



Letter of Comment No: 109
File Reference: EITF03-1A

Via email director@fasb.org

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RE: Proposed FASB Staff Position
EITF Issue No. 03-1-a, "The Meaning of Other Than Temporary Impairment and
Its Application to Certain Investments"

To Whom It May Concern:

Before commenting on the FSP related to 03-1, I want to thank the FASB staff, board, and EITF for your efforts related to 03-1. Having listened to many of the EITF and board meetings and corresponded with staff, I know and appreciate the effort which has been put forth to present guidance which will allow for consistent and fair application of the concept of other-than-temporary impairment ("OTTI").

Many constituents have suggested that 03-1 should be either completely scrapped or completely revisited, arguing that it breaches the spirit of FAS 115 and is unnecessary. Those comments have come primarily from financial institutions, a universe of institutions with whom our firm deals with on a daily basis. In fact, we conduct business annually with over 3,000 financial institutions. In addition, we provide investment accounting for over 700 institutions. Those financial institutions' primary investments are debt securities.

We join them in questioning whether there has been a pattern of inconsistent application of the concept of OTTI to debt securities. Nevertheless, we will use this opportunity to comment specifically on the proposed FSP, answer the questions posed in the request for comments, and make suggestions as to how we believe that the FSP and 03-1 can be clarified in order to achieve the end goals of fair and consistent accounting application which provides transparency for financial statement users.

Question 1: Unit of Account

We support the FSP's statement that an investor should assert its ability and intent at the individual security level.

Question 2: Minor Impairments

We strongly support having a "bright-line" test to determine "minor impairments" as we do not believe that financial statement preparers and auditors can apply the notion of "minor impairments" consistently without additional guidance from the FASB.

Our first choice would be a numeric threshold bright-line; however, the 5% threshold discussed in the September 8 board meeting is far too restrictive. A 10-15% threshold would be more reasonable and more representative of a loss which can be and has often been recovered within a time period that is easily identifiable as "temporary". Consider, for example, that just since the EITF's March meeting at which the 03-1 consensus was reached, the ten-year Treasury has seen its price fall 8% and rise 7%. History tells us that individual debt securities common to the investment portfolios of financial institutions often rise and fall 10% or more over a twelve month period. Five year Treasury notes have experienced a median price change of over 12% during twelve month periods over the past twenty years. OTTI resulting from interest rate shifts should be reserved for losses whose severity is such that they are not regularly recovered within a year or two, a time period which seems to be far short of other-than-temporary – a time period which is certainly shorter than permanent but is also beyond temporary or transitory.

Our second choice would be to devise a bright-line test for debt securities which is based on the yield change needed to trigger a recovery. Since rates have often moved 200bp to 300bp up or down within a year, it would be reasonable to state that a "minor loss" is one in which such a rate move is projected to trigger a recovery. This approach would be simpler than using historic yield volatilities (an approach which has not been shown to be accurate historically) but would take into consideration the duration of the investment security.

Further Clarification Required

We also believe that it is important that the FASB clarify whether a holder can consider a debt security which exceeded the "minor loss" as having recovered once it returns to having only a minor loss. We strongly support this notion as a way to achieve consistency. Absent such clarification, we anticipate that auditors will apply varying standards for "recovery" and that, in many cases, institutions could find

themselves with two identical investment securities with identical “minor” losses which are treated differently for OTTI purposes.

Question 3(a): Expected Sale

We have no comment.

Question 3(b): Change in Ability and Intent Not Necessarily Tainting

While we would appreciate more flexibility, we believe that the guidance provided in the FSP is generally sufficient. **An additional provision for other rare, nonrecurring circumstances would be reasonable.** For example, as discussed by the FASB board on September 8, consider an institution, which holds corporate, agency, Treasury, and mortgage securities whose management or board decides to divest entirely of corporate debt, should be allowed to do so without tainting its intent and ability as to other securities. The board’s reluctance to allow unlimited portfolio segmentation is well founded but limiting such a provision to rare, nonrecurring circumstances should be sufficient.

The discussion under paragraph number 8 of the FSP is necessary and important.

Additional Clarification Needed

There are a number of additional issues which have arisen as we have gained a better understanding of auditors varying interpretations of 03-1. We ask that you consider providing clarification of the following issues.

- **In the determination of whether an investment is subject to paragraph 16 or paragraph 10, clarify what is meant by “substantially all”.** Historic accounting practice, examples included in EITF 03-1 and FAS 133, and the application of FAS 133 leads us to conclude that receiving “substantially all” means 85-90% of the carrying value. This would result in applying paragraph 16 to almost all standard mortgage pass-thru securities. In addition, because callable securities’ premiums represent excess interest to be received, all callable securities which trade at positive yields to their call dates would be covered by paragraph 16. Only a few, highly complex debt instruments would fall subject to paragraph 10.
- **Clarify the application to debt like equity instruments.** As discussed in our April 2003 comment letter to the EITF, certain equity instruments which bear no substantive resemblance to equities but substantial resemblance to debt securities should be accounted for as if they are debt securities. Most notable, non-convertible preferred stocks are, for all practical purposes, debt securities. In fact, there is little substantive differentiation between non-convertible preferred stocks and long-term subordinated debt. After all, holders of non-convertible preferred stocks are entitled only to periodic dividend payments (computed at a specified interest rate or based on an interest rate-related formula). Price changes in these non-convertible preferred stocks are based on market yields and are quoted at spreads to the Treasury market, swap curve, corporate debt, etc. They are often

traded by fixed-income traders who also trade corporate bonds. These instruments offer no speculative opportunities which are not also afforded by corporate debt.

As a result, non-convertible preferred stocks should be subjected to the same accounting treatment as debt securities. By doing so, the accounting for these instruments can be based on their substance rather than their name, a concept which is historically consistent and appropriate for both accounting instruments and public reporting.

Consistency and fairness in accounting application could be achieved by applying the phrase "contractually prepaid or otherwise settled in such a way that the investor would not recover substantially all of its cost" to both debt and equity securities.

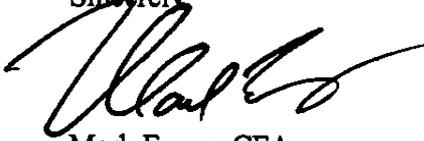
Effective Date

Because of some of the ramifications of 03-1, we encourage you to consider making the guidance in 03-1 **effective at least three but preferably six months from the publication of the guidance.** Implementation issues are not technical but rather management issues. Specifically, as currently crafted, 03-1 will:

- force institutions to view their FAS 115 investment securities in a different light than before,
- require changes to investment policies, asset/liability management policies, and liquidity policies and ratios,
- trigger some investment portfolio restructuring, and
- cause certain investment strategies to be phased out by institutions.

Thank you for your consideration of these comments. Please do not hesitate contacting me if you have any questions.

Sincerely,



Mark Evans, CFA
Senior Vice President
Director of Investment Strategies