August 24, 2004

Mr. Lawrence W. Smith
Chairman
Emerging Issues Task Force
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856-5166

Re: EITF Issue 03-1 "The Meaning of Other-Than-Temporary Impairment"

Dear Mr. Smith:

America's Community Bankers ("ACB")[1] appreciates the efforts of the Financial Accounting Standards Board ("FASB") and the Emerging Issues Task Force ("EITF") in promulgating implementation guidance through the issuance of EITF Issue 03-1 "The Meaning of Other-Than-Temporary Impairment." ACB welcomes a common approach to evaluating other-than-temporary impairment for investments that would reduce inconsistent application of impairment models for securities currently accounted for in accordance with Opinion 18 and FAS 115. However, we do not believe that the guidance in EITF 03-1 provides this type of consistency.

Based on a significant amount of input we have received from community banks and other industry analysts, we strongly urge FASB and the EITF to immediately consider delaying the current effective date that calls for the application of EITF 03-1 to interim or annual reporting periods beginning after June 15, 2004. ACB believes the FASB and EITF need additional time to gather further input from market participants to ensure that EITF 03-1 will be properly applied and reevaluate how the proper application will impact current practice to provide better assurance that the appropriate financial statement results are achieved. More specifically, the EITF needs to reconsider aspects of the guidance regarding what constitutes a "pattern" of selling below market value securities and when such a pattern would "taint" the remainder of the securities in that portfolio.

Financial institutions of all sizes hold debt and equity investment securities to attain various financial objectives, including hedging their interest rate risk. FAS 115 states, "investments not

[1] America's Community Bankers is the member-driven national trade association representing community banks that pursue progressive, entrepreneurial and service-oriented strategies to benefit their customers and communities. To learn more about ACB, visit *www.AmericasCommunityBankers.com.*

classified as trading securities (nor as held-to-maturity securities) shall be classified as *available-for-sale ("AFS") securities."* The mere title of the AFS category implies that these securities are "available" to be sold by institutions as part of their asset / liability management ("ALM") strategies.

As the securities in the AFS portfolio fluctuate in value, a decline in fair value below the price originally paid means some securities will become impaired. These impaired assets are often referred to as "underwater" securities. Typically, if the decline is solely due to changes in interest rates, no impairment charge needs to be made if a company asserts that it has the ability and intent to hold the security for a sufficient period of time to allow for a recovery of fair value up to or beyond the cost of the investment. Rather, the value fluctuations of AFS securities are recorded as unrealized gains and losses directly in equity, in an account known as accumulated other comprehensive income ("AOCI"). However, institutions periodically sell some of these underwater AFS securities in order to better manage their businesses, and it is not uncommon for them to change their intentions regarding some AFS securities when considering ALM and hedging strategies in light of changes in the market, economy and other unpredictable factors.

This selling of underwater securities seems to be the triggering event for much of the confusion surrounding what we perceive to be a misapplication of EITF 03-1. Many banks are being told by their auditors that the sale of underwater securities will likely lead to a determination that the entire portfolio is "tainted," because the bank appears to have developed a "pattern" of selling securities for which it previously asserted that it intended to hold until full recovery. We are concerned about the ambiguous meaning that is being ascribed to the word "pattern" in this context. This new approach not only threatens the mere ability of a bank to "change" intentions of an "available for sale" security, it would also take away much of the flexibility needed to adjust financial strategies to compensate for unanticipated market forces. ACB believes the EITF needs to reevaluate what constitutes a "pattern" when selling below market value or underwater securities and better define when such a pattern would warrant the remainder of the portfolio being declared "tainted."

The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment. Given the recent guidance provided to many of our member banks by their auditors with regard to applying EITF 03-1, ACB is concerned that some auditors appear to be hastily and inappropriately concluding that a portfolio is "tainted" and that an impairment charge must be made for all underwater securities in that portfolio. More importantly, this appears to be true despite the institution employing a systematic and rational methodology that includes documentation of the factors used by management in reaching its conclusion regarding whether or not a write-down is required.

It appears that this rather abrupt interpretation of EITF 03-1 by several accounting firms will result in most, if not all in some cases, of the unrealized losses being declared other-than-temporary and the company will be forced to take an impairment charge through earnings. This interpretation not only contradicts the guidance provided in FAS 115, but it also jeopardizes the company's ability to justify carrying securities in the AFS category. We believe that these financial statement results represent much more severe consequences than what FASB and EITF intended with the EITF 03-1 impairment model.

Furthermore, the widespread removal of unrealized losses will closely resemble a lower-of-cost or market ("LOCOM") method, which will also unjustly impact banks' regulatory capital positions. Ironically, Appendix A of FAS 115 stated that the "current requirement to use the LOCOM method for debt securities held for sale and for noncurrent marketable equity securities is not evenhanded because it recognizes the net diminution in value but not the net appreciation in the value of those securities." We believe that the current incorrect application of EITF 03-1 is an example of what the FASB deemed to be "not evenhanded" in their deliberations on FAS 115 issues.

***We strongly urge the FASB and EITF to take immediate action in reconsidering the ratification of the EITF consensus and delay the effective date of EITF 03-1***. ACB believes that this prompt action is essential to allow the EITF more time to determine what further action needs to be taken to ensure that improper implementation does not result in unintended consequences for financial institutions. We strongly urge the EITF to gather additional input from banks, national trade organizations, and regulatory agencies on the practical impact that EITF 03-1 will have on the financial statements and potentially significant impact on the financial services industry as a whole. If ignored, this unsuitable application of EITF 03-1 is likely to cause material distortions in financial statements, confuse investors, and promote a rules-based accounting system.

We stand ready to work with FASB and the EITF to develop a workable solution to this issue and look forward to further dialogue. Please feel free to contact the undersigned at 202-857-3158 or via e-mail at dhild@ACBankers.org.

Sincerely,

Dennis M. Hild
Vice President – Accounting and Financial Management Policy
America's Community Bankers

cc: Robert H. Herz, Chairman, Financial Accounting Standards Board
Mr. Donald T. Nicolaisen, Chief Accountant
Eric J. Schuppenhauer, Senior Advisor to the Chief Accountant
Securities and Exchange Commission

Freddie Mac
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1551 Park Run Drive
McLean, VA 22102-3110

August 26, 2004

Mr. Lawrence W. Smith
Chairman of Emerging Issues Task Force
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

VIA E-MAIL

Reference: EITF 03-01

Dear Mr. Smith:

We are writing to you regarding EITF Issue No. 03-01 (EITF 03-01), "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." We wish to share our concerns about implementation issues related to adopting the measurement consensus in EITF 03-01.

Our primary concerns relate to the EITF 03-01 requirement to make an assertion about the intent and ability to hold a debt security until a forecasted recovery of fair value. We believe the requirement to make this assertion –

(a) Contradicts existing GAAP guidance including SFAS 115 and SAB 59
(b) Presents significant implementation issues (including questions about the practicability of forecasting fair value recovery; operational complexity related to designation of intent, ability, and forecasts; and questions regarding the interpretation and risks associated with "tainting" through subsequent sales activity)

Potential negative consequences of this EITF 03-01 guidance include –

(a) Possible incentive for "gains trading"
(b) Impairment loss recognition for some securities that will never experience a realized loss, with subsequent accretion of the impairment discount into interest income over time as an increased effective yield
(c) Expanded use of the HTM category

We also have concerns about transition issues, including several questions about the interaction of this standard with SOP 03-3 and concerns about the timing of transition given the significant operational challenges of implementation such as the need to develop new systems.

We respectfully request either reconsideration of the consensus including seeking public comment on the issues that we describe more fully below, or a delay in the effective date of the EITF 03-01 measurement consensus to allow preparers and their accounting firms more time to interpret the standard.

We appreciate your consideration of the issues in this letter, and we would be happy to discuss them with you at your convenience.

**Background**

Our concerns relate to investments in debt securities classified as available-for-sale (AFS) which are in an unrealized loss position due to changes in interest rates. For those securities which are under the scope of paragraph 16 of EITF 03-01, we would be required to apply the following guidance to determine whether an impairment should be deemed other-than-temporary:

> *". . . An impairment should be deemed other than temporary if (a) the investor does not have the ability and intent to hold an investment until a forecasted recovery of fair value up to (or beyond) the cost of the investment, which in certain cases may mean until maturity . . . Although not presumptive, a pattern of selling investments prior to the forecasted recovery of fair value may call into question the investor's intent."*[1]

In evaluating this guidance, we have identified several issues that we wanted to share with you. These issues are related to (a) difficulties with making an assertion about "intent and ability to hold until forecasted recovery," and (b) the implications of alternatively choosing not to make that assertion. We have also identified some issues related to transition.

**Assertions about "intent and ability to hold until forecasted recovery"**

Investments in debt securities may frequently be in unrealized loss positions due to changes in interest rates. The paragraph 16 guidance for determining whether interest rate-driven declines in fair value are other-than-temporary presents some practical and conceptual difficulties.

*Estimation of "forecasted recovery" for interest rate-driven declines in fair value is impracticable*

We are unsure of how to make the required estimate of "forecasted recovery of fair value" for interest rate-driven declines in fair value. The guidance provided in the consensus (paragraph 15) primarily relates to forecasting recovery in cases where declines in fair value are driven by credit-related factors. The consensus does not provide guidance about forecasting recovery in cases where declines in fair value are driven by changes in interest rates. On a practical basis, estimation of "forecasted recovery" of fair value before maturity would require a forecast of the future direction and extent of interest rate changes. While a company might make an educated guess about future changes in interest rates, one would not expect to forecast the extent or timing of recovery in fair value (prior to maturity) with consistent accuracy.

*Designation of "intent" at trade lot level is operationally complex and may contradict business practice*

Designation of the "intent to hold until fair value recovery" poses some practical problems. First, making such a designation at the unit of account (the trade lot level) requires identification of both a forecasted recovery date and a corresponding intent to hold or sell (in reference to the

[1] EITF 03-01, paragraph 16.

forecasted recovery date). This designation of intent (and the forecasted recovery) must be refreshed each reporting period.[2] These requirements add significant operational complexity to the current requirement to designate the SFAS 115 intent (HTM, AFS, trading) upon purchase. Just as companies did to accommodate hedge designation under SFAS 133, companies may be required to implement processes and systems to accommodate the designation of "intent to hold" under EITF 03-01. Given the policy interpretation issues (described in this letter) plus the operational complexity of implementing an intent designation system, the transition period provided in EITF 03-01 seems inadequate.

Furthermore, designation of the "intent to hold until fair value recovery" also poses some conceptual problems. The requirement to make an accounting designation of "intent to hold" at the trade lot level may contradict how the securities are actually managed (which may be on a portfolio basis). Consider an enterprise with a business model that involves sales decisions based on economic or risk management reasons at the time of sale, independent of the accounting unrealized gain or loss of an individual trade lot at a particular period-end. This company may not be able to forecast which lots will be subsequently sold or the timing of the sales. The requirement to make such a forecast seems to contradict the requirements originally specified in SFAS 115 for the AFS category.[3] Current guidance requires impairment loss recognition in the period a company has made a "decision to sell."[4] Absent an affirmative "decision to sell," current GAAP does not require the forecast of amount and timing of sales for AFS securities.[5]

*"Intent to hold" assertions for impaired securities could encourage gains trading*

The paragraph 16 assertion requirements could encourage gains trading. Companies are incented to avoid undesirable accounting consequences. That is, companies might avoid impairment loss recognition by continuing to hold securities in unrealized loss positions (with deferral in OCI), having made an assertion of the intent to hold until a forecasted recovery, and instead choose unrealized gain positions for use in subsequent sales transactions. This behavior would defeat one of the Board's original objectives in improving financial reporting related to resolving the gains trading issue.[6]

*The interaction of EITF 03-01 guidance with existing GAAP guidance on "other-than-temporary" impairments is unclear*

In addition to the concerns outlined above, we have some concerns about how to interpret some of the EITF 03-01 guidance in light of the already-existing GAAP guidance on determining other-than-temporary impairments.

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[2] Under paragraph 6 of EITF 03-01, the impairment assessment must be made each reporting period.

[3] Per SFAS 115, paragraph 82: The AFS category includes "debt securities that are being held for an unspecified period of time, such as those that the enterprise would consider selling to meet liquidity needs or as part of an enterprise's risk management program."

[4] Per EITF Topic D-44, "Recognition of Other-Than-Temporary Impairment Upon the Planned Sale of a Security Whose Cost Exceeds Fair Value," " . . . when an entity has decided to sell an available-for-sale security whose fair value is less than its cost basis and the entity does not expect the fair value of the security to recover prior to the expected time of sale, a write-down for other-than-temporary impairment should be recognized in earnings in the period in which the decision to sell is made."

[5] The SEC's Staff Accounting Bulletin No. 59 (SAB 59), "Accounting for Noncurrent Marketable Equity Securities," does not require a forecast of the amount and timing of sales for each security. SAB 59 cites intent and ability to hold until any anticipated recovery as *one* factor that may be helpful in indicating whether a decline is other-than-temporary; SAB 59 acknowledges that "there are numerous factors to be considered in such an evaluation and their relative significance will vary from case to case."

[6] Also, per SFAS 115, paragraph 84: SFAS 115 was expected to "help resolve the gains trading issue, not aggravate it."

We are uncertain about the interaction between EITF 03-01 and existing other-than-temporary impairment guidance (SAB 59 and AICPA Statement on Auditing Standards No. 92, "Auditing Derivative Instruments, Hedging Activities and Investments in Securities," or SAS 92). SAB 59 and SAS 92 require consideration of all potential relevant factors (including duration and extent of decline, prospects of the issuer, and intent and ability to hold), *without a predetermined weight on any particular factor*, in judging whether impairments are other-than-temporary. In contrast, in EITF 03-01 the requirement to make a positive assertion of the "intent and ability to hold until forecasted recovery" takes on increased prominence. Duration and extent of the decline in fair value are considered, not as equally important factors (as is true in SAB 59 and SAS 92) but as indicators of the amount of evidence needed to support the company's forecast of recovery in fair value.[7]

While the requirements in EITF 03-01 involve the same key phrases used in SAB 59 and SAS 92 such as "intent and ability to hold," the relative emphasis on factors to be considered and the exercise of management judgment seems different. This distinction may seem subtle, but it can result in differences in the processes designed to identify other-than-temporary impairments. We are unclear how to resolve these differences when making other-than-temporary impairment decisions in practice.

*The interpretation and consequences of "tainting" are ambiguous*

We are unsure of how to implement the paragraph 16 guidance about "a pattern of selling investments prior to the forecasted recovery of fair value." The notion of a pattern of sales that "calls into question the investor's intent" implies the concept of tainting events. We also understand that some accounting firms have taken the position that a small number of subsequent sales for which an accounting loss is recognized constitute a "tainting" of the intent assertions for future periods.

Our questions include the following.

(a) How many instances of loss sales constitute a "pattern?" How should we interpret "although not presumptive?"

(b) If one sells at an accounting loss *subsequent* to the "forecasted recovery" (that is, the forecasted recovery has not materialized), what are the implications?

(c) What are the consequences of "tainting?"

(d) How do changes in the forecast affect "tainting?"

(e) What intervening factors (subsequent to period-end) that affect the investor's intent or forecasted recovery date are allowable without creating a "tainting" event?

We also observe that the risks associated with a potential "tainting" event might lead companies to choose *not* to make assertions about the "intent and ability to hold until forecasted recovery." This choice would lead to unattractive alternatives, which may include (a) defaulting to a modified "LOCOM" approach for all AFS securities, (b) an expansion of the use of the HTM category, or (c) expansion of the use of the trading category on a large scale, with regulatory capital implications for financial institutions. We discuss these alternatives further below.

[7] Per paragraph 11 of EITF 03-01.

**Alternatives if companies choose *not* to make assertions about "intent and ability to hold until forecasted recovery"**

As described above, a company trying to implement the paragraph 16 assertions about the "ability and intent to hold an investment until a forecasted recovery of fair value" for AFS securities may face (a) practical constraints (such as the inability to estimate forecasted recoveries or designate intent), or (b) the risk of potential "tainting" from subsequent sale activity. In response to these problems, a company might choose not to make the assertions, and instead choose from several unattractive alternatives.

*Adopt a modified "LOCOM" approach for AFS securities*
If a company does not make assertions about the intent to hold until a forecasted recovery, EITF 03-01 requires recognition of impairment losses through earnings. This approach, with establishment of the fair value as a new cost basis, is effectively a modified LOCOM approach. This contradicts the stated intent of SFAS 115[8] and is effectively an amendment to the AFS accounting prescribed by SFAS 115.

This approach is unattractive as it will involve impairment loss recognition due to interest rate changes in the short term, for some securities which will never experience a realized loss. These unrealized losses are not truly "other-than-temporary." In addition, the modified LOCOM approach would require that an impairment loss be recognized currently in earnings and reversed over time through subsequent accretion into interest income, as an increase in the effective yield. Neither the potentially significant impairment loss recognition (on securities for which a loss will never be realized) nor the income reclassification (impairment losses versus interest income) is desirable or reflective of economic reality. Finally, the move to a modified LOCOM approach is inconsistent with the Board's stated objective of moving toward fair value accounting for financial instruments.

*Expand use of the HTM category*
As an alternative to the modified LOCOM approach for AFS securities, companies might seek to expand use of the HTM category. We do not believe expanded use of HTM accounting for marketable securities is an improvement in financial reporting or consistent with the Board's stated objective of moving toward fair value accounting for financial instruments.

*Expand use of the trading category*
As another alternative to the modified LOCOM approach for AFS securities, companies might seek to expand use of the trading category. A significant portion of Freddie Mac's sales and resecuritization activities are not consistent with SFAS 115's indication of the character of "trading" securities ("generally used with the objective of generating profits on short-term differences in price").[9] Instead of representing trading activities, Freddie Mac's retained portfolio transactions are meant to facilitate our housing mission by providing market liquidity for mortgage-backed securities in a manner that is consistent with our disciplined approach towards risk management.

Expanded use of the trading category would create trading-like earnings volatility related to non-trading assets (without the ability to mark debt to fair value through earnings), and could have significant regulatory capital implications. The Board acknowledged this problem in its SFAS

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[8] Per SFAS 115, paragraph 97: SFAS 115 was meant to "eliminate the unevenhandedness of LOCOM, which recognizes the net diminution in value of securities but not the net appreciation in value."
[9] SFAS 115, paragraph 12.

115 deliberations, and resolved the issue by creating the AFS category.[10] The "modified LOCOM" approach for AFS securities, a potential consequence of EITF 03-01, effectively nullifies the Board's prior resolution of this issue.

One approach might be to reconsider the EITF 03-01 guidance and make its effective date coincident with the Board's conclusions on the Fair Value Option project. Expanded use of the trading category would present fewer concerns if coupled with the ability to recognize changes in the fair value of liabilities through earnings.

**Transition issues**

We have also identified several transition issues.

*Adoption of SOP 03-3 guidance for income recognition subsequent to impairment*
In paragraph 20, EITF 03-01 mandates application of SOP 03-3 for interest income recognition subsequent to recognition of an impairment loss. For securities that are not accounted for under EITF 99-20, this requirement would result in a change from SFAS 91 *retrospective* effective yield amortization to SOP 03-3 *prospective* effective yield amortization (after recognition of an impairment loss). We have several questions.

> (a) Did the EITF and Board intend to shift securities away from SFAS 91 accounting upon an impairment triggered solely by interest rate changes? Does the mixed model (some securities on SFAS 91, some securities on SOP 03-3) for similar instruments result in improved financial reporting?
>
> (b) Did the EITF and Board intend to add to the scope of SOP 03-3 by adding interest rate-driven impairments? As stated in SOP 03-3, the scope of that standard includes loans and securities acquired with evidence of deterioration of *credit quality* since origination. Although SOP 03-3 acknowledges that changes in interest rates affect fair value, interest rate-driven changes are not explicitly included in the SOP 03-3 scope. Instead, SOP 03-3 states that SFAS 91 and related EITF consensuses "address accounting for differences in prepayments and interest rates that are not attributable to credit quality."[11]
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> (c) Did the EITF and Board intend to add retained interests to the scope of SOP 03-3? SOP 03-3 explicitly excludes retained interests from its scope.[12]
>
> (d) Did the EITF and Board intend to accelerate the effective date of SOP 03-3? Implementation of EITF 03-01 for reporting periods beginning after June 15, 2004 (as

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[10] Per SFAS 115, paragraphs 93 – 94: "Some enterprises, particularly financial institutions, that consider both their investments in securities and their liabilities in managing interest rate risk contend that reporting unrealized holding gains and losses on only the investments, and not related liabilities, in earnings has the potential for significant volatility that is unrepresentative of both the way they manage their business and the impact of economic events on the overall enterprise. Based principally on those concerns, the Board decided that unrealized holding gains and losses on debt and equity securities that are available for sale but that are not actively managed in a trading account should be reported outside earnings . . . That reporting would alleviate the potential for volatility in reported earnings resulting from a requirement to value some assets at fair value without at least permitting fair-value-based accounting for related liabilities. It would also mitigate concerns about reporting the fluctuation in fair value of long-term investments in earnings."
[11] SOP 03-3, "Accounting for Certain Loans or Debt Securities Acquired in a Transfer," paragraph 2.
[12] SOP 03-3, paragraph 3.

required by paragraph 23 of EITF 03-01) would effectively require early adoption of SOP 03-3 (which by its terms is not effective until fiscal years beginning after December 15, 2004).

*Timing of paragraph 16 assertions about "intent and ability to hold until forecasted recovery"*
The transition provisions of EITF 03-01 are unclear about the date as of which a company must make its first paragraph 16 assertions for each impaired security and when the transaction history that would establish a "pattern" commences.

*One-time transfer to trading category*
We understand that, according to SFAS 115, transfers to and from the trading category should be rare. Does adoption of EITF 03-01 constitute an event that would justify a transfer to trading?

*Operational issues*
As discussed previously, we anticipate there may be significant operational complexities to implement the EITF 03-01 measurement consensus. Companies may be required to implement processes and systems to designate intent and forecasts and to convert to SOP 03-3.

We think that these operational challenges merit a longer period before transition.

**Our request**

Given the significance of the issues we have articulated, we respectfully request either reconsideration of the consensus including seeking public comment on these issues, or a delay in the effective date of the EITF 03-01 measurement consensus to allow preparers and their accounting firms more time to interpret the standard. We would also request that you consider coordinating this significant change with the timing of the Board's project on the "Fair Value Option," which would make the expanded use of the trading category more feasible.

Thank you for your consideration of these issues. We are available at your convenience to discuss these issues in detail. If you would like to contact us to discuss these issues directly, please feel free to call Marty Baumann at (703) 903-3940 or John Woods at (571) 382-3900.

Sincerely,

Martin F. Baumann
Executive Vice President – Finance & Chief Financial Officer

John F. Woods
Senior Vice President – Principal Accounting Officer

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*Freddie Mac is a stockholder-owned corporation established by Congress in 1970 to support homeownership and rental housing. Freddie Mac fulfills its mission by purchasing residential mortgages and mortgage-related securities, which it finances primarily by issuing mortgage-related securities and debt instruments in the capital markets. Over the years, Freddie Mac has made home possible for one in six homebuyers in America. For additional information about Freddie Mac, please see our Web site at www.FreddieMac.com.*

August 26, 2004

Mr. Robert Herz
Chairman
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Mr. Lawrence W. Smith
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RE: Emerging Issues Task Force Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments"

Dear Mr. Herz and Mr. Smith:

The Independent Community Bankers of America (ICBA)[1] urges the Financial Accounting Standards Board to revisit EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Instruments," due to the significant concerns expressed by many community banks about its interpretation. We urge you postpone the effective date of September 30, 2004 so its interpretation can be resolved.

EITF 03-1 requires that an investor have the intent and ability to hold an investment until a forecasted recovery of fair value up to or beyond the cost of the debt security in order to determine that the impairment is temporary. If the investor does not have the intent and ability to hold the security in accordance this requirement, then an "other than temporary

[1] The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to protecting the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace. For more information, visit ICBA's website at www.icba.org.

impairment" must be recognized. This must be done regardless of whether the investor believes that no credit concerns exist with respect to an investment in a debt security.

We are concerned that some in the accounting profession are now suggesting that as few as two sales of securities at a loss from the available-for-sale account could indicate that there was an intent to sell all similar securities under that classification. This could taint the entire portfolio and necessitate the permanent right down of all such securities, regardless of the length of time they are expected to be held. We do not believe that this is consistent with FAS 115, "Accounting for Certain Investments in Debt and Equity Securities."

Although the issue addressed in EITF 03-1 is not a new one, having been discussed by the Emerging Issues Task Force (EITF) for more than a year and having produced two consensuses, the very restrictive and likely unintended interpretations of it now being adopted by some accounting firms has caused ICBA members great concern. As a result, we are asking FASB to postpone the application of the March 2004 consensus of EITF 03-1 in order to clarify its intended application and to receive and consider our newfound concerns given some of the interpretations currently being discussed.

In the past few weeks, it has become clear that, at a minimum, some accounting firms intend to interpret EITF 03-1 in a manner that was unforeseen, and surprising, and that would threaten the ability of banks to manage their asset/liability and liquidity positions in a manner consistent with safe and sound business and banking practices.

The application was unforeseen even though we have followed the evolution of EIFT 03-1. Consistently throughout the discussion process of EITF 03-1, members of the EITF seemed appropriately reluctant to trigger impairment of debt securities due to changes in interest rates. In addition, the EITF did not appear to indicate a desire to greatly alter the appropriate management of "available-for-sale" investment securities as called for by FAS 115. Furthermore, there did not seem to be a desire on the part of FASB to extend other-than-temporary impairment of debt securities beyond credit risk situations.

Even conversations with accountants and regulators in the months immediately following the March consensus did not set off concerns as those we talked to did not foresee any major impact on debt securities. For example, widespread impairment of Treasury securities as well as widespread limitations on the sale of available-for-sale securities were not contemplated. In part, they were not contemplated because the language being cited by some for such treatment mirrored language in the SEC's 1985 Staff Accounting Bulletin 59 requiring an "intent and ability to hold."

If these restrictive applications stand, it will completely change how banks manage their investment securities, depriving them of the ability to use this component of their balance sheet to manage their asset/liability and liquidity positions. If this draconian application had existed in 2000, banks would have faced two equally unacceptable alternatives – sell a few securities to fund loan growth and face other-than-temporary impairment of the entire investment portfolio or turn down a quality loan. Both alternatives would have been contrary to good business practices.

The restrictive application of EITF 03-1, which some accounting firms are describing, does not further the objective of more transparent and reflective financial statements. Instead, it represents the biggest change in accounting for investment securities since FAS 115's adoption, one that distorts banks' financial statements and undermines banks' ability to appropriately manage their business. FAS 115 not only significantly changed accounting methods, but it also significantly changed how banks manage their investment portfolios. FAS 115 provided investment classifications that reflected business reality. Unfortunately, the troubling interpretation of EITF 03-1 takes a large step away from business reality.

While the expedient request may be to obtain a clearer, industry-applicable definition of "intent and ability to hold until a forecasted market price recovery" under EITF 03-1's discussion of debt securities, we believe that such a request would understate the problem and ramifications. As a result, in addition to requesting an immediate postponement of the application of EITF 03-1, we request that a conference be convened including representatives of the banking industry, banking regulators, FASB, the SEC, and others to discuss guidance which may accomplish the aim of EITF 03-1 without the problems which are now evident.

We look forward to further discussions and to finding a workable solution to this issue. Please contact Ann M. Grochala at (202) 659-8111 or ann.grochala@icba.org to discuss this further.

Sincerely,

Camden R. Fine

Camden R. Fine
President and CEO