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September 8, 1988

The Honorable William Proxmire
Chairman
Committee on Banking, Housing & Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

In recent weeks, a great deal of attention has been given by your Committee to the severe problems in the thrift industry and the actions of the Federal Home Loan Bank Board (FHLBB). The American Bankers Association (ABA) will soon be adopting a detailed position paper on the underlying causes of, and potential solutions to, the FSLIC insured thrift crisis. However, in view of the active role you took during the enactment of the Competitive Equality Banking Act (CEBA) with respect to improving the accounting practices of the thrift industry, I wish to bring to your attention ABA's concerns with the FHLBB's implementation of the thrift accounting provisions of CEBA.

In 1987, as part of CEBA, Congress mandated that the FHLBB shift from thrift regulatory accounting principles (RAP) to generally accepted accounting principles (GAAP) to the same extent that GAAP is required by the banking regulators. The ABA supported those efforts.

The FHLBB's timetable for the implementation regulations (Uniform Accounting Standards rule, No. 87-1293, adopted December 21, 1987), however, is most troubling. In general, CEBA requires that the conversion to GAAP take effect on December 31, 1987; but the FHLBB regulations substitute December 31, 1988, delaying any change for a full year. Further, the regulations allow thrifts to wait until December 31, 1993 to fully complete the shift to GAAP. As explained more fully below, the ABA believes that the FHLBB's Uniform Accounting Standards rule is inconsistent with the statute and undermines the intent of the Congress. In effect, the FHLBB has granted a six year delay beyond the implementation date required by Congress.

Section 402 of CEBA requires the FHLBB and the FSLIC to issue regulations prescribing "uniformly applicable accounting standards" to be used by all federal and state

chartered thrift institutions "to the same degree that generally accepted accounting principles are used to determine compliance with rules and regulations of the Federal banking agencies." In general, under Section 402(d)(2)(A), the regulations are required to take effect on December 31, 1987. The law provides the following exceptions for compliance at a later date per Sections 402(a),(b), and (d)(2)(B) if: (1) the application of the standard would result in the institution being treated differently than a bank, (2) the transaction was consistent with GAAP when it was completed, or (3) the institution demonstrates to the FHLBB that it is not feasible to comply by December 31, 1987. (In this case, the institution must submit a plan to the FHLBB for compliance, and the exception exists until the earlier of feasible compliance or December 31, 1993.)

On October 5, 1987 the FHLBB issued a proposed rule concerning uniform accounting standards under Section 402 of CEBA. (See the Federal Register of October 20, 1987 at pages 39145 et. seq.) In the preamble to the regulations the FHLBB expressed the view that CEBA calls for a phase-in of GAAP for thrifts. The preamble to the FHLBB regulations states, "The Board believes that the legislative history of the CEBA shows a clear congressional intent that the Board act by December 31, 1987, to promulgate regulations establishing a timetable that will move the thrift industry to uniform, GAAP-based, accounting standards by December 31, 1993." The Board used this phase-in theory to delay adoption of the Definition of Regulatory Capital Regulation from December 31, 1987 to December 31, 1988. The Board took the position that the regulations had to be issued by December 31, 1987, but that the substantive rule would not have to take full effect for many thrift institutions until December 31, 1993.

On December 21, 1987 the FHLBB adopted the final rule concerning uniform accounting standards without correcting the effective date provision of the proposed rule. (See the Federal Register of January 6, 1988, at pages 324 et. seq.) The rule allows many thrifts to convert from RAP to GAAP based upon a phase-in period beginning January 1, 1989 and ending January 1, 1994. More specifically, RAP may continue to be used in preparing unaudited regulatory financial statements beginning on or after January 1, 1989, for the following:

- (1) Deferred loan losses: These may continue to be reported through December 31, 1993. Beginning January 1, 1994, such losses are not allowed.

- (2) Mutual funds: Investments in liquid asset mutual funds may be reported at cost through December 31, 1993. Beginning January 1, 1994, mutual funds must be reported in accordance with GAAP (SFAS 12).
- (3) Consolidated reporting: Financials may continue to be reported on an unconsolidated basis through December 31, 1989. Beginning January 1, 1990, consolidated reporting is required.

Thus, the regulation does not follow the statute. CEBA requires that the rules take effect December 31, 1987; the FHLBB regulations not only delay the effective date by one year, they also allow the three RAP exceptions and a phase-in period not authorized by the statute.

The FHLBB interpretation of Section 402(d) is totally incorrect and contrary to the plain words in the statute; their interpretation renders meaningless the provisions of Section 402(d)(2)(B) concerning the exception for individual institutions.

First, this exception is only intended to apply to those institutions which cannot comply with the December 31, 1987 date in subparagraph (A). Clearly this indicates that the December 31, 1987 date is not simply the deadline for the issuance of the regulations, but a deadline for most institutions to move to GAAP. (Note that the FHLBB's proposed regulations - 12 CFR Parts 561, 563, and 563c supplementary information IVD - provided for a 30-day rather than a 60-day public comment period "because Section 402(d)(2)(A) of the CEBA requires the Board to implement this regulation by December 31, 1987.") Second, the exception for institutions to wait until a later date, but no later than December 31, 1993, is clearly limited to individual institutions upon written application with supporting evidence demonstrating to the satisfaction of the Board that it is not feasible for that institution to comply by December 31, 1987. If the Board approves the institution's plan, the date for compliance is the earlier of achievable compliance or December 31, 1993. To summarize: (1) CEBA required that the uniform GAAP accounting standards be effective on December 31, 1987 except for certain institutions and transactions; and (2) the Board has simply made that exception into a general rule, eliminating the written application process and in effect permitting thrifts to continue to use RAP beyond the December 31, 1987 effective date required by law.

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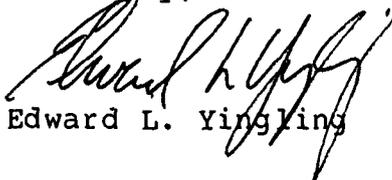
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In the past, some of the exceptions described above have led to the accumulation of accounting information that is very misleading and unfair to competitors, including banks, and, more importantly, to financial statement users. One of the principles of CEBA was to bring back fairness in the area of accounting standards by requiring that FSLIC insured thrifts convert from RAP to GAAP to the same degree that GAAP is required of banks by the Federal banking regulators.

We believe that the thrift RAP conversion required in CEBA is one that is appropriate and long overdue. Our major concerns with the thrift-RAP rules permitted by the Federal Home Loan Bank Board are: (1) the RAP rules have given an unfair advantage to thrifts in the marketplace; (2) the resulting financial information has proven to be misleading; and (3) in many cases, thrift-RAP has actually encouraged FSLIC insured thrifts to become involved in abusive practices and has contributed to the problems that the thrift industry is now facing. The current state of the FSLIC insured thrift industry is resulting in a steady loss of public confidence. Because banks and FSLIC insured thrifts are often perceived by the public to be similar, we believe that the lack of public confidence in the thrift industry is also becoming a burden to banks. In order to alleviate the problems associated with thrift-RAP and in order to restore confidence in the financial services industry, CEBA required that the FSLIC insured thrifts move toward GAAP.

Congress sought to direct the FHLBB to correct the accounting standards applicable to the thrift industry. Instead of issuing regulations that fulfill the statutory requirements, the regulators, despite the clear language of the statute, have allowed an extension of the practice that Congress intended to halt. The ABA believes that the implementation of these provisions of CEBA should be subjected to close scrutiny as part of the current Congressional review of the thrift industry crisis.

Sincerely,



Edward L. Yingling