



Letter of Comment No: 180
File Reference: EITF03-1A

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Mr. Lawrence Smith, Chairman
Emerging Issues Task Force
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

October 29, 2004

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 Mr. Smith,

We appreciate the opportunity to express our views relating to the proposed FASB Staff Position, EITF Issue 03-1. Shay Financial Services, Inc., and its affiliates Shay Assets Management, Inc. and First Financial Bank and Trust Co., deliver comprehensive institutional fixed-income brokerage, asset management, and banking products to more than 1,000 investors nationwide.

Issue: EITF Issue 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments"

The objective of financial statements is to provide the reader with an accurate understanding of the financial condition of an economic enterprise. The introduction of an "Other-Than-Temporary Impairment Charge" through the income statement obfuscates that understanding if, as currently contemplated, it is applied to assets selectively and to liabilities not at all. Moreover, this arbitrary and asymmetric treatment will profoundly impact the financial reporting and management practices of financial institutions, particularly depositories. Management will strive to minimize the instances in which an "impairment charge" is required rather than to optimize the economic performance of their enterprises.

The Issue of Impairment Is Neutral with Respect to Asset Type:

No purpose is served in applying different "impairment" treatment to debt securities versus equity securities. A financial statement does not differentiate among the causes for a decline in the value of assets. The dollar value of the change, once observed, is not further refined by the factors that led to the change or their anticipated duration. Having ascertained value, for the purposes of financial reporting, the contributing or mitigating factors are irrelevant. Yet, the EITF 03-1 seems to establish a hierarchy of factors, apparently endorsing some while subjugating others. Should an enterprise "prefer" to suffer a price decline due to interest rates rather than prepayment acceleration, spread changes rather than credit deterioration, option volatility rather than gross margin changes, embedded cap restrictions rather than interest rate risk revaluations? Is the owner of an "impaired" asset required to query the valuation provider to determine the factors impacting the current price?

Market Price Captures All Relevant Asset Valuation Information:

Market forces, reflected in market prices, are the only arbiter of "Other-Than-Temporary Impairments." The market price of an asset, by definition, embodies all that is known regarding that asset's capacity to generate earnings or returns. Market price changes implicitly and efficiently weigh the myriad of factors impacting an asset's value. It is the collective wisdom of market participants evaluating countless data inputs, therefore, which ascertains the degree to which an asset's value is "other-than-temporarily impaired." The larger the negative price move, the more severe the impairment; the smaller the negative price move, the less severe the impairment. Asset owners and their auditors need not consult a complex study of causality to ascertain the nature of the price change. For financial reporting purposes, it should suffice that a small change in market price indicates that an asset is temporarily or minimally impaired with respect to its capacity to generate earnings. A large negative price change relative to cost indicates "other-than-temporary" or substantive impairment in that capacity. By accepting the conclusions of the market, the EITF need only agree on the magnitude of price change that likely evidences a severe or "other-than-temporary" impairment. Moreover, the EITF is freed from demands to proscribe causality hierarchies or to define such terms as "substantially all" or to customize the rule to accommodate the specific security types (today's and those yet to come).

The Application of Market Values to Determine "Other-Than-Temporary" Impairment:

Price changes that imply "other-than-temporary" impairment apply to all assets, irrespective of class (debt or equity). For instance, a decline of say 50% in the value of a long U.S. Treasury Bond indicates that the capacity for that asset to generate earnings for the owner is severely impaired. Although the asset enjoys the guarantee of the federal government, price recovery clearly will take a long-time and therefore it can be considered "other-than-temporarily" impaired. A decline of 50% in the value of a NYSE listed stock also indicates that the capacity for that asset to generate earnings for the owner is severely impaired. Unlike the treasury security, ultimate price recover is not assured although it may in fact occur. At this point, however, it also can be considered "other-than-temporarily" impaired.

Alternatively, consider a price decline of only 10% in the above securities, indicating a minimal, perhaps temporary, impairment of their respective capacities to generate earnings. A full price recovery in a timely fashion is more probable simply because the price decline is relatively small. Moreover, the amount of the price decline likely is, at 10%, a minimal fraction of the owner's balance sheet. If, and when, circumstances evolve which would jeopardize this outlook, negative price changes will be more pronounced. At that time a reconsideration of the nature of the impairment would be appropriate.

It follows that the appropriate guidance of the EITF with respect to this issue will provide either a "bright-line" price change test applied to all assets equally or a "range" test which leaves some discretion to the asset owner. We would suggest the latter: safe harbor "temporary" impairment for all price changes of 10 % or less and a de facto "other-than-temporary" impairment for all price changes greater than 20%. For those price changes that fall mid-range of this scale, the asset owner provides positive documentation as to the temporary nature of the valuation.

Institutional Fixed Income Mutual Funds:

It is critical that mutual funds that invest entirely in fixed-income securities should be treated no differently than direct fixed-income investments. Price changes in fixed-income mutual funds are a consequence of the same confluence of factors that impact a portfolio of individual securities

directly owned by an investor. The form of ownership of the investments does not alter the nature of the price change. The accounting treatment should be identical. The EITF guidance should not have the effect of causing an investor to prefer direct ownership of securities merely because of the "other-than-temporary" impairment issue. For thousands of institutional investors, particularly community banks, thrifts, and credit unions, fixed-income mutual funds provide an excellent means to access top-quality asset management, acquire diversified portfolios, and benefit from rigorous regulatory oversight, all within the context of a cost efficient vehicle.

The Special Case of Bank Investors:

The inherent conflicts of the asymmetric treatment being considered by the EITF are particularly evident in the case of bank investors. Consider the very common situation in which a bank buys a high-quality corporate bond, match-funded to maturity with a FHLB borrowing or other similar term borrowing to produce a spread of 1%. From an economic perspective a decline in the value of the bond, due solely to an interest rate change, is exactly offset by a decline in the value of the borrowing. In fact, in all rate scenarios, up and down, the transaction produces a constant return of 1%. A financial accounting that describes any other outcome is fallacious and therefore detracts from the accuracy of an income statement. As currently conceived, EITF 03-1 requires that the bank mark to market the asset through the income statement with corresponding reduction to equity. The offsetting contribution of the change in value of the funding source is ignored. Consequently, the financial statements incorrectly depict the financial condition of the bank. Bank management, in order to avoid this condition, likely will reallocate the asset mix, which ipso facto is non-optimal. So an accounting practice designed to increase the accuracy of disclosures and better align economic interests with reporting standards accomplishes neither.

In conclusion, we believe that the Board has not had the opportunity to completely review all of the pertinent information surrounding the current ownership and benefits derived by GAAP reporting investors in shares of mutual funds that are exclusively limited to owning debt securities and currently being held as available-for-sale. It is therefore requested that the decision regarding this type of security be postponed until the Board can make a more deliberate and expansive study of this investment type.

Sincerely,



Rodger D. Shay
Chairman
Shay Financial Services, Inc.