David Schraa

Director, Regulatory Affairs Department



April 1, 2009

Mr. Hans Hoogervorst Mr. Harvey Goldschmid Co-Chairmen Financial Crisis Advisory Group



Sir David Tweedie Chairman International Accounting Standards Board

Mr. Robert H. Herz Chairman Financial Accounting Standards Board

Re: Response to FCAG request for written submissions

Dear Sirs:

The Institute of International Finance (IIF) Senior Accounting Group appreciates the opportunity to respond to the FCAG's request for written submissions. The Institute is pleased to share its views regarding matters related to accounting and financial reporting that have emerged out of the financial crisis. We welcome the initiatives taken thus far by the Group in addressing the standard setting implications arising from the crisis. The Institute also recognizes both Boards' long standing commitment to coordinate efforts on improving and simplifying accounting and financial reporting in a global context.

Our response to questions requiring specific comment is included in the attached Appendix. Should you have any questions about this comment letter, please contact the undersigned (dschra@iif.com; + 1 202 857 3312) or Eran Meishar (emeishar@iif.com; + 1 202 857 3633).

James Schuser.

Very truly yours,

Enclosure

Appendix 1 Institute of International Finance Senior Accounting Group Responses

Question 1

From your perspective, where has general purpose financial reporting helped identify issues of concern during the financial crisis? Where has it not helped, or even possibly created unnecessary concerns? Please be as specific as possible in your answers.

General-purpose financial statements provide users, both investors and regulators, with decision-useful information. With the growing acceptance of IFRS there has been improvement in financial reporting in recent years but further work is needed on convergence. The financial crisis has highlighted certain financial reporting matters that require thoughtful reconsideration by both accounting standard setting bodies, in conjunction with all stakeholders, with a fundamental objective of promoting international convergence. These matters are predominantly related to implementation issues of fair-value accounting, disclosures of activities associated with securitized financial assets, and accounting for loan-loss provisions. Our responses to those specific issues identified are referred to in the following responses, which summarize in many respects more detailed comments that we have given or are preparing to submit to the standard setters.

The extent and intensity of the debate in the crisis amply demonstrates the need for broad discussion to recreate a consensus on many aspects of modern accounting. As the Institute said in its *Final Report of the Committee on Market Best Practices*, published in July, 2008, "Fair-value accounting has been and remains an essential element of global capital markets as it fosters transparency, discipline, and accountability. This is why it is so important to foster a broad and open dialogue about the lessons of the current crisis. The initiation of such a dialogue, including standard setters, central banks, supervisors and market participants, is therefore one of the central points [of the Report]". Similarly, the *Turner Review* and the UK FSA's related Discussion Paper, *A Regulatory Response to the Global Banking Crisis* suggest the need for taking a step back for consideration in light of recent experience.

In addition, although IFRS 7, for example, has improved disclosures on risks arising from financial instruments and further amendments to this standard and others are being made to augment disclosures, the requirements are developed on a piece meal basis. There is a need to step back and assess the usefulness and coherence of disclosure requirements as a whole to create a framework to provide useful and understandable information to the market without burdening the whole constituency with excessive data requirements that hinder, rather than aid, good communication.

Ouestion 2

If prudential regulators were to require 'through-the-cycle' or 'dynamic' loan provisions that differ from the current IFRS or US GAAP requirements, how should general purpose financial statements best reflect the difference: (1) recognition in profit or loss (earnings); (2) recognition in other comprehensive income; (3) appropriation of equity outside of comprehensive income; (4) footnote disclosure only; (5) some other means; or (6) not at all? Please explain how your answer would promote transparency for investors and other resource providers.

We believe that there should be an open-minded dialogue on provisioning issues that encompasses all available provisioning models.

Narrow interpretations of the current incurred-loss framework may lead to underprovisioning and hence unwarranted procyclicality. It is essential that securities and prudential regulators along with standard setters come together to ensure that preparers of financial statements are not required to apply overly narrow interpretations of incurred loss and are provided with the ability to exercise judgment that is based on experience. This view was also expressed during recent exchanges with the FSF, IASB and Accounting Task Force of the Basel Committee.

Furthermore, some members believe there would be clear benefits from a medium-term reconsideration of the objectives of financial reporting in this area. The Institute has organized an ongoing discussion amongst members on alternative proposals for provisioning. Such proposals are based on mitigating an overly narrow interpretation of the existing judgments allowed for within the incurred-loss model, which allows for incurred but not reported losses, and on a separate proposal for an expected-loss approach that would require changes to standards. The discussion has not reached a consensus but we are of the view that there is a need to think through the options.

With respect to current outstanding proposals, we believe that the notion of undistributable reserves appropriated in equity requires considerably more evaluation. There are practical implementation issues in that, in different jurisdictions, distributable profits are determined in different ways. For example, in the EU, individual companies, not groups, have distributable profits so it is unclear how such a reserve would be determined in group accounts. In addition, different views are emerging on, what the Turner Review points out, is largely a presentational matter, Some believe it not clear why a reserve movement would convey significantly different information to capital disclosures, including the impact on capital of the reserve. They also believe there would be nothing to stop regulators preventing bonuses, dividends and share buy backs having regard to the reserve without its being including in the primary financial statements. Those with this view would prefer disclosure only but could accept a reserve movement, provided that this is entirely consistent with accounting standards. Others share the view expressed by some in the official sector that a below-the-line reserve model would not affect the income statement and thus the perceived profitability of the sector. Those with that view share the concern that not reflecting provisions in profit and loss would mean that bonuses, dividends, share buy-backs and the like would be less likely to be affected by a reserve movement which is not included in the income statement. Although there is not a consensus on the point, some consider earlier recognition of credit losses in earnings would both provide more complete disclosures on risks in portfolios and reduce cyclicality in behavior. Where possible, bearing in mind their different objectives, it is generally preferable that regulatory and accounting provisioning should be aligned.

In any case, of course, clear disclosures on provisioning are necessary. The experience of the insurance industry with disclosures of loss reserving over time may provide a useful model for making the development of provisions transparent over time, allowing for market assessment of management's use of judgment.

In addition, transparency for investors should be understood comprehensively, and careful consideration should be given to arguments that inclusion of disclosure of portfolio losses on a somewhat broader basis would in fact improve investors' understanding of portfolio values and risks.

Question 3

Some FCAG members have indicated that they believe issues surrounding accounting for off-balance items such as securitizations and other structured entities have been far more contributory to the financial crisis than issues surrounding fair value (including mark-to-market) accounting. Do you agree, and how can we best improve IFRS and US GAAP in that area?

As we mentioned in our response to Question 1, the problems that have arisen during the financial crisis have been related to accounting issues on the appropriate application of fair-value measurements to various financial assets, including securitized assets, as well as to disclosures and consolidations of structured entities. We do not believe the question is especially helpful because there needs to be careful consideration of all issues that arose in the course of the crisis.

The essential issue now is to have convergence on consolidation and derecognition, on which we are commenting separately. Convergence on these topics is essential for the development of a future financial system. The Institute is convinced that appropriate securitization must be a significant part of that system, if the credit needs of the economy are going to be met in a structure in which bank capital is likely to be significantly more constrained; hence the capacity of the banks alone to meet legitimate credit needs is limited. Furthermore, in the insurance industry, care must be taken to foster and not to burden the constructive development of insurance-linked securities and, while further work needs to be done, particularly on derecognition tests, the same essential consideration of allowing the appropriate use of structures to enhance financial capacity applies. We urge both leading standards setters to align their guidance and their time-lines for adoption of modifications of guidance to ensure the greatest possible consistency of application across jurisdictions.

While improvement and convergence of accounting for off-balance sheet items, especially securitization, are important, some IIF members do not believe that flaws in

the existing accounting rules have contributed so significantly to the crisis as is suggested by the question.

We also support initiatives for the enhancement of transparency and more robust disclosures of securitization activities. However, care must be taken in the setting of such disclosure requirements so as to not create overly burdensome and non decision-useful rules that may further hinder the revamping of the securitization markets. Disclosures should remain risk-based. In addition, the overall structure of both financial and non-financial (Pillar 3) disclosures needs to be taken into consideration to make sure that information provided to the market is coherent, useful, and avoids both reconciliation issues and information-overload that may be confusing or obfuscating rather than illuminating.

Question 4

Most constituents agree that the current mixed attributes model for accounting and reporting of financial instruments under IFRS and US GAAP is overly complex and otherwise suboptimal. Some constituents (mainly investors) support reporting all financial instruments at fair value. Others support a refined mixed attributes model. Which approach do you support and why? If you support a refined mixed attributes model, what should that look like, and why, and do you view that as an interim step toward full fair value or as an end goal? Whichever approach you support, what improvements, if any, to fair value accounting do you believe are essential prerequisites to your end goal?

The application of the current classification scheme is overly complex and should be simplified. We believe the mixed-attribute model clearly remains the most appropriate for the financial-services industry, but support a refined mixed-attribute model with fewer classification criteria and a more consistent economic and strategic view of the underlying rationale for investing in financial instruments. We would support a two- or three- classification mixed attribute model for assets as long as there is sufficient clarity on the principles to be applied.

There are several existing complexities in the current model for accounting and reporting of financial instruments, the most pressing of which include hedge accounting, multiple impairment models, own-credit considerations and classification schemes. Significant reduction in complexity may be achieved by addressing these critical issues. For example, while we believe that hedge accounting should be maintained, we also think that simplifying the documentation and allowing for prospective assessment of hedge effectiveness are two areas where complexity could be reduced. In our view it is important that hedge accounting be modernized at the same time: we have discussed this important point with the IASB in some detail.

On the insurance side, it is important to move ahead with a coherent approach to both assets and insurance liabilities, as is widely recognized, and it is important not to lose momentum in that direction.

Question 5

What criteria should accounting standard-setters consider in balancing the need for resolving an 'emergency issue' on a timely basis and the need for active engagement from constituents through due process to help ensure high quality standards that are broadly accepted?

The IIF has previously communicated in its *Final Report of the IIF Committee on Market Best Practices* that accounting standard setters should have in place an expedited due process for interpretations and amendments of standards that arise in periods of urgency. Such process, with enhanced coordination between the main international boards (including the Japanese ASBJ as well as the IASB and FASB), would contribute to increased consistency and comparability among preparers and auditors of financial statements, potentially lessening misinterpretation and possible erosion of confidence.

There should be an appropriate balancing of speed and due process. In anticipation of possible emerging crises, the FASB and IASB should establish a framework for management of crisis-related accounting and financial reporting issues, in the form of joint working groups and a unified standard setting process. Indeed, the formation of the FCAG is a fine example of what such framework should entail. Perhaps it would be feasible on that basis to develop a joint rapid process for providing coordinated guidance and clarification on any urgent topic, with a well-understood procedure to convert such urgent guidance or clarification into more permanent standards or interpretations in due course. Such a process could leverage off the existing framework of both the EITF and IFRIC as those responsible for interpretation, rather than changing accounting standards, in an expedited manner.

Such responses to urgent issues should in the future be coordinated with the "macroprudential" review process being put in place by the IMF and FSF, taking advantage of the insights coming out of that process while maintaining the independence of the standard setters.

While it will probably never be possible to avoid confronting urgent situations altogether, it might be possible to lessen the danger of either Board's feeling the need for rapid, independent action, or of needing to resort to expedited procedures. One way to do this would be to take possible effects of economic downturns more into account in devising standards. It may be advisable in the future to apply stress tests to proposed standards to try to estimate their performance in different parts of the economic cycle.

Question 6

Are there financial crisis-related issues that the IASB or the FASB have indicated they will be addressing that you believe are better addressed in combination with, or alternatively by, other organizations? If so, which issues and why, and which organizations?

As we have mentioned in several of our previous responses, both the FASB and the IASB should not address financial reporting issues in "silo". There should be

increased exchanges with prudential regulators, particularly in the areas of provisioning and Pillar 3 related disclosures to make sure that the process of making changes is as well informed and as coherent as possible.

We acknowledge that the objectives of financial reporting are not those of prudential regulation; however, taking into account regulatory developments concerns may help reduce complexity, avoid sources of confusion to investors and increase certainty in globally integrated financial markets. The FCAG should be mindful of the FSF working group on provisioning and, on an ongoing basis; the standard setters need to find an appropriate way of plugging into the developing international discussions on macroprudential issues, while at the same time maintaining their independence within the accounting sphere.

Question 7

Is there any other input that you'd like to convey to the FCAG?

IIF members strongly support increasing the overall convergence of international accounting standards. Such efforts promote the objective of achieving integrated international capital markets and consistent and uniform accounting standards. We support the objective of the standard setters to achieve substantial accounting convergence across the major markets by 2011.