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December 30, 2008

Mr. Russell G. Golden Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116



LETTER OF COMMENT NO. 234

Re: File Reference: Proposed FSP EITF 99-20-a

Dear Mr. Golden:

The Clearing House Association L.L.C. ("The Clearing House"), an association of major commercial banks¹, appreciates the opportunity to comment on the Exposure Draft of the proposed FASB, FSP EITF 99-20-a, Amendments to the Impairment and Interest Income Measurement Guidance of EITF Issue No. 99-20.

We strongly agree with the Board's rationale to amend EITF Issue No. 99-20, Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets (EITF 99-20) to require that debt securities subject to EITF 99-20 be evaluated for other-than-temporary impairment ("OTTI") in accordance with FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities. The result is a single model for determining OTTI recognition for debt securities under U.S. GAAP. The proposed amendment is a critically required "fix" to eliminate inconsistent and misleading accounting outcomes for securities with similar credit facts and circumstances. The differing OTTI

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accounting determinations under these standards have been highlighted by current market conditions. Failure by the Board to immediately adopt its proposed amendments to EITF 99-20 will result in material overstatements of OTTI on investments where there has not been any change in underlying debtor credit or cash flows.

We are also concerned that the Exposure Draft has proposed to delete the last sentence in paragraph 12(b) of EITF 99-20, which states that if all the impairment is due to changes in interest rates and absent other factors indicating that there is other-than-temporary impairment, then there would generally be no recognition of other-than-temporary impairment. We believe that this sentence should be retained in EITF 99-20 and that FSP FAS 115-1 should be amended to incorporate the same guidance. Restoring this guidance would be helpful in ensuring that impairment is not recognized on otherwise performing securities.

We believe the proposed amendment improves financial reporting because the application of present guidance could result in different OTTI outcomes for similar securities with similar risks, caused by having two different OTTI models. The primary inconsistency between the two models is how the evaluation of a security's credit risk – that is, the risk of not collecting future cash flows according to the security's contractual terms – impacts the determination of OTTI. We can think of no technical justification for evaluating credit risk differently based upon the security class or the security acquisition date. For example, generally investments in securitized assets rated below 'AA' at initial acquisition are subject to the EITF 99-20 model. Yet investments in securitized assets rated 'AA' or above at initial acquisition and investments in non-securitized assets such as corporate or municipal bonds are subject to the FAS 115 model. The result is debt securities that may have similar credit quality, such as noninvestment grade corporate bonds and noninvestment grade securitized assets, are evaluated for OTTI differently. Additionally, because the scope assessment of EITF 99-20 is required only when the security is initially recognized by the reporting entity, rating changes (e.g., downgrades) can result in application of two different OTTI models for the same security, depending solely upon when the security was initially recognized by the reporting entity. We believe these criteria for determining how to assess OTTI are arbitrary and different models are not warranted. Therefore, we applaud the Board for moving to a single OTTI recognition model for debt securities. The questions then become which model is appropriate and how should OTTI be measured.

FAS 115 is the Appropriate OTTI Model for Measuring Impairment of Debt Securities

Currently, a debt security within the scope of EITF 99-20 requires OTTI recognition if there has been an adverse change in cash flows based on the reporting entity's estimate of cash flows that a market participant would use in determining the fair value of the security. Accordingly, use of market participant assumptions in developing cash flow estimates is required and, under the EITF 99-20 model, cannot be overcome by reasonable management judgment regarding the probability of collecting future cash flows, regardless of whether or not the underlying assets are performing. For most EITF 99-20 debt securities, existing infrastructure in the financial markets does not provide reporting entities with readily available data regarding a market participant's views of cash flows. Therefore, in practice, determination

of whether these cash flows have deteriorated defaults to what the security's fair value (or market yield implied by the fair value) implies about a market participant's views of the cash flows. Declines in fair value (or increases in market yield) to a certain level are treated by independent auditors as prima facie evidence that market participants are signaling adverse changes in estimated cash flows and therefore OTTI should be recognized, regardless of the probability that cash flows will be collected. In dislocated markets, EITF 99-20 securities can experience severe price declines due to factors other than credit risk (e.g., liquidity risk). This market scenario has been exemplified by instances in which securities have experienced price declines even where the underlying assets are fully performing or significant protection against credit losses exist. We believe recognition of OTTI in such instances, where credit risk is presumed to have deteriorated solely based upon fair value declines (or market yield increases), is not appropriate and is not what the authors of EITF 99-20 intended. We believe that this presumption is effectively rebutted and should not apply when the current low price/high yield required in the market is not a reflection of high expected losses in the investment security, but rather a by-product of the massive liquidity premium that is required in the market under current conditions for EITF 99-20 securities. This liquidity premium can be observed in the low prices/high yields required for even very senior AAA-rated investments, ones which few market participants would accuse of having any reasonable risk of credit loss.

Proposed Solution to Accounting for Impairment Measurement of Debt Securities

We have produced in the Appendix to this letter a marked version of the simple changes that we believe could easily be made to FASB Staff Position FAS 115-1 and FAS 124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments ("FSP 115-1") to better align the impairment measurement of debt securities with that used by many banks outside of the United States that have adopted International Financial Reporting Standards ("IFRS"). This simple fix will bring consistency, relevance, reliability and further disclosure to the accounting for impaired debt securities at a time when the United States banking system needs improved and simplified standards to address the current global credit and financial crises.

So long as an entity has the intent and ability to hold investments in debt securities to recovery of the unrealized loss (which may be at maturity), we believe the fundamental determinant for OTTI recognition should be credit risk, that is, the risk that principal and interest payments will not be collected according to the security's contractual terms. We believe a security's credit risk requires OTTI to the extent it becomes significant enough that it is probable cash flows will not be collected as contractually scheduled. Evaluation of credit risk for debt securities that are securitized financial assets requires evaluation of the credit quality of the underlying assets, how the cash flows from the underlying assets are distributed to the beneficial interest holders (cash flow waterfall) and the credit protection or other subordination that exists relative to the reporting entity's beneficial interest that will absorb credit losses on the underlying asset pool. Assessing the probability of collecting future cash flows for EITF 99-20 securities requires careful study of these elements and application of reasonable management judgment, particularly in dislocated markets. FAS 115 requires OTTI recognition if it is probable the investor will be unable to collect contractually scheduled

principal and interest payments. FAS 115 does not require exclusive reliance on a market participant's view of expected cash flows, therefore allowing for reasonable management judgment for assessing probability of collecting future cash flows. Accordingly, we support elimination of the EITF 99-20 OTTI model and use of the principle-based guidance in paragraph 16 of FAS 115 for determining whether a debt security's credit risk requires OTTI recognition.

The use of the FAS 115 model reduces the complexity of financial reporting by utilizing an impairment model for debt securities that is similar to the model for evaluating impairment for investments in loans under FASB Statement No. 114, Accounting by Creditors for Impairment of a Loans, an amendment of FASB Statements No. 5 and 15. Under both FAS 115 and FAS 114, an impairment charge is recognized in earnings if it is probable that the investor/creditor will be unable to collect cash flows as contractually scheduled. We believe it is appropriate to evaluate impairment for investments in loans and investments in beneficial interests in securitized assets (where loans are often the underlying assets) similarly and that the impairment evaluation focuses on the presence of credit risk, and not other risks (e.g., market risk or liquidity risk) in the instruments. Additionally, we encourage the Board to amend the FAS 115 model for OTTI measurement to be more consistent with FAS 114 impairment measurement for loans. We believe that since credit risk is the primary trigger for OTTI recognition that measurement of any impairment charges should also be based upon the credit risk component of the loss. Measuring OTTI equal to the difference between cost and fair value of the security results in impairment charges recognized in earnings unrelated to the risk(s) that triggered OTTI recognition (e.g., liquidity risk, interest rate risk and other market risks). Use of the FAS 114 loan impairment model would more appropriately align OTTI measurement with the OTTI recognition model.

Recoveries of Other-Than-Temporary Impairment (Reversals)

Under current GAAP, when an other-than-temporary impairment has been identified, a loss is recognized in earnings for the difference between the cost of the security and its fair value. The fair value becomes its new cost basis from which future other-than-temporary impairments are determined. We support the FASB' staff recommendation that the Board consider allowing the recovery through earnings of an other-than-temporary impairment when evidence exists that a loss has reversed. This would ensure consistency with IFRS guidance. We believe that this guidance should be effective for periods beginning after December 15, 2008.

Conclusion

We agree with the Board's decision proposed in the amendment to utilize the FAS 115 model for assessing OTTI for investment in all debt securities. We believe the FAS 115 model is an appropriate and operational model for assessing OTTI for securities within the scope of EITF 99-20. However, we believe the proposed amendment should also address measurement of OTTI, specifically amending FAS 115 OTTI measurement to be consistent with FAS 114 impairment measurement for loans. Lastly, given the proposed amendment represents a significant improvement to financial reporting, we agree with the Board that the FSP should be effective immediately (4th quarter for calendar-year companies) and not delayed until 2009.

If action is not taken in time for this year end, we expect that banks' operating income will be impacted negatively because of excessive impairment charges that are not reflective of the true cash flows of the debt securities they own for the long term with no current intention of selling.

Thank you for considering the comments provided in this letter. If you have any questions or are in need of any further information, please contact me at (212) 612-9205.

Sincerely yours,

Kerman R. Nelson

Appendix

The Clearing House's Additional Proposed Revisions to Existing FASB Guidance

FSP FAS 115-1 and FAS 124-1

FSP on Statements 115 and 124 (FSP FAS 115-1 and FAS 124-1)

FASB STAFF POSITION Nos. FAS 115-1 and FAS 124-1

Title: The Meaning of Other-Than-Temporary Impairment and Its Application to Certain

Investments

Date Posted: November 3, 2005

Step 2: Evaluate Whether an Impairment Is Other Than Temporary

13. When the fair value of an investment is less than its cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is either temporary or other than temporary. An investor shall apply other guidance that is pertinent to the determination of whether an impairment is other than temporary, such as paragraph 16 of Statement 115 (which references SEC Staff Accounting Bulletin Topic 5M, Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities) and, paragraph 6 of Opinion 18., and EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets." Absent any other factors that indicate an other-than-temporary impairment has occurred, changes in the interest rate of a "plain-vanilla," variable-rate beneficial interest generally should not result in the recognition of an other-than-temporary impairment (a plain-vanilla, variable-rate beneficial interest does not include those variable-rate beneficial interests with interest rate reset formulas that involve either leverage or an inverse floater). [carried from last sentence of EITF 99-20, paragraph 12(b).]

Step 3: If the Impairment Is Other Than Temporary, Recognize an Impairment Loss Equal to the Difference between the Investment's Cost and Its <u>Present Fair-Value (Based on Estimated Future Cash Flows Discounted at the Asset's Original Effective Interest Rate)</u>

15. If it is determined in Step 2 that the impairment is other than temporary, then an impairment loss shall be recognized in earnings equal to the entire difference between the investment's cost and its—fair present value at the balance sheet date of the reporting period for which the assessment is made. The investment's present value is based on estimated future cash flows discounted at the investment's original effective interest rate; therefore, such cash flow estimates provide for the expected loss of cash flows due to expected credit losses. The measurement of the impairment shall not include partial recoveries subsequent to the balance sheet date. The present fair-value of the investment would then become the new cost basis of the investment and shall not be adjusted for subsequent recoveries in-fair value.

NOTE: The above changes will make this impairment recognition more consistent with FAS 114, Accounting by Creditors for Impairment of a Loan, as described in paragraph 13.