Washington Mutual

Letter of Comment No: 78
File Reference: EITF03-1A

October 27, 2004

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

Re: Proposed FASB Staff Position No. EITF Issue 03-1-a

Dear Mr. Smith:

Washington Mutual, Inc. is a financial services company with over $289 billion in total assets as of September 30, 2004. Based on those total assets, Washington Mutual is the largest savings institution and one of the largest financial institutions in the nation. It also is one of the largest residential mortgage loan originators and mortgage loan servicers.

We appreciate the opportunity to comment on the Proposed FASB Staff Position (FSP) No. EITF Issue 03-1-a. We believe that the consensus reached in Emerging Issues Task Force Issue No. 03-1, "The Meaning of Other than Temporary Impairment and Its Application to Certain Investments," is seriously flawed (as it currently is being interpreted in practice) and effectively represents an amendment to FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, with respect to those securities classified as *available for sale*. Consequently, we urge the Board to rescind that consensus and instead add a project to its agenda to consider the issue under the due process for an amendment to an existing accounting pronouncement.

If Issue 03-1 is not rescinded, then we strongly support the proposed changes to paragraph 16 of Issue 03-1. Furthermore, we believe that the changes proposed for paragraph 16 should be extended to paragraph 10. In that case, we have some suggestions that we believe would enhance the changes proposed by the FASB staff.

Rescind EITF Issue 03-1

We believe that paragraph 16, as it is being interpreted in practice (without the proposed changes), would not meet the spirit behind the notion of *other than temporary* impairment. No consideration would be given to the severity or duration of an unrealized loss before an assessment for *other than temporary* impairment was required to be performed. Instead, an entity would be required to make an assertion regarding its intent and ability to hold a debt security to recovery even if that security had been purchased only a few days before the end of a reporting period and the amount of unrealized loss was within a normal range of price fluctuations for that security. Such an approach would place a costly operational burden on entities and would significantly disrupt the current use of certain securities designated as *available for sale* for asset-liability and other risk mitigation purposes.

For example, at any given time, our company holds from 1,500-2,000 debt securities that are classified as *available for sale*. Monitoring that many positions on a daily basis for new occurrences of unrealized losses or tracking the status of positions with outstanding unrealized losses that have been designated as held to recovery will be costly and time consuming. To our knowledge, few, if any, accounting systems for such securities have existing capabilities to handle all of the additional accounting and tracking that will be required. Consequently, much of the effort in tracking and monitoring the status of each position will be manually intensive. Furthermore, our securities accounting system would require a debt security to be (hypothetically) sold and repurchased at a new (current fair value) cost basis in order to properly accrete the (hypothetical) discount that would result from an *other than temporary* impairment. In that case, the original cost basis of the security would be lost for tax purposes. We believe that our system is not unique in that regard.

Significant new processes and internal accounting controls would be required to ensure that any impairment was recorded properly and on a timely basis. Those processes and controls would need to be evaluated and tested for compliance with Sarbanes-Oxley Section 404. With a proposed effective date of December 31, 2004, the challenge to have those processes in place and proven as functioning properly would be enormous. In our opinion, any perceived benefits from such an onerous accounting standard would be far outweighed by the added costs to implement the necessary controls and accounting procedures.

Prior to the issuance of the consensus in Issue 03-1, sufficient accounting guidance already existed regarding the immediate recognition of impairment for a debt security with an unrealized loss that was expected to be realized (e.g., sold at a loss) and not recovered (e.g., FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, EITF Topic D-44, "Recognition of Other than temporary

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Impairment upon the Planned Sale of a Security Whose Cost Exceeds Fair Value," and SEC Staff Accounting Bulletin Series Topic No. 5M, *Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities*). We believe that the consensus reached in Issue 03-1 contradicts and effectively amends the principles underlying the notion of *available for sale* securities provided in Statement 115 and should be rescinded in its entirety. It fails to require evidence of a probable unrecoverable loss before triggering an assessment of *other than temporary* impairment. If Statement 115 is to be amended, such a change should be considered by the Board under due process for an amendment to an existing accounting standard.

If the consensus in Issue 03-1 is not rescinded, then we believe that the changes proposed in the FSP are essential for the consensus to be reasonably applied in practice. In that case, our comments regarding the proposed FSP are noted below.

Exclude Minor Impairment

We agree that minor impairment or impairment within a normal range around a mean price should not warrant an assessment of whether such impairment is *other than temporary*. We believe that the notion of *other than temporary* implies that a certain level of observable evidence exists which indicates that an unrealized loss is probable of not being recovered (or is probable of being realized) in the foreseeable future. Unless an unrealized loss has existed for a significant period of time (e.g., 12 months) or is severe (e.g., due to an unusually large spike in interest rates), we believe that there generally would be insufficient observable evidence to indicate that a debt security was impaired beyond the foreseeable future and warrant an assessment for *other than temporary* impairment.

We do not favor a bright-line test (e.g., five percent) to determine a minor impairment. Such an approach would be arbitrary and would reflect more rule-based rather principle-based accounting. Furthermore, a bright-line test might not be appropriate in all cases. Instead, more guidance should be provided regarding the concept of what level of unrealized loss should represent a "minor" impairment. We believe that the concept of a minor impairment should incorporate the notion of a normal range of volatility around a mean price in which the likelihood of reversal is reasonably possible in the foreseeable future. Although in theory the determination of a normal range of volatility would be made at the individual security level, we believe that an entity should be permitted to define a normal range of volatility for a group or class of securities that share similar risk characteristics such that their volatility would be similar or within a narrow range.

Apply the Proposed FSP to Paragraph 10

We believe that the notion of "minor" impairment also should apply to those securities covered by paragraph 10 of Issue 03-1. Particularly in the case of equity securities, we believe that minor fluctuations in price do not represent sufficient observable evidence that an unrealized loss might be an *other than temporary* impairment. As mentioned above, we believe that an assessment of *other than temporary* impairment should be triggered by observable evidence indicating that an unrealized loss might not be recovered in the foreseeable future. Unless that trigger exists, no assessment should be required for any equity or debt security.

Consider the Duration of an Unrealized Loss as a Triggering Event

We believe that one significant element of *other than temporary* impairment that has been diminished in the consensus reached in Issue 03-1 and the proposed FSP is the length of time that a security has been impaired. Barring any plans on the part of an entity to realize a loss, one necessary indicator of a potential *other than temporary* impairment should be the length of time that an unrealized loss has existed. In defining minor impairment or conditions in which an unrealized loss should be deemed temporary, we ask that the Board consider including some notion of how long an unrealized loss has existed (absent any plans by an entity to realize that loss). Furthermore, we suggest that the minimum the length of time that should be required to represent observable evidence of a potential *other than temporary* impairment should be 12 months. In other words, barring any other indicators of other than temporary impairment, an unrealized loss would need to be outstanding for a minimum of 12 months before an assertion regarding the ability and intent to hold that security to recovery would be required.

Delay the Effective Date of Issue 03-1

As noted above, the application of Issue 03-1 (even with the proposed changes) would require significant changes to accounting systems, procedures, and internal controls (that would need to be documented and tested for compliance for Sarbanes Oxley Section 404). Furthermore, the application of Issue 03-1 would make it more difficult to use debt securities classified as *available for sale* to economically hedge the risk of impairment related to mortgage servicing rights or interest rate risk because those securities might need to be sold before they have recovered unrealized losses in value. Consequently, we believe that the effective date of paragraphs 10-20 of Issue 03-1 should be delayed until the Board's project related to fair value accounting for servicing rights is completed and effective. Such a delay would give companies an opportunity to classify such securities (if permitted) or newly acquired similar securities as trading securities and to account for mortgage servicing rights at fair value, providing a symmetrical accounting result. The delay also would give companies time to evaluate whether or how they might use *available for sale* securities to economically hedge interest rate risk under the new guidance.

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Summary

We urge the Board to rescind the consensus in Issue 03-1 in its entirety. If that consensus is not rescinded, then we believe that the clarifications to paragraph 16 of Issue 03-1 proposed by the Board are absolutely necessary to properly account for *other than temporary* impairment for certain types of securities and should be extended to paragraph 10. Furthermore, we believe that the suggestions noted above to the proposed FSP would enhance greatly the application of Issue 03-1 in practice and that the Board should consider delaying the effective date to coincide with the effective date of its project to account for mortgage servicing rights at fair value.

If you have any questions about our comments, please contact me at (206) 377-5957 (or robert.miles@wamu.net) or Larry Gee, Deputy Controller, at (206) 377-3684 (or larry.gee@wamu.net).

Very truly yours,

Robert H. Miles
Senior Vice President and Corporate Controller