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Letter of Comment No: 148
File Reference: EITF03-1A

Mr. Lawrence W. Smith
Director of Technical Application & Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Proposed FASB Staff Position 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:

The Clearing House Association L.L.C. ("The Clearing House"), an association of major commercial banks¹, appreciates the opportunity to comment on the Financial Accounting Standards Board's (the "FASB") proposed implementation guidance for the application of paragraph 16 of Emerging Issues Task Force Issue No. 03-1 ("EITF 03-1") related to debt securities that are impaired solely because of interest rate and/or sector spread increases (the "Proposal").

We appreciate the opportunity to comment on the Proposal and commend the FASB for their swift response to the questions regarding implementation of EITF 03-1.

We believe EITF 03-1 represents a significant departure from Statement 115 and current practice. The predominant issues pertaining to EITF 03-1 relate to two broad areas: 1) the conflict of "other-than-temporary" guidance with Statement 115 available-for-sale

¹ The members of The Clearing House are Bank of America, National Association; The Bank of New York; Citibank, N.A.; Deutsche Bank Trust Company Americas; HSBC Bank USA, National Association; JPMorgan Chase Bank; LaSalle Bank National Association; U.S. Bank National Association; Wachovia Bank, National Association; and Wells Fargo Bank, National Association.

portfolio classifications and 2) the impact of broad market-driven factors on the value of classes of investments.

EITF 03-1 and the Proposal modify EITF Topic D-44 guidance regarding available-for-sale securities from an "intent to sell" model to an "intent to hold" model. The proposed guidance effectively establishes a lower-of-cost-or-market ("LOCOM") model for available-for-sale securities where an investor is not willing to assert its "intent to hold" temporarily impaired securities, despite having no intention of selling such securities or realizing any temporary losses. The FASB deliberated the merits of LOCOM models in accounting for investments when it issued Statement 115. The FASB's conclusion, as discussed in Appendix A of Statement 115, was that the available-for-sale investment category "eliminates the unevenhandedness of LOCOM, which recognizes the net diminution in value of securities but not the net appreciation in value." Therefore, creation of a LOCOM model is in direct conflict with Statement 115's intent in developing an available-for-sale securities classification and reintroduces the "unevenhandedness" the Board rejected in creating the available-for-sale category.

Additionally, Securities and Exchange Commission ("SEC") Staff Accounting Bulletin ("SAB") No. 59 provides a listing of some of the indicators that should be considered when assessing the realizable value of all types of marketable securities. Consistent with the guidance in SAB 59, the impact of broad market-driven factors, such as fluctuations in interest rates, equity price levels and foreign currency exchange rates, can only be assessed on an individual facts and circumstances basis and must consider various other elements such as historical levels, volatility, and duration of the market factors. Without considering all of these elements, an illogical result such as an "other-than-temporary impairment" of U.S. Treasury securities is a very real possibility. We find it difficult to believe that such a result was intended.

We believe the guidance within SAB 59 effectively emphasizes the need for a comprehensive analysis focused on the facts and circumstances of a security in ascertaining whether an impairment is temporary versus other-than-temporary. Additionally, the guidance within EITF Topic D-44, for temporary impairments of available-for-sale securities, requires direct write-down of securities when a decision to sell has been made. While the guidance within SAB 59 and EITF Topic D-44 has been understood and reasonably applied in practice, we ask the FASB to utilize EITF 03-1 and the Proposal to codify the requirements of the existing guidance within these two sources to enhance consistent application in practice. In other words, we ask the FASB to use EITF 03-1 and the Proposal to reinforce the concept of an "intent to sell" model, and to emphasize consistency in the assessment of facts and circumstances when assessing whether impairments are temporary or other-than-temporary. We believe that codification of current practice, along with the enhanced financial statement disclosures already required under EITF 03-1, will provide adequate guidance for consistency in the assessment and reporting of other-than-temporary impairments.

Should the FASB and the FASB Staff believe EITF 03-1 must continue to be as broad in scope as drafted, we offer the following comments on the Proposal.

Question 1

Question 1 within the Proposal indicates that an investor should assert its intent and ability to hold an investment to a forecasted recovery at the individual security level. We agree with the guidance within Statement 115 and EITF 03-1 that an investor's assessment of other-than-temporary impairment should be based upon the facts and circumstances surrounding an individual security holding. Further, we would ask the FASB to confirm our understanding that 1) securities within separate and distinct portfolios can have differing assertions made with respect to intent and ability to hold the securities within each portfolio to recovery and 2) any notion of "tainting" an investor's future ability to assert its intent and ability to hold securities to recovery is contained within an individual portfolio and does not extend to other portfolios' holdings.

Many entities have multiple portfolios within their organization. Those separate portfolios often exist for a variety of reasons including differing objectives, differing management teams, or differing geographies. Throughout those multiple portfolios, an entity may hold several securities from the same issuer or with the same CUSIP. Clearly, the facts and circumstances driving the intent and ability to hold an individual investment will be as separate and distinct as the portfolio within which it resides. Accordingly, a particular security in one portfolio should be analyzed and a decision regarding intent and ability to hold or a decision to sell should not be determinative for that same security in another portfolio. We suggest that the FASB illustrate the rationale for the response to Question 1 with just such an example.

Similarly, we would expect any notion of "tainting" of management's assertions regarding intent and ability to hold an investment to a forecasted recovery would consider the same rationale as the example above. Given the variety and complexity of factors driving an individual portfolio manager's investment goals and risk management objectives, it follows that conclusions reached for one portfolio may not be consistent for other portfolios within an entity. Should all investment goals and risk management objectives be consistent from portfolio to portfolio, there would be no reason to establish separate, distinct portfolios, incurring additional cost and effort in the process. Therefore, any assertions of "intent and ability to hold to recovery" should be made at the individual portfolio level, with any subsequent "tainting" impact limited to that portfolio as well.

To further clarify the impact of "tainting" as it is included within EITF 03-1 and the Proposal, we ask the FASB to clarify how long a "tainting" would limit management's ability to assert intent and ability to hold temporarily impaired investments to a forecasted recovery. In an SEC speech at the January 1995 AICPA 22nd National Conference, a period of at least two years was given as a reasonable timeframe for management to have "tainted" its intent and ability to hold securities to maturity when management sold a held-to-maturity security outside of the permitted exceptions within Statement 115. We would expect a similar time constraint for any "tainting" scenarios under the proposed guidance as well.

Question 2

We firmly oppose any bright line definition of what constitutes *minor impairments* as this arbitrary assessment would move away from a comprehensive assessment of the facts and circumstances for individual security holdings. Question 2 within the Proposal recognizes that normal market volatility can cause impairment that is quite clearly temporary in nature. We strongly support adding a notion of “severity” as an element to consider in distinguishing between temporary and “other-than-temporary” impairments.

Establishing an arbitrary threshold for *minor impairments* ignores the possibility that impairments require examination of all facts and circumstances underlying the impairments in order to assess their other-than-temporary nature. Each security is impacted by not only its specific attributes, e.g., long-term versus short-term, but also by broader market-driven elements, such as fluctuations in interest rates, equity price levels and foreign currency exchange rates. Therefore, severity, or what constitutes a *minor impairment*, is only one element of the assessment of whether an other-than-temporary impairment exists and should be examined on a case-by-case basis given all facts and circumstances surrounding the impairment of an individual security. Consider recent fluctuations noted within foreign currency exchange rates. The foreign exchange rate between the United States Dollar (“USD”) and the Euro moved 5.4% from May 13, 2004 to July 16, 2004. Similarly, the foreign exchange rate between the USD and the Japanese Yen moved 6.7% from May 14, 2004 to June 24, 2004. These fluctuations over two- and one-month periods, respectively, may have resulted in the severity of impairment for a particular investment falling outside of an arbitrary, preset threshold at a point in time. However, a determination of whether an impairment is temporary or other-than-temporary will depend upon the specific circumstances and characteristics of a particular security and is not merely a function of a bright-line triggering point.

Further consider the example of a 30-year U.S. Treasury note with a coupon of 5 3/8 purchased at 102.500 on April 27, 2004. This Treasury note could have been considered impaired on May 13, 2004 with its fair value having decreased to 97.406 (a 5.2% decline in value). Compare this Treasury note to a 10-year corporate bond with a coupon of 5 3/8 purchased at 103.039 on April 27, 2004. Under an arbitrary 5% threshold for minor impairments, this corporate bond would not have been examined to determine whether an other-than-temporary impairment existed on May 13, 2004 as its fair value had only decreased to 98.820 (only a 4.3% decline in value). Also note, the Treasury note had recovered completely by July 12, 2004 with a fair value of 102.500, while the corporate bond included in this example recovered completely on August 9, 2004 with a fair value of 103.500. Based upon the facts and circumstances in this example, neither security appears to have been other-than-temporarily impaired at the original measurement date of May 13, 2004; however, a bright-line threshold would have required a deeper analysis of the U.S. Treasury note, while ignoring the impairment of the corporate bond. The use of an arbitrary threshold ignores the other facts and circumstances involved in these two securities (i.e., security type, duration, recovery, etc.) and could, inherently, lead to inappropriate conclusions.

An analysis, which narrowly focuses on declines in value caused by isolated market movements, such as the interest rate or currency movements in the previous examples, fails to recognize the importance of performing a robust analysis of the facts and circumstances surrounding each individual security class to ascertain whether an other-than-temporary impairment exists.

Question 3(b)

Question 3(b) within the Proposal outlines additional circumstances which, together with those changes in circumstances discussed in paragraphs 8 and 11 of Statement 115, would not necessarily call into question the investor's intent or ability to hold other securities to recovery. We fully support an expansion of the provision, within the response to this question, allowing a "de minimis volume of sales of securities." Although this provision takes into account the fact that factors outside of the investors' control could occur, necessitating an unanticipated security sale, it is more appropriate when assessed in conjunction with the other facts and circumstances impacting a particular security.

We do not agree that all possible circumstances that could be included in the context of deeming an impairment to be other-than-temporary are included. We ask the FASB to clarify that the changes in circumstances included represent *types* of changes in circumstances, which would not call into question the investor's intent or ability to hold other securities to recovery. Even within Statement 115, paragraphs 9 and 10 indicate circumstances when an investor should not classify debt securities as held-to-maturity but should, for an investor's legitimate risk management purposes, hold debt securities as "available-for-disposition." Legitimate risk management reasons for selling available-for-sale securities include 1) management's overall asset-liability management strategies, which need to be responsive to both internal and external developments impacting the business for active risk mitigation; and 2) business line reorganizations. The focus on *types* of changes that ensure reasonable management objectives, as defined within current guidance, are not neglected when management assesses whether a "tainting" has occurred.

In addition, we are concerned with the term "unexpected" as utilized in response to question 3(b). Unexpected is a vague term that may be influenced by a wide variety of disparate factors unique to each reporting entity. Value-at-risk models are one example of how some entities model the "expected" paths a market movement may take. Yet, each entity applies different assumptions to such a model including time horizons, number of paths chosen, sources of data, etc. Thus, each entity likely would have different definitions of "unexpected." We recommend striking the term "unexpected" from these descriptions.

Reclassifications between Investment Categories

Statement 115 suggests that transfers of securities from available-for-sale to trading should be rare. Consistent with past precedent in the transition provisions of Statement 133, we suggest that the FASB consider an open period during transition where portfolio classifications may be reassessed and both portfolios and individual securities may be

reclassified without needing to meet the conditions in Statement 115 for transfers between investment categories. We expect such a reassessment likely would be portfolio-by-portfolio as well as security-by-security and would suggest language that is suitably broad to encompass a complete review.

Transition

While the Proposal does not discuss transition provisions, we encourage the FASB to allow adequate time for implementation given the complexities involved in interpretation and adoption of the proposed guidance. The guidance proposed in EITF 03-1 and the Proposal represent changes in practice that will require development of different business policies, as well as education of management and the investment community as a whole (i.e., analysts and investors). Additionally, and more difficult, the proposed guidance likely will require creation of monitoring and reporting mechanisms within existing systems: programming changes that have not yet been contemplated and, while not as extensive as many recognition and measurement impacts on systems, will require some time to execute, particularly when integrated with hedge accounting implications. To illustrate, many portfolios encompass hundreds or even thousands of securities. Historically, impairment analysis for debt securities focused principally on credit risk and liquidity factors. Similar analysis has been conducted for foreign exchange denominated debt securities. The Proposal will require an individual analysis of each security, as well as a specific assertion of "intent" to hold each security. This is much more time intensive than the current approach which requires analysis of securities by major category (e.g., bond type, industry, duration, severity) and then considers factors across categories to determine whether there is the intent to sell individual securities within a category. Should the guidance within EITF 03-1 be finalized by year-end, we recommend an effective date of no earlier than March 31, 2005.

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Thank you for considering our thoughts on the Proposal. The Clearing House members hope you find our comments helpful, and we would welcome the opportunity to meet with you in person if you would find that to be useful. If you have any questions, please contact Norman R. Nelson, General Counsel of The Clearing House, at 212-612-9205.

Sincerely yours,

