



BNY MELLON

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**Re: IASB File: Supplement to Impairment ED/2009/12
FASB File Reference: 2011-150**

Dear Sir/Madam,

The Bank of New York Mellon Corporation (“BNY Mellon”) appreciates the opportunity to comment on the IASB’s Supplement to Impairment ED/2009/12 and the FASB’s Supplementary Document on Impairment (the “Exposure Draft”). BNY Mellon is a global financial institution with \$247 billion in assets and \$1.17 trillion in assets under management.

We understand the difficult issues the FASB and IASB have been dealing with in their efforts to converge the accounting for financial instruments. We applaud the agreement reached regarding the measurement of financial instruments held for the collection of cash flows to account for them on an amortized cost less impairment basis. We also believe the tentative decision to account for impairment separately from the interest yield on loans and debt securities provides better information to both users and preparers of financial statements. This reflects the way such financial instruments are managed. We also recognize that the two boards had approached the

accounting for impairment from two different directions and that the “dual impairment” model based on a “good book” for open portfolios represents a significant compromise on the parts of both boards. As strong proponents for adoption of IFRS in the U.S., and largely in the interests of convergence at this critical juncture, we support the proposed compromise approach between the FASB and the IASB that would be the higher of the time proportional income statement approach that the IASB board found suitable, and the FASB’s “foreseeable future” balance sheet approach. We understand that this Exposure Draft is intended to solicit feedback only regarding the operationality of what the boards believe to be the most challenging area (i.e. open portfolios) and to obtain such feedback first, before addressing and redeliberating on several other aspects of impairment of financial assets. We are concerned that constituents may not have had sufficient time to develop their views and written comments on the impairment issues addressed in the Exposure Draft as it has coincided with year-end annual reporting season (which included the new credit quality disclosure requirements for U.S. issuers) and the end of the first quarter earnings season, along with the recent comment deadline on the IASB’s Hedge Accounting proposals.

We acknowledge that the boards do not request additional comments on the issues that are not included in this Exposure Draft. We therefore look forward to another opportunity to provide written comments on the “full scope” of the boards’ redeliberated impairment proposals, to include financial assets that are not part of open portfolios or are evaluated individually, other problem loans, purchased loans, and investments in debt securities. We also expect a further opportunity to comment on the methods for measuring credit losses (e.g. whether to use discounted or undiscounted amounts), troubled debt restructurings, the concept of “non-accrual”, and presentation and disclosures. We are concerned that with the June 2011 Memorandum of Understanding deadline fast approaching, that once the “full scope” impairment proposals have been published, insufficient time will have been afforded to constituents to provide comprehensive and thorough feedback to the boards. If the boards decide not to re-expose a “full scope” impairment proposal for comment, we are very concerned that the final standards may contain several fatal flaws that might be best resolved through a 90-120 day formal review and comment letter process.

We strongly support a move from an incurred loss model to a model that measures financial asset impairment losses based on forecasted losses of principal over the foreseeable future. We do not support any “bright line” definition of what “foreseeable future” means and believe that the term is suitably described in the proposal. Each type of financial asset portfolio may be ascribed different forecast periods based on their composition and unique facts and circumstances (we would not expect that “foreseeable future” would ever be less than one year).

We have commented on each of the questions raised by the IASB and the FASB in the following sections of this letter.

General

Question 1

Do you believe the approach for recognition of impairment described in this supplementary document deals with this weakness (i.e. delayed recognition of expected credit losses)? If not, how do you believe the proposed model should be revised and why?

Yes. Each of the three proposed approaches would have outcomes that should accelerate recognition of expected credit losses. The IASB-only approach might have a lesser impact on the concerns expressed by constituents during and after the credit crisis than the FASB-only or the IASB-FASB “compromise” approaches. We had earlier commented in our September 30, 2010 letter to the FASB on its Financial Instruments proposal that: “...the lesson to be learned from this crisis is that impairments on loans and investment securities should have been anticipated and recognized earlier in the cycle; and accordingly, this should be the focus of accounting standard setting for these financial assets.” In that letter we encouraged the boards to “continue to work towards developing a suitable asset impairment model that has the following attributes:

- Require the use of expected cash flows to estimate expected losses;
- Require the consideration of future events and conditions;
- Create a clear distinction between impaired financial assets and assets without indication of impairment
- Decouple interest income from the provision for credit losses and permit the calculation of expected losses to be separate from the calculation of the effective interest rate;
- Allow earlier recognition of expected losses than the existing incurred loss methodology;
- Use open portfolios; and
- Use incurred losses as a built-in floor for the total amount of the allowance.”

We are encouraged that the boards impairment proposals have made progress towards achieving some of the objectives we believe are important, however we shall await to see a further exposure draft of the complete broader proposals for financial instruments, including impairment for all types of financial assets and for all types of portfolio (e.g. investment securities, purchased loans, closed portfolios, open portfolios, good book, bad book, and financial assets individually evaluated for impairment including troubled debt restructurings) before commenting further.

Scope – Open Portfolios

Question 2

Is the impairment model proposed in the supplementary document at least as operational for closed portfolios and other instruments as it is for open portfolios? Why or why not?

Although the supplementary document seeks views on whether the proposed approach is suitable for open portfolios, the boards welcome any comments on its suitability for single

assets and closed portfolios and also comments on how important it is to have a single impairment approach for all relevant financial assets.

Open Portfolios are described in the Exposure Draft as:

“portfolios for which financial assets are grouped on the basis of similar characteristics but irrespective of the time of their origination. In an open portfolio, financial assets are added through origination or purchase and removed through transfers to other portfolios, sales or transfers to external parties, repayment and write-offs each period. The characteristics used in defining a portfolio include asset type, industry, credit risk ratings, geographical location, collateral type, and other relevant factors.”

Further clarification as to what is meant by the definition of “open portfolio” may be helpful to practitioners, possibly by inclusion of examples. For example a portfolio of Commercial Real Estate loans where originations have ceased and, in effect, the portfolio is in “run-off” mode may or may not meet the above criteria, although we believe such a portfolio may be best classified as a closed portfolio.

The Exposure Draft does not discuss closed portfolios or certain other financial instruments, therefore it is difficult to provide any specific comments until we see a written proposal from the boards. However, we believe that there do not appear to be any obvious barriers to application of the proposed compromise model to closed portfolios. However, for “good book” assets individually assessed for impairment, unless there are indicators of impairment present, we do not understand how an estimate of losses could be developed, whether over the life of the individual loan or security or over the foreseeable future in order to calculate a time proportional allowance (“TPA”) or foreseeable future allowance (“FFA”). Although, once an individual asset has been determined to be impaired there appears no reason the “bad book” approach could not be applied to that financial asset.

We have made general comments to the boards on impairment of financial assets in the past (see our response to Question 1), however those comments were provided when (particularly regarding the FASB’s proposals) financial instruments measurement was of greater concern and consequence. With fair value measurement no longer being proposed for most of these assets, we encourage the boards to provide a comprehensive written proposal that fully and addresses the accounting for financial instruments and impairment of all types of assets and portfolios that will enable constituents to provide formal written comments over a 90-120 day comment period.

To illustrate our concern that a full and comprehensive proposal should be exposed for a formal comment period, we believe that the following potential impairment groupings could apply to banks, however the Exposure Draft only addresses Open Portfolios of loans and debt instruments that are not measured at fair value with changes in value recognized in net income (scope of the Exposure Draft shown in bold below):

Open Portfolios (Loans)

- **Good Book – higher of:**
 - o **Time Proportional Expected Credit Losses, or**
 - o **Credit Losses Expected Over Foreseeable Future**
- **Bad Book**

Closed Portfolios (Loans)

- *Good Book – higher of:*
 - o *Time Proportional Expected Credit Losses, or*
 - o *Credit Losses Expected Over Foreseeable Future*
- *Bad Book*

Loans Individually Evaluated For Impairment

Purchased Loans (U.S. GAAP “SOP 03-3” Loans)

Open Portfolios (Investment Securities)

- **Good Book - higher of:**
 - o **Time Proportional Expected Credit Losses, or**
 - o **Credit Losses Expected Over Foreseeable Future**
- **Bad Book**

Individually Evaluated Investment Securities

Closed Portfolios (Investment Securities)

- *Good Book - higher of:*
 - o *Time Proportional Expected Credit Losses, or*
 - o *Credit Losses Expected Over Foreseeable Future*
- *Bad Book*

We believe that for impairment accounting purposes, and given our current loan portfolio strategies and compositions, our loans could be allocated into each of the above potential loan impairment groupings, not only into open portfolios. The boards have not yet clearly articulated their proposals for the above italicized portfolios or groupings of financial assets. We strongly believe that the “full scope” of the boards’ impairment proposals should be presented in an exposure draft with sufficient time for constituents to understand the full interaction between the various models and to provide meaningful input.

**Differentiation of credit loss recognition
(paragraphs 2, 3 and B2-B4)**

Question 3

**Do you agree that for financial assets in the “good book” it is appropriate to recognize the impairment allowance using the approach described above?
Why or why not?**

Yes. We believe that for financial assets in the “good book” it is appropriate to recognize an impairment allowance based upon the principles described in paragraphs 2, 3 and B2-B4.

Question 4

Would the proposed approach to determining the impairment allowance on a time-proportional basis be operational?

Why or why not?

We have not completed our assessment as to whether this proposed approach would be operational. We do note that the “compromise approach” that incorporates each of the models proposed by the FASB and IASB would result in duplicate models being required for entities to assess each accounting period which model is to be applied for impairment measurement purposes (the “higher of” the two models). This would require additional systems resources and personnel; and a multi-year implementation period would be required.

Question 5

Would the proposed approach provide information that is useful for decision-making? If not, how would you modify the proposal?

While the key decisions and management processes for assets held for the collection of cash flows such as valuation, servicing and collection are affected by the amount and type of losses expected in a portfolio, from a preparer’s perspective, whether impairment is measured using the time proportional income statement approach or “foreseeable future” balance sheet approach should not affect those decisions or processes. We have heard some have expressed a concern that the “Day-1” loss recognition may restrain the origination of financial assets.

Question 6

Is the requirement to differentiate between the two groups (i.e. “good book” and “bad book”) for the purpose of determining the impairment allowance clearly described? If not, how could it be described more clearly?

No. We believe that the principle should be based on the performance characteristics of the financial asset, or group of financial assets, and should not be based on the way the assets are managed. We do not agree with the description of the principle that “it is no longer appropriate to recognize expected credit losses over a time period (i.e. for open portfolio “good book” assets) if the collectability of a financial asset, or group of financial assets, becomes so uncertain that the entity’s credit risk management objective changes for that asset or group thereof from receiving the regular payments from the debtor to recovery of all or a portion of the financial asset”.

We are also concerned that auditors, regulators and other practitioners may encourage practice that could institute a series of “bright lines”, particularly with regard to determining when open portfolio financial assets are to be categorized as either “good book” or “bad book”. The

involvement of typical management functions in managing a credit relationship may be construed inappropriately as triggering an arbitrary requirement to classify these assets as within either the open portfolio “good book” or “bad book” (e.g. if there is any contact between Loan Workout Groups and Credit Officers with respect to open portfolio financial assets in the “good book” but when the principle above has not been met).

Question 7

Is the requirement to differentiate between the two groups (i.e. “good book” and “bad book”) for the purpose of determining the impairment allowance operational and/or auditable? If not, how could it be made more operational and/or auditable?

Yes. We believe that the principle of when a loan is impaired as currently described in U.S. GAAP¹ would suitably describe loans or portfolios of loans that are to be classified as “bad book”.

Question 8

Do you agree with the proposed requirement to differentiate between the two groups (i.e. “good book” and “bad book”) for the purpose of determining the impairment allowance? If not, what requirement would you propose and why?

Yes.

Minimum impairment allowance amount (paragraph 2(a)(ii))

Question 9

The boards are seeking comment with respect to the minimum allowance amount (floor) that would be required under this model. Specifically, on the following issues:

- (a) Do you agree with the proposal to require a floor for the impairment allowance related to the “good book”? Why or why not?**

Yes. Although this will be operationally challenging and require two computations for every “good book” portfolio each accounting period, a floor requirement should ensure that the primary objective of ensuring that loan and debt securities losses are adequately provided for sooner than under existing accounting standards.

- (b) Alternatively, do you believe that an entity should be required to invoke a floor for the impairment allowance related to the “good book” only in circumstances in which there is evidence of an early loss pattern?**

¹ Accounting Standards Code 310-10-35-16, a loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement.

No. As experienced during the credit crisis, losses may emerge suddenly and dramatically. However, it would be appropriate to perform and document a qualitative evaluation of a portfolio's characteristics and determine that the floor would be based on either the TPA or FFA approach without necessarily calculating both amounts, while closely monitoring those characteristics and being prepared to implement the alternative approach, if the floor amount would change.

- (c) If you agree with a proposed minimum allowance amount, do you further agree that it should be determined on the basis of losses expected to occur within the foreseeable future (and no less than twelve months)? Why or why not? If you disagree, how would you prefer the minimum allowance to be determined and why?**

We agree with a proposed minimum allowance amount and that it should be determined on the basis of losses expected to occur within the foreseeable future. However we do not believe that the term "foreseeable future" should be defined as any particular time period in the standards (or the audit firm's interpretations). We note that "foreseeable" is defined in the Merriam-Webster dictionary as:

- 1: being such as may be reasonably anticipated "*foreseeable* problems";
- 2: lying within the range for which forecasts are possible "in the *foreseeable* future"

We believe that different portfolios would be subject to different facts and circumstances and that some portfolios may afford management the ability to reasonably anticipate expected losses for longer periods than others. Such forecasts may be dependent on many different and unique factors that may be specific to each portfolio. Portfolio types are different, origination criteria are different, economic factors are different, geographies are different, borrower demographics are different etc. We believe that to arbitrarily specify "12 months" as a bright line would not meet any of the objectives of impairment measurement and reporting.

- (d) For the foreseeable future, would the period considered in developing the expected loss estimate change on the basis of changes in economic conditions?**

Yes. The concept of foreseeable future embeds inherent reliability considerations. As more reliable information becomes available to a preparer or information becomes less reliable, the foreseeable future may either lengthen or shorten.

- (e) Do you believe that the foreseeable future period (for purposes of a credit impairment model) is typically a period greater than twelve months? Why or why not? Please provide data to support your response, including details of particular portfolios for which you believe this will be the case.**

As discussed in "(c)", above we do not believe there should be any bright line in the standards. While there may be some initial differences in application, we believe the

accounting standard should remain principles based. Over time we believe practice will evolve to more uniform application based on asset/portfolio characteristics.

- (f) If you agree that the foreseeable future is typically a period greater than twelve months, in order to facilitate comparability, do you believe that a “ceiling” should be established for determining the amount of credit impairment to be recognized under the “floor” requirement (for example, no more than three years after an entity’s reporting date)? If so, please provide data and/or reasons to support your response.**

No. We do not believe that there should be any “ceiling”, see comments above.

Question 10

Do you believe that the floor will typically be equal to or higher than the amount calculated in accordance with paragraph 2(a)(i)? Please provide data and/or reasons to support your response, including details of particular portfolios for which you believe this will be the case.

The floor may be either the TPA or FFA amount depending on the characteristics of the portfolio. As noted above, it would be appropriate to evaluate a portfolio’s characteristics and determine that the floor would be based on either the TPA or FFA approach without calculating both amounts, while closely monitoring those characteristics and being prepared to implement the alternative approach, if the floor amount would change.

Flexibility related to using discounted amounts (paragraphs B8(a) and B(10))

Question 11

The boards are seeking comment with respect to the flexibility related to using discounted amounts. Specifically, on the following issues:

- (a) Do you agree with the flexibility permitted to use either a discounted or undiscounted estimate when applying the approach described in paragraph B8(a)? Why or why not?**

Yes. For portfolios of assets being managed for the collection of cash flows, the amount of estimated principal loss is generally more reliably estimated than the amount and timing of cash flows in each and every period. A loss calculated based on the lost interest and principal discounted based on the effective rate in the asset, generally would be very close to the principal loss - if they could be reliably forecast. In developing an

accounting estimate of impairment loss that is inherently judgmental, we believe that imposing a false sense of precision is not warranted.

In cases where the recovery of an individual asset is dependent on the cash flows of the underlying collateral (e.g. in certain real estate loan workouts), we would expect that a discounted cash flow analysis would be used. However, this Exposure Draft is focused on open portfolios of financial assets.

(b) Do you agree with permitting flexibility in the selection of a discount rate when using a discounted expected loss amount? Why or why not?

As noted above, in most cases an estimated “gross” principal loss estimate should be adequate. To the extent discounting is applied, we believe the contractual rate in the instrument should generally result in a reasonable estimate of loss, unless it is substantially different than the original effective interest rate of the asset. See response to (a) above, in developing an accounting estimate of impairment loss that is inherently judgmental, we believe that imposing a false sense of precision is not warranted.

Approaches developed by the IASB and FASB separately

Question 12

Would you prefer the IASB approach for open portfolios of financial assets measured at amortised cost to the common proposal in this document? Why or why not? If you would not prefer this specific IASB approach, do you prefer the general concept of the IASB approach (i.e. to recognize expected credit losses over the life of the assets)? Why or why not?

No. As we prefer a floor in the model, we generally support the common proposal in this document, subject to our other comments herein. We do not support recognition of credit losses expected in the foreseeable future to be spread over the life of the financial assets.

Question 13

Would you prefer the FASB approach for assets in the scope of this document to the common proposal in this document? Why or why not? If you would not prefer this specific FASB approach, do you prefer the general concept of this FASB approach (i.e. to recognize currently credit losses expected to occur in the foreseeable future)? Why or why not?

No. We generally support the common proposal in this document. We strongly support a move from an incurred loss model to a model that measures financial asset impairment losses based on forecasted losses of principal over the foreseeable future. We do not support any “bright line” definition of “foreseeable future” and believe that each type of financial asset portfolio may be ascribed different forecast periods based on their composition and unique

facts and circumstances. As strong proponents for adoption of IFRS in the U.S., and largely in the interests of convergence at this critical juncture, we support the proposed compromise approach between the FASB and the IASB that would be the higher of the time proportional income statement approach that the IASB board found suitable, and the FASB's "foreseeable future" balance sheet approach.

IASB only Appendix Z Presentation and disclosure

Impairment of financial assets

Question 14Z

Do you agree that the determination of the effective interest rate should be separate from the consideration of expected losses, as opposed to the original IASB proposal, which incorporated expected credit losses in the calculation of the effective interest rate? Why or why not?

Yes. While theoretically this presentation has some merits, we do not believe that the interest and the loan loss provision should be commingled together in the income statement. This presentation would not provide suitable transparency for users and would be overly operationally complex. Finally, the resulting allowance would not be adequate to cover the losses expected over the foreseeable future.

Scope – Loan commitments and financial guarantee contracts

Question 15Z

Should all loan commitments that are not accounted for at fair value through profit or loss (whether within the scope of IAS 39 and IFRS 9 or IAS 37) be subject to the impairment requirements proposed in the supplementary document? Why or why not?

Yes. Loan commitments are contractual obligations that are subject to credit risk and therefore should be subject to impairment measurement requirements.

Question 16Z

Would the proposed requirements be operational if applied to loan commitments and financial guarantee contracts? Why or why not?

The same operational complexities of this proposal applicable to loans and investment securities would be applicable to loan commitments and financial guarantee contracts.

Presentation

Question 17Z

Do you agree with the proposed presentation requirements? If not, what presentation would you prefer instead and why?

We will provide comments once the full scope of the boards' impairment proposals is published for comments.

Disclosure (paragraphs Z6-Z15)

Question 18Z

(a) Do you agree with the proposed disclosure requirements? If not, which disclosure requirements do you disagree with and why?

We would like to see an exposure draft of the full scope of the boards' impairment proposals, including disclosures before providing comment. We believe the recent disclosures about credit quality implemented in the U.S. are appropriate for financial statement users. We recognize that certain analysts develop their own estimates of allowances and the current disclosures are adequate to support those particular needs; accordingly, we are skeptical that even more disclosures are needed.

(b) What other disclosures would you prefer (whether in addition to or instead of the proposed disclosures) for the proposed impairment model and why?

No response.

Question 19Z

Do you agree with the proposal to transfer an amount of the related allowance reflecting the age of the financial asset when transferring financial assets between the two groups? Why or why not? If not, would you instead prefer to transfer all or none of the expected credit loss of the financial asset?

We believe that transfers between "good book" and "bad book" will add greater operational complexity and we encourage the boards to develop a solution that is operational. In general, we believe that all of the expected credit loss of a loan or security should be transferred to the "bad book"; resulting in a true up the "good book" allowance based on the portfolio's estimated TPA determined based on its life and expected losses.

Thank you for considering our comments regarding the Exposure Draft. If you have any questions or require further information, please contact me at 212-635-7080 or Ross Brown at 212-635-7023.

Sincerely,



John A. Park
Controller