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September 1, 2009

Sir David Tweedie, Chairman
International Accounting Standards Board
First Floor 30 Cannon Street
London, EC4M 6XH
United Kingdom
Via email: iasb@iasb.org

File Reference: Request for Information *Impairment of Financial Assets: Expected Cash Flow Approach*

Dear Sir David Tweedie:

The American Bankers Association (ABA) appreciates the opportunity to comment on the Request for Information: *Impairment of Financial Assets: Expected Cash Flow Approach* (RFI). 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 $12.7 trillion in assets and employ over 2 million men and women.

In summary, ABA supports the IASB's efforts to consider expanding the "incurred loss" model to provide more robust loan and lease loss allowances than are currently allowed in practice. Although the use of expected losses may be an appropriate solution, we believe using the expected cash flows methodology, as described in the RFI, leads to operational issues that will cost far more than any benefits the Board perceives will be derived. Further, any implementation period will likely need to be two to four years. A time period is also required for investors and Board members to understand the expected cash flow concept and to develop reliable performance measures and forecasting tools. As a result, the ABA supports consideration of using expected losses – rather than expected cash flows – over a time horizon that can be reasonably estimated.

Below are our responses to what we view as the most important questions asked in the RFI.

The Approach Needs to be More Clearly Defined

As we currently understand the expected cash flow approach outlined in the RFI, we believe there are specific points of clarification that are necessary. We understand that both incurred and expected credit losses are included in the estimate of expected cash flows. However, because of how the RFI is worded, it is unclear whether expected prepayments should continue to be included in the estimate. As explained below, including prepayments within expected cash flow estimates for loans that have shown no evidence of loss has enormous operational challenges. We do not support requiring that cash flow estimates include prepayment assumptions and believe only credit-related cash flow events should be included in the estimation process.

Based on previous discussions that have been conducted on "dynamic provisioning", "inherent losses in a portfolio", and "losses across the business cycle", the time period over which expected losses are based must be specifically defined. As we note below, we believe that losses that are "foreseeable" – over a horizon that is reasonably estimable – can be the most operational, both from a preparer's perspective and that of an auditor. It is also the most understandable from a user's perspective.

The Approach is Not Operational

The approach presented in the RFI is extremely cumbersome and will lack reliability and relevance. The approach is very close to that used in the U.S. to comply with AICPA Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* (SOP 03-3). The SOP requires that purchased loans and debt securities that have previously experienced a decline in credit quality be accounted for differently than other purchased assets. In summary, it requires continuous expected cash flow estimates on these assets.

During the development of SOP 03-3, the ABA raised concerns that are now surfacing and are problematic. The experience thus far of U.S. companies to implement SOP 03-3 leads us to the conclusion that applying expected cash flow estimates across the entire company's portfolio is unworkable. There are no commercially available software systems to effectively perform these estimates, and propriety packages used by companies are fragmented and full of manual overrides.

Even if efficient software were available, determining the expected cash flows is arduous and manually time-consuming. Prepayment projections, at a minimum, must include interest rate and yield curve forecasts and are adjusted based on regional economies and legal requirements. Many companies would also require many assumptions: product type, underwriting criteria, geographic area, issuance period, etc., which may affect payment patterns. It is not hard to see how an organization could have thousands of cohorts to estimate. The manpower to effectively manage and update such data, all in a controlled fashion and within the tight reporting deadlines, is daunting. Additionally, in the end, these estimates will often be arbitrary, since much of the history to base assumptions is currently unavailable or, because of the current "once-in-a-lifetime financial crisis", rendered irrelevant. Relevance is also particularly in question regarding any new products.

As a result of these issues, we strongly recommend that if the expected cash flows concept is the method used for impairment, it must relate only to expected *principal* losses, and not to *income-related* losses. Further, a time horizon that is reasonably estimable must be understood so these estimates can be similarly understood within the investor community.

Expected Costs of the Approach Will be Prohibitive

In the issues noted above, we have described a number of the critical issues in implementing a system to estimate expected cash flows on a quarterly basis across an entire banking portfolio. We believe it would take a minimum of two to four years to design, test, and implement such a system for most companies. At least one year will be required for investors and board members to understand and develop reliable performance measures and forecasting tools.

ABA represents institutions of all sizes and in all markets. An estimate of costs to implement and properly maintain and audit these systems would be based on the size and complexity of each individual institution. Because of the intricate calculations required, we believe these costs would be significant for all banking institutions – even community-based banks with limited product offerings. Costs would go up exponentially, based on the number of products offered and number of markets in which each institution participates.

In conclusion, we support amending the existing practice for estimating loan and lease loss allowances, which are currently limited to "incurred losses". Although the use of expected losses may be an appropriate solution, we believe using the expected cash flows methodology as described in the RFI is unworkable. As a result, the ABA supports consideration of using expected losses – rather than expected cash flows – over a time horizon that can be reasonably estimated.

Thank you for your attention to these matters and for considering our views. Please feel free to contact if you would like to discuss our views.

Sincerely,

Michael L. Gullette