## THE CHARLES SCHWAB CORPORATION

101 Montgomery Street, San Francisco, California 94104

October 29, 2004

Mr. Lawrence Smith
Director and Chairman of the Emerging Issues Task Force
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Letter of Comment No: 199 File Reference: EITF03-1A

Re: Proposed FASB Staff Position EITF 03-1-a, Implementation Guidance for the Application of Paragraphs 16 of EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments"

Dear Mr. Smith

We are pleased to respond to the Financial Accounting Standards Board ("FASB") with our comments on its proposed staff position EITF 03-1-a. The Charles Schwab Corporation is a financial holding company engaged, through its subsidiaries, in securities brokerage, banking, and related financial services with over \$45 billion in total assets, including significant investments in available-for-sale ("AFS") debt securities. We strongly support the FASB's objectives of improving U.S. financial accounting and reporting standards.

We have the following comments on the FASB Staff proposal:

Individual investors need reliable financial information in order to make informed investment choices. We believe the FASB Staff implementation guidance should provide specific measurement guidance for the critical terms of EITF 03-1 to ensure consistent application of the other-than-temporary impairment concepts to promote comparability between publicly traded companies, including the following: what constitutes a "minor" impairment; what is meant by recovery of "substantially all" of the cost of a security; and what constitutes a "pattern" of selling securities otherwise intended to be held. We encourage the Staff to consider expanding the definition of minor impairment to include consideration of the length of time a security is impaired.

We do not believe it is appropriate to apply the provisions of EITF 03-1 to debt securities. SFAS 115 and related interpretive guidance address other-than-temporary impairment of debt securities with accounting rules that are consistent with prudent bank management activities and result in fair and accurate financial reporting.

Absent relief from applying the provisions of EITF 03-1 to debt securities, we encourage the FASB to delay the effective date of the final rule for a reasonable time to allow time to implement the systems and processes necessary for compliance.

## **FASB Staff requested comment:**

Minor Impairments: We encourage the FASB to specify a threshold in defining minor impairments and believe 5% of the carrying amount of a debt security is a reasonable threshold. We do not believe that financial statement preparers and auditors will be able to apply the notion of minor impairment <u>consistently</u> without this additional guidance.

Further, we support expanding the application of *minor impairments* to <u>all</u> investments in <u>debt</u> securities analyzed under EITF 03-1, including those debt securities that may be settled for less than cost. We believe normal price volatility caused by changes in interest rates can reasonably be expected to eliminate a minor impairment for all debt securities, including those that may be settled for less than cost.

## Comments on other issues:

<u>Debt securities should be excluded from EITF 03-1</u>: We believe that existing accounting literature is adequate for determining the timing and amount of other-than-temporary impairment for AFS debt securities; including debt securities that may be settled for less than cost. We recommend limiting application of EITF 03-1 to equity investments.

The recognition of impairment charges for AFS debt securities related to credit quality and adverse changes in estimated cash flows for a particular security is consistent throughout the banking industry, pursuant to SFAS 115, EITF 99-20, and related interpretive guidance. Impairment of debt securities that is caused solely by increases in interest rates should not result in other-than-temporary impairment unless and until a company has a clear intent to sell the securities prior to recovery, and as long as the entity has the *ability* to continue to hold the securities. This is consistent with long-standing industry practice and is entirely consistent with the requirements of FAS 115 (in fact, the notion introduced by EITF 03-1 that a company declares its "intent to hold" a debt security classified as "available for sale" is contradictory).

We believe the application of the EITF 03-1 "intent to hold" criteria for debt securities that are impaired due to changes in interest rates and/or sector spreads is inappropriate for the following reasons:

Application of EITF 03-1 to debt securities contradicts the notion of "level yield" accounting which is a fundamental financial reporting concept in the banking industry. Absent an intent to hold AFS securities (which may be impractical given liquidity and risk management requirements), banks will record immediate impairment charges as interest rates increase and this permanent cost adjustment then increases future earnings through prospective yield adjustments. The resulting volatility is inconsistent with the notion of level yield accounting.

- Application of EITF 03-1 results in asymmetrical accounting and misleading
  financial results. Banks that sell AFS securities to manage overall interest rate
  sensitivity would generally be required under the EITF to recognize market losses
  related to increases in interest rates as a charge to earnings, with no
  corresponding gain as interest rate trends reverse.
- EITF 03-1 impairs banks ability to practice day-to-day prudent balance sheet and asset/liability management activities

In summary, we believe there is nothing for the FASB to "fix" in the banking industry related to other-than-temporary impairment of debt securities.

Change in ability and intent to hold: EITF 03-1-a, question 3(b)-a. proposes that the sale of an impaired debt security due to unexpected and significant changes in liquidity needs would not necessarily call into question the investor's ability and intent to hold other debt securities to recovery. We agree that a sale under these circumstances should not "taint" the remaining AFS securities. However, the proposed language would limit the company's ability to use AFS security sales to manage its interest rate sensitivity and liquidity positions, both of which are critical to our banking businesses.

We suggest that this section be expanded to include exceptions for a debt security sale made for the following reasons: to manage a company's overall interest rate risk position; to provide funds to meet loan portfolio growth; to meet unexpected liquidity needs; or to maintain compliance with internal investment or credit policies.

We appreciate the opportunity to express our views. If you have any questions regarding our comments, please contact me at (415) 636-3191.

Thank you,

Geoffrey Huggins

Senior Vice President, Finance Accounting Policy