

## Issue Paper No. 135

# Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others

### STATUS

Finalized October 18, 2010

Original SSAP and Current Authoritative Guidance: SSAP No. 5R

### Type of Issue:

Common Area

### SUMMARY OF ISSUE

1. In November 2002, the Financial Accounting Standards Board (FASB) issued *FASB Interpretation No. 45: Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB interpretation No. 34 (FIN 45) to elaborate on the disclosures required for obligations issued under certain guarantees and to clarify that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. In November 2005, the FASB issued FASB Staff Position *FIN 45-3, Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or its Owners* (FSP FIN 45-3). This FSP modified the scope of FIN 45 to expressly include guarantees granted to a business or owner guarantying that the revenue of the business (or a specific portion of the business) for a specified period will be at least a specified amount within the scope of FIN 45. For purposes of this Issue Paper, the Statutory Accounting Principles Working Group will consider FIN 45, as modified by FSP FIN 45-3 for statutory accounting.

2. Current statutory accounting guidance for guarantees is limited to the disclosure requirements in paragraph 16 of *SSAP No. 5—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5). In accordance with this existing guidance, guarantees shall be disclosed in the financial statements even though the possibility of loss may be remote and disclosures are required regarding the indebtedness of others. These disclosure requirements were incorporated through the adoption of *FASB Interpretation No. 34—Disclosure of Indirect Guarantees on Indebtedness of Others, An Interpretation of FASB Statement No. 5* (FIN 34) and *FSP FAS 133-1 and FIN 45-4: Disclosures about Credit Derivatives and Certain Guarantees, An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45 and Clarification of the Effective Date of FASB Statement No. 161* (FSP FAS 133-1 and FIN 45-4). With the issuance of FIN 45, FASB superseded FIN 34.

3. The purpose of this issue paper is to update statutory accounting principles for guarantees. The proposed result will be adoption, with modification, of guidance from FIN 45, and the incorporation of substantive revisions to SSAP No. 5 and nonsubstantive revisions to *SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties* (SSAP No. 25). In accordance with the adoption, with modification, of FIN 45, guarantors will be required to recognize, at the inception of the guarantee, a liability for the obligations it has undertaken in issuing the guarantee, including its obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur. The adoption, with modification, of FIN 45 will also require the following disclosures by guarantors: (a) the nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose, and the events or circumstances that would require the guarantor to perform under the guarantee; (b) the maximum potential amount of future payments under the guarantee; (c) the carrying amount of the liability, if any, for the guarantor's obligations under the guarantee; and (d)

the nature and extent of any recourse provisions or available collateral that would enable the guarantor to recover the amounts paid under the guarantee.

## SUMMARY CONCLUSION

4. This issue paper adopts, with modification, guidance within FIN 45, as modified by FSP FIN 45-3, indicating that at the inception of a guarantee, the guarantor shall recognize in its statement of financial position a liability for that guarantee, which generally equals the fair value of the guarantee at its inception. This issue paper also adopts the disclosures within the modified FIN 45 to ensure proper information is provided within the financial statements regarding guarantees, even if the likelihood of having to make payments under a guarantee is remote.

## DISCUSSION

5. The FASB issued FIN 45 as a result of observing differing interpretations about the disclosures required of guarantors under *FASB Statement No. 5, Accounting for Contingencies* (FAS 5) and about the need for a guarantor to recognize an initial liability for its obligation under a guarantee. As some constituents believed that FAS 5 prohibited a guarantor from initially recognizing a liability for a guarantee issued unless it is probable that payments will be required under that guarantee, the issuance of FIN 45 clarified the requirements of FAS 5 relating to the guarantor's accounting for and disclosures of certain guarantees issued.

6. FIN 45 clarified that a guarantor is required to disclose (a) the nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose, and the events or circumstances that would require the guarantor to perform under the guarantee; (b) the maximum potential amount of future payments under the guarantee; (c) the carrying amount of the liability, if any, for the guarantor's obligations under the guarantee; and (d) the nature and extent of any recourse provisions or available collateral that would enable the guarantor to recover the amounts paid under the guarantee. For product warranties, instead of disclosing the maximum potential amount of future payments under the guarantee, a guarantor is required to disclose its accounting policy and methodology used in determining its liability for product warranties as well as a tabular reconciliation of the changes in the guarantor's product warranty liability for the reporting period. In issuing FIN 45, the FASB noted that disclosures under the prior practice generally included only the nature and amount of guarantees, but did not provide the same level of useful information as required by FIN 45.

7. FIN 45 also clarified that a guarantor is required to recognize, at the inception of a guarantee, a liability for the obligations it has undertaken in issuing the guarantee, including its ongoing obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur. The objective of the initial measurement of that liability is the fair value of the guarantee at its inception. Before the issuance of FIN 45, the FASB believed that many entities may not be recognizing a liability for a guarantee because the recognition requirements in FAS 5 (pertaining to loss contingencies) have not been met at the inception of the guarantee and the premium for the guarantee was not separately identified because it was embedded in purchase or sales agreements, service contracts, joint venture agreements, or other commercial agreements.

8. In issuing FIN 45, and requiring recognition of a liability for the obligations undertaken upon issuing a guarantee, the FASB believed that it resulted with a more representationally faithful depiction of the guarantor's assets and liabilities. When a guarantee is issued without a separately identified premium in conjunction with another transaction, the gain or loss recognized on that other transaction would be misstated if the guarantor fails to recognize a liability for the guarantee. For example, if a seller-guarantor issues to its customer's bank a guarantee of the customer's loan to facilitate the customer's obtaining funds to pay the seller for the assets being purchased, the failure to recognize a liability for the issuance of the guarantee overstates the profit on the sale. In those circumstances, the recognition of the liability for

the guarantee results in a more representationally faithful depiction of the seller-guarantor's liabilities and results of operations. The initial recognition and initial measurement requirements within FIN 45 were expected to affect primarily the accounting for multiple-element transactions that include issuance of a guarantee by one party to the other. Additionally, the FASB concluded that the disclosures required by FIN 45 improve the transparency of the financial statement information about the guarantor's obligations and liquidity risks related to guarantees issued.

9. The FASB concluded that the disclosures and initial recognition of guarantees required by FIN 45 complies with the *FASB Concept Statement No. 1, Objectives of Financial Reporting by Business Enterprises*, as financial reporting should provide information to help users assess the amounts, timing, and uncertainty of the guarantor's prospective net cash flows. Furthermore, the FASB concluded that recognition of a liability at the inception of a guarantee is consistent with the definition of a liability in *FASB Concepts Statement No. 6, Elements of Financial Statements*.

10. In November 2005, the FASB issued FASB Staff Position *FIN 45-3, Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or its Owners* (FSP FIN 45-3). This FSP modified the scope of FIN 45 to expressly include guarantees granted to a business or owner guarantying that the revenue of the business (or a specific portion of the business) for a specified period will be at least a specified amount within the scope of FIN 45. In making this decision, the FASB concluded that a minimum revenue guarantee granted to a business or its owners meets the characteristics in paragraph 3.a. of FIN 45 because the guarantee's underlying (business gross revenues) is related to an asset or equity security of the guaranteed party. The FASB also clarified that the five examples included within paragraph 3.a. do not constitute an all-inclusive listing of the contracts that would meet the scope provisions of FIN 45.

11. In considering FIN 45, as modified for FIN 45-3, for statutory accounting purposes, the adoption of the guidance in FIN 45 is consistent with the conservatism concept stated within the preamble: "In order to provide a margin of protection for policyholders, the concept of conservatism should be followed when developing estimates as well as establishing accounting principles for statutory reporting." In accordance with this concept, it is presumed that there must be a compelling reason to have statutory accounting principles that are less conservative than GAAP. In reviewing this issue, staff was unable to identify any such compelling reasons, however, until FIN 45 is adopted for statutory accounting, it will result with less-conservative financial statements for statutory accounting.

12. It is anticipated that comments will be received indicating that the initial recognition of a liability will not represent a "probable" occurrence, and thus will not meet the definition of a liability per SSAP No. 5, paragraph 3. Similar to the FASB's response to such comments, the probability of performance under the guarantee will affect the measurement of the liability at inception, but the probability of performance does not change the fact that a liability has been created upon the issuance of the guarantee and should be reflected in the financial statements. The recognition of a liability for a guarantee is a valid under SSAP No. 5 because it clarifies that the definition of a liability within SSAP No. 5 should not be understood as prohibiting the recognition of a liability for the obligations undertaken in issuing a guarantee, even if the likelihood of the event that would trigger performance under the guarantee is less than remote.

**RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE****Statutory Accounting**

13. Statutory accounting guidance regarding guarantees is included within *SSAP No. 5—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5). The guidance for guarantees is limited to disclosures within paragraph 16. The current disclosure requirements, which require disclosure of guarantees even if the possibility of loss is remote and disclosures on guarantees on the indebtedness of others, were adopted from *FASB Interpretation No. 34, Disclosure of Indirect Guarantees of Indebtedness of Others, An Interpretation of FASB Statement No. 5* and *FSP FAS 133-1 and FIN 45-4: Disclosures about Credit Derivatives and Certain Guarantees, An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45 and Clarification of the Effective Date of FASB Statement No. 161*.

16. Certain loss contingencies, the common characteristic of each being a guarantee, shall be disclosed in financial statements even though the possibility of loss may be remote. Examples include (a) guarantees of indebtedness of others, and (b) guarantees to repurchase receivables (or, in some cases, to repurchase related properties) that have been sold or otherwise assigned. The disclosure of those loss contingencies, and others that in substance have the same characteristics, shall be applied to statutory financial statements. The disclosure shall include the nature and amount of the guarantee. Consideration shall be given to disclosing, if estimable, the value of any recovery that could be expected to result, such as from the guarantor's right to proceed against an outside party.

- a. For guarantees on indebtedness of others, disclosure shall include the nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose, the events and circumstances that would require the guarantor to perform under the guarantee, and the current status as of the reporting date of the payment/performance risk of the guarantee. For example, the current status of the payment/performance risk of a credit-risk related guarantee could be based on either recently issued external credit ratings or current internal groupings used by the guarantor to manage its risk. An entity that uses internal groupings shall disclose how those groupings are determined and used for managing risk.

14. With the adoption of this issue paper, SSAP No. 5 will reflect the adoption, with modification, of FIN 45, as modified by FSP FIN 45-3. The statutory modifications require an initial liability recognition for guarantees issued as part of intercompany or related party transactions, require assessment and recognition of non-contingent guarantee obligations after recognition and settlement of a contingent obligation and revise the GAAP guidance to reflect statutory accounting terms and restrictions. (For example, a GAAP exclusion for capital leases will not be incorporated within SSAP No. 5 as the concept of capital leases has previously been rejected for statutory accounting.) Although FIN 45 does not require initial liability recognition for the following guarantees: 1) guarantee issued either between parents and their subsidiaries or between corporations under common control; 2) parent's guarantee of its subsidiary debt to a third party, and 3) subsidiary's guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent, this Issue Paper requires an initial liability recognition under statutory accounting for such guarantees. For these instances, and other intercompany and related party guarantees, this Issue Paper requires that an initial liability must be recognized for the guarantee unless the guarantee is considered "unlimited" or is a guarantee made to/or on behalf of a wholly owned subsidiary. (An example of an intercompany "unlimited" guarantee would be a guarantee issued in response to a rating agency's requirement to provide a commitment to support.) In instances in which an "unlimited" guarantee exists or a guarantee has been made to/or on behalf of a wholly owned subsidiary, this Issue Paper would require disclosure, pursuant to the disclosure requirements adopted from FIN 45. These disclosure requirements include the maximum potential amount of future payments of the guarantee, and if the guarantor is unable to determine the maximum potential, the reasons why this amount cannot be

determined. The adoption of this Issue Paper will also revise the current disclosure requirements, presented within SSAP No. 5, paragraph 16.a., regarding guarantees on the indebtedness of others. These disclosure requirements, adopted from FSP FAS 133-1 and FIN 45-4, will be reorganized within SSAP No. 5 and presented in a manner consistent with the modifications incorporated within FIN 45 pursuant to the adoption of this FASB Staff Position.

15. Upon adoption of this Issue Paper, the NAIC will release an updated SSAP No. 5 for comment. The SSAP will contain the adopted substantive changes to SSAP No. 5, shown in this Issue Paper. Users of the Accounting Practices and Procedures Manual should note that issue papers are not represented in the Statutory Hierarchy (see Section IV of the Preamble) and therefore the conclusions reached in this issue paper should not be applied until the corresponding SSAP has been adopted.

16. Guidance is currently included within paragraph 18.e. of *SSAP No. 25—Accounting for and Disclosures About Transactions with Affiliates and Other Related Parties* (SSAP No. 25) that requires related party disclosures for guarantees or undertakings that result in a material contingent exposure:

18. The financial statements shall include disclosures of all material related party transactions. In some cases, aggregation of similar transactions may be appropriate. Sometimes, the effect of the relationship between the parties may be so pervasive that disclosure of the relationship alone will be sufficient. If necessary to the understanding of the relationship, the name of the related party should be disclosed. Transactions shall not be purported to be arm's-length transactions unless there is demonstrable evidence to support such statement. The disclosures shall include:

- e. Any guarantees or undertakings, written or otherwise, for the benefit of an affiliate or related party which result in a material contingent exposure of the reporting entity's or any related party's assets or liabilities;

17. This Issue Paper also proposes nonsubstantive revisions to the SSAP No. 25, paragraph 18.e. guidance to require the FIN 45 disclosure requirements for related party guarantees, including those issued between parents and their subsidiaries or between corporations under common control and situations in which a parent guarantees its subsidiary's debt to a third party or the subsidiary has guaranteed debt owed to a third party by either its parent or another subsidiary of that parent.

18. The adoption of FIN 45 or FSP FIN 45-4 will not impact any of the existing statutory interpretations of SSAP No. 5:

- a. *INT 01-31: Assets Pledged as Collateral* (INT 01-31) – This interpretation addresses the accounting issues on whether assets pledged as collateral under specific situations should be considered admitted assets. The consensus reached for INT 01-31 is that the collateral would continue to be recorded as an admitted asset until the reporting entity has committed a contract default that has not been cured in accordance with the contract provisions. To the extent that an uncured default remains without the secured party utilizing the collateral to offset the obligation, the pledging insurer should only record an admitted asset for the amount of collateral that it can redeem.
- b. *INT 01-32: EITF 01-10: Accounting for the Impact of the Terrorist Attacks of September 11, 2001* (INT 01-32) – This interpretation incorporated specific disclosures for losses and costs incurred as a result of the September 11, 2001 events. On June 2, 2007, these disclosure requirements were deemed no longer useful by the Statutory Accounting Principles Working Group.

- c. *INT 03-07: EITF 00-19: Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, A Company's Own Stock* (INT 03-07) – This interpretation rejected the guidance in EITF 00-19 as not applicable to statutory accounting.
- d. *INT 04-05: Clarification of SSAP No. 5 Guidance on When a Judgment is Deemed Rendered* (INT 04-05) – The consensus reached under INT 04-05 incorporated guidance within SSAP No. 5 that a judgment is considered “rendered” when a court enters a verdict, notwithstanding the entity’s ability to file post trial motions and to appeal.

19. The Form A summary of this issue also identified *INT 01-03: Assets Pledged as Collateral or Restricted for the Benefit of a Related Party* (INT 01-03) as a possible interpretation that may be affected with FIN 45. The consensus under INT 01-03 indicates that if an asset of an insurance entity is pledged or otherwise restricted by a related party, the assets are not under the exclusive control of the insurance entity, and should not be recognized on the balance sheet. As this interpretation specifically addresses the treatment of the pledged asset, and not the recording or disclosure of a guarantee, it is anticipated that no revisions will be necessary to this interpretation with the adoption of this Issue Paper.

### Generally Accepted Accounting Principles

20. This issue paper adopts, with modifications, guidance included within FIN 45, as modified by FSP FIN 45-3. (Guidance from FSP FAS 133-1 and FIN 45-4 has previously been adopted for statutory accounting. However, the current version of FIN 45, including the revisions from FSP FAS 133-1 and FIN 45-4 are reflected below.)

FIN 45, as Modified by FSP FIN 45-3 and FSP FIN 45-4:

#### INTRODUCTION

1. The Board observed differences in interpretation about the disclosures required of issuers of guarantees and about the need for an issuer of a guarantee to recognize an initial liability for its obligations under the guarantee. This Interpretation clarifies the requirements for a guarantor’s accounting for and disclosures of certain guarantees issued and outstanding. This Interpretation also incorporates without reconsideration the guidance in FASB Interpretation No. 34, *Disclosure of Indirect Guarantees of Indebtedness of Others*, which is being superseded.

#### SCOPE

2. This Interpretation addresses the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees. This Interpretation also clarifies the requirements related to the recognition of a liability by a guarantor at the inception of a guarantee for the obligations the guarantor has undertaken in issuing that guarantee. As discussed in paragraph 12, this Interpretation does not specify the subsequent measurement of the guarantor’s recognized liability for either the noncontingent aspect of the guarantee or the contingent aspect of the guarantee. The accounting for the contingent aspect of the guarantee, if it is not accounted for as a derivative under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, is covered by FASB Statement No. 5, *Accounting for Contingencies*. The provisions in Statement 5 about disclosure of a loss that is reasonably possible are not affected by this Interpretation.
3. Except as provided in paragraphs 6 and 7, the provisions of this Interpretation apply to guarantee contracts that have any of the following characteristics:

- a. Contracts that contingently require the guarantor to make payments (either in cash, financial instruments, other assets, shares of its stock, 1 or provision of services) to the guaranteed party based on changes in an underlying 2 that is related to an asset, a liability, or an equity security of the guaranteed party. Thus, for example, the provisions apply to the following:
    - (1) A financial standby letter of credit, which is an irrevocable undertaking (typically by a financial institution) to guarantee payment of a specified financial obligation
    - (2) A market value guarantee on either a financial asset (such as a security) or a nonfinancial asset owned by the guaranteed party
    - (3) A guarantee of the market price of the common stock of the guaranteed party
    - (4) A guarantee of the collection of the scheduled contractual cash flows from individual financial assets held by a special-purpose entity (SPE)
    - (5) A guarantee granted to a business or its owner(s) that the revenue of the business (or a specific portion of the business) for a specified period of time will be at least a specified amount.
  - b. Contracts that contingently require the guarantor to make payments (either in cash, financial instruments, other assets, shares of its stock, or provision of services) to the guaranteed party based on another entity's failure to perform under an obligating agreement (performance guarantees). Thus, for example, the provisions apply to a performance standby letter of credit, which is an irrevocable undertaking by a guarantor to make payments in the event a specified third party fails to perform under a nonfinancial contractual obligation.
  - c. Indemnification agreements (contracts) that contingently require the indemnifying party (guarantor) to make payments to the indemnified party (guaranteed party) based on changes in an underlying that is related to an asset, a liability, or an equity security of the indemnified party, such as an adverse judgment in a lawsuit or the imposition of additional taxes due to either a change in the tax law or an adverse interpretation of the tax law.
  - d. Indirect guarantees of the indebtedness of others, as that phrase is used in paragraphs 17 and 18 (and originally in Interpretation 34), even though the payment to the guaranteed party may not be based on changes in an underlying that is related to an asset, a liability, or an equity security of the guaranteed party.
4. Commercial letters of credit and other loan commitments, which are commonly thought of as guarantees of funding, are not included in the scope of this Interpretation because those arrangements do not meet any of the four characteristics identified in paragraph 3 above. Similarly, the scope of this Interpretation does not encompass indemnifications or guarantees of an entity's own future performance (for example, a guarantee that the guarantor will not take a certain future action). It does not include a noncontingent forward contract for which the net settlement can flow from either party to the other party; however, a contingent forward contract may meet one of the characteristics in paragraph 3 and be included in the scope of this Interpretation.
  5. Some securitizations and other arrangements involve the subordination of the rights of some investors (or creditors) to the rights of others, in which case, for example, the investors in one (subordinated) class or tranche of an entity's securities might not receive any cash flows until the investors in another (priority) class or tranche are fully paid. Because that type of subordination provides credit protection by the subordinated

investors, those subordination arrangements are commonly thought of as guarantees issued by the subordinated investors. Such subordination arrangements do not meet the characteristic-based scope provisions in paragraph 3 and, thus, are not included in the scope of this Interpretation.

#### Scope Exceptions from the Entire Interpretation

6. Notwithstanding the characteristic-based scope provisions in paragraph 3, this Interpretation does not apply to the following guarantee contracts:
  - a. A guarantee or an indemnification that is excluded from the scope of Statement 5 under paragraph 7 of that Statement.
  - b. A lessee's guarantee of the residual value of the leased property at the expiration of the lease term, if the lessee (guarantor) accounts for the lease as a capital lease under FASB Statement No. 13, Accounting for Leases.
  - c. A contract that meets the characteristics in paragraph 3.a. but is accounted for as contingent rent under Statement 13.
  - d. A guarantee (or an indemnification) that is issued by either an insurance company or a reinsurance company and accounted for under FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises, No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments, No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts, or No. 120, Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts (including guarantees embedded in either insurance contracts or investment contracts).
  - e. A contract that meets the characteristics in paragraph 3.a. but provides for payments that constitute a vendor rebate (by the guarantor) based on either the sales revenues of, or the number of units sold by, the guaranteed party. (Vendor rebates based on the volume of purchases by the buyer would not meet the characteristics in paragraph 3.a. because the underlying relates to an asset of the seller, not the buyer who receives the rebates.)
  - f. A guarantee (or an indemnification) whose existence prevents the guarantor from being able to either account for a transaction as the sale of an asset that is related to the guarantee's underlying or recognize in earnings the profit from that sale transaction.
  - g. A registration payment arrangement within the scope of FSP EITF 00-19-2, "Accounting for Registration Payment Arrangements."
  - h. A guarantee that is accounted for as a credit derivative instrument at fair value under Statement 133, as described in paragraph 44DD of Statement 133.

#### Scope Exceptions from Only the Initial Recognition and Initial Measurement Provisions

7. The following types of guarantees are not subject to the initial recognition and initial measurement provisions of this Interpretation but are subject to its disclosure requirements:
  - a. A guarantee, other than a credit derivative as described in paragraph 44DD of Statement 133, that is accounted for as a derivative instrument at fair value under Statement 133.



- b. A guarantee for which the underlying is related to the performance (regarding function, not price) of nonfinancial assets that are owned by the guaranteed party. Thus, the initial recognition and initial measurement provisions of this Interpretation do not apply to product warranties issued by the guarantor, regardless of whether the guarantor is required to make payment in services or cash, including separately priced extended warranty or product maintenance contracts that are addressed in FASB Technical Bulletin No. 90-1, Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts.
- c. A guarantee issued in a business combination that represents contingent consideration (as addressed in FASB Statement No. 141, Business Combinations).
- d. A guarantee for which the guarantor's obligation would be reported as an equity item (rather than a liability) under generally accepted accounting principles (GAAP).
- e. A guarantee by an original lessee that has become secondarily liable under a new lease that relieved the original lessee from being the primary obligor (that is, principal debtor) under the original lease, as discussed in paragraph 38 of Statement 13, as amended by FASB Statement No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections. This exception shall not be applied by analogy to secondary obligations that are not accounted for under paragraph 38 of Statement 13. (The disclosure requirements of this Interpretation do apply to the original lessee that has become secondarily liable for the lease payments.)
- f. A guarantee issued either between parents and their subsidiaries or between corporations under common control.
- g. A parent's guarantee of its subsidiary's debt to a third party (whether the parent is a corporation or an individual).
- h. A subsidiary's guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent.

## INTERPRETATION

### Initial Recognition and Initial Measurement of the Liability for a Guarantor's Obligations

- 8. The issuance of a guarantee obligates the guarantor (the issuer) in two respects: (a) the guarantor undertakes an obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur (the noncontingent aspect) and (b) the guarantor undertakes a contingent obligation to make future payments if those triggering events or conditions occur (the contingent aspect).
- 9. Because the issuance of a guarantee imposes a noncontingent obligation to stand ready to perform in the event that the specified triggering events or conditions occur, the provisions of paragraphs 8-12 of Statement 5 regarding the guarantor's contingent obligation under a guarantee should not be interpreted as prohibiting the guarantor from initially recognizing a liability for that guarantee even though it is not probable that payments will be required under that guarantee. At the inception of a guarantee, the guarantor shall recognize in its statement of financial position a liability for that guarantee. Except as indicated in paragraph 10, the objective of the initial measurement of the liability is the fair value of the guarantee at its inception.

- a. When a guarantee is issued in a standalone arm's-length transaction with an unrelated party, the liability recognized at the inception of the guarantee should be the premium received or receivable by the guarantor as a practical expedient.
  - b. When a guarantee is issued as part of a transaction with multiple elements with an unrelated party (such as in conjunction with selling an asset or entering into an operating lease), the liability recognized at the inception of the guarantee should be an estimate of the guarantee's fair value. In that circumstance, guarantors should consider what premium would be required by the guarantor to issue the same guarantee in a standalone arm's-length transaction with an unrelated party as a practical expedient.
  - c. When a guarantee is issued as a contribution to an unrelated party, the liability recognized at the inception of the guarantee should be measured at its fair value, consistent with the requirement to measure the contribution made at fair value, as prescribed in paragraph 18 of FASB Statement No. 116, Accounting for Contributions Received and Contributions Made. For example, a community foundation may have a loan guarantee program to assist not-for-profit organizations in obtaining bank financing at a reasonable cost. Under that program, the community foundation may issue a guarantee of a not-for-profit organization's bank debt. Upon the issuance of the guarantee, the community foundation would recognize a liability for the fair value of that guarantee. The issuance of that guarantee would not be considered merely a conditional promise to give under paragraph 22 of Statement 116 because, upon the issuance of the guarantee, the not-for-profit organization will have received the gift of the community foundation's credit support, which enables the not-for-profit organization to obtain a lower interest rate on its borrowing.
10. In the event that, at the inception of the guarantee, the guarantor is required to recognize a liability under Statement 5 for the related contingent loss, the liability to be initially recognized for that guarantee shall be the greater of (a) the amount that satisfies the fair value objective as discussed in paragraph 9 or (b) the contingent liability amount required to be recognized at inception of the guarantee by paragraph 8 of Statement 5. For many guarantors, it would be unusual for the contingent liability amount under (b) above to exceed the amount that satisfies the fair value objective under (a) above at the inception of the guarantee.
11. This Interpretation does not prescribe a specific account for the guarantor's offsetting entry when it recognizes the liability at the inception of a guarantee. That offsetting entry depends on the circumstances in which the guarantee was issued, as illustrated by the following examples:
- a. If the guarantee were issued in a standalone transaction for a premium, the offsetting entry would be consideration received (such as cash or a receivable).
  - b. If the guarantee were issued in conjunction with the sale of assets, a product, or a business, the overall proceeds (such as the cash received or receivable) would be allocated between the consideration being remitted to the guarantor for issuing the guarantee and the proceeds from the sale. That allocation would affect the calculation of the gain or loss on the sale transaction.
  - c. If the guarantee were issued in conjunction with the formation of a partially owned business or a venture accounted for under the equity method, the recognition of the liability for the guarantee would result in an increase to the carrying amount of the investment.
  - d. If a residual value guarantee were provided by a lessee-guarantor when entering into an operating lease, the offsetting entry (representing a payment in kind made

- by the lessee when entering into the operating lease) would be reflected as prepaid rent, which would be accounted for under paragraph 15 of Statement 13.
- e. If a guarantee were issued to an unrelated party for no consideration on a standalone basis (that is, not in conjunction with any other transaction or ownership relationship), the offsetting entry would be to expense.
12. This Interpretation does not describe in detail how the guarantor's liability for its obligations under the guarantee would be measured subsequent to its initial recognition. The liability that the guarantor initially recognized under paragraph 9 consistent with the fair value objective discussed in that paragraph would typically be reduced (by a credit to earnings) as the guarantor is released from risk under the guarantee. Depending on the nature of the guarantee, the guarantor's release from risk has typically been recognized over the term of the guarantee (a) only upon either expiration or settlement of the guarantee, (b) by a systematic and rational amortization method, or (c) as the fair value of the guarantee changes (as is done, for example, for guarantees accounted for as derivatives). The discussion in this paragraph about how the guarantor typically reduces the liability that it initially recognized does not encompass the recognition and subsequent adjustment of the contingent liability recognized under Statement 5 related to the contingent loss for the guarantee.

#### Disclosures about a Guarantor's Obligations under Guarantees

13. A guarantor shall disclose the following information about each guarantee, or each group of similar guarantees, even if the likelihood of the guarantor's having to make any payments under the guarantee is remote, except as provided in paragraph 14 with respect to the disclosure specified in paragraph 13.b.:
- a. The nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose, the events or circumstances that would require the guarantor to perform under the guarantee and the current status (that is, as of the date of the statement of financial position) of the payment/performance risk of the guarantee. For example, the current status of the payment/performance risk of a credit-risk-related guarantee could be based on either recently issued external credit ratings or current internal groupings used by the guarantor to manage its risk. An entity that uses internal groupings shall disclose how those groupings are determined and used for managing risk.
  - b. The maximum potential amount of future payments (undiscounted) the guarantor could be required to make under the guarantee. That maximum potential amount of future payments shall not be reduced by the effect of any amounts that may possibly be recovered under recourse or collateralization provisions in the guarantee (which are addressed under (d) below). If the terms of the guarantee provide for no limitation to the maximum potential future payments under the guarantee, that fact shall be disclosed. If the guarantor is unable to develop an estimate of the maximum potential amount of future payments under its guarantee, the guarantor shall disclose the reasons why it cannot estimate the maximum potential amount. (Refer to the following paragraph for an exception to the requirements of this subparagraph.)
  - c. The current carrying amount of the liability, if any, for the guarantor's obligations under the guarantee (including the amount, if any, recognized under paragraph 8 of Statement 5), regardless of whether the guarantee is freestanding or embedded in another contract.
  - d. The nature of (1) any recourse provisions that would enable the guarantor to recover from third parties any of the amounts paid under the guarantee and (2) any assets held either as collateral or by third parties that, upon the occurrence

of any triggering event or condition under the guarantee, the guarantor can obtain and liquidate to recover all or a portion of the amounts paid under the guarantee. The guarantor shall indicate, if estimable, the approximate extent to which the proceeds from liquidation of those assets would be expected to cover the maximum potential amount of future payments under the guarantee.

14. For product warranties and other guarantee contracts that are excluded from the initial recognition and initial measurement requirements of this Interpretation pursuant to paragraph 7.b. (collectively referred to as product warranties), a guarantor is not required to disclose the maximum potential amount of future payments specified in paragraph 13.b. above. Instead, the guarantor is required to disclose for those product warranties the following information:
  - a. The guarantor's accounting policy and methodology used in determining its liability for product warranties (including any liability [such as deferred revenue] associated with extended warranties).
  - b. A tabular reconciliation of the changes in the guarantor's aggregate product warranty liability for the reporting period. That reconciliation should present the beginning balance of the aggregate product warranty liability, the aggregate reductions in that liability for payments made (in cash or in kind) under the warranty, the aggregate changes in the liability for accruals related to product warranties issued during the reporting period, the aggregate changes in the liability for accruals related to preexisting warranties (including adjustments related to changes in estimates), and the ending balance of the aggregate product warranty liability.
15. The disclosures required by this Interpretation do not eliminate or affect the requirement in FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments, as amended by FASB Statement No. 126, Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities, that certain entities disclose the fair value of their financial guarantees issued.
16. Some guarantees are issued to benefit entities that meet the definition of a related party in paragraph 24.f. of FASB Statement No. 57, Related Party Disclosures, such as joint ventures, equity method investees, and certain entities for which the controlling financial interest cannot be assessed by analyzing voting interests. In those cases, the disclosures required by this Interpretation are incremental to the disclosures required by Statement 57.

#### Indirect Guarantees of Indebtedness of Others Encompassed by Paragraph 12 of Statement 5

17. An indirect guarantee of the indebtedness of another arises under an agreement that obligates one entity to transfer funds to a second entity upon the occurrence of specified events, under conditions whereby (a) the funds become legally available to creditors of the second entity and (b) those creditors may enforce the second entity's claims against the first entity under the agreement. Examples of indirect guarantees include agreements to advance funds if a second entity's net income, coverage of fixed charges, or working capital falls below a specified minimum.
18. The term guarantees of indebtedness of others in paragraph 12 of Statement 5 includes indirect guarantees of indebtedness of others as described in paragraph 17 of this Interpretation.

#### RESCISSION OF INTERPRETATION 34

19. Interpretation 34 is superseded by this Interpretation.

## EFFECTIVE DATE AND TRANSITION

20. The initial recognition and initial measurement provisions in paragraphs 9 and 10 shall be applied only on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The guarantor's previous accounting for guarantees issued prior to the date of this Interpretation's initial application shall not be revised or restated to reflect the effect of the recognition and measurement provisions of the Interpretation.
21. The disclosure requirements in paragraphs 13-16 are effective for financial statements of interim or annual periods ending after December 15, 2002. The guidance on indirect guarantees of the indebtedness of others in paragraph 18 continues to apply to financial statements for fiscal years ending after June 15, 1981.

21. FIN 45 supersedes FASB Interpretation No. 34, Disclosure of Indirect Guarantees of Indebtedness of Others, An Interpretation of FASB Statement No. 5 (FIN 34). FIN 34 had previously been adopted within SSAP No. 5 and resulted with disclosure requirements for guarantees, even if the possibility of payment under the guarantee was remote. The guidance in FIN 45 has incorporated more conservative accounting and disclosure requirements for guarantees than FIN 34.

22. The NAIC Statutory Accounting Principles Working Group previously considered *FSP FAS 133-1 and FIN 45-4: Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161* (FSP FAS 133-1 and FIN 45-4), and adopted revisions to SSAP No. 5 to incorporate the revised disclosures within paragraph 13.a. of FIN 45 as modified by FSP FAS 133-1 and FIN 45-4. (The revisions to FIN 45 from FSP FAS 133-1 and FIN 45-4 are reflected within the FIN 45 guidance included in paragraph 20 of this Issue paper.)

**RELEVANT LITERATURE:****Statutory Accounting**

- *SSAP No. 5—Liabilities, Contingencies and Impairments of Assets*

**Generally Accepted Accounting Principles**

- *FASB Statement No. 5, Accounting for Contingencies*
- *FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan*
- *FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements*
- *FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss, An Interpretation of FASB Statement No. 5*
- *FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57, 107 and rescission of FASB Interpretation No. 35*
- *FASB Interpretation No. 45-3, Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Grated to a Business or Owner*
- *FSP FAS 133-1 and FIN 45-4: Disclosures about Credit Derivatives and Certain Guarantees, an Amendment of FASB Statement No. 133 and FASB Interpretation No. 45. and Clarification of the Effective Date of FASB Statement No. 161.*
- *Accounting Principles Board Opinions No. 12, Omnibus Opinion—1967, paragraphs 2 and 3*

**State Regulations**

No additional guidance obtained from state statutes or regulations.

**Appendix A: Substantive Revisions to SSAP No. 5 Adopting, with Modification, FIN 45**

## SCOPE OF STATEMENT

1. This statement defines and establishes statutory accounting principles for liabilities, contingencies and impairments of assets.

## SUMMARY CONCLUSION

## Liabilities

2. A liability is defined as certain or probable<sup>1</sup> future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).
3. A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable<sup>1</sup> future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statements when incurred.
4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.

## Loss Contingencies or Impairments of Assets

5. For purposes of implementing the statutory accounting principles of loss contingency or impairment of an asset described below, the following additional definitions shall apply:
  - a. Probable—The future event or events are likely to occur;
  - b. Reasonably Possible—The chance of the future event or events occurring is more than remote but less than probable;
  - c. Remote—The chance of the future event or events occurring is slight.
6. A loss contingency or impairment of an asset is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an enterprise that will ultimately be resolved when one or more future event(s) occur or fail to occur (e.g., collection of receivables).
7. An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations if both of the following conditions are met:

---

<sup>1</sup> FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states:

Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in *FASB Statement 5, Accounting for Contingencies*, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

- a. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and
  - b. The amount of loss can be reasonably estimated.
8. This accounting shall be followed even though the application of other prescribed statutory accounting principles or valuation criteria may not require, or does not address, the recording of a particular liability or impairment of an asset (e.g., a known impairment of a bond even though the VOS manual has not recognized the impairment).
9. Additionally, in instances where a judgment, assessment or fine has been rendered against a reporting entity, there is a presumption that the criteria in paragraph 7.a. and 7.b. have been met. The amount of the liability shall include the anticipated settlement amount, legal costs, insurance recoveries and other related amounts and shall take into account factors such as the nature of the litigation, progress of the case, opinions of legal counsel, and management's intended response to the litigation, claim, or assessment.
10. When condition 7 a. above is met with respect to a particular loss contingency, and the reasonable estimate of the loss is a range, which meets condition 7 b. above, an amount shall be accrued for the loss. When an amount within management's estimate of the range of a loss appears to be a better estimate than any other amount within the range, that amount shall be accrued. When, in management's opinion, no amount within management's estimate of the range is a better estimate than any other amount, however, the midpoint (mean) of management's estimate in the range shall be accrued. For purposes of this paragraph, it is assumed that management can quantify the high end of the range. If management determines that the high end of the range cannot be quantified, then a range does not exist, and management's best estimate shall be used.
11. The use of the midpoint in a range will be applicable only in the rare instance where there is a continuous range of possible values, and no amount within that range is any more probable than any other. This guidance is not applicable when there are several point estimates which have been determined as equally possible values, but those point estimates do not constitute a range. If there are several point estimates with equal probabilities, management should determine their best estimate of the liability.

#### Gain Contingencies

12. A gain is defined as an increase in surplus which results from peripheral or incidental transactions of a reporting entity and from all other transactions and other events and circumstances affecting the reporting entity except those that result from revenues or investments by owners. If, on or before the balance sheet date, (a) the transaction or event has been fully completed, and (b) the amount of the gain is determinable, then the transaction or event is considered a gain, and is recognized in the financial statements. The definition of a gain excludes increases in surplus that result from activities that constitute a reporting entity's ongoing major or central operations or activities. Because investment activities are central to an insurer's operations, increases in surplus that result from such investment activities are excluded from the definition of gains. Revenues are inflows or other enhancements of assets of a reporting entity or settlements of its liabilities (or a combination of both) from providing products, rendering services, or other activities that constitute the reporting entity's ongoing major or central operations. Investments by owners include any type of capital infused into the surplus of the reporting entity.

13. A gain contingency is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain (as defined in the preceding paragraph) to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur (e.g., a plaintiff has filed suit for damages associated with an event occurring prior to the balance sheet, but the outcome of the suit is not known as of the balance sheet date). Gain contingencies shall not be recognized in a reporting entity's financial statements. However, if subsequent to the balance sheet date but prior to the issuance of the financial statements, the gain contingency is realized, the gain shall be disclosed in the notes to financial statements and the unissued financial statements should not be adjusted to record the gain. A gain is generally considered realizable when noncash resources or rights are readily convertible to known amounts of cash or claims to cash.

### Guarantees

14. A guarantee contract is a contract that contingently requires the guarantor to make payments (either in cash, financial instruments, other assets, shares of its stock, or provision of services) to the guaranteed party based on changes in the underlying that is related to an asset, a liability, or an equity security of the guaranteed party. Commercial letters of credit and loan commitments, by definition, are not considered guarantee contracts. Also excluded from the definition are indemnifications or guarantees of an entity's own performance, subordination arrangements or a noncontingent forward contract. This definition could include contingent forward contracts if the characteristics of this paragraph are met.

15. The following guarantee contracts are not subject to the guidance in paragraphs 18-23 and paragraphs 26-29:

- a. Guarantees already excluded from the scope of SSAP No. 5R;
- b. Guarantee contracts accounted for as contingent rent;
- c. Insurance contract guarantees, including guarantees embedded in deposit-type contracts;
- d. Contracts that provide for payments that constitute a vender rebate by the guarantor based on either the sales revenue or the number of units sold by the guaranteed party;
- e. A guarantee or indemnification whose existence prevents the guarantor from being able to either account for a transaction as the sale of an asset that is related to the guarantee's underlying or recognize in earnings the profit from that sale transaction;
- f. Registration payment arrangements; and
- g. A guarantee that is accounted for as a credit derivative instrument at fair value under SSAP No. 86, as described in paragraph 53.e. of SSAP No. 86.

16. The following types of guarantees are exempted from the initial liability recognition in paragraphs 18-23, but are subject to the to the disclosure requirements in paragraphs 26-29:

- a. Guarantee that is accounted for as a derivative instrument, other than credit derivatives within SSAP No. 86;
- b. Guarantee for which the underlying is related to the performance of nonfinancial assets that are owned by the guaranteed party, including product warranties;



- c. Guarantee issued in a business combination that represents contingent consideration;
  - d. Guarantee in which the guarantor's obligation would be reported as an equity item;
  - e. Guarantee by an original lessee that has become secondarily liable under a new lease that relieved the original lessee from being the primary obligator; and
  - f. Guarantees (as defined in paragraph 14) made to/or on behalf of a wholly owned subsidiary.
  - g. Intercompany and related party guarantees that are considered "unlimited" (e.g., typically in response to a rating agency's requirement to provide a commitment to support).
17. With the exception of the provision for guarantees made to/or on behalf of a wholly owned subsidiaries in paragraph 16.f. and "unlimited" guarantees in 16.g, this guidance does not exclude guarantees issued as intercompany transactions or between related parties from the initial liability recognition requirement. Thus, unless the guarantee is provided on behalf of a wholly owned subsidiary or considered "unlimited," guarantees issued between the following parties are subject to the initial recognition and disclosure requirements:
- a. Guarantee issued either between parents and their subsidiaries or between corporations under common control;
  - b. A parent's guarantee of its subsidiary's debt to a third party; and
  - c. A subsidiary's guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent.
18. At the inception of a guarantee, the guarantor shall recognize in its statement of financial position a liability for that guarantee. Except as indicated in paragraph 20, the objective of the initial measurement of the liability is the fair value<sup>2</sup> of the guarantee at its inception.
19. The issuance of a guarantee obligates the guarantor (the issuer) in two respects: (a) the guarantor undertakes an obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur (the noncontingent aspect) and (b) the guarantor undertakes a contingent obligation to make future payments if those triggering events or conditions occur (the contingent aspect). Because the issuance of a guarantee imposes a noncontingent obligation to stand ready to perform in the event that the specified triggering event occurs, the provisions of paragraph 7 should not be interpreted as prohibiting the guarantor from initially recognizing a liability for that guarantee even though it is not probable that payments will be required under that guarantee.
20. In the event that, at the inception of the guarantee, the guarantor is required to recognize a liability under paragraph 7 for the related contingent loss, the liability to be initially recognized for that guarantee shall be the greater of (a) the amount that satisfies the fair value objective as discussed in paragraph 18 or (b) the contingent liability amount required to be recognized at inception of the guarantee by paragraph 7. For many

---

<sup>2</sup> As practical expedients, when a guarantee is issued in a standalone arm's-length transaction, the liability recognized at the inception of the guarantee should be the premium received or receivable by the guarantor. When a guarantee is issued as part of a transaction with multiple elements, the liability recognized at the inception of the guarantee should be an estimate of the guarantee's fair value. In that circumstance, guarantors should consider what premium would be required by the guarantor to issue the same guarantee in a standalone arm's-length transaction.

guarantors, it would be unusual for the contingent liability under (b) above to exceed the amount that satisfies the fair value objective at the inception of the guarantee.

21. The offsetting entry pursuant to the liability recognition at the inception of the guarantee depends on the circumstances in which the guarantee was issued. Examples include:
- a. If the guarantee was issued in a standalone transaction for a premium, the offsetting entry would be the consideration received.
  - b. If the guarantee was issued in conjunction with the sale of assets, a product, or a business, the overall proceeds would be allocated between the consideration being remitted to the guarantor for issuing the guarantee and the proceeds from that sale. That allocation would affect the calculation of the gain or loss on the sale transaction.
  - c. If a residual value guarantee were provided by a lessee-guarantor when entering into an operating lease, the offsetting entry would be reflected as prepaid rent, which would be nonadmitted under SSAP No. 29.
  - d. If a guarantee were issued to an unrelated or related party for no consideration on a standalone basis, the offsetting entry would be to expense.
22. Except for the measurement and recognition of continued guarantee obligations after the settlement of a contingent guarantee liability described in paragraph 23, this standard does not describe in detail how the guarantor's liability for its obligations under the guarantee would be measured subsequent to initial recognition. The liability that the guarantor initially recognized in accordance with paragraph 18 would typically be reduced (as a credit to income) as the guarantor is released from risk under the guarantee. Depending on the nature of the guarantee, the guarantor's release from risk has typically been recognized over the term of the guarantee (a) only upon either expiration or settlement of the guarantee, (b) by a systematic and rational amortization method, or (c) as the fair value of the guarantee changes (for example, guarantees accounted for as derivatives). The reduction of liability does not encompass the recognition and subsequent adjustment of the contingent liability recognized under paragraph 7 related to the contingent loss for the guarantee. If the guarantor is required to subsequently recognize a contingent liability for the guarantee, the guarantor shall eliminate any remaining noncontingent liability for that guarantee and recognize a contingent liability in accordance with paragraph 7.
23. After recognition and settlement of a contingent guarantee liability in accordance with paragraph 7, a guarantor shall assess whether remaining potential obligations exist under the guarantee agreement. If the guarantor still has potential obligations under the guarantee contract, the guarantor shall recognize the remaining noncontingent guarantee that represents the current fair value of the potential obligation remaining under the guarantee agreement. This noncontingent guarantee liability shall be released in accordance with paragraph 22.

#### Disclosures

~~14~~24. If a loss contingency or impairment of an asset is not recorded because only one of the conditions 7 a. or 7 b. is met, or if exposure to a loss exists in excess of the amount accrued pursuant to the provisions described above, disclosure of the loss contingency or impairment of the asset shall be made in the financial statements when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made.

~~45~~25. Disclosure is not required of a loss contingency involving an unasserted claim or assessment when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable.

~~46~~26. Certain loss contingencies, the common characteristic of each being a guarantee, shall be disclosed in financial statements even though the possibility of loss may be remote. Examples include (a) guarantees of indebtedness of others, and (b) guarantees to repurchase receivables (or, in some cases, to repurchase related properties) that have been sold or otherwise assigned. The disclosure of those loss contingencies, and others that in substance have the same characteristics, shall be applied to statutory financial statements. The disclosure shall include the nature and amount of the guarantee. Consideration shall be given to disclosing, if estimable, the value of any recovery that could be expected to result, such as from the guarantor's right to proceed against an outside party.

~~a. For guarantees on indebtedness of others, disclosure shall include the nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose, the events and circumstances that would require the guarantor to perform under the guarantee, and the current status as of the reporting date of the payment/performance risk of the guarantee. For example, the current status of the payment/performance risk of a credit risk related guarantee could be based on either recently issued external credit ratings or current internal groupings used by the guarantor to manage its risk. An entity that uses internal groupings shall disclose how those groupings are determined and used for managing risk.~~

27. A guarantor shall disclose the following information about each guarantee, or each group or similar guarantees (except product warranties addressed in paragraph 29), even if the likelihood of the guarantor's having to make any payments under the guarantee is remote. In addition, the nature of the relationship to the beneficiary of the guarantee or undertaking (affiliated or unaffiliated) shall also be disclosed:

a. The nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose, and the events and circumstances that would require the guarantor to perform under the guarantee, the ultimate impact to the financial statements (specific financial statement line item) after the settlement of the contract guarantee if action under the guarantee was required (e.g., increase to the investment, dividends to stockholder, etc) and the current status (that is, as of the date of the statement of financial position) of the payment/performance risk of the guarantee. For example, the current status of the payment/performance risk of a credit-risk-related guarantee could be based on either recently issued external credit ratings or current internal groupings used by the guarantor to manage its risk. An entity that uses internal groupings shall disclose how those groupings are determined and used for managing risk.

b. The potential amount of future payments (undiscounted) the guarantor could be required to make under the guarantee. That maximum potential amount of future payments shall not be reduced by the effect of any amounts that may possibly be recovered under recourse or collateralization provisions in the guarantee (which are addressed under (d) below). If the terms of the guarantee provide for no limitation to the maximum potential future payments under the guarantee, that fact shall be disclosed. If the guarantor is unable to develop an estimate of the maximum potential amount of future payments under its guarantee, the guarantor shall disclose the reasons why it cannot estimate the maximum potential amount.

c. The current carrying amount of the liability, if any, for the guarantor's obligations under the guarantee (including the amount, if any, recognized under paragraph

7). regardless of whether the guarantee is freestanding or embedded in another contract.

- d. The nature of (1) any recourse provisions that would enable the guarantor to recover from third parties any of the amounts paid under the guarantee and (2) any assets held either as collateral or by third parties that, upon the occurrence of any triggering event or condition under the guarantee, the guarantor can obtain and liquidate to recover all or a portion of the amounts paid under the guarantee. The guarantor shall indicate, if estimable, the approximate extent to which the proceeds from liquidation of those assets would be expected to cover the maximum potential amount of future payments under the guarantee.

28. An aggregate compilation of guarantee obligations shall include the maximum potential of future payments of all guarantees (undiscounted), the current liability (contingent and noncontingent) reported in the financial statements, and the ultimate financial statement impact based on maximum potential payments (undiscounted) if performance under those guarantees had been triggered.

29. As product warranties are excluded from the initial recognition and initial measurement requirements for guarantees, a guarantor is not required to disclose the maximum potential amount of future payments. Instead the guarantor is required to disclose for product warranties the following information:

- a. The guarantor's accounting policy and methodology used in determining its liability for product warranties (including any liability associated with extended warranties).
- b. A tabular reconciliation of the changes in the guarantor's aggregate product warranty liability for the reporting period. That reconciliation should present the beginning balance of the aggregate product warranty liability, the aggregate reductions in that liability for payments made (in cash or in kind) under the warranty, the aggregate changes in the liability for accruals related to product warranties issued during the reporting period, the aggregate changes in the liability for accruals related to preexisting warranties (including adjustments related to changes in estimates), and the ending balance of the aggregate product warranty liability.

~~47.~~30. The financial statements shall contain adequate disclosure about the nature of any gain contingency. However, care should be exercised to avoid misleading implications as to the likelihood of realization.

~~48.~~31. Refer to the preamble for further discussion regarding disclosure requirements.

#### Relevant Literature

~~49.~~32. This statement adopts *FASB Statement No. 5, Accounting for Contingencies* (FAS 5), *FASB Statement 114, Accounting by Creditors for Impairment of a Loan* only as it amends in part FAS 5 and paragraphs 35 and 36 of *FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements*. *FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss, An Interpretation of FASB Statement No. 5* (FIN No. 14) is adopted with the modification to accrue the loss amount as the midpoint of the range rather than the minimum as discussed in paragraph 3 of FIN No. 14.

33. This statement ~~also~~ adopts, with modification, *FASB Interpretation No. 45: Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No. 34* (FIN 45), *FASB Interpretation No. 45-3, Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Grated to a Business or Owner* (FSP FIN

45-3), and FASB Staff Position FAS 133-1 and FIN 45-4, Disclosures about Credit Derivatives and Certain Guarantees, An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45 (FSP FAS 133-1 and FIN 45-4). Statutory Modifications to FIN 45 include initial liability recognition for guarantees issued as part of intercompany or related party transactions, assessment and recognition of non-contingent guarantee obligations after recognition and settlement of a contingent obligation and revise the GAAP guidance to reflect statutory accounting terms and restrictions. Under this SSAP, intercompany and related party guarantees (including guarantees between parents and subsidiaries) should have an initial liability recognition unless the guarantee is considered "unlimited" or is made to/or on behalf of a wholly owned subsidiary. (An example of an intercompany "unlimited" guarantee would be a guarantee issued in response to a rating agency's requirement to provide a commitment to support.) In instances in which an "unlimited" guarantee exists or a guarantee has been made to/or on behalf of a wholly owned subsidiary, this statement requires disclosure, pursuant to the disclosure requirements adopted from FIN 45. The adoption of FIN 45 superseded the previously adopted guidance in *FASB Interpretation No. 34, Disclosure of Indirect Guarantees of Indebtedness of Others, An Interpretation of FASB Statement No. 5*. ~~*FASB Interpretation No. 34, Disclosure of Indirect Guarantees of Indebtedness of Others, An Interpretation of FASB Statement No. 5* and *This statement also adopts Accounting Principles Board Opinion No. 12, Omnibus Opinion—1967, paragraphs 2 and 3 with the modification that AVR, IMR and Schedule F Penalty shall be shown gross. Appropriation of retained earnings discussed in paragraph 15 of FAS 5 is addressed in SSAP No. 72—Surplus and Quasi-Reorganizations. This statement adopts FSP FAS 133-1 and FIN 45-5: Disclosures about Credit Derivatives and Certain Guarantees, An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45 and Clarification of the Effective Date of FASB Statement No. 161 (FSP FAS 133-1 and FIN 45-4) and requires disclosures by sellers of credit guarantees.*~~

#### Effective Date and Transition

~~20.34.~~ This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors.

35. The guidance for guarantees included within paragraphs 14-23 and 27-29 shall be applicable to all guarantees issued or outstanding as of December 31, 2011. Thereafter, disclosure of all guarantees shall be annually reported, with interim reporting required for new guarantees issued, and/or existing guarantees when significant changes are made.

#### Authoritative Literature

##### Generally Accepted Accounting Principles

- *FASB Statement No. 5, Accounting for Contingencies*
- *FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan*
- *FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements*
- *FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss, An Interpretation of FASB Statement No. 5*
- ~~*FASB Interpretation No. 34, Disclosure of Indirect Guarantees of Indebtedness of Others, an Interpretation of FASB Statement No. 5*~~
- *FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57, 107 and rescission of FASB Interpretation No. 35*

- [FASB Interpretation No. 45-3, Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Grated to a Business or Owner](#)
- *FSP FAS 133-1 and FIN 45-4: Disclosures about Credit Derivatives and Certain Guarantees, An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45 and Clarification of the Effective Date of FASB Statement No. 161.*
- *Accounting Principles Board Opinions No. 12, Omnibus Opinion—1967, paragraphs 2 and 3*

**SSAP No. 5R – Appendix A – Disclosure Illustrations**

Example illustration for paragraph 27.a, including the potential maximum guarantee from paragraph 27.b:

<u>Nature and circumstances of guarantee and key attributes, including date and duration of agreement</u>	<u>Liability recognition of guarantee. (Include amount recognized at inception. If no initial recognition, document exception allowed under SSAP No. 5R)</u>	<u>Ultimate financial statement impact if action under the guarantee is required</u>	<u>Maximum potential amount of future payments (undiscounted) the guarantor could be required to make under the guarantee. If unable to develop an estimate, this should be specifically noted</u>	<u>Current status of payment or performance risk of guarantee. Also provide additional discussion as warranted</u>

Example Illustration – Paragraph 28:

<u>1. Aggregate Maximum Potential of Future Payments of All Guarantees (undiscounted) the guarantor could be required to make under guarantees. (This amount should agree to the total amount reported for all guarantees within paragraph 27.b (illustrated above), thus it excludes guarantees for which estimates of potential future payment cannot be made.)</u>	\$
<u>2. Current Liability Recognized in F/S:</u>	
<u>a. Noncontingent Liabilities</u>	\$
<u>b. Contingent Liabilities</u>	\$
<u>3. Ultimate Financial Statement Impact if action under the guarantee is required. (This should equal the total reported in line 1 reflected in the applicable financial statement line items.)</u>	
<u>a. Investments in SCA</u>	\$
<u>b. Joint Venture</u>	\$
<u>c. Dividends to Stockholders (capital contribution)</u>	\$
<u>d. Expense</u>	\$
<u>e. Other</u>	\$

**Appendix B: Nonsubstantive Revisions to paragraph 18.e of SSAP No. 25**

18. The financial statements shall include disclosures of all material related party transactions. In some cases, aggregation of similar transactions may be appropriate. Sometimes, the effect of the relationship between the parties may be so pervasive that disclosure of the relationship alone will be sufficient. If necessary to the understanding of the relationship, the name of the related party should be disclosed. Transactions shall not be purported to be arm's-length transactions unless there is demonstrable evidence to support such statement. The disclosures shall include:

- e. Any guarantees or undertakings, written or otherwise, shall be disclosed in accordance with the requirements of SSAP No. 5R, ~~for the benefit of an affiliate or related party which result in a material contingent exposure of the reporting entity's or any related party's assets or liabilities;~~