, with the way Market Participants would consider FVM.
3. Additional disclosures about FVM
 - a. Both public and nonpublic companies are to provide
 - i. Quantitative information about unobservable inputs that are significant to the Level 3 fair value measurements. (This may include disclosing information about, for example, multiples, discount rates, discounts, etc).
 - ii. A description of the valuation processes in place for Level 3 FVM. (This includes discussion of the group within the entity responsible for its valuation policies and procedures, the frequency and methods of calibrating models, the methods used to develop and substantiate unobservable inputs, and others.)
 - iii. Disclose why a nonfinancial asset is used in a manner different from its highest and best use (if applicable).

ASU No. 2011-04 – What is Relevant to BDCs?



3. Additional disclosures about FVM (continued)
 - b. Public companies are to
 - i. Provide a qualitative discussion of the sensitivity of recurring Level 3 measurements to changes in the unobservable inputs used, if the effect of change is significant for the fair value measurement.
 - ii. Provide information about any transfers between Levels 1 and 2.
 - iii. Disclose the classification in the hierarchy of items disclosed at fair value in the footnotes.

ASU 2011-04 Disclosure Example



Example of Quantitative Information About Level 3 Fair Value Measurements

	Fair Value at 12/31/X9	Valuation Techniques	Unobservable Inputs	Range
Commercial mortgage-backed securities	\$50,000,000	Discounted cash flow	Constant prepayment rate	3.0% – 5.0% (4.1%)
			Probability of default	2% – 25% (5%)
			Loss severity	10% – 50% (20%)
Collateralized debt obligations	\$35,000,000	Consensus pricing	Offered quotes	20 – 45
			Comparability adjustments (%)	-10% – +15% (+5%)