American Bankers Association
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Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Via website submission

RE: Staff Paper: *Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers: Exploring a Possible Method of Incorporation*

Dear Ms. Murphy:

The American Bankers Association (ABA) appreciates the opportunity to comment on the Staff Paper: *Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers: Exploring a Possible Method of Incorporation* (Staff Paper). ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.3 trillion in assets and employ over 2 million men and women.

World-wide convergence of high-quality accounting standards is an important factor in the efficient operation of capital markets, and ABA supports efforts by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) to reduce the differences that exist between U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS). We are encouraged that the Staff of the Securities and Exchange Commission (SEC) has issued this paper in order to obtain feedback on incorporating IFRS into the U.S. financial reporting system.

Summary of ABA's Views

The ABA has been supportive of international *convergence* of accounting standards; however, we are not yet in a position to support *requiring* U.S. companies to adopt IFRS. We do believe that because the SEC has already permitted foreign registrants to adopt IFRS without reconciliation to GAAP, it is important to permit U.S. companies to adopt IFRS. However, before *requiring* IFRS, the following concerns should be examined:

1. Is IFRS an improvement over GAAP?
2. The process for developing high quality U.S. accounting standards must be maintained.

3. The risks and costs of adoption must be clearly worthwhile to preparers and their shareholders.

If the decision is made to require IFRS, ABA generally supports the framework provided in the Staff Paper, in which the Convergence Approach would be used during the transitional period. An Endorsement Approach, in which FASB would incorporate individual IFRSs into GAAP, would be used thereafter. We believe that, as a whole, the framework provides a practical option that can work effectively. With that in mind, however, we have serious concerns about:

- Transition period of 5-7 years – We believe the transition period will need to be longer, possibly double that time frame for full adoption.
- U.S. influence on standards – The U.S. will need to have a strong, continuing role in the world-wide accounting standard setting process, both during and after transition.
- Prospective adoption – The Staff Paper notes that the transition period may need to be lengthened and that lessening costs and burdens by the use of prospective application should be used whenever possible. With this in mind, companies that early-adopt should be allowed to transition to IFRS with a one-time beginning balance adjustment, rather than a full retrospective adjustment.[1]

Additionally, the banking industry accounting model is currently undergoing significant change (financial instruments, loan impairment, hedge accounting, leasing, etc.), and there are risks of the accounting standards being different (or being interpreted differently) under GAAP vs. IFRS. These changes will require significant resources and time to implement, regardless of whether IFRS is adopted, and the timing and related costs must be weighed against the alternative of adopting IFRS directly, rather than facing the potential of executing two sets of changes, first to GAAP and then to IFRS.

Our views are more fully described below.

Is IFRS an Improvement over GAAP?

If the U.S. requires IFRS, the case must be made that IFRS – on a standard by standard basis – is a clear improvement over GAAP. As the Staff Paper indicates, Section 19(b)(1)(A)(v) of the Securities Act specifies that, for the SEC to recognize a standard-setting body's accounting principles as "generally accepted" for the purposes of the securities laws, the standard-setting body is to consider "the extent to which international convergence …is necessary or appropriate in the public interest and for the protection of investors."

A goal of a single set of high quality global standards appears to be theoretically sound; however, what is more critical is to apply standards that provide the best transparency. If the global standard does not provide the best information, the markets in which the banks operate will not benefit simply because a uniform global accounting standard is followed. For shareholders, are the risks and costs of conversion outweighed by the improvement in

[1] IFRS No. 1 (*First-time Adoption of International Financial Reporting Standards*) essentially requires companies to report all information as though it had always been recorded under IFRS, which we believe will be burdensome. We believe that efforts to incorporate IFRS into GAAP should be executed in ways that provide high quality information while not hampering U.S. companies' efforts to compete internationally.

transparency? For some banks, this can be answered affirmatively; for many other banks, there are too many unknowns about GAAP vs. IFRS. Examples of some of the unknowns are:

- There is a high level of uncertainty as to whether IFRS does, in fact, represent an improvement over GAAP for most companies. The level of understanding related to the differences between GAAP and IFRS is insufficient, including not only the standards themselves, but how IFRS would be specifically applied in practice. This makes the evaluation difficult.

- The level of implementation guidance is, in most circumstances, much greater under GAAP than in IFRS, and how to adapt to such a framework has not been sufficiently addressed. During the SEC Roundtable on IFRS (July 7, 2011), there was discussion about the need for such guidance to continue if the IASB does not provide it. If this is the case, then many would question the point of convergence. If the U.S. and other countries have variations in application, the end goal of a single set of high quality global accounting standards will not be achieved. Alternatively, the question may be whether IFRS, with an overlay of U.S. guidance, would be an improvement over existing GAAP. If not, then the effort is circular, and the cost vs. benefit test will have failed.

- The impact of adopting IFRS is not yet known. For example, how will the SEC, banking regulators, and investors view these standards and how will they respond?

The roundtable provided some valuable information. As could be observed during the roundtable, the value of moving to IFRS depends upon one's perspective. For many in the banking industry, a bank's business model is the key factor in evaluating whether IFRS represents an improvement over GAAP. For example:

- Large banks with a broad scope of operations – This category of banks generally includes the largest banks, but it could also include U.S. subsidiaries of foreign-owned banks. We believe that the SEC's decision to permit foreign registrants to follow IFRS without reconciliation was a turning point in the acceptance of IFRS for U.S. reporting. Some U.S. registrants with significant international operations believe IFRS should be permitted as the more broadly accepted world-wide set of high quality standards. They view the dual standards as an inefficient alternative for both preparers and users, compared to a uniform set of accounting standards applied among their consolidated banks. Others in this category of banks have concerns about whether IFRS represents an improvement across the various individual accounting standards. Many are also concerned about whether any shortage of guidance under IFRS (compared with GAAP guidance) could result in a significant interpretive effort under IFRS and the complexities that could result from the need to defend differences in practice.

  ABA believes this category of banks should be permitted to adopt IFRS as soon as they wish to do so, particularly because foreign banks are already allowed to follow IFRS for SEC purposes.

- Medium-size and small banks – While some in this group of banks have begun to acknowledge that IFRS may be on the horizon, they are generally not be prepared to support or oppose the notion of adopting IFRS. For these banks, there is probably less incentive to move to IFRS, compared with banks that have significant international operations, as the "unknowns" relating to IFRS are broad.

Small banks[2], which have a more limited base of financial statement users, comprise the largest number of banks in the U.S. – approximately 90% of banking institutions are community banks. Typically, these banks do not participate enough in the international arena to attract them to IFRS. Some are required to follow GAAP for SEC purposes, while others are not SEC registrants but are required to follow GAAP for regulatory reporting purposes.

During the roundtable, the point was made that for small companies, there are no benefits to adopting IFRS – only costs. Balancing company and shareholder dollars against measurable benefits is a challenge, as these banks generally view the adoption of IFRS as a drain on their scarce resources with no corresponding benefit to the banks or their shareholders. For this group of banks, the focus is not on the theory of a need for global standards, but on whether IFRS provides sufficient improvement over GAAP. To date, this group has not been convinced of this.

Although we do not anticipate many in this category of banks would choose to adopt IFRS in the time frame provided in the Staff Paper, we believe that if they are interested in adopting IFRS, they should be permitted to do so.

The process for developing high quality U.S. accounting standards must be maintained.

There has been much discussion, both in the U.S. and abroad, about how to improve the quality of the accounting standard-setting process. Improvements continue to be made, and this is an important area that should be evaluated prior to requiring the adoption of IFRS. Below are some points to consider:

- The IASB's process must be transparent and independent, with an investor focus rather than one heavily influenced by public policy. This is an area where the IASB has a challenge, whether it is in fact or in appearance. The IFRS Foundation is currently performing a strategy review, which includes consideration of these issues, and the SEC and others will need to have confidence in their decisions.

- The U.S. must continue to have oversight over the accounting standards used in the U.S. A critical component of the oversight of accounting standards includes input from preparers, investors, banking regulators, and others, as well as the FASB and SEC. Dilution in this process could result in accounting standards that are not of high quality. The Staff Paper notes that "The FASB is well-positioned to ensure that U.S. constituents continue to have a voice in global standard setting." We agree with this point in the current environment as the FASB and IASB continue to work and complete (often side-by-side) the projects within their Memorandum of Understanding. However, it is unclear whether this will continue if IFRS is required in the U.S. The differences of

[2] Included in this group are privately-held banks, as we assume that any decision made by the SEC will ultimately have an impact on GAAP for all banks, since banks must follow GAAP for regulatory reporting purposes.

views internationally versus domestically in some of the current joint IASB/FASB deliberations on financial asset and liability offsetting indicate that a strong and influential U.S. view is needed in the process. We are concerned that this influence will be lost if, as the Staff Paper contemplates, FASB is relegated to virtually the same status as other IASB constituents.[3] At the same time, we recognize that some believe that if the U.S. signals a strong commitment to the adoption of IFRS, its influence will increase. They also point out that the influence of the FASB on IASB projects would improve if they work on those projects at the same time and in concert, rather than starting as independent projects.

Some of our members have noted that U.S. views are not necessarily represented by U.S. members on IASB. That is, U.S. representation of the FASB's views does not necessarily exist simply because an American is appointed to the IASB. Although retaining the FASB in the role described in the Staff Paper may help with the dilution concerns, it does not equate to domestic standard-setting. Additionally, although we would hope that the instances of divergence from IFRS would be rare, some anticipate that the degree of influence the U.S. currently has will wane after an agreement to adopt IFRS, and placing such a limitation in advance could reduce FASB's ability to have influence in the future. There may be instances in which the U.S. has emerging issues that other countries are not facing, and the FASB needs to have the ability to address them on a timely basis. Thus, it is important that the FASB's role be substantive.

Other ABA members, however, point out that the SEC itself has a great deal of influence and has frequently exercised it, for example, through its reviews of registrants' financial statements, involvement in the EITF, etc. They believe that the bigger risk is that local country variations in accounting continue to make global capital markets less efficient than they could be and increase the risk of cross-border accounting arbitrage. They believe the SEC should work through International Organization of Securities Commissions (IOSCO), the Financial Stability Board and other forums to influence other markets to adopt IFRS, as written, without carve-outs or carve-ins.

- More detail is needed about the endorsement process. While it is reasonably clear from the Staff Paper as to how the FASB will be involved in setting GAAP when it endorses a new IFRS pronouncement, it is unclear what will happen if FASB disagrees with the IASB. The FASB can require additional disclosure and provide implementation guidance, but there may be circumstances in which the accounting that the FASB would proscribe is in conflict with the decisions of IASB. For example, the current differences between FASB and IASB on the issue of offsetting have been so wide that it seems likely that, at some point, FASB would not endorse a new IFRS.

[3] The Staff Paper: "FASB would participate in the process for developing IFRS, rather than serving as the principal body responsible for developing new accounting standards or modifying existing standards under U.S. GAAP. The FASB would play an instrumental role in global standard setting by providing input and support to the IASB in developing and promoting high-quality, globally accepted standards; by advancing the consideration of U.S. perspectives in those standards; and by incorporating those standards, by way of an endorsement process, into U.S. GAAP. Additionally, the FASB would become an educational resource for U.S. constituents to facilitate the understanding and proper application of IFRS and promote ongoing improvement in the quality of financial reporting in the U.S." These duties are currently performed, to one degree or another, by virtually all active constituents of the IASB, including the ABA.

- Consistency in interpretation and enforcement must accompany any transition to IFRS. During the roundtable, it was noted that IFRS is more complex because of the higher degree of judgment needed to apply principles-based standards. One of the fears of moving to IFRS is that as new IFRSs are developed, these gray areas will be addressed – either by regulators, auditors, or diversity in practice. If this is the case, then some concerns would include whether application of the standards will vary widely across jurisdictions and due to differing interpretation/judgments being made, whether the lack of due process is appropriate (effectively, writing guidance behind closed doors), and whether the U.S. process for additional guidance and open deliberation is in fact preferable. Alternatively, if guidance is not developed, then we must ensure that the SEC, banking regulators, investors, and other users of financial statements support and accept accounting standards that do not include such guidance.

The risks and costs of adoption must be clearly worthwhile to preparers and their shareholders.

At this point in time, the need to adopt IFRS may depend on an entity's business model. For some entities, IFRS is viewed as an improvement and passes the cost vs. benefit test; for others, the costs of conversion cannot be justified. Below are some additional points about risks and costs of adoption:

- The costs relating to staffing and other resources – without being able to pin down the advantages of IFRS for individual banks – is a concern. The education of internal staff, external auditors, and regulators is expected to be time-consuming.

- Internal controls reporting relating to Section 404 of the Sarbanes Oxley Act of 2002 (SOX 404) could be at risk, as many companies are not familiar with IFRS or how it should be applied. The resources that will be needed to establish internal controls relating to IFRS in order to be in compliance with SOX 404, how auditors will react to the new framework of internal controls, and how auditors and investors will react to any lack of understanding of IFRS by companies, are also of concern.

- Sufficient lead time is needed for conversion. U.S. banks will be facing an unprecedented amount of accounting change, whether through the current projects or adoption of IFRS, and it is only with sufficient lead time for standards implementation and optional conversion to IFRS that banks can make rational cost-benefit evaluations to determine how or whether to adopt IFRS.

- Litigation risk should be evaluated. Litigation risk in the U.S. is significantly greater than that in many other parts of the world. Many accounting standard-setters, auditors, regulators, and preparers tend to prefer rules-based accounting in order to mitigate this litigation risk. This may be an important factor in determining whether IFRS should be required in the U.S.

- Organization of and funding for the accounting standard setting process must be fully considered. Currently, U.S. companies are required by law to fund the accounting standard setting process in the U.S. This process will need to be reviewed, as the IASB will become either the primary standard setter or a standard setter for some U.S. companies. U.S. funding of the FASB and IASB needs to be carefully considered in order to avoid double funding and to ensure a fair allocation of costs. If allocation is based on a formula, for example, a review of efficiencies/inefficiencies in the IASB's staffing and processes should be considered. This arrangement is further complicated by the fact that FASB currently sets standards for private companies and there is a separate IFRS for small and medium-sized entities. We also wonder whether the Emerging Issues Task Force and FASB advisory groups will have authority to continue. Questions regarding how these organizations will be managed and funded need to be addressed.

- Transition is a key issue.

  - Costs vs. benefits: The primary concern is whether the benefits of conversion exceed the costs for banks and their shareholders. During transition, there will be uncertainty as to whether there is a clear and consistent understanding of the meaning and application of IFRS by preparers, investors, auditors, and regulators. At this point, the opportunity to adopt IFRS should be open-ended and the SEC should not have plans to require all remaining U.S. issuers to move to IFRS. This may mean that the SEC should evaluate the adoption and implementation of IFRS – similarly to the staggered implementation date for SOX 404 – so that any pitfalls in education, staffing, systems, internal controls, and regulatory oversight of the standards and the companies can be identified and resolved prior to any requirement to adopt IFRS. We believe this time frame will need to be longer than the 5-7 year implementation date discussed in the Staff Paper.

  - Timing of transition: With the number of accounting changes that are in store for companies over the next several years, it is critical that investors receive information that is accurate and consistent, while at the same time not overburdening banks and other companies in implementing any new standards. Changes in accounting for financial instruments, which include classification and measurement, impairment and hedge accounting, as well as lease accounting, will require enormous resources and significant changes to key systems. While FASB recently issued the request for comment on Effective Dates and Transition, their decisions have not been finalized. In any event, the focus needs to be on streamlining any transition so that adoption of the new standards under GAAP is not immediately followed by a requirement to adopt unconverged IFRS standards. Such a "double jeopardy" situation would be unacceptable. Under the current separate paths that FASB and IASB are taking with accounting for financial instruments, such a situation could result. The Staff Paper appropriately notes that the FASB would need to consider timing of implementation of new GAAP during the interim when determining the timing and transition to IFRS.

Thank you for your attention to these matters and for considering our views. Please feel free to contact Mike Gullette (mgullette@aba.com; 202-663-4986) or me (dfisher@aba.com; 202-663-5318) if you would like to discuss our views.

Sincerely,

Donna J. Fisher