

- c) Pricing models whose inputs are observable for substantially the full term of the asset or liability; and
- d) Pricing models whose inputs are derived principally from or corroborated by observable market information through correlation or other means for substantially the full term of the asset or liability.

Our level 2 financial assets predominately included commercial paper purchased from the State Street-administered asset-backed commercial paper conduits, various types of interest-rate and foreign exchange derivative instruments, and various types of fixed-income investment securities. We categorized approximately \$53.37 billion of trading account assets, investment securities available for sale and derivative instruments, and approximately \$18.09 billion of derivative instruments, in level 2 financial assets and liabilities, respectively, at December 31, 2008.

*Level 3.* Financial assets and liabilities with values based on prices or valuation techniques that require inputs that are both unobservable in the market and significant to the overall fair value measurement. These inputs reflect management's judgment about the assumptions that a market participant would use in pricing the asset or liability, and are based on the best available information, some of which is internally developed. The following provides a more detailed discussion of our financial assets and liabilities that we may categorize in level 3 and the related valuation methodology.

- For certain corporate debt securities carried in trading account assets, fair value was measured using information obtained from independent third parties or through the use of pricing models. Management evaluated its methodologies used to determine fair value, but considered the level of market-observable information to be insufficient, given the lack of trading activity, to categorize the securities in level 2.
- For certain investment securities available for sale, fair value was measured using information obtained from third-party sources or through the use of pricing models. Management evaluated its methodologies used to determine fair value, but considered the level of market-observable information to be insufficient to categorize the securities in level 2.
- Foreign exchange contracts carried in other assets and other liabilities were primarily composed of forward contracts and options. The fair value of foreign exchange forward contracts was measured using discounted cash flow techniques. However, in certain circumstances, extrapolation was required to develop certain forward points, which were not observable. The fair value of foreign exchange options was measured using an option pricing model. Because of a limited number of observable transactions, certain model inputs were unobservable, such as volatilities which were based on historical experience.
- The fair value of certain interest-rate caps with long-dated maturities, also carried in other assets and other liabilities, was measured using a matrix pricing approach. Observable market prices were not available for these derivatives, so extrapolation was necessary to value these instruments, since they had a strike and/or maturity outside of the matrix.

We categorized approximately \$10.01 billion of investment securities available for sale, primarily asset-backed securities, as well as derivative instruments, and \$857 million of derivative instruments, in level 3 financial assets and liabilities, respectively, at December 31, 2008.

In October 2008, the FASB issued FSP No. FAS 157-3, *Determining Fair Value in a Market That Is Not Active*, to help entities measure fair value in markets that are not active. The FSP provides clarification of guidance with respect to the determination of fair value pursuant to SFAS No. 157 when markets are inactive. The FSP reiterates current accounting standards that require us to carry certain of our investment securities at fair value in our consolidated statement of condition. Fair value continues to be defined as the price at which a transaction would occur between willing market participants on the measurement date. Consistent with the FSP, we continue to assess the amount and quality of market information that supports our estimate of the fair value of the above-mentioned investment securities in our portfolio. Given current market illiquidity, we will continue to assess our portfolio valuations to determine the most appropriate method for estimating fair value.