BridgewaterSavings

October 14, 2004

Letter of Comment No: 13
File Reference: EITF03-1A

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

Mr. Lawrence Smith, Chairman
Emerging Issues Task Force
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 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 the Bridgewater Savings Bank (the 'Bank'), a $300 million state-chartered mutual savings bank headquartered in Raynham Massachusetts.

We are very apprehensive about the potential negative ramifications of EITF 03-1. Our concerns include the following:

- financial statements that inaccurately reflect the results of our business activities or current financial position;
- as a result of above, very real concerns by senior Bank officers required to sign off on financial statements that might be "technically correct" from an accounting perspective, yet are misleading as to the true financial performance and risk profile of our Bank (i.e. placing higher value on form over substance);
- potential to hinder prudent risk management objectives, such as liquidity and interest rate risk sensitivity, at the enterprise level;
- a systemic and permanent lowering of banking industry capital and earnings;
- inappropriately reduced regulatory capital levels that constrains the banking industry's ability to support economic growth (especially for community Banks); and
- decreased availability and/or higher cost of raising capital.

In this regard our primary concern is the introduction of potential other than temporary impairment (OTTI) accounting treatment on fixed income investment securities that have a diminished market value due solely to changes in interest rates (levels or yield curve shape), market volatility variables, and/or sector spreads.

Administrative Offices
756 Orchard Street
Raynham, MA 02767-1028
(508) 884-3300 • (800) 356-8622
www.bridgewatersavings.com

Changing of the rules

Notwithstanding our specific concerns (some of which are noted below), the proposed guidance appears to reflect more of a "breaking of new ground" (establishing new accounting principles) than a clarification of existing accounting principles. Since the inception of FAS115, we are not aware of any confusion or inconsistency regarding the use of the Available-For-Sale classification as a vehicle for realizing losses on the sale of fixed income securities.

Candidly, we view this as a severely problematic and unwarranted changing of the rules. A change whose timing exacerbates the potential financial statement impact to a banking industry who purchased unprecedented amounts of fixed-income securities in the last few years. Many bankers would have made different, and we believe poorer balance sheet management decisions if the "new rules" had been in effect.

Had these rules been in place, the result would have fewer security purchases. Financial institutions would have increased their investment in other asset classes, like loans, that are often similar in cash flow structure yet not subject to potential interest rate related impairment. The pending EITF 03-1 interpretation creates an unlevel playing field that would ***materially*** effect the multi-trillion dollar markets for both fixed-income securities and loans.

Inconsistent with Bank performance and risk management

Most importantly, the proposed accounting application is in conflict with the way that the vast majority of Banks: 1) generate earnings, and 2) measure and manage the liquidity and interest rate risks of their balance sheet. As managers of balance sheet spread, the focus is appropriately on total balance sheet risk (enterprise level), not just the risk of the fixed-income portfolio or that of an individual security within a portfolio.

To broaden the concept of OTTI to interest rate only issues invites a level of volatility into bank financial statements that will diminish the value of this information. Why not let the current and fairly comprehensive fair value disclosures continue as is, which serves to also avoid the unnecessary and problematic reduction in regulatory capital? If financial statement users, including Bank regulators, have "doubts" (on rare occasions) with regards to certain carrying values, they can and do quite easily make corresponding adjustments to earnings and capital, and act accordingly. The new rules will likely lead to a revival in RAP to GAAP differences.

Ability and Intent

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

We believe that ability and intent is a dynamic set of variables that can change over time when market conditions change, risk positions (e.g. interest rate and liquidity) change, strategic direction changes, senior management teams change, etc. Accordingly, we believe that a narrow and static interpretation of ability and intent is inherently problematic.

More importantly, the selling of fixed-income securities that have lost value due interest rate movements is a cornerstone of prudent investment portfolio and bank balance sheet management. The selling of fixed-income securities at a loss enables profitable banks like ours to realized immediate tax-reducing cost savings and reinvest at a time when interest rates have moved higher into cash flows that will

produce higher future balance sheet performance. A sale in this case doesn't indicate lack of intent; it represents the ability of management to react in an economically logical manner to changes in the marketplace in which it operates. Movement of interest rates changes the marketplace!

Fair Value Accounting and piecemeal application thereof

One of our greatest concerns with EITF 03-1 is the continued trend in accounting literature towards fair value accounting on only portions of the balance sheet.

We believe this in itself will lead to misleading representations of financial performance for Banks, like ours, whose primary business model requires growth of net interest income over all interest rate cycles, not the management of reported earnings caused by monthly variations in fair values of certain financial instruments. We believe the accounting should do a better job of reflecting how earnings and wealth is created and managed vs. the trend, which we see as the increased generation of misleading information that results in poor decision making by managers and faulty analysis by financial statement users.

If only EITF 03-1 merely applied fair value accounting as applied to fixed-income securities. Unfortunately, it attempts to revive the insipid 'lower-of-cost or market' approach absent the ability to write it up to amortized cost when (we do not think 'if' is appropriate, since rates always move) rates move. This is the stone-age interpretation of conservatism -its O.K. to write it down, but never adjust any value up. This is a step forward for accounting?

Even fair market value accounting, if applied to our entire balance sheet would be very problematic. Many assets and liabilities have values that extend beyond the present value of their future cash flow, such as the value of having loan and deposit customer relationships that will generate profitable future business. Also, many assets do not trade in deep and liquid markets, so fair value estimates can vary widely, even between institutions owning similar assets.

Recommendations

Our recommendation is to clarify FAS115 by excluding other than temporary impairment accounting from situations where there have been market value declines due solely to interest rate related changes; unless an entity's actions speak clearly to exception treatment. 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. Similarly, if there was an "egregious" pattern of selling that would seem to indicate that 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 at the very least it should address clearly with pertinent examples some of the more common issues facing a typical community bank. This is especially important given the accounting profession's (e.g. "Big 4") recent trend –to issue their own interpretation of FASB's writings, creating their own case law, as if every word published by FASB has a singular exact meaning, leaving little room for application of common sense and materiality. We do not believe FASB's intent is to be intentionally vague and leave it to a few accountants to figure out FASB's desired outcome. Some of the more salient issues requiring a more definitive clarification include:

- Enable sales to be conducted for documented strategies related to prudent risk management such as portfolio restructuring, interest rate sensitivity, liquidity management and tax planning.

BridgewaterSavings

- Provide a "bright-line" test for minor impairment (at least 5%, and preferably much higher) whereby impairment would be assumed to be temporary without requiring further analysis/documentation. Requiring formal analysis/documentation for every security with an unrealized loss would be an extreme burden. With bank portfolios skewed heavily towards AFS classifications, this could result in most if not all securities requiring specific documentation in a rising interest rate environment. The 5% threshold is too low and would result in widespread impairment for relatively minor movements in interest rates.

- 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. On 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 done 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 guidance on what constitutes a pattern of selling (e.g. relative level of sales either in # of transactions or $ volume; time period over which activity analyzed, etc.). Interpretations from the accounting profession have varied greatly.

Thank you for taking the time to consider Bridgewater Savings Bank's comments regarding the very critical issues associated with EITF 03-1 and the related ramifications for my bank specifically, and for the banking industry in general.

Sincerely,

Mark C. Ingalls
Executive Vice President & CFO

Cc: James C. Lively, President & CFO
Board of Directors