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Letter of Comment No: 62
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Mr. Larry Smith
Director of Technical Application & Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856

Via Email: director@fasb.org

October 25, 2004

Dear Mr. Smith:

Thank you for the opportunity to comment on the proposed FASB Staff Position No. EITF Issue 03-1-a, *Implementation Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments"* (the "FSP"). Goldman, Sachs & Co. has many clients who have classified at least a portion of their securities portfolios as available-for-sale and will be impacted by the guidance in EITF Issue 03-1. Our comments on the FSP are as follows:

Minor Impairments

We support the FASB Staff's inclusion of the notion that "minor impairments" can be considered temporary without further analysis because normal interest rate and/or sector spread volatility is expected to eliminate a minor impairment. However, we do not support including a bright-line test (such as 5%) to be used in determining whether an impairment is minor without alternatives being provided that would take into account duration.

A simple bright-line threshold will be relatively easy for companies to apply; however it will set an arbitrary rule for determining whether an impairment is minor. Suppose the Board sets a 5% bright-line threshold. It clearly will be easy to determine if the threshold has been met; however, it will ignore a factor that we believe is crucial to any concept of minor for fixed income securities, namely that a minor impairment should be based on rate moves that are minor. Yet unless the Staff allows the concept of duration to be included, potentially significant rate moves will produce minor impairments on shorter duration securities, while small rate moves will produce other than minor impairments on longer duration securities. To illustrate, let us compare a 5 year bond with a 4 year duration and a 30 year bond with a 14 year duration. A move of 100 bps in 5 year rates would reduce the price of the 5 year bond by approximately 4 points to 96. On the other hand, a move of only 40bps in 30 year rates would reduce the price of a 30 year bond by 5.6% to 94.4. Thus, a bright line which was a simple percentage of price would lead to a result in which most impairments of short duration securities will be considered minor and most impairments of longer duration securities would not be considered minor.

We believe that the FASB should include general guidance regarding how a company should determine whether an impairment is minor, however we do not believe the Board should specify a single numerical rule of threshold. This would be similar to the guidance provided in FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, for testing hedge effectiveness – the Board required companies to test hedge effectiveness and provided general guidelines but did not prescribe a single method for testing hedge effectiveness. Similarly, we believe there are several reasonable methods for determining whether an impairment should be considered minor.

One method would be for a company to define “minor impairments” as a one point decline in the price of the security for every year of duration of the security. In that case a decline in value to 96 on a three year security would not be considered a minor impairment, but a decline in value to 96 on a seven year security would be.

Alternatively, a company could decide that a decline in value of a security would be considered minor if it were less than 5% or less than a point for each year of duration.

A third alternative would be to define minor as price changes of less than 1 standard deviation over a 1 year time horizon.

Limiting the Notion of Minor Impairments

The Staff asked for comments on the Board’s conclusion to limit the notion of “minor impairments” to debt securities analyzed for impairment under paragraph 16 that are

impaired because of interest rate and / or sector spread increases. We believe that the Board should expand the notion of “minor impairments” to include changes in both paragraph 10 and paragraph 16 securities due to factors other than interest rate and / or sector spread increases. We agree with the Board members who support expanding the notion of “minor impairments” to all investments analyzed under Issue 03-1 because we agree that normal price volatility may eliminate the impairment. Further, we believe that all securities should be afforded the “minor impairments free pass”. It does not make sense to us that an equity security price decline of 3% would not be considered minor if (i) a similar decline in a fixed income security would be considered minor, or (ii) the expected price change in a 1 year period given the volatility of that security was 10%.

General

As evidenced by the number of comment letters received by the EITF and the FASB on EITF Issue 03-1, there is a great deal of confusion regarding the implementation of the guidance in EITF Issue 03-1. In addition, as noted in many comment letters, many constituents believe the guidance provided in EITF Issue 03-1 is an amendment of FASB Statement No. 115, *Accounting for Investments in Debt and Equity Securities*, and other existing GAAP. Given this, we would recommend the FASB reconsider its ratification of EITF Issue 03-1. If the Board ultimately determines that the guidance in EITF Issue 03-1 should be ratified, we would recommend that the Board permit companies to re-balance their securities portfolios by permitting one time (a) transfers of securities to the trading portfolio and (b) sales of impaired securities from the available-for-sale portfolio without triggering the “tainting” provisions of Statement 115 and EITF Issue 03-1.

If you would like to discuss our comments or any other issues further you can contact me at 212-902-7052 or Nora Dougherty at 212-357-8391.

Sincerely,

Timothy J. Bridges
Managing Director

Copy: Nora Dougherty
Mark Evans
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