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September 25, 2008

Mr. John C. Dugan  
Comptroller of the Currency  
OCC  
250 E Street, SW  
Washington, D.C. 20219-0001

Dear Mr. Dugan:

In recent months, a number of AABD members and others have expressed concerns to us about how their outside accounting firms have allowed market conditions to override credit quality issues in determining whether and to what extent there are other-than-temporary impairments on certain investments their banks hold.

As the number of banks and savings institutions facing capital adequacy pressures increases just as sources of capital have dwindled, the impact of OTTI on bank regulatory capital requires immediate bank supervisory agency attention.

Despite repeated efforts by the accounting profession and the SEC to set objective and uniform standards by which to determine whether an impairment on an investment is “temporary” or “other-than-temporary”, the process remains highly subjective and the results remain very uneven.

Outside accounting firms will come to different conclusions on the same securities in the same time frame. Some banks are taking hits to their income statement from these impairments while others are not, often dictated by the attitude of their accounting firm or based on variation in individual bank methodology and application of that methodology. There also have been incidents reported to us of the same accounting firms requiring OTTI on the same securities bought for the same amount for one bank and not another bank client in the same time frame.

We have even seen an instance of an accounting firm relying on what it believed the “Big Four” accounting firms were doing with respect to a particular security rather than conducting its own independent review of the bank’s methodology and its application of that methodology.

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The accounting literature is a maze of different and typically imprecise factors that banks and their outside accounting firms are required to consider in deciding whether there is an OTTI and if so, the amount of such impairment. The literature doesn't instruct how to balance these various factors, so even if the accountants and banks were to agree on the meaning of subjective terms used in the literature, the weight ascribed to each factor remains highly judgmental.

Then there is the phenomenon of securities whose obligors remain capable of fully repaying their obligations and, yet, the market for those securities freezes up because of herd mentality or a generalized concern over the economy.

The accounting literature takes into account not just the creditworthiness of the obligor and the obligor's financial capacity to repay the obligation as agreed, but also market conditions affecting the market value of the security. For example, SAS No. 92 lists factors that may indicate an other-than-temporary impairment condition; the factors include the fact that "fair value is significantly below cost and the decline in fair value has existed for an extended period of time (e.g., more than six months)." SAB 59 sets forth factors such as "the length of the time and the extent to which the market value has been less than cost." In an American Bankers Association letter to the SEC dated September 11, 2008, the ABA wrote that "it appears that some auditors may presume that the degree of market discount in pricing is, in and of itself conclusive evidence of OTTI. Little regard is being placed on the actual cash flow modeling and credit analyses done by the banks."

AABD is not requesting the federal banking agencies to change GAAP accounting or how banks and thrifts prepare their balance sheets and income statements. However, we are asking the agencies to allow OTTI that has been or will be written off, based on GAAP or an interpretation of GAAP, to be counted as part of regulatory capital if the bank in question applies a reasonable methodology to determine the current sound worth and paying capacity of the obligor and/or of the collateral pledged on the security, and has a current intention to hold the security indefinitely. The bank methodology and determination would be reviewed during bank examinations and the examiners would have the authority to override any bank determination if they determined that it was not reasonable.

If the bank reasonably determines that the obligor on the investment can reasonably support the obligation as agreed, the investment would be carried at cost for purposes of calculating regulatory capital even though, under GAAP, such investment might be deemed to be OTTI for book purposes. If, however, the obligor does not have the current capacity to repay the obligation as agreed, then the traditional classification system (and not OTTI under GAAP) would dictate the effect of the obligation on the bank's regulatory capital. The fact that the market for the security is illiquid or not reflective of the expected payout value of the security would not affect regulatory capital.

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Your agency and the other federal banking agencies, under current guidelines, do not permit regulatory capital to be affected by the market value of the securities in a bank's available-for-sale and hold-to-maturity portfolio, notwithstanding the GAAP requirement that the book capital of the bank be depreciated by the amount of the market decline in the value of the securities portfolio. We are simply requesting an extension of this approach to amounts attributable to OTTI.

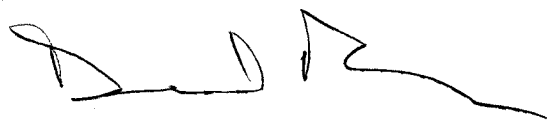
In determining regulatory capital, the agencies are not wedded to GAAP, and departure from GAAP makes sense particularly where the results are, by their nature, based on subjective judgments and fluctuating markets (we presume that the accounting profession settled on the label "OTTI" recognizing that it is different from "permanent."). The agencies should evaluate regulatory capital based on the credit quality of the investment. The market value is not always an accurate measure of the value of the investment because many banks hold their securities in "hold to maturity" or "available for sale" categories. These categories reflect the long-term nature of the investments.

We also suggest consideration of changing the risk weight for Freddie and Fannie Mae debt securities as a result of the U.S. government placing those firms in conservatorship. It is our understanding that the debt securities effectively now have the full faith and credit of the U.S. behind them. As a consequence, these debt securities should be moved from a 20% risk-weighting to a 0% risk-weighting.

It is crucial that the federal banking agencies act prior to year-end 2008 in order to avoid potentially catastrophic scenarios.

Thank you for your consideration.

Sincerely,

A handwritten signature in black ink, appearing to read "David Baris", with a stylized flourish at the end.

David Baris  
Executive Director  
AABD