## THE BANK OF NEW YORK

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

Letter of Comment No: 23
File Reference: FSPFAS133A

November 21, 2005

Linda MacDonald
Project Manager
Financial Accounting Standards Board
401 Merritt 7
Norwalk CT 06856

Dear Ms. MacDonald:

The Bank of New York Company, Inc. (the "Company), a global financial institution, appreciates the opportunity to provide comments on the Proposed FASB Staff Position, "Accounting for Unrealized Gains (Losses) Relating to Derivative Instruments Measured at Fair Value under Statement 133" ("the Proposed FSP"). Our comments relate specifically to the Proposed FSP's guidance with regard to footnote 3 in EITF Issue No. 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities" ("EITF 02-3"), which would be nullified by the Proposed FSP. This guidance applies to revenue recognition for a transaction in which a difference exists between the transaction price and the model value at the inception of the transaction, a concept also referred to as "Day 1 profit" or "dealer profit (loss)".

As a global financial institution whose portfolio of derivative instruments includes transactions for which there are not active two-way markets and which contain model inputs which may be derived from market observable sources, we have been closely following the developments in the guidance governing revenue recognition for these instruments, which began as an expansion of guidance applicable to energy trading contracts. We appreciate the complexity of the valuation and implementation issues that the Board has addressed with regard to complex derivative instruments, as reflected in the June 2004 Exposure Draft, "Fair Value Measurements", in this Proposed FSP, and in the working draft of the Statement of Financial Accounting Standards "Fair Value Measurements" (the "Working Draft"), and have observed how the issue of revenue recognition of Day 1 profits has emerged from this greater undertaking.

Revenue Recognition of Day 1 Profit:

We are aware of the many differing views regarding the issue of revenue recognition of Day 1 profits, both with regard to immediate recognition versus deferral, and with regard to the quality of inputs required for revenue recognition. Generally, we support the concept of immediate revenue recognition of Day 1 profit as proposed in this FSP when model inputs are supportable by market-corroborated data.

Day 1 Profit Recognition Criteria:

In as much as the Proposed FSP draws from the Working Draft's Fair Value Hierarchy to establish standards for when Day 1 profits should be recognized, we note that the Working Draft is still a work-in-progress that has evolved in the past year from a three-level input valuation hierarchy to a five-level hierarchy. We believe that the Fair Value Hierarchy affords stratification of the criteria for the recognition of Day 1 profit, however we feel that further refinement of the attributes of the relative reliability of the inputs is needed.

In particular, the definition of Level 4 inputs as "market inputs that are not directly observable for the asset or liability but are corroborated by other market data through correlation or by other means, thereby incorporating market data that are observable (market-corroborated inputs)," would seem to imply that an independent price verification service such as Markit's® Totem Service (a price verification service) would satisfy the "minimum reliability threshold" of this level. We believe the Totem Service (where there are sufficient survey participants) to be a fair representation of consensus by the significant participants of the current market prices for model inputs that otherwise are not directly observable in the marketplace, and therefore would consider the Totem Service to be a "market-corroborated input." We feel that using the Totem Service elevates "entity generated inputs" into "market-corroborated inputs". Because the Level 4 definition, in its current form, is subjective, others may not regard the Totem Service (or similar services) as a "market-corroborated input." The lack of objectivity in the minimum reliability threshold of this level will make the determination of revenue recognition of Day 1 profit a case-by-case, judgmental issue with many differing interpretations, yielding many inconsistent conclusions.

Significance of Market Inputs:

We also feel that further clarification and implementation guidance is required regarding par. 24 of the Working Draft that provides that, "Where within the fair value hierarchy the estimate of fair value falls depends on where within the fair value hierarchy the inputs that have a significant effect on the estimate fall." Clarification is needed here to address how this guidance is to be applied to complex derivative instruments that have more than one model input, i.e., having some model inputs that may be directly observable in the marketplace, and others which may not be directly observable in the marketplace.

**Summary** 

In conclusion, the Company recommends that the revenue recognition guidance of the Proposed FSP with regard to Day 1 profit should be implemented pending further refinement of the Fair Value Hierarchy

Sincerely,

John A. Park III

Managing Director

Corporate Finance and Accounting Policy

.