169

Letter of Comment No: File Reference: EITF03-1A

# BOSTON PRIVATE BANK TRUST COMPANY A Boston Private Wealth Many

October 25, 2004

Mr. Robert Herz Chairman Financial Accounting Standards Board 401 Merritt 7 Norwalk, Connecticut 06856-5166

Mr. Lawrence Smith
Chairman
Emerging Issues Task Force
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856-5166

Re: EITF 03-1 "The Meaning of Other Than Temporary Impairment and its Application to Certain Investments"

### Gentlemen:

Thank you for the opportunity to comment on your recently issued E1TF Issue 03-1 "The Meaning of Other Than Temporary Impairment and Its' Application to Certain Investments" ("EITF 03-1"). I am the Treasurer of Boston Private Bank & Trust Company ("the Bank"). We are a \$1.8 billion bank subsidiary of Boston Private Financial Heldings Inc. publicly-traded on NASDAQ under the symbol BPFH.

Senior management at the Bank remains very apprehensive about the potential negative ramifications of EITF 03-1. While we can appreciate the need to recognize the fair value of certain assets with permanent impairment, the changes proposed under EITF Issue 03-1 may have the following unintended consequences:

- reported financial statements that do not accurately reflect the 1 sults of our business activities (earnings volatility, asset carrying values, capital levels, risk profile, etc.);
- as a result of above, Sarbanes-Oxley related concerns will arise associated with required approval by senior Bank officers on financial statements that might be "technically correct" from an accounting perspective, yet materially misleading as to the true financial performance and risk profile of our Bank;
- a hindered ability to prudently manage risks, such as liquidity and interest rate sensitivity, at the enterprise level;
- a systemic lowering of banking industry earnings not reflective of balance sheet structure or business practices;
- inappropriately reduced regulatory capital levels that constrains the banking industry's ability to support economic growth (especially for community Banks); and
- decreased availability and/or higher cost of raising capital.

In this regard our primary concern is the introduction of potential other than temporary impairment (OTTI) accounting treatment on fixed income investment securities that have a diminished market value due solely to changes in interest rates, market volatility variables, and/or sector spreads.

The proposed accounting application is in conflict with the way that the vast majority of Banks: 1) generate earnings, and 2) measure and manage the liquidity and interest rate risks of their balance sheet. As managers of balance sheet spread, the focus is appropriately on total portfolio risk, not individual financial instrument risk.

To broaden the concept of OTTI to interest rate only issues invites a level of volatility into our and most Bank financial statements that will potentially diminis 1 the value of the related information for the industry as a whole. We believe the current disclosures within other comprehensive income (OCI) to be sufficient and that the proposed changes could result an unnecessary and problematic reduction in regulatory capital throughout the banking community. If the user, including Bank regulators, has concerns regarding the carrying values, it is quite easy for them to make the corresponding adjustments to earnings, and act accordingly.

## Ability and Intent

The EITF guidance implies that ability and intent is a one-time "pen nanent" declaration as it relates to impaired securities.

We believe that ability and intent is a dynamic set of variables that can change over time when market conditions change, risk positions (e.g. interest rate and liquidity) change, strategic direction changes, senior management teams change, etc.

Accordingly, we believe that a narrow and static interpretation of ab lity and intent is inherently problematic.

## Fair Value Accounting and piecemeal application thereof

One of our greatest concerns with EITF 03-1 is the continued trend in accounting literature towards mark-to-market accounting on only portions of the balance wheet.

We believe this in itself will lead to misleading representations of fir ancial performance for Banks; especially banks whose primary business model relates to managing the stability of total balance sheet spread over interest rate cycles as opposed to variations in monthly prices of financial instruments. We encourage FASB to enable the accounting to reflect how earnings are created and managed.

More importantly, we do not believe that the solution rests in full fai market value accounting for the entire balance sheet for similar reasons; notwithst inding the inherent inconsistencies associated with "estimating" fair values for Bank deposit bases.

### Recommendations

Our recommendation is to clarify FAS115 by excluding other than temporary impairment accounting from situations where there have been market value declines due solely to interest rate related changes; unless an entity's actions speak clearly to exception treatment. For example, in situations where there is a definitive plan for sale, we concede that banks would

consider such securities as held for sale and recognize the fair market value. Similarly, if there was a pattern of selling inconsistent with normal portfolio activity that would seem to indicate that a portion or all of a portfolio should be reclassified as a trading account, the bank should employ fair value accounting.

In advance of implementing any changes, FASB should address clearly with pertinent examples some of the more common issues facing banks of various: izes and structures. Some of the more salient issues requiring a more definitive clarification include:

- Provide a "bright-line" test for minor impairment whereby impairment would be
  assumed to be temporary without requiring further analysis/documentation. Requiring
  formal analysis/documentation for every security with an unrealized loss would be an
  extreme burden. With bank portfolios skewed heavily towards AFS classifications, this
  could result in most if not all securities requiring specific documentation in a rising
  interest rate environment.
- For pre-payable/callable premium securities with book prices a rove the "bright-line" test, provide concrete examples of typical securities and how they would be accounted for under the "new rule". For example, premium mortgage-backed securities (MBS) and collateralized mortgage obligations (CMO), callable bonds priced at premiums and amortized to call date, long-term municipal bonds, premium commercial MBS and other types of premium bonds with yield maintenance agreements and/or prepayment penalties.
- Allow rate related impairments to be recovered up to amortized cost as is done for mortgage servicing rights. Why create a new "permanent" cost basis that implies a low probability of recovery for a financial instrument whose value changes daily and is expected to increase with business cycles (when rates decline) and/or as time passes (the security moves closer to maturity)?
- Provide tangible guidance on what constitutes a pattern of sellir g (e.g. relative level of sales either in # of transactions or \$ volume; time period over which activity analyzed, etc.). Interpretations from the accounting profession have varied greatly.
- Enable sales to be conducted for documented strategies related 15 prudent risk management such as interest rate sensitivity and liquidity management.

Thank you for taking the time to consider my comments regarding the very critical issues associated with EITF 03-1 and the related ramifications for Boston Private Bank and for the banking industry in general.

George G. Schwartz EVP, Treasurer

Sincerely