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June 5, 2009

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

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

The Honorable John Bowman
Acting Director
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

The Honorable Elizabeth A. Duke
Governor
Board of Governors of the Federal Reserve System
20th and C Streets, NW, (Mail Stop 54)
Washington, DC 20551

The Honorable Daniel K. Tarullo
Governor
Board of Governors of the Federal Reserve System
20th and C Streets, NW, (Mail Stop 54)
Washington, DC 20551

Re: Regulatory Capital Adjustments Required in Response to FASB Sales and Consolidation Accounting Changes

Ladies and Gentlemen:

With the issuance of the amendments to FASB Statement No. 140 ("FAS 140", ***Accounting for Transfers of Financial Assets***) and FASB Interpretation No. 46R ("FIN 46R", ***Consolidation of Variable Interest Entities***) expected in the next few weeks, billions of dollars worth of assets and liabilities that reside in special purpose entities and are currently disclosed in footnotes to the financial statements will now be reported on bank balance sheets. Due to the regulatory impact of this "gross up" of balance sheets, it is critical that banking institutions, as well as the investment community, understand the impact of these changes. Specifically, with a significant increase in assets and liabilities being expected to be recorded on bank balance sheets, both banks and investors need to understand how the accounting changes will affect the regulatory capital of banking institutions.

The expected changes to FAS 140 and FIN 46R will also have an enormous potential impact on the operations of many banks, whether or not they are involved in securitization activities. New quarterly fair value estimates and analyses of each interest in a variable interest entity, as well as comprehensive consolidation accounting procedures, are just a few of the necessary processes that are not currently in place in the vast majority of institutions. These major new processes could pose operational concerns for banking institutions, especially when considering these companies are required to set these processes up within approximately six months of issuance of the final accounting standard.

We have been in contact with staff at your agencies regarding this matter over the past several months. Whatever the actual regulatory impact may be, we believe it is critical that this guidance coincide with the issuance of the FASB changes in order to avoid unnecessary uncertainty in the markets.

With that in mind, we respectfully submit our recommendations regarding how these changes should be treated for regulatory capital purposes. We believe these recommendations reflect the practical impact of how these changes will affect the safety and soundness of banking institutions.

Recommendations

Look through the reported asset to the underlying guarantee: Because most guaranteed mortgage securitizations will no longer meet the new sales criteria in FAS 140, banks will no longer record such securitizations as securities, but will maintain them on their books as loans. However, whether the securitizations are recorded as loans or as securitizations, once the loans are guaranteed, they should naturally carry a correspondingly lower risk weighting than an unguaranteed whole loan. Therefore, we recommend that regulations "look through" the accounting for the instrument to determine whether the loans are securitized and are guaranteed. If so, those securities reported as loans should carry the same risk weighting as those recorded as guaranteed securities.

Link the assets to the corresponding liabilities of the trust: While the FASB is discontinuing the concept of the qualifying special purpose entity (QSPE), this does not affect the fact that many securitizations are performed through legal trusts where the transferred financial assets have been isolated beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership. The new FASB rules also do not change the fact that loans residing in SPEs to be recorded on the balance sheet will have a significantly different risk profile than those loans directly held by the company. In other words, while the accounting has changed for the assets and liabilities within the SPEs, the risks to the banking institution have not, and, thus, the risk weightings should remain consistent with the substance of the structures.

As one example, loans that are securitized and reside in SPEs will often now be consolidated by the credit enhancer/servicer of the securities (the primary beneficiary). However, the portion held by third parties (through beneficial interests of the related securities) does not subject the primary beneficiary to the same market risks (e.g. interest rate, liquidity) as a recorded whole loan. Those risks are borne by the security holder. Only if the primary beneficiary holds the security is it exposed to these risks.

With this in mind, we recommend that assets in SPEs that have met the isolation test, along with the corresponding amounts payable to security holders (excluding the credit loss reserve), be linked and excluded from an individual bank's regulatory capital ratios. Regulatory capital should be maintained only for those assets that are retained by the banking institution and subject to claims of its creditors or receiver/conservators. To assign risk weightings to these consolidated assets in a manner similar to risk weightings for whole loans or securities would be inappropriate and arbitrary. Further, a requirement that specific capital be held for the proportionate amount of assets that reside in securities held by others would result in an industry-wide double counting of required capital.

Transition period for any additional capital required: In addition to the operational impact discussed above, the potential impact of these changes on banking regulatory capital is obviously significant – not just to the banks, but also to the economy. With any increase in required capital, a banking institution is likely to reduce the amount of lending using such securitization vehicles, as well as other lending. No matter what the new capital requirements may be, and in consideration of the time required to effectively create and implement such necessary operational processes and to determine and execute alternatives to address any increased regulatory burden, we recommend that the agencies carefully consider whether regulatory changes are necessary from a safety and soundness perspective. If changes are to be required, we recommend that they be phased in over a period of time. Because of the numerous challenges being faced by banking institutions in the current market, we recommend that the transition period be at least three years, with the first year having no regulatory capital impact and the following two years being the time period for implementing the regulatory capital requirements. Such a transition, allowing a bank to "catch up" the incremental capital requirement over a three year period, will allow banks to migrate to alternative procedures and funding without completely halting the markets that rely on securitization.

Thank you for considering our request. Please contact Mike Gullette, ABA's Vice President, Accounting and Financial Management (202-663-4986 or mgullette@aba.com) or me if you have any questions or would like to discuss these issues in greater detail

Sincerely,

Robert R. Davis

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