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October 29, 2004

Mr. Lawrence W. Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
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Dear Larry:

The Committee on Corporate Reporting ("CCR") of Financial Executives International ("FEI") appreciates the opportunity to comment on the proposed FASB Staff Position EITF 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,* (the proposed FSP). FEI is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. CCR is a technical committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. This document represents the views of CCR and not necessarily those of FEI.

We strongly support the Board's decision on September 30th to broadly defer the effective date of the consensus until full implications of the tainting language of Issue 03-1 can be considered further and resolved satisfactorily. It is an understatement to say that the present controversy was unexpected – even by members of the Working Group, the Task Force and interested observers, many of whom viewed the consensus as a codification of existing best practices with respect to determining whether an impairment is other than temporary (OTT). Indeed, both the Working Group and Task Force explicitly discussed the importance of not imposing tainting provisions similar to those applied to FAS 115 investments classified as "Held to Maturity" (HTM), noting that such an approach is inconsistent with the "Available for Sale" (AFS) category. It is therefore imperative that actions taken by the Board move that guidance further in the direction of permitting sales of underwater securities as part of normal portfolio management activities. It also critically important that the Board broaden the application of the minor impairment concept to all investments covered by the consensus, rather than limiting it to investments covered by paragraph 16.

We believe that the guidance in the proposed FSP will mitigate but not eliminate the unintended consequences associated with the EITF consensus. As discussed further below, the risk of running afoul of these tainting provisions may cause financial institutions to move away from economically sound asset/liability management practices in favor of policies that lower accounting risk. We offer several examples of circumstances not currently contemplated in the FSP, that should not call into question the entity's positive intent and ability to hold underwater securities to recovery. However, if the Board does not support modifying the FSP to accommodate these situations, we believe that the most appropriate resolution of Issue 03-1 would be for the Board to rescind the consensus and either (1) refer the issue back to the EITF, or (2) undertake a project of its own to consider the broader implications of this issue. In our view, the guidelines proposed in the FSP are not sufficient to avoid imposition of lower of cost or market (LOCOM) accounting for the AFS portfolios across a broad array of companies. An accounting change of that magnitude can only be legitimately promulgated with significantly more due process than has been applied thus far to this issue.

In practice today, enterprises focus their reviews of AFS securities for OTT impairment on securities for which there has been a sharp decline in fair value and/or fair value has been below carrying amount for an extended period of time. As discussed below, interest-rate related effects on the fair value of debt securities were considered by definition to be temporary unless the issuer had a credit-related event or the entity had a present intent to sell the investment prior to recovery. It was, and continues to be, appropriate to focus on the former group of securities for reviews because these are the securities for which there is a higher probability of OTT impairment. Moreover, by limiting the focus to that subgroup of securities, practice avoided the onerous documentation requirements to which the present interpretation of Issue 03-1, as clarified by the FSP, seems to be leading.

CCR believes that the intention of the Task Force in developing the guidance in EITF Issue 03-1 was to clarify application of disparate sources of authoritative guidance in this area and to improve transparency of OTT impairment risk through enhanced disclosure, not to create an entirely new accounting model for AFS investment securities in a loss position. With respect to debt securities that were underwater as a result of changes in interest rates or sector spreads, existing practices under SAB 59 and EITF Topic D-44 would deem that impairment was temporary provided the entity had the ability to hold the security to maturity and no present intent to sell. This is a reasonable position to take because, absent a sale or a credit event, the security is guaranteed to recover any unrealized loss by maturity. In the same vein, existing practice with respect to equity securities and debt securities not covered by paragraph 16 for which the severity of the impairment was minor, would typically not require an assessment whether the carrying amounts of these investments were recoverable. We believe that the focus of guidance developed by the EITF is on equity securities and debt securities with credit events where fair value has been below cost over an extended period or the severity of the impairment is other than minor.

We are concerned that even with the supplemental guidance provided in the FSP, there are a wide array of circumstances in which sale of a security should not call into question previous assertions about intent and ability to hold to recovery. We have outlined those circumstances below. In addition, we note that the record-keeping and control implications of the FSP's proposed guidance are significant. We are further concerned if the guidance is to be implemented while companies are attempting to implement Sarbanes Oxley 404 certification. The current timetable for finalizing the FSP falls squarely into that same timetable. Some reasons for selling at a loss, after a previous declaration that the entity had a positive intent and ability to hold to recovery that should not "taint" the entire underwater AFS portfolio include the following:

Portfolio Strategy Reasons
In situations where management is anticipating rising interest rates, portfolio managers may sell bonds and raise cash in order to put cash back to work later for more income. This might mean selling a set of bonds essentially "gain neutral" overall, offsetting some issues at a gain with others at a loss in order to reposition the overall portfolio. This is a far broader concept than the FSP's criterion of "unexpected and significant increases in interest rates and/or sector spreads that significantly extend the period that a security would need to be held by the investor."

Similarly, an entity may make a relative value call between different market segments where portfolio managers believe they could enhance future income by rotating out of a lower yielding group and into a higher yielding group. In equities (which are typically a small percentage of total investment portfolios in industries such as insurance), portfolio managers might feel that more recent data on either the overall market or a specific industry indicates higher risk of losses and therefore believe that selling at current levels (even if it means incurring some losses) could prevent incurring even larger losses in the future.

Issuer Deterioration
Generally this would encompass situations in which current information that was not foreshadowed in prior periods heightens concern over a debt security or a stock. Where portfolio managers believe that further weakening in prices is forthcoming, it is only prudent to sell in order to prevent future larger losses in the security. While the information may take the form of "headline" news, it may also take on more subtle forms (e.g., sales not growing as planned, the effect of historically high oil prices on consumer spending). This could be a particular risk in holding equities; while portfolio managers may believe that recovery could still occur, the passage of time could lower the probability of recovery within the acceptable bright line period (as established by a company). Upon considering the most current available information, management may conclude that resources would be better redeployed into a different security with higher potential future upside.

Asset-Liability Matching
Portfolio managers often need to re-optimize a portfolio in order to better match assets and liabilities, lowering mismatch risk. In the insurance industry this could include altering overall duration of the portfolio or getting a closer match of product cash needs and bond maturity buckets.

Changes to the Liquidity Needs of an Entity
Based on an entity's changing liquidity needs, portfolio managers may need to rebalance the portfolio – for instance to keep duration in a proper range, credit quality where they are comfortable, allocate among asset classes reasonably, etc.

Capital / Rating Agency Issues
If the capital base of an entity is changing, it could affect the overall risk level that is acceptable to that entity and therefore lead to a portfolio restructuring. For example, if it were decided that a legal entity holding a more volatile asset class like equities was to have its excess capital significantly reduced, it would be reasonable to re-examine the desirability of holding that asset class as this lower capital figure would be at risk of being significantly depleted. Once that decision is made, there would almost certainly be at least some lots of securities that were in an unrealized loss situation which would either need to be sold, realizing the loss, or at least impaired due to the lack of intent to hold until recovery. Another situation might be if a rating agency negatively changes their view on an asset class, which could lead a company to re-think the size of its position in that asset class. Also, if a security gets downgraded, then there might be a requirement for the insurance company, under risk-based capital rules, to hold additional capital if the security is retained.

Tax-Related Issues
Entities may need to sell securities in a particular time period for tax reasons, including changes in tax law that would have an adverse effect on investments in particular market sectors. Portfolio managers should be able to decide to sell securities that had previously been declared as held to recovery in order to respond to those factors without calling into question their intent.

Compliance Reasons
For regulated industries, such as insurance, there are a wide variety of situations that could require an entity to reduce positions in certain issuers and or types of securities. For example, prior security sales out of a portfolio can cause the relative allocation of existing positions to increase (i.e., their percentage of the portfolio). Likewise a downgrade of a particular issuer or a rating issues change could cause an entity to have to sell in order to get back into compliance with portfolio guidelines.

By limiting the circumstances under which an underwater security could be sold to circumstances identified in the FSP, the FASB will be instituting unreasonable restraints on portfolio managers in trying to execute prudent and sound investment policies that are in the best interests of shareholders.

Specific Issues in the Request for Comments

Minor Impairments

Issue 1: The Board considered defining minor impairment as an impairment of 5 percent or less. Some Board members believe that minor impairments can be considered temporary without further analysis because normal interest rate and/or sector spread volatility is expected to eliminate a minor impairment. Some Board members disagree with defining minor impairment as an impairment of 5 percent or less because that definition embodies assumptions about the volatility of the applicable interest rate. Others prefer that the guidance not provide a "bright-line" test. For these reasons, the Board generally supported the notion that minor impairments can be considered temporary and did not support *including either additional guidance or a numerical threshold to be used in determining whether an impairment is minor. Do you believe that financial statement preparers and auditors will be able to apply the notion of "minor impairment" without any additional guidance from the FASB? If not, do you believe that the Board should specify a numerical rule or threshold and, if so, what would that rule or threshold be?*

We agree with paragraph 5 of the proposed FSP, which states "For purposes of applying paragraph 16, a minor impairment caused by interest rate and/or sector spread increases can be considered temporary and would not create the need for an assertion about the ability and intent to hold an investment until a forecasted recovery."

We do not support a 5% bright line threshold because we believe that for any given security, it would not necessarily capture the normal trading range for that issuer. That said, if a bright line is not instituted we would want to be sure that 5% would not become the de-facto ceiling that overrides the results of an analytical model that establishes a securities trading range. If the Board decides that a bright line is necessary, we believe that the concept of a normal trading range dictates a quantitative threshold that is well in excess of a 5% threshold.

Limiting the Notion of Minor Impairments to Debt Securities Evaluated for Impairment Pursuant to Paragraph 16 of Issue 03-1

Issue 2: The Board generally believes that it is appropriate to limit the notion of "minor impairments" that would not create the need for an ability and intent assertion to debt securities analyzed for impairment under paragraph 16 that are impaired because of interest rate and/or sector spread increases, since, absent a sale prior to recovery or maturity, such impairments will be recovered. Because the same cannot be said for debt securities that can be contractually prepaid or otherwise settled in such a way that the investor would not recover substantially all of its cost and equity securities, the Board generally does not support extending the exclusion to investments analyzed for impairment under paragraphs 10–15 of Issue 03-1. However, some Board members support expanding the notion of "minor impairments" to all investments analyzed under Issue 03-1 because they acknowledge that normal price volatility may eliminate an impairment. Do you support the Board's conclusion to limit the notion of "minor impairments" to debt securities analyzed for impairment under paragraph 16 that are impaired because of interest rate and/or sector spread increases? If not, why?

CCR strongly disagrees with the Board's tentative conclusion to limit the application of guidance on minor impairments to a subset of debt securities as proposed in the FSP. We agree with those Board members that support application of this guidance to all investments analyzed under Issue 03-1. All instruments have a normal trading range that can create and eliminate impairments over any given period of time. Moreover, for reasons discussed above, the requirement to document intent and ability to hold investments that are impaired to a very minor extent will generate enormous problems for companies as they seek to comply with the new rule. Notwithstanding the additional risks involved, debt and equity securities that fall outside the scope of paragraph 16 for which declines in fair value below amortized cost are considered minor may also be at an extremely low risk for OTT impairment and therefore should be exempt from the requirements to assert intent and ability to hold to recovery under

EITF Issue 03-1 as supplemented by the FSP.

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CCR understands how difficult this issue will be to resolve – even among our members there is no obvious solution that we all agree will resolve the concerns identified. That suggests that the Board should proceed cautiously and be sensitive to the burdens imposed by various approaches under consideration. While we understand the need to curb potential abuses, the revised guidance must preserve the ability of portfolio managers to make investment decisions that are in the best interests of shareholders rather than to minimize risk of an adverse result under an accounting standard. Given the difficulty we have had with this issue, we question whether it is feasible to develop a high quality solution in time for implementation by December 31, 2004.

Even if the Board were successful in doing so, it is unclear that companies will be able to respond in a timely manner to the revised guidance in light of other, equally important demands. We observe that recent adoptions of standards with short transition periods have led to significant implementation problems and we see a similar risk in this area. We therefore request that the Board take whatever time is necessary to ensure that it has addressed the issues comprehensively and that it has a high comfort level that the concerns have been addressed. We appreciate the Board's efforts on this important issue. Representatives of CCR will be pleased to meet with the Board and Staff at your convenience to address any remaining questions.

Sincerely,

Frank H Brod

Frank H. Brod
Chair, Committee on Corporate Reporting
Financial Executives International