

THE BANK OF NEW YORK

NEW YORK'S FIRST BANK – FOUNDED 1784 BY ALEXANDER HAMILTON

Letter of Comment No: 95
File Reference: EITF03-1A

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 Bank of New York Company (the Company) appreciates 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 Company supports the 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 deferral was an appropriate interim measure that avoided unnecessary dislocations throughout the debt markets that might have resulted from application of EITF 03-1.

The Company does not support issuance of EITF 03-1 as we believe that:

- it is inconsistent with the conceptual basis in FAS 115 that established the concept of an available-for-sale ("AFS") portfolio in 1994,
- 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,
- 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 the above 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 Financial Accounting Standards Board (the Board) can consider the broader implications of these issues in connection with other projects on its agenda. Alternatively, we believe that the Board should consider amending FAS 115 in an appropriate manner. In our view, the scope of the accounting changes proposed in EITF 03-1 constitute a change in, rather than a clarification of current GAAP, and therefore require consideration of the full Board standard setting process.

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

In our opinion, the guidance in EITF 03-1 is not consistent with the wording or the intent of FAS 115 with respect to securities classified as AFS. We do not believe that GAAP requires an assertion regarding the expected holding period for AFS securities which, by definition, are those

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held for an unspecified period of time. FAS 115 indicates that 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 AFS.

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 problems of prior accounting practice that often resulted in measuring securities at the lower of cost or market. It is our understanding that the AFS category was intended to reduce the potential for volatility in reported 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.

EITF 03-1 guidance is inconsistent with prudent portfolio management

For The Bank of New York Company, and other large financial institutions, an AFS portfolio can easily consist of thousands of individual securities held in 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 evaluation of risks/opportunities at the time of sale without regard to the historical cost of an individual security. 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. The proposed guidance in EITF 03-1 would create restrictions on management's ability to sell these securities, which runs counter to prudent portfolio management.

Another consequence of this new guidance would be a disruption in the fixed income capital markets. If implemented, the guidance in EITF 03-1 is likely to result in less liquidity in the fixed income markets. We believe there would be a movement to held-to-maturity portfolios, and away from available-for-sale portfolios. Investors may also shorten the maturity of their portfolios to reduce the risk of incurring an impairment charge.

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, populating, and maintaining models to predict recovery periods, applying the models on a security-by-security basis, conducting discussions between portfolio managers and accounting departments regarding

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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. Nor is this a meaningful concept for portfolio management. Further, because of the inherent difficulties in forecasting future 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?

Given all these complexities, we strongly believe that the costs of implementing this guidance will outweigh the potential benefits. Further, numerous additional implementation questions are certain to arise which might necessitate creation of additional FSPs. In short, the guidance in EITF 03-1 is not well thought out and will not improve financial reporting, as was its objective.

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

The Company is not aware of practice problems with respect to "other than temporary impairment" relating to debt securities that require the type of guidance provided by EITF 03-1. 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.

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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 practice situations that were found to be inappropriate which necessitated the issuance of EITF 03-1. Rather than proceeding with EITF 03-1, 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 a company has plans to sell specific securities with unrealized losses. FASB should also give the mandatory EITF 03-1 disclosures time to work.

The Company recommends 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.

The Company does 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 need for a 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, the Company recommends that the effective date for all but the disclosure provisions be for years beginning after December 15, 2005.

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 me at 212-635-7080.

Sincerely yours,



John A. Park, III
Senior Vice President