\*\* The Following form letter was also submitted by various other individuals as well. Only one copy of this letter has been posted to the website.





LETTER OF COMMENT NO. 219

March 30, 2009

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

File Reference: Proposed FSP FAS 115-a, 124-a, and EITF 99-20

Dear Mr. Golden:

The Federal Home Loan Bank of San Francisco (the "FHLBank of San Francisco") appreciates the opportunity to comment on the proposed FASB Staff Position No. FAS 115-a, FAS 124-a, and EITF 99-20-b, "Recognition and Presentation of Other-Than-Temporary Impairments," (the "proposed FSP"). We believe the proposed FSP significantly improves the guidance relating to other-than-temporary impairment ("OTTI"), and we commend the Board for its prompt efforts in this regard.

The recognition of only the credit component of OTTI in earnings is an improvement in the accounting for investment securities because it more closely aligns the amounts recognized in earnings for the impairment of debt securities with the amounts recognized in earnings for the impairment of loans. In addition, the recognition of the credit component alone provides useful and meaningful information because it informs users of the actual loss expected to be realized and eliminates the potential distortion of future earnings that occurs under existing accounting rules. However, as described in more detail below and in the responses to the specific questions included in the proposed FSP, the FHLBank of San Francisco suggests that the Board revise the proposed FSP to reflect the following recommendations, which would make financial statements more useful and meaningful for users.

Recommendation #1: For held-to-maturity debt securities, only the estimated credit losses should be reflected in the financial statements. Non-credit-related losses on held-tomaturity debt securities should not be charged to current period earnings or other comprehensive income ("OCI") for several reasons:

- Debt securities are different from equity securities because of the contractual cash flows and maturities. Losses excluding credit losses for held-to-maturity debt securities, are expected to reverse over time.
- Recording non-credit losses on held-to-maturity debt securities as OTTI makes financial statements less transparent and more confusing for financial statement users. It contradicts the definition of such investments as held-to-maturity securities, which should not be subject to market-related losses. It also distorts capital to reduce

the book value of a debt security as a loss to OCI, only to accrete the amount back over time. Recording only the estimated credit losses would be consistent with the accounting treatment of loans held-for-investment, a closely related investment, and would further align the proposed FSP with the accounting requirements of the International Accounting Standards Board.

For these reasons, for held-to-maturity debt securities with OTTI, only the credit losses should be reflected in the financial statements, while the fair value and the unrealized loss that is not attributable to the estimated credit losses should continue to be shown in the notes to the financial statements, where they are readily available to financial statement users.

Recommendation #2: Retrospective application should be permitted. Many organizations have already recorded large OTTI charges, a significant portion of which were attributable to market losses rather than credit losses as a result of current market turmoil. The proposed FSP should be modified to permit organizations the ability to elect a retrospective application. This would enable financial statement users to compare consistent information over reporting periods. This would also permit those institutions that have begun to amortize significant non-credit impairment amounts to net interest income as a result of prior OTTI charges to avoid ongoing distortions to net interest income, again enhancing the clarity and transparency of the financial statements.

Additional information regarding these concerns and our responses to several of the specific questions posed by the Board are presented in the pages that follow.

We thank the Board for its consideration of the FHLBank of San Francisco's views and welcome the opportunity to discuss this matter with the Board and its staff. Please do not hesitate to contact me at (415) 616-2603.

Sincerely,

Vera Maytum

Vera Maytum

Senior Vice President and Controller Federal Home Loan Bank of San Francisco

cc: Robert H. Herz, Chairman, Financial Accounting Standards Board

# Responses to Questions Posed by the Board:

### Question 1

This proposed FSP would require entities to separate (and present separately on the statement of earnings or "performance indicator") an other-than-temporary impairment of a debt security into two components when there are credit losses associated with an impaired debt security for which management asserts that it does not have the intent to sell the security and it is more likely than not that it will not have to sell the security before recovery of its cost basis. The two components would be (a) the credit component and (b) the noncredit component (residual related to other factors). Does this separate presentation provide decision-useful information?

### Response to Question 1

The FHLBank of San Francisco suggests that the Board remove the requirement to include a presentation of "total" impairment offset by the non-credit component in the statement of income. This presentation would complicate the face of the statement of income with information that is already required when reporting the components of comprehensive income, and we believe this information would be more appropriately included in the disclosures to the financial statements. In addition, the FHLBank of San Francisco believes that presentation of the credit component alone provides useful and meaningful information because it informs users of the actual loss expected to be realized. See our response to question 2 below for additional views regarding the non-credit component.

#### Question 2

This proposed FSP would require that the credit component of the other-than temporary impairment of a debt security be determined by the reporting entity using its best estimate of the amount of the impairment that relates to an increase in the credit risk associated with the specific instrument. One way of estimating that amount would be to consider the measurement methodology described in paragraphs 12–16 of FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan [("Statement 114")]. For debt securities that are beneficial interests in securitized financial assets within the scope of Issue 99-20, the amount of the total impairment related to credit losses would be determined considering the guidance in paragraph 12(b) of Issue 99-20. Do you believe this guidance is clear and operational? Do you agree with the requirement to recognize the credit component of an other-than-temporary impairment in income and the remaining portion in other comprehensive income? Under what circumstances should the remaining portion be recognized in earnings?

### Response to Question 2

The FHLBank of San Francisco agrees with the requirement to recognize the credit component of OTTI in income. However, regarding held-to-maturity securities, we do not believe that the non-credit component should be recognized in OCI. We believe this introduces additional and unnecessary complexity into the financial statements. Subsequent to the day impairment is recognized, a held-to-maturity security would be carried at neither

fair value (due to accretion of the non-credit component) nor amortized cost (which is defined as previous cost basis less the impairment recognized in earnings). Rather than recording a held-to-maturity security at fair value for only one day (because of the accretion under the proposed FSP), the accounting for held-to-maturity debt securities should be amended to be consistent with the accounting for loans held for investment purposes under Statement 114. Under the historical cost method of accounting, held-to-maturity securities and loans held for investment are both carried at amortized cost. However, impairment of a loan held for investment purposes does not include an adjustment for non-credit impairment losses. The recognition of non-credit impairment on held-to-maturity debt securities in OCI is effectively recognizing losses that are currently not expected to occur in the future. This would not be allowed under Statement 114 as stated in the response to question 14 of the FASB Staff implementation guide to Statement 114, which states, in part, "... Under generally accepted accounting principles, losses should not be recognized before they have been incurred, even though it may be probable based on past experience that losses will be incurred in the future. It is inappropriate to recognize a loss today for possible or expected future trends that may lead to a loss in the future."

Furthermore, the FHLBank of San Francisco believes that aligning the impairment model for held-to-maturity securities with the impairment model for loans held-for-investment would result in guidance that is more consistent with International Accounting Standards No. 39, specifically, paragraphs 63 – 65, which apply to financial assets carried at amortized cost. This would further the Board's goal of convergence with International Financial Reporting Standards.

Finally, in response to question 2, both FASB Statement No. 5, Accounting for Contingencies (paragraph 23), and Statement 114 (paragraph 8) indicate that insignificant delays and/or insignificant shortfalls should not be considered. Accordingly, we recommend that the proposed FSP include an amendment to the existing accounting guidance that clearly states that insignificant delays and/or insignificant shortfalls associated with probable losses should not result in determining that a security has been other-than-temporary impaired.

### Question 3

This proposed FSP modifies the current indicator that, to avoid considering an impairment to be other than temporary, management must assert that it has both the intent and the ability to hold an impaired security for a period of time sufficient to allow for any anticipated recovery in fair value. Does this modification make this aspect of the other-than-temporary impairment assessment more operational (the remaining factors discussed in FSP FAS 115-1/FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, would remain unchanged)? Should this modification apply to both debt and equity securities? Will this change result in a significant change to the assessment of whether an equity security is other-than-temporarily impaired?

## Response to Question 3

We believe this modification will make this aspect of the other-than-temporary impairment assessment more operational. However, we encourage the Board to complete its project on recovery of fair value. Because the FHLBank of San Francisco does not invest in equity securities, we have no further comments regarding this question.

### Question 4

This proposed FSP would require that the portion of an impairment recognized in other comprehensive income for held-to-maturity securities be amortized (through other comprehensive income) over the remaining life of the debt security in a prospective manner based on the amount and timing of future estimated cash flows by offsetting the recorded value of the asset (that is, an entity would not be permitted to adjust the fair value of a held-to-maturity security for subsequent recoveries in the fair value of the security similar to the accounting for available-for-sale securities). Do you agree with this requirement?

## Response to Question 4

As stated in our response to question 2, we do not believe that the non-credit component should be recognized in OCI for held-to-maturity debt securities and as such do not agree with this requirement of the proposed FSP. However, if this requirement is not amended, then we agree that the non-credit portion should be amortized over the remaining life of the debt security in a prospective manner based on the amount and timing of future estimated cash flows by offsetting the recorded value of the asset.

#### Other Considerations for the Board:

The FHLBank of San Francisco believes that it is imperative that the proposed FSP also be modified to permit organizations that have already recorded OTTI charges to have the option to elect retrospective application of the modified accounting guidance. Financial institutions that have recorded significant OTTI charges have amortized and will continue to amortize significant non-credit impairment amounts to interest income, which has distorted and will continue to distort net interest income. We believe that permitting retrospective application will enable financial statement users to compare consistent information over reporting periods. This would also permit those organizations that have begun to amortize significant non-credit impairment amounts to net interest income as a result of prior OTTI charges to avoid ongoing distortions to net interest income, again enhancing the clarity and transparency of the financial statements.

Also, we suggest that the Board consider further amending Statement 115 and EITF 99-20 to provide detailed guidance for the accounting of investment securities subsequent to the recognition of OTTI, including providing detailed examples that illustrate various methods of amortizing the non-credit component in response to changes in forecasted and realized cash flows.

Finally, the Board should consider revisions to the disclosure requirements of Statement 115 because the amortized cost of a held-to-maturity security subsequent to the recognition of OTTI (as defined in the proposed FSP) will no longer equal the carrying value.