September 25, 2009

Board of Governors of the Federal Reserve System,
20th & C Streets, N.W.,
Washington, D.C. 20551.

Attention: The Honorable Daniel K. Tarullo,
Governor

Office of the Comptroller of Currency,
250 East Street, S.W.,
Washington, D.C. 20219.

Attention: The Honorable John C. Dugan,
Comptroller of the Currency

Federal Deposit Insurance Corporation,
550 17th Street, N.W.,
Washington, D.C. 20429.

Attention: The Honorable Sheila Bair,
Chairman

Office of Thrift Supervision,
1700 G Street, N.W.,
Washington, D.C. 20552.

Attention: The Honorable John Bowman,
Acting Director

Re: Regulatory Capital Limits on Deferred Tax Assets

Ladies and Gentlemen:

The Clearing House Association L.L.C. ("*The Clearing House*")[1] and the American Bankers Association (the "*ABA*")[2] are writing to urge the Board of Governors

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1 The member banks of The Clearing House are ABN AMRO Bank, N.V., Bank of America, National Association, The Bank of New York Mellon*, Citibank, N.A.*, Deutsche Bank Trust Company Americas, HSBC Bank USA, National Association*, JPMorgan Chase Bank, National Association*, UBS AG, U.S. Bank National Association*, and Wells Fargo Bank, National Association*. Those member banks whose names are marked with an asterisk in the preceding sentence actively participated in the preparation of this letter, including the materials enclosed as Annex 1, and are referred to herein as the "*Participating Clearing House Members*".

2 The ABA brings together banks of all sizes and charters into one association. The 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.

of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and the Office of Thrift Supervision (together, the "*Agencies*") to revisit the continued appropriateness of the provisions in their risk-based capital guidelines and regulations (together, the "*Capital Regulations*") that limit the amount of deferred tax assets ("*DTAs*") dependent upon future taxable income that may be included in – or, more specifically, not deducted from – a banking organization's regulatory capital. For the reasons discussed further below, The Clearing House and the ABA believe that now is an appropriate time for the Agencies to revisit whether the present limitations on DTAs as set forth in the Capital Regulations continue to be appropriate. We believe strongly that they are not and urge the Agencies either to eliminate the limitations, with the consequence that the Capital Regulations would simply follow U.S. generally accepted accounting principles ("*U.S. GAAP*") in their treatment of DTAs, or at the least significantly relax the existing limitations.

I. Background

Prior to the Financial Accounting Standards Board's adoption of its Statement No. 109, "Accounting for Income Taxes" ("*FAS 109*"), which became effective for fiscal years beginning on or after December 15, 1992, U.S. GAAP did not permit the recording of deferred tax assets that are dependent upon future taxable income. FAS 109 changed U.S. GAAP to require the recording of DTAs that are dependent upon future taxable income, but requires the establishment of a valuation allowance, if warranted, to reduce the DTA net of the valuation allowance to an amount that is more likely than not (i.e., a greater than 50% likelihood) to be realized.

Effective April 1, 1995, the Agencies, in response to the changes in the U.S. GAAP treatment of DTAs brought about by FAS 109, amended the Capital

Regulations to include the current limitations on deferred tax assets.[3] Prior to those amendments, the Capital Regulations did not include a limitation on DTAs. Those amendments provide that DTAs dependent upon future taxable income, net of the valuation allowance, must be deducted from core capital elements in determining Tier 1 capital to the extent that they exceed the lesser of (i) the amount of those DTAs that the banking organization is expected to realize within one year of the calendar quarter-end date, based on its projections of future taxable income for that year, or (ii) 10% of Tier 1 capital.

We believe this is an appropriate time for the Agencies to revisit the treatment of DTAs in the Capital Regulations for two reasons, as follows:

> First, the credit and liquidity crises of the last several years have only heightened the critical importance of regulatory capital as a measure of banking organizations' financial health and strength. The mere passage of time – 17 years since the adoption of FAS 109 and 14 years since the adoption by the Agencies of related amendments to their Capital Regulations limiting DTAs – warrants a re-evaluation of whether the limitations on DTAs are in fact sensible and appropriate. Measures of regulatory capital are not only a critical tool for the Agencies in their supervision of banking organizations; they are also a critical measure monitored by the investor and analyst communities, with distortions to regulatory capital having the potential to likewise distort the perceptions by those communities of the financial health and stability of banking organizations.
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> Second, the credit and liquidity crises of the last several years inevitably will, and should, lead to a more general re-evaluation of regulatory capital regulations for banking organizations, not only in the United States but

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3 The Agencies' proposing and adopting releases appear at 58 Fed. Reg. 8007 (February 11, 1993) and 59 Fed. Reg. 65920 (December 22, 1994), respectively.

internationally. The United States Treasury Department, in its policy statement on capital released on September 3, 2009 entitled "Principles for Reforming the U.S. and International Regulatory Capital Framework for Banking Organizations" (the "*Treasury Policy Statement*"), noted that "the inclusion in regulatory capital of deferred tax assets…should be subject to strict, internationally consistent qualitative and quantitative limits." We understand that the United States is the most restrictive of the G-10 – i.e., those countries whose banking supervisory authorities participate in the Basel Committee on Banking Supervision – in its disallowance of DTAs as a limitation on capital. Pending the convergence on an international standard as part of that re-evaluation, we urge the Agencies to conform the treatment of DTAs under the Capital Regulations so as to be more in line with international standards.

The disallowance from Tier 1 capital of excess DTAs is not an issue only for larger banking organizations. We anticipate that during the next several years it is likely to be at least as constraining, and perhaps more constraining, for community banks and other smaller banking organizations as the resolution of troubled assets "ripples" through the banking system. That is not, of course, a reason for inappropriately relaxing capital standards, whether with respect to DTAs or other components. It is a reason, however, for revisiting whether the limitations on DTAs in the Capital Regulations continue to be appropriate.

II. Discussion

When the Capital Regulations were amended in 1995 to limit the inclusion of DTAs in Tier 1 capital, the comment letters submitted by the banking industry, including The New York Clearing House Association (as The Clearing House was then known) and the ABA, uniformly opposed the limitation and urged the Agencies to simply follow U.S. GAAP. Some of the considerations bearing upon the appropriateness of the limitation, both pro and con, are the same now as those discussed in 1993/1994; some are different. We have set forth below the considerations that cause us to believe that the limitation decided upon by the Agencies in 1995 should now be eliminated or relaxed.

1. Experience

Banking organizations and their independent accountants have had substantial experience since 1995 with DTAs that are dependent on future taxable income (and, accordingly, the appropriateness of their inclusion in Tier 1 capital), including actual practice in evaluating the need (or lack of a need) for the establishment of valuation allowances under FAS 109 through several credit cycles. We believe experience shows that valuation allowances have been conservatively established and that DTAs net of any valuation allowance that appear on banking organizations' balance sheets under U.S. GAAP are not lesser assets (in terms of realizability) that should be subject to a risk-based capital limitation.

In preliminary discussions that The Clearing House and the ABA have had with the Agencies during the past several months, including meetings with representatives of the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency on May 19, 2009, the Agencies understandably have questioned whether empirical evidence supports that conclusion. An empirical determination of whether DTAs net of any valuation allowance, as reflected on a banking organization's balance sheet as of a particular date, were in fact usable or realizable (and in fact used or realized) against future taxable income, and how quickly, necessarily requires access to granular detail. The granular detail likely would include managements' and accountants' work papers, as to the precise content – by type and transaction – of those DTAs and any related valuation allowances as of a date, followed by a "tracking" of whether and how they were used or realized. That information is not available from public sources, whether periodic reports (including financial statements included with such reports) filed by public companies with the Securities and Exchange Commission under the Securities Exchange Act of 1934 (the "*1934 Act*"), financial information filed by bank holding companies on Form FR Y-9C, or Call Reports filed by banks with the Agencies.

In the absence of more granular data that is not publicly available, the Participating Clearing House Members and the ABA nevertheless have assembled the information in the tables included as Annex 1[4] from the financial statements and related tax footnotes included in annual reports filed under the 1934 Act for 17 bank holding companies. For each of the 17 bank holding companies, we have included two tables. The first table includes data from 1993 through 2008 and shows: (i) in columns (1) through (3), the bank holding company's DTA (i.e., the DTA net of the deferred tax liability) before the valuation allowance, the valuation allowance, and the DTA after the valuation allowance (the "*Net DTA*"); (ii) in columns (4) through (7), information with respect to current tax expense for the relevant years and whether the future year's or years' tax expense equaled or exceeded the current year's Net DTA within one, two or three years; (iii) in columns (8) through (10), the DTA arising from the loan loss reserve for the current year, the utilization or realization of DTAs by the tax deduction for net write-offs in the current year, and the number of future years that were required for the net write-offs in those future years to equal or exceed the loan loss reserve for the current year; and (iv) in column (11), the net operating loss and tax credit carryforward as of the end of the current year. We focused on comparing the loan loss reserve DTA to tax

[4] The 17 bank holding companies are the holding companies for the six Participating Clearing House Members and six other bank holding companies for which they prepared tables – American Express Company, Fifth Third Bancorp, First Horizon National Corporation, State Street Corporation, SunTrust Banks, Inc. and Zions Corporation. Tables were prepared by the ABA for five bank holding companies which, in accordance with ABA practice, are not identified on the charts but generally are smaller institutions, with the total asset size for each bank holding company as of June 30, 2009 indicated at the top of the first page of the two-page table for such bank holding company.

deductions for net write-offs in columns (8) through (10) because the temporary difference between the U.S. GAAP and the income tax treatments of credit expense is among the items likely to be the most significant during periods of credit stress.

The second table for each bank holding company provides a historical perspective for that bank holding company, setting forth Tier 1 capital before any DTAs disallowed by the Capital Regulations, total risk-weighted assets, total assets, the Net DTA as a percentage of Tier 1 capital, DTAs before deducting deferred tax liabilities or the valuation allowance ("*Gross DTAs*") as a percentage of risk-weighted assets, and Gross DTAs as a percentage of total assets.

The tables show that, since the adoption of FAS 109:

(a) For those bank holding companies that had Net DTAs,[5] current tax expense (reflecting the presence of current taxable income) generally has aggregated to an amount exceeding a prior year's Net DTA very quickly — generally within one year.

(b) For the larger bank holding companies, the year-end DTA related to loan loss reserves generally equaled the actual tax deductions for net write-offs within the subsequent two to three years, but for the smaller bank holding companies the period has been somewhat longer (in one case as many as nine years).

(c) Predictably the DTA related to loan loss reserves (in column (8) of the first table) as well as the tax deduction for net write-offs rose substantially in 2008. It is important to note that both items increased, the implication being that

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5 A number of the bank holding companies had net deferred tax liabilities instead of net DTAs for many of the years in the period, including the down years in the credit cycle.

the disparity between the U.S. GAAP and the income tax treatments of credit expense does not necessarily increase during the down period in economic cycles because write-offs occur and tax deductions are realized within a reasonable period after provisions are taken to increase the loan loss reserve.

With respect to how the Agencies might access the more granular data that would be most useful for an empirical analysis, we understand that the Agencies are making inquiry of the major accounting firms, including the "Big Four" (Deloitte & Touche, Ernst & Young, KPMG, and Pricewaterhouse Coopers), concerning their experience as independent accountants' in auditing financial statements and reviewing clients' DTAs and the need for related valuation allowances since the adoption of FAS 109. We encourage those discussions. Although banks (including the Participating Clearing House Members) would not generally be willing to share with competitors their own granular data, each of the Participating Clearing House Members would be willing to meet with representatives of the Agencies, along with their independent accountants, to discuss confidentially the details of their individual DTAs and related valuation allowances.

2. Rulemaking by Exception

Rules and regulations, as an objective, should be of general applicability and work without a need for frequent one-off exceptions. During the past year, however, the Federal Reserve on three occasions has accorded DTA capital relief to large banking organizations in connection with acquisitions of troubled institutions: by letter dated December 22, 2008 to PNC Financial Services Group, Inc. in connection with its acquisition of National City Corporation; by letter dated February 20, 2009 to Wells Fargo & Company in connection with its acquisition of Wachovia Corporation; and by letter dated March 30, 2009 to Bank of America Corporation in connection with its acquisition of Merrill Lynch & Co. Incorporated. The need for these three bank holding companies to seek DTA capital relief, and the Federal Reserve's determination to grant the relief sought, indicate the need for a more comprehensive re-evaluation of the Capital Regulations' treatment of DTAs and the constraint that that treatment can have on acquisitions of troubled entities at a time when acquisitions should be facilitated where possible.

3. Capital Regulations Assume Banking Organizations Are Going Concerns

One of the arguments that the banking industry made in 1993/1994 was that the Agencies' concern with respect to the usability or realizability of DTAs against future taxable income was, although not misplaced, likely overstated given the core premise of the Capital Regulations. The Capital Regulations are premised upon banking organizations as going concerns, not failed entities, and accordingly the concern that there will never be future taxable income against which deferred tax assets could be used or realized should not be the major concern. That premise as applied to DTAs, unlike the scope and application of the Capital Regulations more generally, was rejected in the Agencies' determination to amend the Capital Regulations in 1995. We strongly urge the Agencies to reconsider their view. Moreover, we note that the banking organization failures (or near failures, resulting in forced mergers) in the current financial crisis have for the most part not resulted from periods of losses or low earnings (whether relating to asset quality concerns or otherwise) or even expectations of sustained future periods with no earnings but, instead, from liquidity crises.

4. Loss of DTAs in Mergers and Acquisitions

One of the concerns the Agencies raised at the time of adoption of the existing Capital Regulation limitations was with the possible loss of DTAs dependent upon future taxable income due to the limitations on net operating loss carryforwards under Section 382 of the Internal Revenue Code if a change in control occurs. The

Clearing House and the ABA respectfully submit that that should not be a major concern because the context in which the loss of carryforwards most commonly would arise is in an acquisition subject to regulatory approval. The relevant Agency will have an opportunity to assess capital adequacy at the time in evaluating whether or not to grant approval. In addition, under current purchase accounting rules acquiree DTAs are revalued and closely scrutinized.

III. Proposal

The Clearing House and the ABA believe that the Capital Regulations should simply follow U.S. GAAP in their treatment of DTAs, including those dependent upon future taxable income, and not treat DTAs dependent upon future taxable income as “lesser assets” (or assets the future realization of which is in doubt) that are analogous to intangible assets the value of which can decline or disappear, even for a going concern. Accordingly, we strongly urge the Agencies to commence a formal rulemaking to eliminate the current limitation in the Capital Regulations on DTAs dependent upon future taxable income.

If the result of the Agencies’ own investigation as well as comments made during a formal rulemaking ultimately do not, in the Agencies’ view, support simply conforming the treatment of DTAs in the Capital Regulations to U.S. GAAP, we strongly urge the Agencies to consider other alternatives that do not require a 100% capital charge for excess DTAs. Those alternatives could include one or more of: (i) meaningfully extending the current one-year “look forward” period during which banking organizations currently must expect to realize DTAs that are not disallowed; (ii) meaningfully increasing the 10% of Tier 1 capital limit on DTAs that are not disallowed; or (iii) instead of requiring a deduction in calculating Tier 1 capital of 100% of DTAs dependent upon future taxable income that exceed the more restrictive threshold, require a deduction of 50% of such excess DTAs.

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The Clearing House and the ABA would be pleased to discuss with the Agencies the enclosed charts and the views expressed in this letter. Please direct any questions to Joseph R. Alexander, Senior Vice President and Senior Counsel of The Clearing House, 212-612-9234, and Fran Mordi, Vice President and Senior Tax Counsel of the ABA, 202-663-5317.

Very truly yours,

The Clearing House Association L.L.C

Joseph R. Alexander
Senior Vice President
and Senior Counsel

Very truly yours,

American Bankers Association

Robert R. Davis
Executive Vice President