October 29, 2004

Mr. Lawrence Smith
Director-Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: Proposed FASB Staff Position EITF Issue 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 Mr. Smith:

The Bond Market Association [1] and the American Securitization Forum[2] (the "Associations") appreciate the opportunity to submit this comment letter in response to the Proposed FSP EITF 03-1-a ("EITF 03-1-a"), relating to implementation guidance on the meaning of other-than-temporary impairment and its application to certain investments.

The Associations also appreciate FASB's decision to defer application of the recognition and measurement provisions of EITF 03-1 until further guidance can be issued. We believe this was an appropriate interim measure that avoided unnecessary dislocations

[1] The Bond Market Association represents securities firms and banks that underwrite, distribute and trade in fixed income securities, both in the United States and globally. More information about the Association is available on its website at www. bondmarkets.com. This letter was prepared in consultation with the Association's Accounting Policy Committee.

[2] The American Securitization Forum (the "ASF") is a broadly-based professional forum of participants in the U.S. securitization market. Among other roles, the ASF members act as issuers, underwriters, dealers, investors, servicers and professional advisors working on securitization transactions. The ASF is an adjunct forum of The Bond Market Association. The views expressed in this letter are based upon input received from a broad range of ASF members including members of the ASF Accounting and Tax Subcommittee. More information about the ASF, its members and activities may be found at its internet website, located at www.americansecuritization.com.

throughout the debt markets that might have resulted from more immediate application of those provisions.

However, we do not support issuance of the FSP for the following reasons:

- It is inconsistent with the conceptual basis of an available-for-sale ("AFS") portfolio as defined in FAS 115

- it is inconsistent with prudent portfolio management

- it will place undue operational burdens on companies and is therefore not justified from a cost-benefit perspective

- it diverges from, rather than converges with, International Accounting Standards

- existing guidance, coupled with the disclosure requirements of EITF Issue No. 03-1, are sufficient to address any issues noted in practice regarding impairment write-downs

For these reasons, we believe that the proposed FSP and the provisions of EITF 03-1 relating to debt securities (other than the disclosure provisions) should be deferred until the Board can consider the broader implications of these issues in connection with other projects on its agenda, including how to address situations where assets and liabilities are used in the same business activity but are accounted for differently (that is, how to address a measurement attribute mismatch or anomaly). Alternatively, we believe that the Board should consider amending FAS 115 in an appropriate manner.

If, however, the Board elects to proceed with issuing this guidance, we believe that significant changes to the proposed guidance are necessary:

- We do not support a "bright line" approach, as a single threshold for impairment is not appropriate for securities that are of different durations or may be denominated in different currencies.

- Instead, we propose that an other-than-temporary impairment review would be triggered if a security suffered a decline in value that is outside a normal range of volatility for that security.

- We propose additional circumstances in which a sale of an AFS security at a loss would not call into question the investor's ability and intent with respect to other AFS securities.

- We request that the Board reconsider the proposed application of SOP 03-3 to securities for which an impairment charge has been recorded.

- We request that the Board allow a one-time transfer of AFS securities into trading.

We elaborate on each of these comments and recommendations below.

The proposed guidance is inconsistent with the conceptual basis of an available-for-sale portfolio as defined in FAS 115

Although the clarifying guidance in the proposed FSP represents an improvement over the way that many were interpreting the provisions of EITF 03-1, in our opinion, it is not true to the wording or the intent of FAS 115 with respect to securities classified as available for sale ("AFS"). We do not believe that GAAP requires an assertion regarding the expected holding period for AFS securities which, by definition, are those held for an **unspecified** period of time.[3] As indicated in FAS 115, investors may wish to sell securities not classified as held-to-maturity (HTM) as a result of changes in market interest rates, needs for liquidity, changes in the availability and yield of alternative investments, changes in funding sources, changes in the credit outlook, changes in foreign currency risk, and asset liability adjustments. As further evidence that FAS 115 did not intend to unduly restrict the ability to sell AFS securities, paragraph 71 states that securities that may need to be sold to implement tax-planning strategies should be classified as available-for-sale.

We believe that the proposed guidance, by imposing requirements on investors to assert their intent and ability to hold a security for a specified period of time, effectively creates a fourth category of "held-to-recovery investments." Barring an investor's ability to make the required assertions, we believe that the guidance effectively moves FAS 115 back to a lower-of-cost-or market standard. We believe this runs counter to the reasons for issuing FAS 115, as one of the stated objectives of and expected improvements in the AFS model was to eliminate the lack of evenhandedness in the prior accounting practice of measuring securities at the lower of cost or market, which "…recognizes the net diminution in value but not the net appreciation in value of those securities." The AFS category was intended to "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….[and] mitigate concerns about reporting the fluctuation in fair value of long-term investments in earnings."

We believe that EITF 03-1 also goes well beyond the guidance in SAB 59m (SAB 59 updated by SAB 103). SAB 59m lists the intent and ability of the holder to retain its investment for a period of time sufficient to allow for any anticipated recovery in market value as an example of one of the factors that indicate an other than temporary decline, and concludes that there are numerous factors to be considered in such an evaluation and their relative significance will vary from case to case. We believe that this was appropriate guidance, and did not conflict with the conceptual basis of an AFS portfolio as defined in FAS 115.

The proposed guidance is inconsistent with prudent portfolio management

[3] Paragraph 82 of FAS 115.

For larger institutions, an AFS portfolio can easily consist of many thousands of individual securities which may be held at several different legal entities that are included in the consolidated financial statements, but may be managed at the legal entity level. Portfolio managers of debt securities rarely establish anticipated holding periods for individual security positions; this is more appropriately done at the portfolio or segment of a portfolio level. The optimal return on investment is achieved through prudent risk/opportunity evaluation at the time of sale without regard to the historical cost of an individual security at a particular point in time. Thus, before a decision is made to sell, the investor is not able to make a good faith assertion about which individual security might be sold and when. Further, selling fixed-income securities that have declined in value due to interest rate movements enables the entity to reinvest at a time when interest rates have moved higher into cash flows that will produce higher future yield. Restrictions on the ability to sell these securities runs counter to prudent portfolio management.

Further, recognizing losses in the income statement merely because of the inability to make the assertion in good faith distorts net income and ignores the economic reality of the inherent "gains" in the fixed rate portion of the company's funding structure when interest rates have risen. Assuming that professional portfolio managers will continue to manage based on the prudent risk-reward considerations and without being excessively influenced by new accounting rules, we anticipate that many entities will be presenting and emphasizing a new non-GAAP measure of net income as a way to adjust EITF 03-1 impairment charges out of net income. The effects of presenting this non-GAAP measure will be exacerbated by the positive impact on net income in future periods, resulting from the amortization of the impairment writedown over the remaining life of the security.[4] Thus, we do not believe that the new guidance will enhance existing GAAP or make GAAP more generally accepted.

The proposed guidance would place undue operational burdens on companies, and is therefore not justified from a cost-benefit perspective

Implementing the assertion about intent and ability to hold requirements of EITF 03-1, even if only for securities with more than "minor" differences between current fair value and cost, will be a time consuming and difficult task for financial institutions. It will entail developing and populating models to predict recovery periods, applying the models on a security-by-security basis, conducting discussions between portfolio managers and accounting departments regarding intent and ability, documenting intent and ability, and monitoring subsequent actions and changing conditions against the documented intent. Once these systems are developed and are in place, they will have to operate every reporting period.

The requirement to predict a recovery period is especially challenging. In general, we believe that market conditions are too dynamic to have a meaningful basis for creating a "hold-to-recovery" portfolio. Because of the inherent difficulties in forecasting future

[4] If some impairment charge has to be taken on a debt security solely because of increases in market interest rates, it would make more sense for that charge to be allowed to be reversed in future periods when the price recovers, as is presently the case in IAS 39 (Revised).

interest rates, the estimated period will be only an educated guess, based on the prediction of future direction and extent of interest rate changes. Also, for securities denominated in a foreign currency, it will be particularly difficult to forecast a recovery period based solely on changes in interest rates and/or sector spreads without regard to what effect those changes might have on exchange rates. Finally, it is not clear what to do if a partial recovery in value is predicted. For example, if an investor expects that it will hold the security until only 50% of the difference between fair value and amortized cost is recovered, is the impairment loss equal to 50% or 100% of the difference?

In addition, there are many questions that arise regarding how the requirement to forecast a recovery period would actually work in practice. It is not clear whether the forecast has to be updated or if it instead establishes a "minimum holding period." If market interest rates do not behave as predicted and the security has not recovered in value by the end of the forecasted recovery period, must the security be written down at that time? Or, must the investor re-pledge an ability and intent to hold the security until a newly calculated forecasted recovery period? Also, given that one of the permitted reasons for selling identified in the proposed FSP is an "unexpected and significant increase in interest rates and/or sector spreads that significantly extends the period that a security would need to be held by the investor," can the security be sold without calling into question the investor's intent with respect to other securities?

We think that the worst possible answer would be that the assertion has to be updated each reporting period, and a new forecast of the recovery made based on then current circumstances. If that were the case, and the calculations must be continually updated, the proposed standard effectively becomes a requirement to hold until *actual* recovery, rather than *forecasted* recovery.

In addition to the questions noted above, numerous implementation questions are certain to arise that might necessitate creation of additional FSPs. Thus, given all these complexities, we question whether the costs of implementing this guidance will outweigh the potential benefits.

The proposed guidance diverges from, rather than converges with, International Accounting Standards

Our members with international presence and reporting responsibilities have also expressed great concern over the continuing divergence of US and International Accounting Standards. Adoption of EITF 03-1, even with the clarifications in the proposed FSP, would impose a subjective evaluation of impairment and represent a further departure from international standards. Under IAS 39 (Revised), the relevant criterion is not whether the fair value is less than cost, but whether there is objective evidence that a security is impaired. According to paragraph 60 of IAS 39 (Revised), a decline in fair value of an investment in a debt instrument is not necessarily evidence of impairment when, for example, the decline results from an increase in the basic, risk-free interest rate. In addition, paragraph 70 states: "If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss shall be reversed, with the amount of the reversal recognized in profit or loss." We strongly believe that this approach should be incorporated into the U.S. guidance.

Existing guidance, coupled with the disclosure requirements of EITF 03-1, is sufficient to address any practice issues noted regarding impairment writedowns

We are not aware of practice problems in the pre-EITF 03-1 environment that required a re-visitation of the accounting literature relating to debt securities. The origin of the EITF 03-1 agenda item related solely to equity method securities, and although the desire to produce an improved set of unified guidance surrounding other-than-temporary impairments was laudatory, we do not believe that EITF 03-1 accomplished that objective.

We believe the overriding principle for assessing other-than-temporary impairment should be to record a loss when it is *probable of occurrence* rather than when both the amount (if any) and timing (if ever) of loss is uncertain. We think that this principle is appropriately articulated in EITF Topic No. D-44, *Recognition of Other-Than-Temporary Impairment upon the Planned Sale of a Security Whose Cost Exceeds Fair Value* ("D-44"). The threshold for recognizing an impairment in D-44 is when an entity has decided to sell an AFS security whose fair value is less than its cost basis. Although D-44 noted that an entity's decision to sell a security is only one of the circumstances that needs to be considered in determining when an other-than-temporary impairment exists, the fact pattern in that issue indicated that the decline in the security's value may be due to an increase in market interest rates since acquisition, a deterioration in the issuer's creditworthiness, or a change in foreign exchange rates. There is no requirement that the entity assert that it has the ability and intent to hold AFS securities whose fair value is less than cost until an anticipated recovery date, and there is no tainting concept. We think that FASB should re-emphasize the principles in Topic D-44 that interest-related declines in fair value should cause recognition of an other-than-temporary loss *when* the company has plans to sell specific securities with unrealized losses.

For securities where the timing and amount of potential losses is uncertain, because the entity has no current plans to sell the securities, we believe that the disclosure requirements of EITF 03-1 provide transparency to readers of financial statements and are the most effective way to communicate these uncertainties. We believe that FASB should give these disclosures time to work, and perhaps, with the SEC, encourage similar disclosures in interim financial statements as well. The disclosure information will also contribute to greater comparison between companies who might be classifying similar securities as HTM, AFS or Trading.

For all these reasons, we do not support adoption of EITF 03-1 or FSP 03-1-a. If the Board determines nevertheless to implement EITF 03-1 and the FSP, we believe it should first consider the following:

We do not support a "bright line" approach, as a single threshold for impairment is not appropriate for securities of different durations and that are denominated in different currencies

We do not favor a “bright-line” numerical test to evaluate impairments because not all securities react the same to increases in interest rates. For example, the percentage change in value of a Treasury security resulting from a 100 basis point (bp) increase in interest rates would be different from the percentage change in value of a mortgage-backed security even of similar duration. The decline in price depends on both the interest rate change and the duration and convexity of the security. The effects are even more pronounced for so-called “paragraph 10 securities” such as Interest-Only Strips.

The numerical threshold of 5% that is suggested is also impractical, as illustrated in the following example. The Treasury discontinued 30-year issuance in 2001, but the securities are trading in the secondary market. A 30-year Treasury note issued in February 2001 that had a coupon of 5.375% and was originally offered around par is selling at 106.00 in early October 2004. It would only take a 36 bp increase (relatively minor, in the scheme of things) in long-term interest rates to cause the price of that security to decline by 5%. Another example would be a 10-year Treasury note issued in August 2004 that had a coupon of 4.25% and was originally offered around par, that is now selling at 100.08. It would only take a 65 bp increase in long-term interest rates to cause the price of that security to decline by 5%.

For super-premium prepayable securities like Interest-Only Strips, a general rise in Treasury rates could result in an *increase* in fair value of the securities, due to the anticipated effect of slowing prepayments. It is estimated that a 50bp rise in Treasury rates could cause an approximately 13% positive price change in an agency strip IO. Conversely, a 50bp decline in Treasury rates could cause an approximately 21% negative price change on that same security. Note that EITF Issue No. 99-20 would already require recognition of that impairment, since reductions in estimated cash flows resulting from higher prepayment expectations would be the cause of the decline in value.

We also note that currency movements alone, even in relatively stable currencies like the Euro and Canadian dollar, can exceed 10% in a given quarter. When there has been no change in the country credit rating of the currency issuer, we believe that there should be no other-than-temporary impairment to be recognized. When currency movements and interest rate movements coincide, temporary fluctuations in value can easily exceed a 5% threshold, but it is still reasonable to expect recovery.

Further, we note that the Office of Thrift Supervision defines “complex securities with high price sensitivity” to include those whose price would be expected to decline by more than 10 percent under an adverse parallel change in interest rates of 200 basis points.[5] Thus, although we do not support a bright line test, if the Board proceeds in this direction, we believe that a 10% threshold would be more appropriate than 5%, and the length of time that the fair value has been below cost should span at least two interim reporting periods.

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[5] Thrift Bulletin TB 13a. The term “complex security” includes any collateralized mortgage obligation (“CMO”), real estate mortgage investment conduit (“REMIC”), callable mortgage pass-through security, stripped-mortgage-backed security, structured note, and any security not meeting the definition of an “exempt security.” An “exempt security” includes non-callable, “plain vanilla” instruments of the following types: (1) mortgage-pass-through securities, (2) fixed-rate securities, and (3) floating-rate securities.

Instead, we propose that an other-than-temporary impairment review would be triggered if a security suffered a decline in value that is outside a normal range of volatility for that security

As we have noted above, different securities react differently to changes in market conditions. Thus, instead of a bright-line test, we believe that both the significance of the impairment relative to normal market movements and the duration of the impairment caused by a general rise in interest rates are important factors in assessing whether an assertion about the ability and intent to hold a particular security should have to be made. We therefore believe that the notion of "minor impairment" should be replaced with a notion of "temporary impairment," which would be defined as a decline in value which is caused by normal interest rate or sector spread or currency volatility over a short time horizon. As long as the security's decline in value is within this normal range, the security would be viewed as only temporarily impaired, no further analysis would be required, and no assertion regarding intent and ability to hold the security would be required.

We recommend that the Board expand the circumstances which do not call into question an investor's ability and intent

As noted above, we believe that the current approach to addressing the investor's ability and intent, as established in D-44, is consistent with the underlying principles of FAS 115 and the establishment of criteria over and above this guidance is unwarranted. That said, we believe that Board members agree that the list of circumstances in which a sale of an AFS security would not necessarily call into question the investor's ability or intent to hold other securities to recovery should not be nearly as restrictive as the permitted circumstances in paragraph 8 of FAS 115 with respect to held-to-maturity securities.

Consider the following suggested text:

"The following changes in circumstances may cause the enterprise to change its intent to hold an available-for-sale debt security whose current fair value is less than its amortized cost without calling into question its intent to hold other debt securities in the future:

a. Evidence of a deterioration in the issuer's creditworthiness;

b. A change in tax law that eliminates or reduces the tax-exempt status of interest on the debt security or revises the marginal tax rates applicable to interest income;

c. A business combination or disposition (such as sale of a segment) that necessitates the sale of securities to maintain the enterprise's existing interest rate risk position or credit risk policy;

d. A change in statutory or regulatory requirements modifying either what constitutes a permissible investment or the maximum level of investments in certain kinds of securities, thereby causing an enterprise to dispose of a security;

e. An increase by the regulator in capital requirements that causes the enterprise to downsize by selling securities;

f. An increase in the risk weights of debt securities used for regulatory risk-based capital purposes;

g. Changes in the security's prepayment risk;

h. Needs for liquidity (for example, due to the withdrawal of deposits, increased demand for loans, surrender of insurance policies, or payment of insurance claims);

i. Changes in foreign currency risk.

In addition to the foregoing changes in circumstances, other events that are isolated, nonrecurring, and unusual for the reporting enterprise that were not anticipated at the time management made an assertion about its intent and ability to hold until an anticipated recovery date may cause the enterprise to sell a security without necessarily calling into question its intent to hold other debt securities. "

We also request that the Board consider the following recommendations:
First, a *de minimis* volume of sales of securities should be evaluated not as an absolute number of sales but in relation to the size of an investor's portfolio as well as their historical experience in selling AFS securities.

Second, we note that investors often use a variety of instruments to manage the risk inherent in their debt portfolios, without employing hedge accounting pursuant to FAS 133. If an AFS debt security is sold at a loss and there is a corresponding gain on closing out a related derivative, we do not think that the sale should taint the remainder of the AFS portfolio.

Lastly, if the reason for the sale is not one of the specifically permitted reasons under paragraph 7, but would have no relevance to other sectors of the AFS portfolio, clearly that sale should not call into question the investor's intent with respect to debt securities in those other sectors. For example, if a financial institution with a large portfolio of Treasuries, corporate bonds, municipal bonds, and MBS disposes of a portion of its MBS portfolio because of a change in its view of the rate of prepayment or delinquencies of the underlying mortgage loans, this should have no relevance to the other sectors of its AFS portfolio.

We request that the Board allow a one-time transfer of AFS securities into trading

In FAS 115, the Board wanted to avoid the potential consequence of permitting transfers between categories of investments that would allow discretionary adjustments to earnings that could weaken the credibility of reported earnings. Accordingly, the Board decided that unrealized holding gains and losses would be recognized in earnings only if the security were transferred into the trading category, and that such transfers should be rare. We request that the Board provide that at the date of initial application, an entity may transfer any available-for-sale security into the trading category, as the Board permitted upon the initial application of FAS 133. This would at least allow investors, who can not make good faith assertions about their intent with respect to individual securities, to have a more evenhanded approach of recognizing both unrealized depreciation and unrealized appreciation through earnings.

We request that the Board reconsider the proposed application of SOP 03-3 to securities for which an impairment charge has been recorded

Paragraph 20 of EITF 03-1 requires that after an investor recognizes an impairment loss, the investor should adopt SOP 03-3, *Accounting for Certain Loans and Debt Securities Acquired in a Transfer*, to determine the amount and timing of income recognition in subsequent periods. The rationale for this approach is not provided. We are concerned with this guidance as we believe it creates numerous inconsistencies. These include:

- the fact that the SOP was not supposed to be effective until fiscal years beginning after December 15, 2004 (*i.e.*, a different effective date from the one originally contemplated for EITF 03-1);

- it expands the scope of the SOP beyond what was intended, to also include (a) debt securities retained in securitizations, which were specifically excluded from the SOP and (b) securities that have no indication of deterioration of credit quality; and

- the fact that the SOP requires the prospective method of amortization for changes in assumptions, like prepayments, while most of the securities that are subject to EITF 03-1 are accounted for under the FAS 91 retrospective method.

Accordingly, we recommend that the FASB reconsider this aspect of EITF 03-1. In our view, if an impairment charge must be recorded on a debt security solely due to increases in market interest rates, it would make more sense for that charge to be allowed to be reversed in future periods when the price recovers, as is presently the case in IAS 39 (Revised). However, we recognize that this approach is not contemplated by FAS 115.

Need for Reasonable Transition Period

As discussed above, we believe that there will be significant operational challenges in adopting EITF 03-1 which will be quite time consuming. Accordingly, if the Board decides to reinstate the recognition and measurement provisions of EITF 03-1 and adopt this FSP, we request that a transition period of at least two calendar quarters be granted before investors have to adopt it.

Conclusion

EITF 03-1, even with the clarifying guidance proposed in the FSP, is a significant departure from current practice and does not represent improvement over current practice. There has been no clear articulation of the principle in EITF 03-1 or what practice situations were found to be inappropriate that necessitated the issuance of EITF 03-1. Rather than proceeding with this guidance, which we believe is flawed in many respects, we think that FASB should re-emphasize the principles in Topic D-44 that interest-related declines in fair value should cause recognition of an other-than-temporary loss *when* the company has plans to sell specific securities with unrealized losses. FASB should also give the mandatory EITF 03-1 disclosures time to work, and perhaps, with the SEC, encourage similar disclosures in interim financial statements as well.

Barring this approach, we recommend that FASB adopt an approach whereby temporary impairment is defined as a decline in value that is within a normal range of market volatility over the short term, taking into account both interest rate movements and credit spreads for various classes of securities. In addition, we think that the list of circumstances in which a sale of an AFS security at a loss would not call into question the investor's ability and intent with respect to other AFS securities needs to be expanded, in a manner similar to what we propose above.

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Should you have any questions or desire any clarification or additional information regarding any of the matters discussed in this letter, please do not hesitate to contact Esther Mills at 212-449-2048 or George Miller at 646-637-9216.

Sincerely yours,

Esther Mills	George Miller
Chair, Accounting Policy Committee of	Executive Director of
The Bond Market Association	*American Securitization Forum*