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Letter of Comment No: 78
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Mr. Robert Herz, Chairman Financial Accounting Standards Board 401 Merritt 7, P.O. Box 5116 Norwalk, CT 06856-5116

Mr. Lawrence W. Smith, Chairman Emerging Issue Task Force Financial Accounting Standards Board 401 Merritt 7, P.O. Box 5116 Norwalk, CT 06856-5116

Re: EITF 03-1 – "The Meaning of Other than Temporary Impairment and It's Application to Certain Investments"

Dear Messrs. Herz and Smith:

We write to offer our perspective on the recently issued EITF Issue 03-1 "The Meaning of Other than Other than Temporary Impairment and It's Application to Certain Investments ("EITF 03-1"). As an investment banking firm focused on providing balance sheet strategies to middle-market banks and thrifts, we at Milestone have explored with our clients a number of troubling questions and potential risks posed by this controversial accounting change. Based on commentary we received and our own observations, we believe that implementation of this pronouncement as is being considered will have a variety of unintended ramifications within the financial services industry. Below we highlight some of those we have identified.

Increased Emphasis on Held-To-Maturity Account

FASB's creation of the "Available-for Sale Account ("AFS") through FAS #115 provided investors in financial companies meaningful insight into the valuation of securities held within these accounts. Since its implementation, the AFS account has become the primary account in which banks and thrifts invest, mainly as it affords these companies the ability to anticipate and manage broad wholesale changes in the national economy, and their individual companies' liquidity and cash flow needs. The after-tax mark-to-market through other comprehensive income ("OCI") accurately reflects much of the risk inherent in the AFS account, whereas, changes in market valuations of

securities held in the Held-to-Maturity ("HTM") account are not reported, in effect hiding elements of risk from investors.

As is being currently considered, EITF 03-01 would effectively place external auditors in the position of determining whether mere fluctuations in market rates have created "other than temporary impairments" in the valuation of securities held within AFS Accounts. Empowering auditing firms with the responsibility of gauging the likelihood of investments' restoration of valuation seems to the majority of bankers we surveyed as highly arbitrary, and unsound practice. Without their having formal training or a fully developed comprehension and historical experience of the financial markets, auditors appear to be ill suited toward making these judgments.

Most bankers with whom we have held discussions indicated that they would place an ever-greater proportion of future security purchases in HTM accounts, where market valuation effectively becomes considerably less consequential. As an unintended result, changes in market valuation of securities would be increasingly hidden from investors, actually moving the financial services industry away from fair-value accounting.

Significant Changes in AFS Investment

EITF 03-1 somehow appears to be linking AFS securities sold at losses with the concept that such action is suggestive of an inability to hold these investments to maturity. While there may be specific instances of abuse that we assume this pronouncement is meant to address, by and large, it is extremely rare that banks are unable to adequately capitalize their AFS purchases. Most often sales of AFS fixed income investments occur in order to: aid in the management of excess liquidity, provide cash for lending opportunities, and a means of managing interest rate risk exposure.

Threatened with even a watered-down form of the original EITF pronouncement, most bankers we talked with suggested that they would likely invest in much shorter, lower yielding investment securities in AFS, inhibiting future earnings. Many treasurers and portfolio managers we surveyed said that they would also likely retain lower yielding loss positions in AFS, while selling higher performing securities at gains in order to meet their institutional needs, contributing further toward the erosion of future profitability.

Members of the EITF should also recognize that EITF 03-1 as it is being considered currently, likely would severely restrict financial companies from effectively managing interest rate risk through use of AFS securities.

Impact on the Banking Industry's Profitability and Valuations

Ultimately, a selection process such described above is apt to have the unintended effect of reducing the future rate of earnings growth within the banking industry as lower yielding, under performing AFS securities remain on the books for longer periods of time

then under FAS115's former interpretation. Further, by also inhibiting means of managing interest rate risk, the industry's risk/reward profile is apt to deteriorate. This has a number of institutional investors and sell-side equity analysts concerned. In our discussions with market participants, EITF 03-1 is seen as posing a considerable threat to the relative valuations of financial stocks when compared against the broader equity market.

Impartiality of Balance Sheet Reporting

Broad changes in interest rates and spreads not only impact investments but also the remainder of a financial company's balance sheet. While the full implementation of fair value accounting of the total balance sheet has been deferred indefinitely due to the inherently ambiguous exercise of valuing deposits and loans, their valuations shift with changes in interest rates. Overstating changes in the valuation of securities may actually become misleading to investors.

Recommendation

Fortunately, the EITF has provided an opportunity for public commentary; this appears to be broadly appreciated throughout the financial industry. Many ramifications expressed by market participants may not have been considered prior to issuance of EITF 03-1. Hopefully those we offered here you find insightful.

As this pronouncement appears to represent a dramatic change in FAS115's application, and not without substantial consequence, we encourage the EITF to reconsider issuance of EITF 03-1, in favor of issuing a pronouncement that more specifically isolates the nature of the problem this edict was meant to address, while posing fewer and less threatening consequences.

Thank you for allowing us to comment on this proposal

Respectfully submitted,

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Chrymly & Sue