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Russell G. Golden
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
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Via email: director@fasb.org

RE: Accounting for the Income Tax Rate Changes of Tax Reform

Dear Chairman Golden:

The American Bankers Association[1] (ABA) wishes to express concerns regarding the accounting for changes to income tax rates within Accounting Standards Codification Topic 740, *Income Taxes* (ASC 740). Of course, this concern has arisen in light of the recent tax reform efforts in the U.S. and the likely occurrence that a material change in the U.S. Federal corporate income tax rate will result. While financial statement preparers in all industries will be challenged to account for a new tax law[2], we believe board members, investors, and regulators will be unnecessarily challenged by the accounting for items currently presented in accumulated other comprehensive income (AOCI).

Specifically, ASC 740-10-45-15 requires deferred tax assets (DTAs) and liabilities (DTLs) to be adjusted upon enactment of the new tax law and their changes to be presented in net income from continuing operations, even when the corresponding deferred taxes relate to items presented in AOCI. As a result, the remaining DTAs and DTLs within AOCI are nowhere near reflecting the appropriate tax rates of the corresponding items within AOCI. This will be confusing to financial statement users, particularly for the banking industry:

- First, adjustments recorded though net income often have different regulatory capital impacts than those recorded in AOCI. Regulatory capital in the banking industry often excludes amounts in AOCI and is normally the basis to determine capital available for dividends and other key items to investors.

[1] The American Bankers Association is the voice of the nation's $16 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend more than $8 trillion in loans.

[2] Per ASC 740-10-25-47, the effect of changes in tax rates is recognized at the date of the enactment of the law. Further, ASC 740-10-30-9 notes that the adjustment of deferred tax assets and liabilities requires knowledge about when they will be realized. These requirements, which ABA does not question, present significant challenges to financial statement preparers, especially considering the possibility that decreases to corporate income tax rates occur in 2019, while other aspects of the bill are effective in 2018.

- On an ongoing basis, the inability to immediately release the residual DTA/DTL amounts caught in AOCI will require reconciliation and potentially burdensome tracking on the part of the preparer or the investor. This is especially true in accounting DTAs and DTLs related to the unrealized capital gains and losses of Available For Sale (AFS) debt securities.

To illustrate the issue, here is an example of the accounting entries under the current standard using unrealized gains on an AFS security:

Entry	Dr	Cr	AOCI[3]	Total Equity		Regulatory Capital[4]
To record an unrealized gain on an AFS security (35% tax rate):						
AFS Security	100					
Unrealized Gain/Loss		100	100	100		
Unrealized Gain/Loss	35		65	65		
Deferred Tax Liability		35				
To record the change in the tax rate (to 20% tax rate):						
Deferred Tax Liability	15					
Income Tax Expense		15		80		15

In this example, a gain of 15 has been recognized in current period net income for a security that has historically been and continues to be marked to fair value through OCI. This results in a mismatch (highlighted in yellow in the table above) between total equity and AOCI for the same security (65 vs 80). Institutions under $250 billion in assets exclude AOCI from regulatory capital and, therefore, this mismatch affects regulatory capital (highlighted in blue in the table above). We acknowledge that total equity is accurate. However, investors and bank board members analyzing and forecasting regulatory capital will observe that the effective tax rate for unrealized capital gains in AOCI (which remains at 35%) and that for those unrealized capital gains reported through net income are both individually misleading. Further analysis and disclosure that would be unnecessary if the impact was presented in OCI will be required.

Further, the difference will need to be tracked and will only release when the security is disposed. As principal on debt securities is paid down over time and the security is often subject to prepayment, forecasting and communicating the impact on an ongoing basis will be challenging. This appears to be an unintended consequence of the current standard, uncovered only by the potential magnitude of the current tax reform efforts.

[3] AOCI is generally excluded from regulatory capital for banks under $250 billion in assets.

[4] This example reflects the Common Equity Tier 1 regulatory capital impact for banks under $250 billion in assets.

Similar mismatches resulting from other items presented in AOCI include:

- Foreign currency translation adjustments
- Certain pension adjustments
- Gains/Losses on cash flow hedges
- Other-Than-Temporary Impairment related to Held-To-Maturity securities
- Credit risk portion of own debt using the Fair Value Option

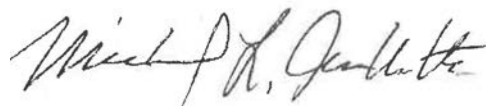
As we noted, the timing of this tax reform will create considerable burden on preparers and investors to calculate and process the impacts. This requirement in the standard will significantly add to this burden and obfuscate the resulting financial statements. We believe a change is needed before this year-end reporting season gets underway.

ABA supports allowing an option to use "backwards tracing", a requirement in International Financial Reporting Standards, which would result in the related items to be reflected within OCI (and AOCI). This should enable most companies to apply the income tax rate change to their DTAs and DTLs without significant additional documentation.

There is a high level of detail needed to track the timing of recognition of specific DTAs and DTLs (whether in AOCI or not) caused by the change in income tax rates. Such work should not then result in confusion for investors. While we realize that time is not our friend given the calendar, we highlight the Board's ability to take swift action and correct the Other-Than-Temporary Impairment issue in less than a month back in 2009.[5] Therefore, we strongly urge you to make an immediate technical correction to mitigate this important issue.

Thank you for your attention to these matters and for considering our views. Please feel free to contact me (mgullette@aba.com; 202-663-4986) or Josh Stein (jstein@aba.com; 202-663-5318) if you would like to discuss this in more detail.

Sincerely,



Michael L. Gullette

[5] The exposure draft for FASB Staff Position No. FAS 115-2 and FAS 124-2 was released on March 17, 2009 and a final standard was issued April 9, 2009.