

Letter of Comment No: 107
File Reference: EITF03-1A

October 29, 2004

Mr. Robert Herz
Chairman
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856-5166

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

Re: Proposed FASB Staff Position: Emerging Issues Task Force Issue No. 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"

Dear Messrs. Herz and Smith,

SunTrust Banks, Inc. (SunTrust) appreciates the opportunity to comment on the Proposed FASB Staff Position ("FSP"), *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"*, issued on September 15, 2004 by the Financial Accounting Standards Board.

SunTrust, headquartered in Atlanta, Georgia, is one of the nation's largest commercial banking organizations with assets of \$154 billion. The Company operates through an extensive distribution network in Alabama, Florida, Georgia, Tennessee, Maryland, North Carolina, South Carolina, Virginia and the District of Columbia and also serves customers in selected markets nationally. SunTrust's primary businesses include deposit, credit, trust and investment services. Through various subsidiaries, the company provides credit cards, leasing, mortgage banking, insurance, brokerage and capital market services.

We would like to thank the FASB for delaying the effective date for the measurement and recognition guidance contained in paragraphs 10-20 of EITF Issue 03-1. Considering the amount of concerns relative to the interpretation and application of Issue 03-1, we believe this was an appropriate measure to take. We appreciate your allowing for more time to learn about the concerns of our industry.

We understand that the purpose of this proposal is to provide a common approach for evaluating other-than-temporary impairment for investments and to improve the transparency of financial reporting. However, we are concerned that the proposal will

not only create inconsistency and ambiguity in existing guidance, but also have severe consequences to financial institutions and the users of our financial statements.

Background

EITF Issue 03-1, "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments", provides guidance as to when an impairment is deemed other-than-temporary.

Two primary issues that are of concern to SunTrust as a result of the EITF are as follows:

1. The application of EITF 03-1 to impairments caused by interest rate changes
2. Whether the sale of investments prior to a forecasted recovery calls into question the investors' intent, thereby "tainting" the remainder of the securities portfolio that is underwater.

In September, the FASB issued Proposed FSP No. EITF Issue 03-1-a, which attempts to provide implementation guidance with respect to application issues. We continue to remain increasingly concerned about the following issues which are not addressed by the FSP:

1. The proposed guidance will impair banks' ability to practice safe and sound liquidity and balance sheet management
2. The proposed guidance will result in dramatically decreased use of the AFS category, which is problematic for financial institutions.
3. The proposed guidance is in conflict with existing GAAP literature

We would also like to provide our comments on the questions the FASB posed to constituents in the proposed FSP:

1. Do you believe the Board should specify a numerical rule or threshold for what constitutes a "minor impairment" and, if so, what would that rule or threshold be?
2. 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?

Concerns

Financial institutions need flexibility for liquidity and balance sheet management

Paragraph 12 of EITF 03-1 states that "*An impairment should be deemed other than temporary unless the investor has the ability and intent to hold an investment for a reasonable period of time sufficient for a forecasted recovery of fair value up to the cost of the investment.....Although not presumptive, a pattern of selling investments prior to the forecasted recovery of fair value may call into question the investor's intent.*" In evaluating this guidance, many financial institutions became concerned that a pattern of

selling securities at a loss would lead to a tainting of their entire securities portfolio. The FSP addressed this issue by presenting limited circumstances where a change in intent would not necessarily call into question the investor's intent to hold other securities to recovery. However, none of the circumstances listed in the FSP consider that financial institutions periodically sell securities in order to better manage their business and overall interest rate risk and liquidity management. It is not uncommon for institutions to change their intentions regarding securities when considering balance sheet strategies due to changes in the market place and structural changes in their balance sheet. Institutions need the flexibility to be able to sell these securities at a gain or loss without having to be concerned with potentially tainting the remainder of the portfolio. If these factors are not taken into account, it will threaten effective asset/liability management.

For example, when interest rates increase, many of our assets, such as mortgage loans, extend in duration while many of our liabilities, such as core deposits, shorten in duration as depositors seek higher yielding investments. The AFS investment portfolio is the primary tool we use to manage this change in our interest rate risk profile. In this case, we would reposition the AFS portfolio by selling longer duration securities, which may result in a realized loss, in order to rebalance our interest rate mismatch. Quite often, we would only need to sell a portion of our AFS portfolio to achieve the desired rebalancing, calling into question our intent to hold similar securities in the portfolio.

Banks will decrease use of the AFS category, creating unintended consequences

Due to the earnings volatility that will result from reporting other-than-temporary losses through income, banks may reclassify securities as held to maturity ("HTM") on the balance sheet. The HTM classification will cause banks to lock away rather than to manage their security losses, reducing liquidity and threatening the viability of the banking industry, similar to what happened to the savings and loan industry. In addition, the weakened financial results may create earnings pressure and drive institutions to make unsound economic decisions such as replacing securities with derivatives or engaging in riskier loan transactions. This effect would have a more dramatic impact on the smaller community banks within the industry since they do not have the same access to other financial markets as larger institutions and they typically have a larger investment portfolio as a percent of total assets.

Alternatively, banks may decide to reclassify securities into the trading category. This would not only cause earnings volatility, but would also impact banks' regulatory capital positions as they would be unable to hold unrealized losses. This issue was acknowledged by the Board in its FAS 115 deliberations and was resolved by the creation of the available for sale category. In addition, the requirements of the FSP could result in an incentive for banks to engage in gains trading. Gains trading is the unsound practice of cherry picking the portfolio by selling the portfolio's highest yields while holding the lowest yields to the detriment of future income and shareholder value. We think the guidance will encourage short-term behavior and may result in bad economic decisions in order to avoid negative accounting results. We are concerned that if this accounting

guidance is issued it will create these unintended consequences that are not consistent with safe and sound banking practices.

The proposed guidance is in conflict with existing GAAP literature

We believe that EITF 03-1 conflicts with current accounting guidance noted in FASB Statement No. 115 (FAS 115), "Accounting for Certain Investments in Debt and Equity Securities". FAS 115 states that "*investments not classified as trading securities nor as held-to maturity securities shall be classified as available for sale securities*". The title alone suggests that these securities are "available" to be sold by institutions. However, based on the current guidance in EITF 03-1, companies are in essence being asked to create a fourth category, "held to recovery" in situations where a security is underwater due to interest rate changes. As mentioned above, the FSP is not taking into consideration the sale of securities due to prudent balance sheet management practices when discussing the limited circumstances that may cause a bank to change its intent to hold securities to a forecasted recovery. This conflicts with Paragraph 82 of FAS 115 which states, "*the available-for-sale category will include 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.*" FAS 115 acknowledged that financial institutions needed flexibility with regard to balance sheet management and therefore developed the concept of AFS. EITF Issue 03-1 appears to be amending FAS 115 and the inconsistencies need to be resolved.

Operational difficulties

The proposed FSP requires investors to assert ability and intent to a "forecasted recovery", at the individual security level; however this is asking companies to predict interest rate changes with a level of precision that is impossible. In order to provide a paper trail for audit purposes and Sarbanes-Oxley control testing, companies would need to develop processes to document and prove ability and intent and additionally, would have to provide analysis to show the forecast for recovery. Questions we have are: How often does a company's intent have to be re-affirmed? How often does the forecasted recovery period have to be refreshed? For companies like SunTrust with over 5,000 security positions and multiple securities portfolios, this is an operationally difficult task. Companies may be required to implement system changes which would require a longer period to transition to the new guidance.

Suggested Solutions

Interest rate changes should not be included in the scope of the EITF

There is nothing more temporary in our business than interest rates. Therefore, it does not seem reasonable to require a permanent or "other-than-temporary" write-down due solely to interest rate changes. Is the security really impaired if it is AAA rated and the company expects to get back 100 cents on the dollar? Securities that are inappropriately deemed other-than-temporarily impaired, which subsequently recover value, will require

banks to record a write-down in one period and subsequently recognize inflated revenue in future periods in order to accrete market to face value over the remaining life of the security. This mismatch in earnings recognition would not be meaningful for financial statement users. We believe the disclosure requirements of Issue 03-1 are helpful in making the financial statement users aware of impairments, without taking an unnecessary permanent write-down.

Remove the “intent” concept

If the above solution is not considered acceptable, we would like the FASB Staff to consider removing the concept of asserting the intent to hold to a forecasted recovery. We believe a focus on ability to hold is reasonable, however it does not seem practical to ask companies to prove they have the intent to hold. Again, what is the purpose of the available for sale portfolio if “intent to hold” must be proven? If this concept remains in the EITF, then the FSP should expand the circumstances that would not call into question the investor’s ability or intent to hold other securities to recovery. The three circumstances currently provided in the proposal, a. unexpected and significant changes in liquidity needs, b. unexpected and significant increases in interest rates and/or sector spreads that significantly extend the period that a security would need to be held by the investor, and c. a de minimis volume of sales of securities, are too draconian and do not allow for changes in intent due to legitimate business reasons. As explained above, financial institutions need to have the flexibility to buy and sell securities for prudent asset/liability management, without having to be concerned that a security sale may call into question their previous assertion on that security or their intent on the remainder of the securities in the portfolio.

Threshold for “minor impairments”

Paragraph 5 of the proposed FSP states that, *“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.”* We would like FASB to consider the above recommendations which would eliminate the need to establish the notion of “minor impairments”, however should the FASB believe that further impairment guidance is necessary, then we believe that additional guidance is needed to determine what threshold constitutes “minor”. We believe that an adequate threshold would be at least 10% considering the historical rate environment. We have based this threshold on results we have encountered in the previous ten years. See attached spreadsheet which details the four major moves for the last 10 years for a 5-year Treasury note. Based on these results, it appears that 10% would be a reasonable threshold for banks to manage its liquidity needs through a normal interest rate cycle. We would also note that we are still historically low in the interest rate cycle and expect rates to increase further in the future.

We recognize the difficulty in establishing a single “bright line” threshold for minor impairment because one size does not fit all institutions. As an alternative to a 10% threshold, we would suggest applying a historical measure of changes in interest rates

over a “normal” interest rate cycle to establish the threshold. Developing a 95% confidence level to historical changes in interest rates could establish a “normal” range of price changes that would be considered temporary impairment. This process could be applied to different security types and different maturities to provide different thresholds without a rigid rule.

The Board has limited the notion of “minor impairments” to debt securities analyzed for impairment under paragraph 16 that are impaired due to interest rate and/or sector increases. If the guidance is issued, we believe that the Board should expand this notion to also cover debt securities that can be contractually prepaid such as mortgage securities. Although the investor may not recover all of the cost on these debt securities, we believe that premium securities are already accounted for under FASB Statement No. 91 (FAS 91), “Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases”. We encourage the FASB to provide further guidance on what threshold would constitute a material premium. We would suggest that, for securities that can be contractually prepaid, substantially all of their cost should be defined to be 90% of the original purchase price, allowing for a 10% premium to be viewed as a minor impairment.

Effective date

Lastly, the proposed FSP states that the guidance in the FSP is effective on the last reporting date for reporting periods ending after the final FSP is posted to the FASB website. If the final guidance issued is similar to the current proposal, we believe there will be significant impacts to the financial services industry and companies will need time to react. The result of this guidance will impact business decisions and strategies. There are operational processes that will need to be developed to fully comply with this guidance and to develop the controls necessary to comply with Sarbanes-Oxley. Assuming that companies will not want a manual process, there are system changes that may be required. We believe that the effective date should not be earlier than January 1, 2006.

Conclusion

In conclusion, we do not believe that the proposed guidance will improve financial reporting. Instead, the guidance may have negative implications to banks’ financial positions which could subsequently lead to decisions that do not promote the safety and soundness of banking institutions. Furthermore, the guidance may change the way that companies view FAS 115, specifically the way companies have designated FAS 115 securities between trading, available for sale, and held to maturity. We strongly urge the FASB to reconsider the ramifications of the proposed guidance to financial statements and potentially the financial services industry as a whole.

Again, we appreciate the opportunity to comment on this proposal. Thank you for considering our views. If you would like to discuss the letter in more detail, please contact Jennifer Stembridge, First Vice President-Accounting Policy at (404) 813-5029

or Ken Houghton, Senior Vice President- Investment Portfolio Administration at (404) 588-8263.

Sincerely,

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**LAST 10 YEAR 100 BPS MOVES FOR
5 YEAR TREASURY CURVE**

Rate Cycle	BPS Move	Duration		
		3	5	7
1/30/96-8/30/96	147	4.4%	7.3%	10.3%
9/30/98-1/31/00	242	7.3%	12.1%	16.9%
10/31/01-3/29/02	129	3.9%	6.5%	9.0%
6/30/03-6/30/04	151	4.5%	7.6%	10.6%