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September 18, 2008

The Honorable Henry M. Paulson, Jr.
Secretary of the Treasury
Office of the Secretary
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

The Honorable Ben S. Bernanke
Chairman
Federal Reserve System
Eccles Board Building
20th Street and Constitution Avenue, NW
Washington, DC 20551

The Honorable Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

The Honorable John M. Reich
Director
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

The Honorable John C. Dugan
Comptroller of the Currency
250 E Street, SW
Washington, DC 20219-0001

Dear Secretary Paulson, Chairman Bernanke, Chairman Bair, Director Reich and
Comptroller Dugan,

The American Bankers Association is deeply concerned about the impact of the recent financial events on our economy and our banking system. A healthy banking industry is fundamental to national economic prosperity. Despite the current financial turmoil, our banking industry remains in strong financial condition. However, there have been real consequences to the latest actions that require the immediate attention of policymakers and regulators.

Specifically, it now is clear that the conservatorship program for Fannie Mae and Freddie Mac (GSEs) is having a significantly greater negative impact on portions of the banking industry than first estimated by policy makers and regulators. It is imperative that this impact be addressed both quickly and in a comprehensive fashion to mitigate the unintended consequences. Anything less could harm otherwise fundamentally sound institutions that are already working overtime to serve their customers and communities in this difficult economic environment.

We understand that support for GSE debt and mortgage backed securities was essential to encourage adequate funding for good home loans. However, the unexpected losses to holders of GSE preferred shares will inhibit a sizable number of banks from making new mortgages or providing other financing. Furthermore, many

banks also held Auction Rate Preferred Securities (ARPS) that were collateralized with Fannie or Freddie preferred shares. Banks were encouraged by favorable regulatory treatment to hold these supposedly low-risk, highly-rated instruments in support of the secondary mortgage markets. Now the losses from that support will impede their ability to make new home loans—at the very time that banks are beginning to see more of that business coming their way—as well as other types of loans.

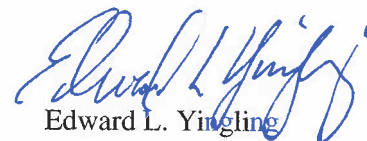
Moreover, there are a variety of follow-on effects from these losses on preferred shares that will further inhibit bank lending. Banks suffering losses from GSE preferred shares may experience a reduction in their capital classification. This, in turn, will expose these banks to potential increases in their deposit insurance premiums and undermine their access to various sources of liquidity. Restoring capital levels, under current market conditions, will mean for many banks that they have to sell assets or shrink rather than make new loans, further contributing to a credit crunch. All of these problems are complicated by the fact that there was no clear guidance from the regulators about how banks should report their preferred holdings, which has resulted in mis-classifications in call reports and thrift financial reports.

We recommend a comprehensive course of action to help rectify the situation. First, at least a portion of preferred share dividends should be restored, which would restore a similar portion of share value and reduce impairment charges. Second, reductions in dividends on preferred stock should be delayed until Congress and the regulators can assess the implications and address solutions. Third, for tax purposes losses should be authorized to be treated as ordinary, and thereby allowed to be offset against a bank's ordinary income. Fourth, risk weights for GSE debt and GSE-guaranteed mortgage-backed securities should be reduced from the current 20 percent weighting. Fifth, the Auction Rate Preferred Securities (ARPS) backed by Fannie Mae and Freddie Mac stock should be consistently risk weighted at twenty percent. These risk weighting changes might be permitted through 2009 during the life of Treasury lending facilities, pending further study, permitting banks to adjust to the impact of impairment charges on capital. Finally, the banking agencies should increase the flexibility of capital restoration plans where they are necessary.

A clear and candid assessment needs to be made of the consequences of the GSE conservatorship program for what appears to be an unexpectedly large number of banks. These issues need to be addressed in a comprehensive and expeditious manner. Ninety-eight percent of the nation's banks are well capitalized and have the talent and mechanisms to fuel economic recovery. Yet these times of financial stress require extraordinary efforts. ABA is asking for prompt, comprehensive action to alleviate the unintended consequences of the GSE bailout on our banking system. We look forward to meeting with you to discuss solutions to these problems.

Sincerely,


Bradley E. Rock


Edward L. Yingling