RBC Financial Group

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Director
Technical Application and Implementation Activities and EITF Chair
Financial Accounting Standards Board
401 Merritt 7
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Attn: Mr Larry Smith

Via email: director@fasb.org

Subject: **Proposed FASB Staff Position EITF 03-1-a,** ***Implementation Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1, " The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments"***

RBC Financial Group would like to thank the Financial Accounting Standards Board ("Board") for the opportunity to comment on the proposed FASB Staff Position No. EITF Issue 03-1-a (the "FSP"). We also want to commend the Board on its earlier decision to extend the delay of implementation guidance from just paragraph 16 as originally proposed in the draft FSP, to also include paragraphs 10-15 in the final FSP EITF 03-1-1 until clear guidance is made available for entities.

Implementation of EITF 03-1 (the "EITF") has created numerous interpretation issues for entities and while this proposed FSP attempts to reduce those issues, ambiguities remain. Our main concerns relate to the definition of "minor impairment" and "de minimis volume of sales", and the perceived conflict with the impairment assessment guidance for available-for-sale investments under FAS 115 *Accounting for Certain Investments in Debt and Equity Securities*. Without clear guidance from the Board on what is considered "minor impairment", there is a risk that the most conservative view will be used for interpretation and almost all impairment may be considered as "severe". Similarly, an extreme view for "de minimus volume of sales" may be interpreted as only one such occurrence and subsequent sales will be treated as a pattern, resulting in tainting of the investment portfolio. We acknowledge that the absence of bright line guidance will allow entities to exercise more judgment in their application of GAAP. Unfortunately, it will also create diversity of practices which contradicts with the goal of issuing the EITF, and exposure to narrow interpretation by accounting firms, as evidenced by the concerns raised by constituents to the Board in earlier months. We are aware that some accounting firms are taking the extreme view in their interpretation, and unless bright line guidance is provided by the Board, entities will have to operate within the restrictive application defined by their auditors.

Lastly, in view of the sensitivity of the issues addressed in this FSP, we would ask the Board to consider re-exposing the FSP for comments if there are substantive changes to its wordings after deliberating on comments received.

Our responses to the specific questions and issues contained in the proposed FSP are included in the attached Appendix. Should you have any questions regarding our comments, please do not hesitate to contact me at 416-955-7876 to discuss our comments with you further.

Thank you.

Yours very truly,

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cc: Robert Guignard, Senior Vice President, Finance & Chief Accountant

Appendix

Question 1: At what unit of account should an investor assert its ability and intent to hold to a forecasted recovery?

We agree that in accordance with paragraph 16 of FAS 115 and as further clarified in Question 48 of the FASB's *Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities: Questions and Answers*, that each individual security should be evaluated for impairment. However, we would like the Board to clarify what is defined as "individual security" due to different interpretations in its application. Is "individual security" defined as (a) security of the same CUSIP and thus securities will be grouped by CUSIP for assessment? or (b) individual position acquired over time regardless of CUSIP, in which case securities of the same CUSIP will be assessed individually as separate position based on when acquired? For financial institutions that typically have significant investment holdings, as is the case for RBC Financial Group, asserting at too granular a level will be practically impossible from an operational view. Our view is that approach under (b) will result in unnecessary administrative burdens to entities, with little or no incremental benefit as securities are managed on portfolio basis, not individually. We would recommend aligning the level required for assertion with the manner in which the portfolios are being managed for business purposes, such as by business groups within the entity that are segregated by their trading activities. If this approach, which we considered to be the least administratively exhaustive, is not acceptable to the Board, then we recommend approach (a) be adopted, which despite requiring a significant administrative effort, is feasible and less burdensome.

Question 2: Although Issue 03-1 states that an investment is impaired if the fair value of the investment is less than its cost, paragraph 16 does not refer to the severity of the impairment. Is there a level of impairment that can be considered temporary that would not create the need for an assertion about the ability and intent to hold an investment until a forecasted recovery?

We believe that the magnitude of impairment should not be considered as severe and thus be exempted from the need of an assertion and impairment assessment, especially if the changes were due to interest and sector spread changes. However, without defining what magnitude is considered as "minor impairment", different thresholds will be adopted by entities. We also believe that this notion of "minor impairment" should be expanded to other than paragraph 16 securities. The Board has also recognized these problems as Issues 1 and 2 in the draft FSP and our comments on these are included under Specific Issues following the specific questions for this FSP.

Question 3(a): If an interest-rate-impaired and/or sector-spread-impaired security for which the investor previously had asserted its ability and intent to hold to a forecasted recovery is expected to be sold prior to recovery, when is the impairment considered other than temporary?

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We believe the guidance on "an investor should recognize an impairment when it has decided to sell an impaired security", which is based on Q47 of the FASB Special Report for FAS 115 and EITF Topic D-44, is clear. The last sentence proposed by this FSP, "However, that guidance should not be interpreted to mean that an investor should wait to recognize an other-than-temporary impairment until it has decided to sell an impaired security." seems to contradict that guidance. We ask the Board to remove the last sentence to avoid any perceived contradiction.

Question 3(b): If an interest-rate-impaired and/or sector-spread-impaired security for which the investor previously had asserted its ability and intent to hold to a forecasted recovery is expected to be sold prior to recovery, are there circumstances for such a change in ability or intent that would not necessarily call into question the investor's ability or intent to hold other securities to recovery?

The proposed guidance refers to paragraph 8 and 11 of FAS 115, which are allowable circumstances for sale or transfer of held-to-maturity ("HTM") security without calling into question the assertion on ability and intent to hold to recovery. If these are the only circumstances acceptable to both the available-for-sale ("AFS") and HTM securities, then securities in the AFS category are being held to the same restrictive criteria as those in the HTM category. This contradicts the intent of the AFS category as stated in FAS 115, which includes debt securities that are being held for an unspecified period of time but will be sold to meet liquidity needs or as part of an enterprise's risk management program. Imposing the HTM criteria on AFS securities will unfairly restrict the entity's flexibility to manage those assets and thus, may compel it to change its risk management strategies. We therefore ask the Board to clarify its intent for those paragraphs with respect to HTM and AFS securities.

We also believe the acceptable circumstances (a) to (c) as proposed in paragraph 7 of the FSP for selling securities prior to cost recovery should be applicable for both paragraph 16 and paragraph 10 securities that are in either the HTM or AFS portfolio, as those circumstances are not driven by the characteristics of the security. In addition, further guidance should be provided on "de minimis" volume of sale under (c), especially as it applies to AFS securities, as an extremely narrow interpretation of this may mean one instance is acceptable but more than one may create a pattern. Entities may then be forced not to trade the AFS securities in order to avoid the accounting exposures, even though such practice may not align with its risk management strategies. Clarification of this term is also essential in relation to application of paragraph 8 of the FSP, as addressed next.

Proposed paragraph 8 of the FSP states "An analysis of the investor's ability and intent to hold other securities to recovery is required only for those securities for which the investor previously had asserted its ability and intent to hold to recovery". A literal interpretation of this guidance would mean that the analysis is required even if there is a single incidence of sale prior to recovery if the investor had previously made the assertion. This will undermine the risk management practice of financial institutions for AFS securities, as they perceive the analysis to be administratively burdensome may choose not to sell any of the underwater securities at all, even though it may be prudent to do so from an asset/liability or liquidity perspective such as to fund loan growth. We are extremely concerned with the consequences that such a narrow read of the EITF may have on risk management practices. We believe that the Board should clarify its intent and consider exempting the need for such analysis if there were only a "de minimis" volume of sales, and they were transacted solely in response to risk management requirements.

There is also a perceived conflict between what is required by the last sentence of paragraph 8 versus the assertion exemption for minor impairment proposed under Question 2. The last sentence of paragraph 8 states "However, impairments on securities for which the investor has not asserted its ability and intent to hold to recovery should be recognized currently in earning". There is no apparent exemption for minor impairments. In contrast, proposed guidance under Question 2 states " a minor impairment caused by interest rate and/or sector spread increases can be considered temporary and would not create the need for an assertion about the ability and intent to hold an investment until a forecasted recovery". Thus if a security has a minor impairment resulting from interest rate increases and no assertion is made nor any impairment charge is recognized by the entity based on guidance provided by Question 2, it will nonetheless be required to recognize an impairment charge in accordance with the last sentence of paragraph 8. We would ask the Board to clarify this perceived conflict in the guidance.

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Specific Issues

Minor Impairments

Issue 1: The Board considered defining *minor impairment* as an impairment of 5 percent or less. Some Board members believe that minor impairments can be considered temporary without further analysis because normal interest rate and/or sector spread volatility is expected to eliminate a minor impairment. Some Board members disagree with defining *minor impairment* as an impairment of 5 percent or less because that definition embodies assumptions about the volatility of the applicable interest rate. Others prefer that the guidance not provide a "bright-line" test. For these reasons, the Board generally supported the notion that minor impairments can be considered temporary and did not support including either additional guidance or a numerical threshold to be used in determining whether an impairment is minor. Do you believe that financial statement preparers and auditors will be able to apply the notion of "minor impairment" without any additional guidance from the FASB? If not, do you believe that the Board should specify a numerical rule or threshold and, if so, what would that rule or threshold be?

Response:
We believe the absence of clear guidance has resulted in diversity in practice in defining 'severity' of impairment. We recognize that both the Board and the SEC staff do not use a bright line to conclude on other-than-temporary impairment[1]. However, the lack of such bright line guidance will result in various practices for impairment testing as entities will have different views on what is considered "severe" and the factors that cause the impairment, resulting in lack of comparability among financial statements. We would ask the Board to consider including a 'bright line' threshold for consideration of temporary impairment, similar to the tentative decision reached by the Board on Employee Share Purchase Plans ("ESPP") at the September 8, 2004 meeting for the Share-Based Payment Exposure Draft, that "Any discount for the purchase of shares provided under the plan results in proceeds to the employer that are not less than the proceeds it would receive in an offering of shares if the shares had been issued to third parties by other means, for example, through an underwriter. A discount of 5 percent or less from the market price shall be considered to comply with this criterion without further justification".

In addition, we concur with the view expressed by the Board member in the September 30, 2004 Board meeting that the context of impairment resulting from foreign exchange losses should also be addressed. This is especially relevant since the movements of foreign exchange are highly impacted by changes in interest rates, as indicated in our September 29, 2004 comment letter on FSP EITF 03-1-b. Therefore, we ask the Board to consider using the same 5% threshold for temporary impairment as that used for ESPP, and to include foreign currency along with interest rates and sector spreads as one of the causes in comparing against this threshold in order to encourage consistency of application by entities.

[1] Speech by SEC Staff: Remarks at the 2003 Thirty-First AICPA National Conference on Current SEC Developments, by D. Douglas Alkema.

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Specific Issues (cont'd)

Limiting the Notion of Minor Impairments to Debt Securities Evaluated for Impairment Pursuant to Paragraph 16 of Issue 03-1

Issue 2: The Board generally believes that it is appropriate to limit the notion of "minor impairments" that would not create the need for an ability and intent assertion to debt securities analyzed for impairment under paragraph 16 that are impaired because of interest rate and/or sector spread increases, since, absent a sale prior to recovery or maturity, such impairments will be recovered. Because the same cannot be said for debt securities that can be contractually prepaid or otherwise settled in such a way that the investor would not recover substantially all of its cost and equity securities, the Board generally does not support extending the exclusion to investments analyzed for impairment under paragraphs 10–15 of Issue 03-1. However, some Board members support expanding the notion of "minor impairments" to all investments analyzed under Issue 03-1 because they acknowledge that normal price volatility may eliminate an impairment. Do you support the Board's conclusion to limit the notion of "minor impairments" to debt securities analyzed for impairment under paragraph 16 that are impaired because of interest rate and/or sector spread increases? If not, why?

Response:
We support the view expressed by some Board members and believe the concept of "minor impairment" should be applicable to all investments not just those under paragraph 16, as normal price volatility does not differentiate between an investment that is contractually prepayable versus one that is not. An entity manages its investment portfolio in reference to various factors including its overall risk management and liquidity strategies, without placing undue emphasis on prepayment terms and incidents of minor impairments. Therefore, to limit this assertion exemption for cases of "minor impairments" to paragraph 16 securities only implies that for other contractually prepayable securities with minor impairment, an entity is automatically assumed not to have the ability and intention to hold until proven and thus, will be held to a higher standard for impairment assessment. We don't believe that different criteria should be used for minor impairments that are caused by the same factors, simply due to the prepayment nature of the security.

Other

Paragraph 20 of EITF 03-1 states " In periods subsequent to the recognition of other-than-temporary impairment loss, the investor should apply the provisions of SOP 03-3 in determining the amount and timing of income recognition".

Response:
SOP 03-3 *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* (the "SOP") addresses the accounting where credit quality has deteriorated since origination. We have several concerns about this application and would ask the Board to reconsider the requirement.

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- The SOP does not address accounting for changes due to interest rate or foreign currency fluctuations, which are also components of fair value for impairment assessment. Thus we do not believe this SOP provides a solution for subsequent recognition for changes resulting from interest rate or foreign currency movements.
- Beneficial interest is within the scope of EITF 03-1 as per Footnote 1, but is specifically excluded from SOP 03-3 under paragraph 3. Thus, there is an apparent conflict in scope application.
- The effective date for SOP 03-3 is for fiscal years beginning after December 15, 2004, By incorporating this SOP requirement in the EITF, the Board is essentially accelerating its effective date and entities may not have the system changes in place to accommodate the accounting requirements.