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November 25, 2008

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

Dear Mr. Secretary:

In your speech in California on November 20, you forcefully expressed the need to “address those aspects of our system that reinforce rather than counterbalance cycles.” You singled out mark-to-market accounting in particular, saying that “mark-to-market accounting is clearly pro-cyclical.” We strongly agree and appreciate your support for the need to find a solution to this problem. This past year has demonstrated that the consequences of these pro-cyclical accounting standards are grave.

Congress has similarly recognized the gravity of these problems in letters and in the recently enacted Emergency Economic Stabilization Act, which calls for a study of mark-to-market. We welcome this review of mark-to-market accounting.

However, ABA strongly believes that immediate action is needed to avoid further hits to the capital of our financial institutions. We simply cannot wait any longer. In a few weeks banks will be required to prepare their year-end financial statements. With market prices continuing to fall well below the actual performance of bank assets, delay in addressing the failures of the mark-to-market mechanisms in fair value reporting will undo much of the work of Treasury’s Capital Purchase Program. While the government makes billions of dollars available to increase capital, other policies simultaneously are needlessly, and wrongly, erasing billions of dollars of bank capital. This should not be allowed to happen. Of course, it is from their capital base that banks are operating as engines of economic growth, multiplying every dollar of capital into additional dollars of new lending. Similarly, every hit to bank capital from poorly designed accounting policies reduces bank lending several times over. Corrective action on these standards and their application is urgently needed.

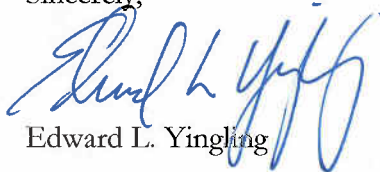
We have recommended several steps that can be taken in the short run – effective prior to year-end 2008. These steps do not require a wholesale re-working of mark-to-market, but rather are clarifications that the SEC can and should make now:

- Other than temporary impairment – The accounting rules for other than temporary impairment should be based on credit impairment;
- Fair value definition – The definition of fair value should be based on willing buyer/willing seller rather than exit price; and
- Mergers and acquisitions – The implementation date for the new business combinations rules, which are controversial and are based on fair value, should be delayed.

These changes will actually *improve* financial reporting for users of financial institutions' financial statements, as the current illiquid values required to be reported have a significant downward bias, which results in overstating losses.

We appreciate your tireless efforts to address the nation's financial problems. The recent release of the term sheets to enable privately held banks to participate in the Capital Purchase Program is much appreciated, and we look forward to the release of term sheets to extend the same opportunities to Subchapter S banks and to mutual institutions. However, to ensure that Treasury's efforts to increase bank capital are not eroded, we urge the prompt implementation of the steps we have outlined to redress some of the key pro-cyclical aspects of current accounting policy.

Sincerely,



Edward L. Yingling

cc: Chairman Christopher Cox, SEC  
Chairman Bernanke, Federal Reserve System  
Timothy Geithner, President and CEO, Federal Reserve Bank of New York  
Chairman Frank  
Chairman Dodd  
Senator Shelby  
Representative Bachus