



September 26, 2008

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

The Honorable John M. Reich
Director
Office of Thrift Supervision
1700 G Street, NW
Washington, D.C. 20552

The Honorable Sheila Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

The Honorable John C. Dugan
Comptroller of the Currency
Office of the Comptroller of the Currency
Independence Square
250 E Street, SW
Washington, D.C. 20219

The Honorable Jorge Solis
Director
Division of Banking
Illinois Department of Financial & Professional Regulation
122 South Michigan Avenue, Suite 1900
Chicago, Illinois 60603

Dear Chairman Bernanke, Chairman Bair, Director Reich, Comptroller Dugan and Director Solis:

On behalf of the Community Bankers Association of Illinois (“CBAI”) and its 475 member financial institutions, I am writing to urge federal and Illinois bank regulatory agencies to proceed with deliberation and with maximum flexibility as financial institutions address the write-down of certain asset values and the impact of those write-downs on their capital accounts. With the end-of-quarter date looming next week and with the details and the potential short term, mid term and long term effects of pending federal legislation still matters of speculation, any dramatic and onerous conclusions and requirements regarding losses to capital and capital restoration plans could be ill-advised and could cause needless harm to the affected financial institutions, to the customers of such financial institutions, and to the nation’s banking system.

Many of the banks and savings associations that will be affected may incur capital losses not

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caused by high risk transactions, by predatory or subprime mortgage activities, or by other activities that exposed those financial institutions to known risks. The conservatorship of Fannie Mae and Freddie Mac, instituted by the U.S. Treasury Department without notice on September 7, 2008, suddenly transformed financial institutions from “well capitalized” or “adequately capitalized” institutions into institutions that may be subject to various degrees of enhanced regulatory oversight and to capital restoration mandates. Those banks and thrifts did not cease operating in a safe and sound manner on September 6th and begin operating in a less safe and sound manner on September 8th. The potential damage to those financial institutions was inflicted, at least in large part, by the federal government’s unilateral decision to subordinate the investments in Fannie and Freddie held by the financial institutions to the new ownership interest of the federal government.

We know that Congress and the Illinois General Assembly had each expressly determined that financial institutions’ investments in Fannie and Freddie were considered to be so safe, sound and low-risk that they were given special status as investments that were not subject to quantitative limitations applicable to other types of investments made by banks and thrifts. Interpretive letters from the State of Illinois and from the Office of the Comptroller of the Currency had verified that special, exempt status. Those statutes and interpretive rulings did not absolve financial institutions of the need to follow prudent investment strategies with respect to the entire investment portfolio. They did, however, send a strong signal that such investments were advisable from a safety and soundness perspective. Those financial institutions that followed that course and purchased investments in Fannie and Freddie could not have anticipated that the U.S. Treasury Department would, on September 7th, convert those assets from safe and sound investment instruments into holdings that could cause dramatic write-downs of the banks’ and thrifts’ capital accounts.

At the time that I am writing this letter, it is unclear how soon Congress will agree to the terms of a “financial bailout” bill and what those terms might be. Even if legislation is finalized prior to the September 30th end-of-quarter, it would be unreasonable to assume that bank regulatory agencies can adequately assess or predict with any degree of certainty the impact that the legislation will have on the affected financial institutions. It is possible that a regulatory response after September 30th that is not measured, deliberate and flexible will cause more harm to financial institutions, to their customers, to their communities and to the banking system than any acts or omissions that can be attributed to the financial institutions.

At CBAI, we are well aware of the importance of regulatory oversight of a bank’s capital position and the justification for “prompt corrective action” and capital restoration plans. However, CBAI strongly believes that the current circumstances were the result of extraordinary events and call for extraordinary flexibility and forbearance on the part of regulators. There are many community banks that now find themselves in new and unwelcome territory not caused by high risk transactions, by predatory lending activities or by subprime lending activities. There is,

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on the horizon, the potential for some degree of relief resulting from federal legislation and the extent of that relief is not yet knowable by either the financial institutions or by the regulatory agencies. In this environment, it would be unreasonable for regulators to react prematurely to any losses against earnings and capital that financial institutions might be forced to recognize on or after September 30th as a result of the federal government's takeover of Fannie and Freddie.

The imposition by, or even the threat from, regulators of onerous requirements could enhance the prospects for the untimely failure of an institution rather than bolster that institution's ability to maintain safe and sound operations.

Taking into account all factors that resulted in the current situation, and understanding that a reasonable amount of time will be needed to assess the relief or the corrective influence that might be generated by federal legislation currently being debated in Washington, D.C., CBAI urges the federal and Illinois bank regulators to take a deliberate and flexible approach toward the capital positions of the affected financial institutions. Any ill-advised regulatory reaction will not serve anyone well. A measured, reasonable and flexible reaction will serve the interests of the financial institutions, their customers, their communities and the nation's banking system.

Thank you for your time and consideration of CBAI's position. If you have any questions, please feel free to contact me.

Sincerely,

Jerry D. Cavanaugh
General Counsel
Community Bankers Association of Illinois