

October 29, 2004

Mr. Lawrence W. Smith, Director
Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O Box 5116
Norwalk, CT 06856-5116

Re: Emerging Issues Task Force Issue No. 03-1, The Meaning of Other-Than-Temporary Impairments and Its Application to Certain Investments ("EITF 03-1") and FASB Staff Position, EITF Issue No. 03-1-1 ("FSP EITF 03-1-1")

Dear Mr. Smith:

FirstMerit Corporation is a \$10.2 billion bank holding company headquartered in Akron, Ohio with an investment portfolio of over \$2.8 billion fixed income securities. We support and appreciate the delay in the implementation of EITF 03-1 and would like to take this opportunity to share our thoughts regarding the current proposal draft.

EITF 03-01 will cause a fundamental shift in the way financial institutions, subject to generally accepted accounting principles, manage their balance sheet. We believe that the proposal in its current form will result in:

- ◆ increased earnings volatility;
- ◆ increased capital volatility;
- ◆ misleading financial statements;
- ◆ a reduction in the institution's flexibility to manage its' interest rate risk;
- ◆ a reduction in balance sheet liquidity;
- ◆ an increase in the level of documentation required for the portfolio.

Before we address the specific material posed in FSP EITF 03-1-1, we would like to state that FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities ("SFAS 115") initially considered recognizing impairment through the income statement. This notion was rejected since that method would subject only one portion (the asset side) of the balance sheet to fair value accounting. If the security was funded with similar term debt and interest rates rose, the market value decline in the asset would be reflected in the income statement without an offsetting increase in the value of the liability. By not allowing the corresponding offset to be realized through the income statement, users of the financial statements could reach an incorrect conclusion about the health of the financial institution.

Regarding FSP EITF 03-1-1 Question 1, Unit of Account, we agree that the investor should assert their ability and intent at the individual security level within the existing SFAS 115 designations of held-to-maturity, available-for-sale and trading.

Regarding Question 2, Minor Impairment, we believe that declines in value, for debt and debt-like securities, related solely to changes in interest rates should be excluded from EITF 03-1, thus eliminating the need to define minor impairment.

In that event that the FASB decides that changes in interest rates can cause other than temporary impairment, we strongly support having a "bright-line" test to determine when impairment is to be considered minor. We believe that not defining an appropriate "bright-line" level would lead to inconsistent application across financial institutions and users of the financial statements would be unable to accurately compare the performance of similar institutions. We find the 5% impairment level initially considered by the FASB to be too restrictive and recommend a 10% to 15% threshold. This level is more consistent with unrealized losses that are recovered over a normal interest rate cycle. We have seen wide swings in interest rates this year, but these gyrations are consistent with historical patterns of interest rate movements. Consider the price of a five year U.S. Treasury security this year. From March to June of this year, a three month time frame, the unrealized price depreciation was 6.5%. Since June, rates have fallen and the unrealized appreciation has been 3.7%. Had EITF 03-1 been in effect and the 5% "bright-line" applied, the price decline would have been recognized through the income statement. However, the current guidance is silent on the ability to recapture any of the subsequent appreciation.

Further clarification. If a security is considered to have losses that are other than minor and the losses recover somewhat so that it could qualify as "minor impairment", can the security be written up in value to reflect this market appreciation?

Question 3b, Change in Ability and Intent - Sales Tainting. At FirstMerit we use a sector or segmentation approach to portfolio management. For instance, we segregate the portfolio into five broad categories, U.S. Treasury, U.S. Agencies, Mortgage-backed securities ("MBS"), Collateral Mortgage Obligations ("CMO") and Corporate Bonds. The Mortgage sector is further segmented into adjustable rate, balloons & hybrid arms, 15 year MBS and 30 year MBS. Each of these segments possess distinctive risk characteristics and cash flow. The diversity created by investing in different asset classes within the portfolio helps to dilute risk and improve overall investment performance. Therefore, we believe that EITF 03-1 should consider the flexibility of allowing financial institutions the ability to sell specific sectors of the portfolio without calling into question the ability and intent of other sectors.

Further clarification of Paragraph 8 is necessary. The wording of the last sentence needs further clarification. The current form could be interpreted to mean that any security impairment, whether "minor" or not, would have to be recognized in earnings.

Paragraph 9, Effective Date, EITF 03-1 as currently written will lead to changes in the methods that financial institutions use to manage their investment portfolio. If adopted EITF 03-1 will:

- ♦ cause some investment portfolio restructuring;
- ♦ likely eliminate certain strategies that some financial institutions currently employ;
- ♦ require that investment, liquidity, and asset/liability policies to be rewritten; and
- ♦ require changes to the Sarbanes-Oxley Section 404 control documentation.

Therefore, we would encourage you to consider making the guidance effective as of June 30, 2005 or later.

Application of Paragraph 16 to Non Debt Securities. Perpetual Preferred stock issued by the Federal National Mortgage Association ("FNMA") and the Federal Home Loan Mortgage Corporation ("FHLMC") is treated from an issuer's perspective as equity due to its' perpetual nature and the noncumulative dividend feature. However, from an investor's perspective, these securities are more analogous to debt securities. These securities trade on a spread to LIBOR or Treasury basis like other debt securities. They possess no voting rights, have senior liquidation and dividend preferences to common equity, are redeemable at the issue price and are non-convertible. These features cause the perpetual preferred's to trade like debt securities, resulting in movements in interest rates having a significant impact on the their valuation. We ask FASB to consider applying Paragraph 16 to non-convertible Perpetual Preferred's securities.

Thank you for considering these comments. Should you have any questions, please do not hesitate to call me at 330.384.7377.

Sincerely,

/s/ Scott D. Free

Scott D. Free, SVP
Portfolio Manager
FirstMerit Corporation

/s/ Nancy Worman

Nancy Worman, SVP
Corporate Controller
FirstMerit Corporation