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Letter of Comment No: 214
File Reference: EITF03-1A

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

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 Larry,

The American Bankers Association (ABA) appreciates the opportunity to comment on the proposed FASB Staff Position, Emerging Issues Task Force Issue 03-1-a (FSP), issued on September 15, 2004 by the Financial Accounting Standards Board (FASB). The American Bankers Association (ABA) brings together all categories of banking institutions to best represent the interests of the rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

We appreciate the willingness of the FASB to delay the effective date of Emerging Issues Task Force Issue No. 03-1 (EITF 03-1) for certain securities and issue this FSP to seek additional constituent input on the accounting for available for sale (AFS) securities that have market values below cost or book value. Although the guidance outlined in the FSP provides further explanation of "other than temporary impairment" in EITF 03-1, more work is needed so that banks can continue prudent risk management practices that have been in place for many years.

We are concerned that EITF 03-1 is already hindering the liquidity in the financial markets. Practices of purchasing or selling assets are being suspended due to the uncertainty and inconsistent interpretations of EITF 03-1. EITF 03-1 and the FSP could result in dramatic changes in the marketplace with respect to risk management practices, U.S. treasuries and other high-grade debt securities, and the overall financial market. It is extremely important that the FASB continue to work with bankers to resolve the problems with the FSP and develop the appropriate standards for other than temporary impairment.

We believe the following changes are necessary to ensure that financial institutions can continue to practice prudent risk management:

- The FSP should state that AFS debt securities or securities with characteristics similar to debt, with declines in value solely due to changes in interest rates, are not viewed as having other than temporary impairment. Interest rates, by nature, are temporary.
- Alternatively, if the FASB determines to move forward without our recommended change, the “intent to hold” should not be required for debt securities with declines in value that are solely due to increases in interest rates. The intent to hold a security conflicts with the definition of available for sale under Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS 115). Instead, the “ability” to hold the security should be the required test. Further, the sale of an AFS security that has a market value below cost or book value should not result in “tainting” similar AFS securities or securities held by an institution in other portfolios.

Declines in value due solely to interest rates should not result in a charge to earnings.

We are puzzled as to the goal of EITF 03-1 and the FSP as they relate to AFS debt securities. At issue is whether AFS securities with market values below cost or book value must be permanently written down to market value through earnings. Currently, such securities are reported at market value, with gains and losses reported in other comprehensive income. Further, the rules would require that an investor have both the intent to hold and the ability to hold individual securities in the AFS portfolio, and, if both conditions do not exist, the securities (and possibly similar securities) must be permanently written down through earnings. This would be the case even though banking institutions are effectively indicating that they do not have the intent to hold AFS securities, by designating them as available for sale.

When SFAS 115 was developed, the decision was made to expand the classification of securities to three categories (held to maturity, AFS, and trading). Sales from AFS were permitted, essentially acknowledging that financial institutions must have flexibility with regard to balance sheet management. Although SFAS 115 requires the intent and ability to hold debt securities in the held to maturity portfolio, this has not historically been applied to AFS portfolio debt securities (with declines in value due solely to changes in interest rates).

Some have indicated that the Securities and Exchange Commission’s Staff Accounting Bulletin No. 59 (SAB 59, codified in Staff Accounting Bulletin No. 103) has always required the intent and ability to hold AFS debt securities. However, SAB 59 applied to equity securities rather than debt. Although the title of SAB 103 was changed to include debt securities, the ABA staff believes that the application of SAB 103 to AFS debt securities was not clear. Further, there is no discussion of the tainting of AFS in either SAB 59 or SAB 103. Thus, the idea of other than temporary impairment for AFS debt securities (with declines in value due solely to changes in interest rates) is a new concept for our industry.

We believe that the FSP and EITF 03-1 will not improve the accounting for debt securities. In fact, it will result in reduced transparency, including:

- illogical recognition of revenue – As proposed, the rule would require losses to be recognized on high-grade debt securities as a result of declines in value that are solely due to changes in interest rates. Such declines in value should not be viewed as other than temporary, as long as the investor has the ability to hold the security. Thus, the FSP would require an artificial write-down, followed by inflated revenue as a result of the subsequent accounting, which would require recognizing the effective yield on the security by accreting from market to face value over the remaining life of the security.
- asymmetrical recognition of gains and losses
 - AFS mark to market gains will be taken in other comprehensive income, but many of the losses will go through earnings.
 - Losses will be taken through earnings for AFS debt securities, but no gains will be recognized on the liability side of the balance sheet.

Certain recent interpretations of EITF 03-1 and the FSP are not appropriate and need to be corrected.

A market value below amortized cost or book value along with a bright-line test for the length of time a security is below market should not automatically mean a debt security is impaired. Instead, it should be based upon whether the entity has the ability to hold the security.

Recent interpretations are focusing solely on investor's intent and are ignoring the events and circumstances surrounding the security. If the FASB decides to continue with the impairment model in the FSP, it should be based on specific facts and circumstances of the security. Management's intent may change for a large variety of reasons. Factors, such as credit ratings, interest payment history, and the ability to repay are examples of many other important factors that should be considered as part of the analysis in determining whether the debt security has experienced other than temporary impairment.

The notion of tainting should be eliminated for AFS debt securities. To our knowledge, tainting is a new concept that has yet to be clearly defined, and was not a part of AFS under SFAS 115, SAB 59, SAB 103, or EITF 03-1. It is our understanding that tainting AFS was introduced by some of the accounting firms as being the result of demonstrating a pattern of sales (which could mean selling one or more below-market securities) from AFS. The pattern of sales from AFS would call into question management's intent and ability to hold the security, which could result in triggering the write-down of other similar AFS securities (or, possibly securities that are not similar or are in the held to maturity portfolio). We believe that the notion of a pattern of sales is inconsistent with available for sale itself and should not

apply to the AFS portfolio. Clearly, one sale from the AFS portfolio does not equal a pattern of sales and should not trigger write-downs of other securities. Further, the AFS classification was created in SFAS 115 to permit the necessary flexibility to manage interest rate risk, which was effectively eliminated as an acceptable practice out of the held to maturity portfolio. Requiring the intent to hold, along with the notion of tainting, are inconsistent with the purpose of AFS. Instead, investors should be required to have the ability to hold the security for an indefinite period of time, which could mean maturity.

“Minor” fluctuations in the FSP needs additional work.

The FASB questioned whether minor fluctuations in interest rates, such as 5% of cost, should be defined in the final rules. We believe the definition of 5% or less is far too low, narrow, and mechanical, and should not be included in the final rule. Interest rates are temporary and can move up and down by significantly more than 5% in any given rate cycle. Should minor fluctuations be defined as 5% in the final rules, it will become the rule rather than basing the evaluation on the facts and circumstances associated with a security. A more reasonable safe harbor is necessary for changes in value as a result of movements in interest rates or spreads for securities held in AFS.

Other than temporary impairment in AFS is expected to impede prudent risk management.

The risk of write-downs on AFS securities places shackles on prudent risk management. AFS securities are the primary source for risk management tools for most banking institutions. Banks’ AFS securities are used for risk management and balance sheet management, liquidity, strategic management, business combinations, non-routine purposes (such as settlement of litigation), portfolio restructuring, etc. We are concerned about providing an all-inclusive list within the FSP to cite the acceptable reasons for sales from AFS, because such reasons could change over time as risk management practices continue to evolve.

The AFS classification is one of the most controllable avenues for financial institutions to manage overall balance sheet positions, and it is imperative that banks have the flexibility to manage their interest rate profiles. Many banks are not extensive users of off-balance sheet transactions, and the ability to sell AFS securities provides a method for banks to respond to liquidity needs, react to changes in interest rates, or adjust risk.

We are concerned about the somewhat unique negative impact that EITF 03-1 and the FSP will have on community banks. Generally, community banks have a higher percentage of their investment portfolio in AFS than other banking institutions have. For this reason, the negative earnings and capital impact of the FSP will be felt more by community banks. Community banks may try to adjust to the new rules by: holding fewer AFS and more held-to-maturity securities; beginning the use of certain derivatives, which might not be prudent for some community banks; adjusting other business practices in order to meet competition from institutions that have smaller

AFS portfolios; and discontinuing the sales of AFS debt securities that are in a loss position. Currently, as a result of the difficulties of using hedge accounting caused by Statement of Financial Accounting Standards No. 133 (Accounting for Derivative Instruments and Hedging Activities), community banks sometimes sell AFS securities at gains and losses to hedge mortgage serving rights. The ability to continue this strategy is necessary for those community banks to protect against interest rate sensitivities.

The FSP is also expected to result in: an increase in earnings volatility and capital volatility, calling into question what the appropriate risk management structure should be subsequent to the rule (from both a regulatory and shareholder perspective); stock price volatility; an increase in the cost of capital; and a view toward short-term investment behavior, even if long-term is more appropriate. It could also result in actually encouraging earnings management, such as gains trading or purposeful tainting.

Effective date must be extended.

The FASB has delayed the effective date of EITF 03-1 from September 30, 2004 until the first reporting period ending after the final FSP is posted to the FASB website. It is our understanding that the FASB hopes to have the final FSP posted prior to year-end, which would result in an implementation date of December 31, 2004. If certain changes are not made to the FSP, December 31 will not provide sufficient time for banks to make changes to their asset/liability processes, procedures, and documentation. As drafted, the FSP will result in:

- the need to re-evaluate how risk management should be performed, because banks will not be eager to buy certain securities or sell certain securities;
- effectively requiring an enormous amount of documentation, because it requires decision-making at the individual security level;
- the need to revise systems, because current risk management systems and processes cannot handle the proposed accounting and level of detail that would be required;
- the development of new procedures and testing to comply with the requirements of Sarbanes-Oxley management reporting (Section 404).

Without significant changes to the FSP, the earliest effective date should be at least one year from when the rule becomes final. (However, please note that this could be longer, depending upon the ability of software vendors to change systems to be in compliance.)

A one-time re-positioning should be permitted at transition.

We strongly encourage the FASB to permit a one-time repositioning of securities from AFS into either the held to maturity portfolio or trading portfolio upon adoption. This is important, because banking institutions made the determinations

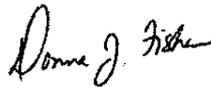
for allocating securities into AFS, held to maturity, and trading based upon a different set of rules (SFAS 115).

* * * * *

In conclusion, we believe that the FSP should state that AFS debt securities and AFS securities with characteristics similar to debt, with declines in value solely due to changes in interest rates, are not viewed as having other than temporary impairment. Alternatively, the requirement to have the "intent and ability to hold" should be replaced with the "ability to hold".

Again, we appreciate the opportunity to comment on the FSP. Thank you for considering our views. If you would like to discuss this letter in more detail, please contact Gwen Ritter (202-663-4986) or me (202-663-5318).

Sincerely,



Donna Fisher

Cc: Don Nicolaisen, Chief Accountant, Securities and Exchange Commission