

Letter of Comment No: 52  
File Reference: EITF03-1A

26 October 2004

Mr. Lawrence Smith  
Director and Chairman of the Emerging Issues Task Force  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, CT 06856

**\*\* By Regular Mail and by e-mail to [director@fasb.org](mailto:director@fasb.org) \*\***

Re: Proposed FASB Staff Position, 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"

Dear Director Smith,

The Savings Bank appreciates the opportunity to comment on the proposed Staff Position, issued on September 15, 2004 by the Financial Accounting Standards Board (FSP 03-1-a). The Savings Bank is a \$400 million mutual savings bank with 6 branch locations. Our state charter dates back to 1869. We currently have a bond portfolio of investment grade securities that totals approximately \$210 million and a portfolio of dividend paying equities with a book value of approximately \$7.5 million. We have a significant interest in the other-than-temporary impairment issue.

We also submitted a comment letter (dated 16 September 2004) on FASB's initiative to delay the effective date of this rule and we thank you for delaying that effective date.

We understand that the purpose of this proposal is to address the accounting for other-than-temporary impairment. This is a critical issue not only for The Savings Bank, but for the banking industry as well. We hold the majority of our debt securities as available for sale ("AFS") although with the amount of our debt securities and our "laddered" approach to investing we could just as easily designate much of our holdings as "held to maturity" (HTM). Why we elect *not* to do this is the subject of this comment letter.

Please consider the following points:

- Securities are merely one component of a bank's balance sheet. Because debt and equity securities are more easily "market priced" does not mean that they should be treated differently than other bank assets or liabilities. For example, at the same time that we buy a 3 year US Treasury Note, we also grant a 15 year fixed rate mortgage to a customer. Both of these transactions occur at 45-year interest rate lows. At any given point, we can easily determine the price of the Treasury and as we know, when yields increase, prices decrease (and vice versa). Rates rise, the Treasury price goes down. But has not the exact same thing happened to our mortgage? Of course it has.

The value of the mortgage, if sold, is less than when we booked it. If we were to sell the mortgage loan would that “taint” our entire loan portfolio? Just the fixed rate loans? Just the 15-year component of the fixed rate loans? What about our deposits? Deposit rates paid that reflect the interest rate “lows” are *more* valuable as rates rise and yet this is not reflected in earnings or in capital. The proposal does not create “transparency.” It does create misleading information about the ENTIRE entity being looked at (i.e. “the bank”).

- When looking at the potential for impairment, it would be useful to consider the overall maturity horizon of the portfolio. A portfolio comprised of investment grade securities, laddered over a four year time period is considerably different from a portfolio that plays the “carry trade” by investing out further along the yield curve. Obviously a two-year weighted average maturity is different than a 10 year weighted average maturity.
- It is vitally important to examine the quality of a portfolio. Is the portfolio investment grade or junk? Is it short term Treasuries or long-term BBB+ corporate debt? Are mortgage-backed securities issued by the Federal Agencies (i.e. FNMA, FHLMC) or “private” placement issues? It is very difficult to imagine that even a long term Treasury would ever be “impaired.”
- When the current accounting rules were developed, the decision was made (and correctly so, in our opinion) to expand to three categories (AFS, HTM, and Held for Trading) acknowledging that financial institutions must have the flexibility to manage their balance sheet. Banking regulators do NOT include unrealized gains in calculating regulatory capital. The AFS designation is a significant, positive management tool that provides much needed flexibility.
- Securities that have a value below cost does not automatically mean those securities are impaired (again, “rates up, prices down” is a function of math, not impairment).
- One sale does not and should not equal a pattern. Each situation must be taken into consideration. “Available for sale” means just that. Otherwise we could place everything into HTM and carry those securities at book value. This would be an unintended consequence of overly harsh impairment guidelines.
- Why do we elect the AFS designation for the majority of our bond holdings?
  - Liquidity. AFS allows us to sell bonds to meet unexpected deposit outflows (i.e. those low-rate deposits I mentioned earlier decide to leave the bank for another bank, or to flow back into the “markets”). Selling this/these bonds should not indicate that they are impaired.
  - Asset/Liability Management. In effect, the ability to re-balance our balance sheet. For example, we sell a corporate bond to buy a Treasury bond to improve our risk-based capital position. We sell bonds to meet increased loan demand (invest directly in our communities). We could sell bonds to pay off debt incurred through “borrowed funds” (wholesale borrowings). Any of these examples serve to strengthen the bank.
  - Improved Earnings. Selling a low yielding Treasury with one year left to maturity to fund mortgage commitments will improve our earnings. In some cases a simple sale and reinvestment could occur (i.e. we currently own a Treasury with 8 months remaining to maturity at a yield below what we are now earning in federal funds [1.14% vs. 1.65%] so we would actually be

improving our earnings with a sale “at a loss.” Do we have to sell the bond? No. But we have that flexibility and we wouldn’t want that one sale to taint our entire holdings – would that be true reflection of our earnings? No.

- Taxes. With the ability to go back three years to re-capture capital gains taxes we could be in a position where a sale, at a loss, would be a tax advantage for us.
- Transparency. The AFS mark-to-market adjustment is reflected in our capital. When we sell a bond at a loss, that loss is taken through earnings. However, the net impact to capital is an improvement as we’ve removed a “loss” while our “gains” look greater by the same amount. Impairment “tainting” would take this non-transparency to a new level – earnings would be reduced but capital would improve. I doubt this is the intent.
- Equity impairment is also a concern. Briefly – should an equity be deemed impaired merely because the market value is less than the book value? Not necessarily. Because there is no “maturity date” for an equity, the evaluation should entail a determination of whether or not the institution *really* needs to sell the equity. For a \$400 million bank, are the sale proceeds of \$165,000 truly important? Or can that equity be held for a time period to bring values back in line (please refer to the 5 year price history of Deere & Company as one example). Also with regard to equities – is this a “dot-com” stock or a company with long-term earnings, regular dividend payments and regular dividend increases? Each individual security is different. A broad-brush evaluation is neither warranted nor merited.
- It is nearly impossible to define an investor’s intentions.

We offer this simplistic analogy for your consideration: a grown adult sits down to a seven-course dinner that will be eaten over one to two hours. During this dinner, the adult decides to drink one 12-ounce alcoholic beverage. While this dinner is on going, a two-year-old toddler wanders into the kitchen, finds an open 12-ounce alcoholic beverage and immediately drinks it. The same amount of beverage in both cases. Is the adult likely impaired? Is the toddler? Impairment should not focus on one set of limited criteria.

Again, we appreciate the opportunity to comment on this proposal. Thank you for considering our views. If you would like to discuss this letter in more detail, please contact the undersigned by direct telephone at 781-224-5428 or by email to [bmccoubrey@tsbawake24.com](mailto:bmccoubrey@tsbawake24.com).

Sincerely,

Brian D. McCoubrey  
President & CEO

Regular Mail Enclosure – Business Card