

INVESTORS SAVINGS BANK

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October 18, 2004

Mr. Robert Herz
Chairman
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5166

Letter of Comment No: *21*
File Reference: EITF03-1A

Mr. Lawrence Smith
Chairman
Emerging Issues Task Force
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5166

Re: EITF 03-1 "The Meaning of Other than Temporary Impairment and its Application to Certain Investments"

Dear Messrs. Herz and Smith:

I am writing to comment on your recently issued EITF Issue 03-1 "The Meaning of Other Than Temporary Impairment and its Application to Certain Investments" ("EITF 03-1"). I am the Chief Financial Officer of Investors Savings Bank (Investors) in Short Hills, NJ, a \$5.4 billion mutual thrift institution with over \$3.7 billion in fixed income investments.

We are very concerned with the introduction of other than temporary impairment (OTTI) accounting treatment for fixed income investment securities whose market value is reduced because of changes in interest rates (levels or yield curve shape), market volatility variables, and/or sector spreads.

In addition, there are a number of negative consequences that may result from the enactment of EITF 03-1

- Financial statements may not accurately reflect the results of our business activities (earnings volatility, asset carrying values, capital levels, risk profile, etc.)
- Concern about compliance with Sarbanes-Oxley when financial statements may be "technically correct" from an accounting perspective, but materially misleading as to the true financial performance and risk profile of our Bank
- Reduced ability to prudently manage risks, such as liquidity and interest rate risk
- A systemic lowering of banking industry earnings
- Reduced regulatory capital levels that will constrain a community bank's ability to support economic growth
- Decreased availability of and a higher cost of raising capital.

Changing of the Rules

This proposed guidance seems to be establishing new accounting principles as opposed to clarifying existing ones. Since FAS115's inception, there has not been any confusion or inconsistency regarding the Available-For-Sale classification as a vehicle for realizing losses on the sale of fixed income securities.

Frankly, we view this “changing of the rules” as problematic and unwarranted. If enacted, this change could significantly increase costs to a banking industry who has invested heavily in securities over the last few years.

Here at Investors we increased our Available-for-Sale holdings significantly (from \$200 million to \$1.3 billion) over the last 15 months in an effort to increase flexibility and help the bank manage liquidity and interest rate risk. I can tell you unequivocally our strategy would have been much different had we known about this new interpretation.

Inconsistent with Bank Performance and Risk Management

In addition this proposed accounting application conflicts with the way most Banks generate earnings and measure and manage liquidity and interest rate risks. As managers of balance sheet spread, we are more focused on total portfolio risk, not individual financial instrument risk.

To broaden the concept of OTTI to interest rate changes invites a level of volatility into our financial statements that may reduce the value of financial information for the entire industry. Why not let the current disclosures within other comprehensive income (OCI) continue as is, also avoiding the unnecessary and problematic reduction in regulatory capital? If the users, including Bank regulators, “doubt” carrying values they can make corresponding adjustments to earnings, and act accordingly.

Ability and Intent

The EITF guidance implies that ability and intent is a one-time “permanent” declaration as it relates to underwater securities.

We believe that ability and intent will be governed by a dynamic set of variables that can constantly change over time. Those variables include but are not limited to market conditions, risk positions, strategic direction, senior management teams changes, etc.

A narrow and static interpretation of ability and intent is a problem.

Fair Value Accounting and Piecemeal Application

Another concern with EITF 03-1 is it demonstrates a continued trend in accounting literature towards mark-to-market accounting on only sections of the balance sheet.

This can lead to misleading representations of a Bank’s financial performance because most banks manage the stability of total balance sheet spread over various interest rate cycles as opposed to managing to changes in the monthly prices of financial instruments. FASB should encourage accounting concepts to reflect how banks create and manage earnings.

More importantly, we do not believe full fair market value accounting for the entire balance sheet is a viable solution for this industry. As an example consider the inherent inconsistencies associated with “estimating” fair values for Bank deposit bases.

Recommendations

We recommend you clarify FAS 115 by excluding other than temporary impairment accounting from securities whose market value declines are due solely to interest rate related changes. Of course there should be exceptions.

For example, in situations where there is a definitive plan for sale (voluntary or otherwise), Banks should record a charge at the time of determination of the plan and not wait for the transaction to occur. Also, if there is an “egregious” pattern of selling that indicates a portion or all of a portfolio was misclassified as available for sale rather than trading.

If FASB moves forward with EITF 03-1, then it should clearly address (with specific examples) some of the more common issues facing a typical community bank. This is especially important because the accounting profession (e.g. “Big 4”) tends to interpret anything FASB puts into writing as if it were

"tax law", analyzing every word as if it were inserted with a singular exact meaning in mind with no room for application of common sense and materiality.

We do not believe FASB's intent is to be vague so the accountants can figure out FASB's desired outcome. Some of the more salient issues requiring a more definitive clarification include:

Allow securities sales for documented strategies related to prudent risk management such as interest rate sensitivity and liquidity management.

Provide a "bright-line" test for minor impairment (preferably more than 5%) where impairment would be assumed to be temporary without requiring further analysis/documentation. Requiring formal analysis/documentation for every security with an unrealized loss is burdensome. With bank portfolios skewed heavily towards AFS classifications, this will result in most securities requiring specific documentation in a rising interest rate environment.

For pre-payable/callable premium securities with book prices above the "bright-line" test, provide concrete examples of typical securities and how they would be accounted for under the "new rule." For example, premium mortgage-backed securities (MBS) and collateralized mortgage obligations (CMO), callable bonds priced at premiums and amortized to call date, long-term municipal bonds, premium commercial MBS and other types of premium bonds with yield maintenance agreements and/or prepayment penalties.

One thing is clear; industry experts (accounting firms, broker-dealers, investment advisors/specialists) are inconsistent with their interpretations.

Allow rate related impairments to be recovered up to amortized cost as is the case for mortgage servicing rights. Why create a new "permanent" cost basis that implies a low probability of recovery for a financial instrument whose value changes daily and is expected to increase with business cycles (when rates decline) and/or as time passes (the security moves closer to maturity)?

Provide tangible and concrete guidance on what constitutes a pattern of selling (e.g. be specific as to the number of transactions, the dollar volume, the time period over which activity is analyzed, etc.). The accounting professions' opinions have varied greatly.

Thank you for taking the time to consider our comments about this very critical issue and the related consequences for my bank and for the banking industry in general. Please call me at (973) 924-5105 if you would like to discuss this further.

Sincerely,



Domenick A. Cama
Senior Vice President and Chief Financial Officer