

COMMITTEE ON CAPITAL MARKETS REGULATION

November 10, 2009

The Honorable Barney Frank
Chairman
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

Use of Non-GAAP Methodology

Dear Mr. Chairman:

I am concerned by a recent suggestion that financial reporting standards be placed under the jurisdiction of a new systemic risk regulator. Such actions could change the objectives of financial reporting, harm the capital formation process in this country, and potentially politicize the process of setting accounting standards.

The missions of bank regulators and accounting standard setters, although often complementary, are different in their purpose. The mission of bank regulators is to ensure the safety and soundness of financial institutions and the banking system. As such, one of their primary responsibilities is to set regulatory capital requirements. In doing so, regulators must take many factors into consideration, including the needs of the economy and the particular circumstances of financial institutions.

However, accounting standard setters have a single mandate: To ensure that investors and the capital markets at large are equipped with the information they need to evaluate U.S. companies. The information contained in financial reports plays an essential role in the effective allocation of capital within the United States; it allows investors to understand the risks facing public and private companies and make informed investment decisions about their value. Unfortunately, the lack of transparency within certain financial institutions was a major cause of the financial crisis.

Grouping these two functions under the auspices of a single systemic regulator threatens to weaken both missions. For that reason, accounting standard setting should remain under the jurisdiction of the SEC, which is responsible for fair, objective, and transparent reporting to those who invest in our public companies.

As you know, as a result of the thrift crisis, FDICIA has provided that regulatory accounting should be at least as strict as GAAP, 12 U.S.C. §1831n (a)(2)(b). This has set up an unhealthy dynamic in which changes in regulatory accounting can only generally be effected by changing GAAP. There is a need for more flexibility in regulatory accounting but this can be achieved in splitting regulatory accounting from GAAP—by having two standards. This makes sense because regulatory accounting is aimed at facilitating regulatory determinations while GAAP is aimed at informing investors. The Committee on Capital Markets Regulation in its May 2009 report, “The Global Financial Crisis: A Plan for Regulatory Reform,” recommended allowing regulatory accounting to depart from GAAP as long as there was a check on forbearance.

This was a major problem in the thrift crisis. We suggested an independent body, not regulating banks, judge whether the departure was reasonable. This split approach is a far superior solution than having regulatory considerations drive the formulation of GAAP.

I urge you to reject any efforts to place general accounting principles setting under a systemic risk regulator and continue to support independent accounting standard setting in the United States.

Sincerely yours,

Hal S. Scott, Director