



The Department of the Treasury's decision to place Fannie Mae and Freddie Mac, each a Government Sponsored Enterprise ("GSE"), in conservatorship on September 7th will have dramatic, negative consequences for community banks throughout Illinois and throughout the nation that Treasury certainly could not have contemplated or intended. Now, it appears that Treasury is working toward a legislative proposal that would provide a massive financial package to rescue some of the nation's larger financial entities that have bad or troubled assets on their books. Treasury is also reportedly prepared to financially backstop investments in money market mutual funds without specifying any cost to be absorbed by those funds.

It is imperative that any Congressional action in the wake of Treasury's takeover of Fannie Mae and Freddie Mac must provide substantial relief for affected community banks. It is noteworthy that community banks were not the financial entities that caused the current situation, but community banks nonetheless will suffer devastating consequences if not provided with reasonable and equitable treatment by Congress and by bank regulators.

Immediate Congressional action is necessary to allow community banks to treat their GSE preferred stock losses as "ordinary losses" as opposed to "capital losses" for tax purposes, so that our community banks will at least have the same opportunity to receive fair and reasonable tax treatment of these losses comparable to the tax treatment received by other business entities. For years, community banks had been told by bank regulators from both the State of Illinois and from the federal Office of the Comptroller of the Currency ("OCC") that investments in Fannie Mae and Freddie Mac securities were not only permitted, but in fact they were not subject to the quantitative limits that applied to other types of bank investments. Those opinions from bank regulators are embodied in Interpretive Letters issued by the Illinois Commissioner of Banks & Trust Companies in 1992 and 1996 and by the OCC in 2002. Now, those same securities that community banks had purchased and held have been subordinated to the new ownership interest of the federal government. The erosion of the value of the banks' GSE shares will cause dramatic, negative consequences to the banks' regulatory capital position if the financial losses on those GSE holdings must be recognized without an offsetting recognition of losses for tax purposes.

Furthermore, if Congress follows through on a proposal to create a new entity that would bail out large financial entities holding bad or troubled assets, it is both essential and reasonable that such an entity must provide comparable relief to community banks by purchasing the GSE shares from affected community banks in a way that will minimize the damage caused by the conservatorship of Fannie Mae

and Freddie Mac in the short term while transferring the potential gain to the Congressionally-created entity in the long term.

Without immediate relief from Congress and from bank regulators, the negative impact on a community bank's capital position will be felt in multiple ways. One effect will be a reduction in the community bank's lending limit to its customer base, meaning that less credit will be available to consumers and small businesses. There may also be regulatory sanctions or requirements imposed on community banks that could be counterproductive, since they may hamper the ability of the community bank to efficiently operate and to raise any needed capital at the very time that maximum flexibility and efficiency are essential.

In addition, there is no fairness in allowing Treasury to essentially underwrite the loss or risk in money market mutual fund investments when community banks are paying federal deposit insurance premiums to maintain deposit insurance for customers' funds at our local banks. If Treasury is going to back investments in money market mutual funds, there must be a cost assigned to those funds that is comparable to the premiums that community banks pay for FDIC insurance. Otherwise, the resulting unlevel playing field will again benefit mutual fund investors to the detriment of the local community banks and will encourage a flight of deposits from conventional depository institutions to those mutual funds.

Illinois has more financial institution charters than any other state in the nation, and that fact is in large measure due to this State's history of community bankers who successfully serve their local communities, who conduct traditional banking activities (i.e., not "high risk" or "predatory" banking engaged in by some other financial entities or subsidiaries), and who follow the rules. On behalf of my community bank and community banks throughout Illinois, I urge you to push for prompt action through the appropriate Committee that will allow community banks to receive fair tax treatment of their GSE losses by being allowed to recognize those losses as "ordinary losses" rather than "capital losses," that will require any newly-created entity to purchase Fannie Mae and Freddie Mac securities from affected community banks if that entity is being created to afford larger financial entities with relief from their troubled assets, and that will impose an equitable cost on money market mutual funds if those funds are backed by the Treasury Department and will compete with community banks that are paying deposit insurance premiums.

I also urge you and your colleagues to contact the OCC, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation and the Federal Reserve with the message that community banks that were blindsided by the Treasury's September 7th act of placing Fannie Mae and Freddie Mac in conservatorship should be given a reasonable period of time and an appropriate amount of regulatory forbearance or flexibility so that those affected banks can stabilize and restore their investment portfolios and capital positions with the least amount of disruption or long term damage.

Time is of the essence, as many community banks will encounter the reality of these GSE investment losses and the corresponding impact on their capital when they file their September 30th call report with their bank regulators. A Congressional response, or even communicating the likelihood of a

Congressional response to the bank regulators, prior to September 30th could mitigate a dramatic and negative episode that will be harmful not only to affected community banks but also to the consumers and small businesses that they serve.

Thank you for your consideration of this issue.