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

Dear Secretary Paulson,

I am writing to request that the Treasury, together with the bank regulators, act quickly to publicly clarify the purpose of the new program for the government to buy preferred shares in banking institutions, as well as the program to guarantee debt. The American Bankers Association represents banks of all sizes and charter types across the country. Banks representing 95% of the industry's assets are members of the ABA. We want to work with you to provide a clear picture of these programs to the banking industry, to the American public, and to other policymakers.

We greatly appreciate the recent efforts of Treasury officials to help clarify the terms of the preferred stock program, including today's conference call with ABA members. In talking to our member banks, we have found that some do have an interest in participating in the program. However, that interest is tempered by a lack of clarity on the purpose of the program and on what the public view will be of banks that choose to participate. We recognize that Treasury and the bank regulators had to move very rapidly to create this program and that you have been working to provide more specifics. However, government officials, particularly members of Congress, have provided widely differing interpretations and recommendations with respect to what the program is designed to do, what it means to and about banks that participate, and what requirements should accompany participation in the program, both now and in the future. There is also a great deal of confusion in the media, which, of course, impacts the views of bank customers.

While the contract terms of the program are being quickly developed, broader, more important issues remain. As we understand this program, it is directed at providing banks with capital to allow them to increase lending at a time when credit markets have tightened considerably. It is intended for use by strong

institutions, not weak ones. Furthermore, as we understand it, the Treasury and bank regulators wish to encourage banks to issue these preferred shares in recognition of two factors: first, the need for strong banks to increase lending at a time when the economy is suffering, in major part because of contractions in the availability of credit from a broad range of financial institutions; and second, the fact that it is very difficult for even the strongest banks (as well as many other companies) to access the troubled capital markets in a cost-effective manner.

However, there is also much talk, particularly in the media, about banks being undercapitalized, although the great majority are well capitalized, and that any bank using the government program is being “bailed out.” Some public policymakers have called for additional restrictions on banks using the program, restrictions that imply such banks are being bailed out.

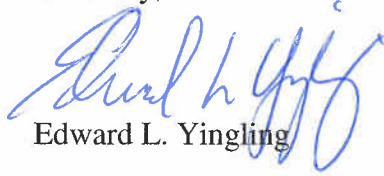
As you know there are thousands of banks across the country that never made one toxic subprime loan, that are strongly capitalized, and that are making loans today.¹ In many cases these banks are attracting new deposits in this economy and are capable of increasing their loan portfolios in a prudent manner. However, to grow their loan portfolios even more, they will need additional capital to support the increase in assets. These banks never asked the government to create a program to make capital available, nor do they need it to continue to be strongly capitalized, solid banks.

These banks have three choices: 1.) they can continue their current levels of activity and do just fine, but not expand their lending to help fill the gaps in credit availability and move our economy forward; 2.) they can obtain some additional private capital, but in these difficult capital markets the cost and availability of such capital may limit their expansion; or, 3.) they can take part in the government preferred stock program. Many such banks would be interested in the third option, but not if they are going to run the risk of being labeled – falsely – as needing government support, or of appearing to be asking for a handout, or of being subjected to additional unknown government requirements or restrictions in the future. There is simply no reason for these banks to run these risks to their reputations or their economic futures. Similar concerns apply to the debt guarantee program, a program that was created primarily to unfreeze lending between large international banks but is being made available more broadly.

¹ There are also a number of well-run, strong banks that will have a one-time reduction in capital because of the government action that placed Fannie Mae and Freddie Mac in conservatorship and in the process wiped out the value of the GSEs’ preferred shares. Unless this situation is addressed along the lines ABA has recommended, these banks will in many cases need to restrict lending temporarily because of their capital constraints.

Therefore, ABA requests that the Treasury and regulators clarify for the banking industry, the media, other policymakers, and most importantly, the American public the purpose of these programs and what they mean for and about the banks that participate.

Sincerely,



Edward L. Yingling

cc: Chairman Bernanke, Federal Reserve System
Chairman Bair, Federal Deposit Insurance Corporation
Comptroller Dugan, Office of the Comptroller of the Currency
Director Reich, Office of Thrift Supervision
