Letter of Comment No: 64 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:

The Financial Institutions Accounting Committee (FIAC) is a group of 11 financial professionals working in executive level positions in the banking and thrift industries and is a standing committee of the Financial Managers Society. FIAC's primary responsibility is to evaluate those accounting and regulatory matters that affect financial institutions. The comments within this letter are representative of FIAC as a whole and do not necessarily reflect views of the individual institutions represented on the Committee.

We appreciate the opportunity to comment on the Proposed FASB Staff Position (FSP) No. EITF Issue 03-1-a. While we commend the Board and the FASB staff in its efforts to make much needed improvements to 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," we strongly believe that the consensus is flawed beyond repair and undermines the principles of FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, with respect to securities classified as available for sale. Consequently, we believe that it should be rescinded in its entirety. If that is not the case, then we believe that it is essential for the Board to move forward with the guidance in the FSP in order to permit EITF 03-1 to be reasonably applied in practice.

EITF 03-1

Despite the Board's efforts to improve the consensus in EITF 03-1, we believe that the manner in which the guidance in paragraph 16 is being interpreted in practice would not apply the concept of other-than-temporary impairment fairly. Rather than considering the severity or duration of an unrealized loss (as suggested by SEC Staff Accounting Bulletin No. 59, Accounting for Noncurrent Marketable Equity Securities), an entity would need to assert its plans and ability to hold a debt security to recovery whenever an unrealized loss exists. Even if a security were held for a short period or the size of the loss was well within the range of normal price

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October 27, 2004 Page Two

volatility, a positive assertion to hold that security to recovery would be required to avoid an impairment loss. For companies that have significant portfolios of such securities and use them to manage risks associated with interest spreads between loan portfolios and funding sources or mortgage servicing rights, such a requirement would inflict a heavy operational burden and significantly limit the use of such securities for risk mitigation purposes. Consequently, we fear that companies might be forced to assume more risk by maintaining smaller portfolios of risk mitigating securities, which is a result that would not bode well for the banking industry.

We believe that the consensus in EITF 03-1 is inconsistent with and redefines the notion of *other than temporary* impairment provided in Statement 115. Statement 115 requires marketable debt and equity securities to be reported at fair value. For securities classified as *available for sale*, unrealized losses are required to be recognized in Other Comprehensive Income. As such, readers of financial statements already are well informed of any unrealized losses in the value of those securities. In our opinion, the focus of *other than temporary* impairment should be to flow through earnings only those losses that are probable of not being recovered in the foreseeable future. We believe that the consensus in EITF 03-1 fails to achieve that result.

The consensus in EITF 03-1 does not require a company to seek evidence of a probable loss (e.g., severity and duration) before being recognized. Instead, it requires an assessment whenever an unrealized loss exists, which represents a much lower threshold. Further, the consensus does not allow a company to consider whether an unrealized loss might recover in the foreseeable future (e.g., whether the loss is within the range of normal price volatility). Finally, the consensus requires a company to recognize the entire existing unrealized loss rather than only the portion expected to be realized, giving no consideration to any future expected recovery in value.

In substance, we believe that the consensus in EITF 03-1 represents an amendment to Statement 115. Accordingly, it should be subjected to the more thorough consideration process required for a change to an existing accounting pronouncement. If the consensus is not rescinded, then below are our comments regarding the much needed modifications proposed in the FSP.

Impairment that is Minor in Nature

We support a change that would spare companies the burden of having to declare and monitor their intentions and ability to hold securities for minor unrealized losses until recovery. Assessing minor unrealized losses for *other than temporary* impairment creates a heavy operational burden in which the costs far outweigh the benefits. In addition, we do not support the use of a bright-line test (e.g., five percent) to determine whether an unrealized loss is minor unless such a test is used only as a minimum safe harbor. We are concerned that a pure bright-line test would not be appropriate in every situation.

Application of FSP to Paragraph 10

We believe that the modifications proposed for paragraph 16 also should apply to paragraph 10 of the consensus for EITF 03-1. The costs of evaluating small unrealized losses in equity or prepayable securities for *other than temporary* impairment also outweigh the benefits. As noted above, such securities already are recorded at fair value with any unrealized losses recognized in Other

October 27, 2004 Page Three

Comprehensive Income. Consequently, those losses should be transparent to the readers of the financial statements and the benefits of recognizing such losses in earnings would be minimal.

Sales that Would not Indicate a Lack of Intent to Hold Securities to Recovery

We strongly support the guidance in Question 3(b) of the proposed FSP. In today's rapidly changing economic conditions, companies cannot be expected to anticipate unusual changes in liquidity needs or Consequently, it might be necessary for a company to sell securities previously interest rates. designated for sale even though the original intent to hold was valid at the time it was made (and would have continued to be valid were it not for the occurrence of an unusual change in economic or market conditions). We also believe that unanticipated isolated sales should not taint a company's ability to assert its intention to hold other securities to expected recovery. Such a stringent application of the consensus would be punitive and would not result in significant benefits to readers of financial statements.

Summary

We seriously question whether the benefits of the consensus in EITF 03-1 truly outweigh the costs of application. The operational burden of evaluating a security every time it incurs an unrealized loss, evaluating whether a positive assertion can be made regarding the company's ability to hold it to recovery, and then monitoring the status of that security will be costly. In addition, there will be added costs to track and amortize back into income any discount recorded for other than temporary impairment.

Available for sale securities already are recorded at fair value and unrealized losses already are recognized in Other Comprehensive Income. Consequently, the recognition of other than temporary impairment amounts to little more than a reclassification in equity between Other Comprehensive Guidance already exists regarding the Income and Retained Earnings on the balance sheet. recognition of other than temporary impairment and companies have been recognizing other than temporary impairment under that guidance. Therefore, we believe that the incremental benefits of this approach are minimal at best.

We also believe that EITF 03-1 undermines and effectively amends the guidance in FAS 115 with respect to other than temporary impairment. Consequently, the Board should apply the proper process for considering an amendment to an existing accounting standard.

If the Board refuses to rescind EITF 03-1, then we believe that the changes proposed in the FSP are essential for the fair application of the consensus and support the proposed FSP.

Very truly yours,

Bill Nunan Chairman Financial Institutions Accounting Committee