



VIA ELECTRONIC MAIL

October 29, 2004

Mr. Lawrence W. Smith
Director, TA&I—FSP
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Proposed FSP 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 Mortgage Bankers Association appreciates the opportunity to comment on the above-referenced FASB Staff Position (the proposed FSP). The proposed FSP would amend the guidance in EITF Issue 03-1 relating to the circumstances in which other-than-temporary (OTT) impairments must be recognized on certain debt and equity securities. It also requests comment on the notion of minor impairment, including whether it should be defined by a “bright line” test and extended to evaluations of securities under paragraphs 10-15, as well as securities under paragraph 16, of Issue 03-1.

I. MBA Position

MBA commends the FASB for responding to constituent requests for a delay in the application of the evaluation guidance in Issue 03-1 and for taking action to address constituent concerns through proposing revisions to that Issue, as set forth in the proposed FSP. However, perhaps inadvertently, the proposed new guidance perpetuates the problems in the old guidance and, in fact, introduces new concerns relating to the implications of sales of impaired securities. Consequently, MBA believes the appropriate course of action for the Board is to retract Issue 03-1, as well as the proposed FSP.

II. Explanation of MBA Position

The fundamental problem with the guidance in the proposed FSP and Issue 03-1 is that it would *require* unrealized losses on temporarily impaired available-for-sale (AFS) securities to be recognized in earnings, rather than equity, *unless* the holder asserts an ability and intent to hold the securities to recovery. However, this approach conflicts with the guidance in Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (FAS 115), which explicitly permits unrealized losses on temporarily impaired AFS securities to be recognized in equity, rather than earnings, even if the holder intends to sell the securities in the future in response to: “changes in market interest rates and related changes in the security’s prepayment risk; needs for liquidity...; changes in the availability of and the yield on alternative investments; changes in funding sources and terms; and, changes in foreign currency risk.”¹ In summary, FAS 115, as interpreted², *does not* require security holders to assert an “intent and ability to hold” impaired AFS securities to avoid recognizing other-than-temporary (OTT) write-downs of the securities.

Some proponents of the proposed FSP point to the effect of a holders’ ability and intent to hold securities to recovery in OTT impairment evaluations under SEC Staff Accounting Bulletin (SAB) Topic 5-M³ as support for the proposed FSP. However, the SAB only treats ability and intent to a hold as a factor, indicating that: “There are numerous factors to be considered in such an evaluation and their relative significance will vary from case to case.” By contrast, Issue 03-1 and the proposed FSP would require a holder’s ability and intent to hold a security to recovery to be *the sole determinant* in *all* impairment evaluations.⁴

Indeed, the “intent and ability to hold” concept is only relevant to the classification of securities as held-to-maturity (HTM) under FAS 115 and as only one of *several* considerations to be taken into account in evaluating impaired securities under SAB Topic 5-M. By elevating the stature of “intent and ability to hold” from one of several factors to consider in an OTT evaluation to the absolute and essentially only factor to consider, the proposed FSP and Issue 03-1 would fundamentally

¹ See paragraph 9 of FAS 115.

² The word “interpreted” is used here to refer to FAS 115 as interpreted by the FASB Special Report, *A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities* (1995). The Guide incorporates the guidance in several earlier releases: SEC Staff Accounting Bulletin (SAB) 59, *Accounting for Noncurrent Marketable Equity Securities* (1985) later codified as Topic 5-M; and AICPA Auditing Interpretation, *Evidential Matter for the Carrying Amount of Marketable Securities* (1975), as well as contemporaneous EITF Topic D-44, *Recognition of Other-Than-Temporary Impairment upon the Planned Sale of a Security Whose Cost Exceeds Fair Value* (1995).

³ Because SAB Topic 5-M was extracted from SAB No. 59 which was released eight years prior to the release of FAS 115, the Board presumably considered its guidance before settling on an approach that permits unrealized losses on AFS securities – that might be sold -- to be recognized in equity, a decision that would be overturned by the proposed FSP.

⁴ At least for securities that are impaired by more than some “minor” amount.

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change the guidance in FAS 115. The change would have significant operational, as well as earnings, implications for our members.

For example, the proposed FSP and Issue 03-1 would preclude mortgage companies from selling AFS securities used to economically hedge mortgage servicing portfolios to offset changes in the fair value of the portfolios. However, this is the same type of risk management activity that was expressly contemplated and sanctioned by the Board in developing the guidance in FAS 115. Instead, they would be forced to seek alternative means of economically hedging their mortgage servicing assets, including using more expensive derivative-based hedging strategies for little to no benefit to the companies or readers of their financial statements.

In fact, readers of financial statements would likely be more confused, rather than more enlightened, by the proposed FSP as they would undoubtedly have great difficulty understanding why an entity recognized OTT impairments on some AFS securities and not others, based on its current, future or past intent with respect to the securities. Furthermore, the current treatment of AFS securities already provides transparency for readers to the extent that unrealized gains and losses are already reported in the equity section of the balance sheet and disclosed in the notes to the financial statements. Also, because the guidance in existing FAS 5, *Accounting for Contingencies*, requires any losses that are probable and reasonable of estimation to be reported in earnings, any losses that meet those criteria should be recognized in earnings regardless of whether a security is deemed OTT impaired under FAS 115.

III. Conclusion and Recommendation

MBA strongly believes that the guidance in the proposed FSP and Issue 03-1 constitutes an amendment of the guidance in FAS 115 as it relates to the accounting treatment of AFS securities. Consequently, we believe the proposed FSP and Issue 03-1 should be retracted. If the Board believes there is sufficient basis for pursuing a change in the guidance in FAS 115, it should be accomplished in accordance with the Board's due process for amending an existing standard.

Thank you for considering our comments. If you have any questions about the content of this letter, please do not hesitate to contact Alison Utermohlen, Staff Representative to MBA's Financial Management Committee, at 202/557-2864.

Most sincerely,



Jonathan L. Kempner
President and Chief Executive Officer