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U.S. Senate Republican Policy Committee

William L. Armstrong, *Chairman* July 16, 1990

# Dealing with the S&L Bailout

Continuing problems with the thrift industry have heightened media interest and increased resentment among taxpayers this year. As the campaign season gathers momentum, criticism on Congressional and Administration action undoubtedly will heat up. The savings and loan issue is not new, simple, or straightforward. Rather, it spans over 50 years of financial sector political rivalries, preferential regulatory treatment, legislative controversy, and supervisory problems. Economic considerations, too, have contributed to vast changes in the industry. Inflation, high interest rates, the rise and fall of energy prices, and real estate speculation are among many factors that have affected the S&L industry. This paper outlines and discusses the many dimensions of the thrift problem facing policymakers. It was prepared with the assistance of the GOP staff on the Senate Banking Committee.

## Origin of the Problem

- The original S&L charter restricted these institutions to making long-term mortgage loans and accepting short-term deposits.
- Whenever interest rates rose, S&Ls found themselves paying out more to depositors than they were receiving from their loan portfolio.
- Congress tried to fix the problem by regulation. It imposed limits on the amount of interest that could be paid on deposits.
- These limits proved ineffective. When interest rates rose, depositors pulled their money out of S&Ls and invested in other instruments paying market rates.
- In 1962, President Kennedy established a special committee to look into this problem. It recommended permitting federal savings institutions to engage in a broad range of new powers.
- These recommendations were endorsed by President Johnson in 1966 and again in 1967 in his Economic Reports to the Congress. In 1967, the House Banking Committee issued its own report calling for more flexible powers for thrift institutions.
- In 1972, a Presidential Commission (Hunt Commission) stated that without additional investment powers, thrift institutions would not be able to survive. In 1975, the House Banking Committee conducted its own study, known as the "FINE" study, that made similar recommendations.

## Deregulatory Legislation — 1980 and 1982

- In the late 1970s, as interest rates rose to record levels, the savings and loan industry collapsed. President Carter formed a special Task Force to study the problem. It recommended deregulation. President Carter submitted these recommendations to Congress in 1979, and in 1980 it passed "The Depository Institutions Deregulation Act."
- The 1980 law: (i) provided for the phase-out of interest rate limits on deposits, (ii) permitted federal savings associations to engage in a range of new bank-like powers, (iii) increased the amount of direct investments that federal savings associations could make, and (iv) raised deposit insurance levels from $40,000 to $100,000.
- As interest rates continued to climb in the early 1980s, savings associations continued to lose money. Some estimate that by 1982 up to two-thirds of the industry were insolvent and almost all thrifts were losing money.
- In response to this crisis, President Reagan submitted a legislative proposal that was enacted into law in 1982 as the Garn-St Germain Act. This legislation: (i) gave the regulators new emergency powers to deal with insolvent institutions (for example, by allowing them to arrange emergency interstate acquisitions); (ii) gave the agencies new powers to provide other assistance to troubled banks and thrifts; and (iii) authorized federally chartered institutions to engage in several additional bank-like powers, such as the authority to make a limited amount of commercial loans.

## State Powers

- The Garn-St Germain Act did not authorize new powers for State-chartered institutions. However, under a number of State laws, these institutions were given *much* broader powers, including the authority to make direct equity investments in speculative ventures, from wind mill farms to hamburger franchises.
- Three states that led the way were California, Texas, and Florida. All of these States passed laws deregulating their thrift institutions before the Garn-St Germain Act was passed by Congress.
- In both 1988 and 1989, over three-fourths of FSLIC losses were caused by State-chartered thrifts.
- The worst states were Texas and California. In 1988 and 1989 approximately two-thirds of FSLIC losses were caused by insolvent State-chartered institutions in just those two States. Insolvencies of this nature stem from risky speculation, unwise investment, and other bad decisions.
- As early as 1984, the Bank Board attempted to curb abuses by State-chartered savings associations. It was opposed by many in Congress, and in particular by the House. In 1985, a resolution calling on the Bank Board to delay its regulation on State-chartered institutions was co-sponsored by over half of the Members of the House of Representatives.
- In 1987, amendments in the House Banking Committee to buttress the Bank Board's authority to regulate State-chartered institutions were defeated by overwhelming margins.

# Bank Board Requests For Financial Assistance

- As early as 1985, the Bank Board requested additional funding to shore up the FSLIC fund. In October 1985, the GAO estimated the problem at $15-20 billion.
- On Feb. 27, 1986, the Administration's Economic Policy Council approved a $15 billion FSLIC recapitalization plan. Beginning in March 1986, Congressional hearings were held on the funding request and S&L problem.
- In May 1986, legislative proposals incorporating the Administration's plan were introduced in the House and Senate.
- In October 1986, the Senate passed the full $15 billion recapitalization plan. The House refused to accept a re-funding plan without an omnibus Housing package and check-hold measure, thus effectively killing the measure.
- In 1987, the Senate Banking Committee reported out a re-funding plan that provided only $7.5 billion, and the House Banking Committee reported out a bill providing for only $5 billion. A House-Senate conference committee was then appointed to reach an agreement on funding.
- The primary reason for the reduced funding was to prevent the Bank Board from closing down insolvent thrifts, especially in Texas. As banking committee transcripts record, the idea was to keep the Bank Board on a "short leash." The 1987 House Banking Committee report states that funding the full $15 billion "would give the Bank Board a mandate to impose stringent regulations ... and close troubled thrifts." The report noted that the $5 billion authorized "is a form of forbearance."
- The Administration objected strenuously and threatened a veto unless funding was increased. On June 1, 1987, the Administration issued a policy statement urging full $15 billion funding. On June 22, Secretary of Treasury Baker wrote to the conferees urging responsible funding. On July 1, the conferees agreed to a $8.5 billion recapitalization. The Administration continued to object. On July 29, the conferees agreed to a $10.8 billion plan.
- On August 10, 1987, a $10.8 billion FSLIC recapitalization plan was finally signed into law. The plan provided only two-thirds of the amount the Administration requested a year and half earlier.

# Forbearance Provisions

- The 1987 legislation contained forbearance provisions designed to protect insolvent undercapitalized savings associations from regulatory action by the Bank Board.
- The 1987 law authorized savings and loans to use certain "phony" accounting techniques to artificially bolster their capital, and specifically authorized the use of "goodwill" in meeting capital requirements.
- The legislation required the Bank Board to allow certain tangibly insolvent institutions to remain open if their financial condition resulted from loans in "economically depressed regions."

- The Act required FSLIC to issue guidelines to provide more "flexibility" on the part of examiners. It also mandated that the Bank Board establish a review procedure that would allow thrifts to challenge decisions made by examiners regarding the accounting treatment of bad loans.
- The Act also provided that in certain cases, forbearance agreements made by the Bank Board with particular institutions were automatically extended for an additional five years.
- These forbearance provisions served no purpose but to protect savings and loan associations from regulatory supervision.

## Culpability

- If the Administration's $15 billion funding request had been met in 1986, would the problem today be much smaller?
- Congress did not act until August 1987, a year and one-half after the original request. Most of the delay was caused by the House of Representatives. Were these stalling tactics justified?
- When Congress did act, it only passed two-thirds of the amount requested. Was this funding constraint meant to stymie supervisory action?
- Congress also insisted on "forbearance" provisions in the legislation. Was this designed to tie the hands of the regulators and protect the interests of thrift owners?
- Why did Congress reject Bank Board requests for remedial legislation to limit direct investments by State-chartered institutions, to limit the use of brokered-deposits, and to increase Bank Board enforcement powers?

## Size and Nature of the Problem Today

- The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) included total funding of **$113 billion** (in present value terms and after asset sales are accounted for) including $40 billion for completing past FSLIC deals, $50 billion to resolve the 500 institutions estimated to represent the caseload of the Resolution Trust Corporation (RTC), and $23 billion for post-RTC failures in the 1990s.
- The Administration has now increased its estimates of losses attributable to the RTC and post-RTC caseload from $73 billion to a range of $89-132 billion, increasing the overall estimated cost by **$16-59 billion**. These estimates are roughly in line with the GAO (although CBO has just reestimated the $73 billion figure to $185 billion).
- Because of a large increase in estimated 1990 and 1991 RTC costs, the Administration and CBO agree that **new spending authority will be needed later this year**, although it is possible this could be delayed until early next year.

- Finally, these loss estimates **do not include "working capital."** These are funds borrowed from the Federal Financing Bank to purchase S&L assets that, although a temporary use of funds, count as budget outlays just like a payment for permanent losses. These costs are offset by receipts from subsequent asset sales. OMB estimates gross 1991 working capital needs at $45-59 billion, or **$15-18 billion** after asset sales are accounted for.

- The loss estimates have increased because losses in individual thrifts have proven larger than expected and more thrifts are failing and failing sooner. Treasury attributes this deterioration to:
  - a general decline in regional real estate markets in which S&L assets are heavily concentrated;
  - interest rates higher than first projected, increasing operating costs of thrifts and weakening real estate markets;
  - reduced interest by the depository institutions that would be primary purchasers of thrifts and thrift assets in taking on additional real estate assets;
  - the decline in the market for "high yield" or "junk" bonds which has left the RTC with large losses on the $4 billion portfolio it has taken over from failed institutions; and
  - restrictions placed on the thrift charter and operations that have greatly decreased the franchise value of thrifts relative to banks.

- Working capital is an important issue in the Budget Summit because of its potential to temporarily increase near-term expenditures and artificially reduce future deficits when asset sales occur. It has long been the practice to exclude asset sales from the deficit calculation. The Administration and the Senate Budget Committee have proposed excluding both RTC asset purchases and sales from the calculation.

### *Total Cash Outlays*

- Total bailout cost estimates of $300-500 billion have been developed by GAO and others, and they are routinely quoted in the press. These figures are produced by adding up nominal expenditures over 30 years including all government borrowing costs over the period. The higher figures are achieved by counting *gross* expenditures without netting out liquidation proceeds.

- Including the government's cost of borrowing over 30 years adds $100 billion or more to the total, depending on interest rates. These costs do not appear in budget estimates for other programs. As an analogy, a homeowner selling his dwelling does not list its value as the entire cost incurred in a 30-year mortgage .

### *Cost to the Taxpayer*

- All non-government sources of funding for the S&L rescue have been exhausted. FIRREA claimed all reasonably available insurance premium income and net earnings of the Federal Home Loan Banks.

- Therefore, the increased costs of the bailout that have been identified by the Administration, including higher RTC losses and working capital, will have to be provided by the government and ultimately borne by the taxpayer.

### *Where Did the S&L Money Go?*

- Some funds were misappropriated by thrift officers and directors.
- The overwhelming amount of losses are in the form of bad loans and investments. The money was spent on construction projects, office buildings, land, and other investments that lost much of their value. This money can not be reclaimed through fraud prosecutions.

### *What is the FIRREA Money Used For?*

- The money raised by FIRREA will be used to protect depositors, not thrift owners.
- If an insolvent thrift is sold to a bank, thrift, or other investor that assumes responsibility to pay depositors, the Government must pay an amount approximating the difference between the value of the asset sold and the amount of the depositor liabilities transferred. Using FIRREA funds this way is usually more cost effective than simply closing the institution and paying off depositors.

## The 1988 Deals

- In 1988, FSLIC attempted to stop the continuing losses at certain institutions by selling them to new parties.
- These transactions also helped reduce the bidding up of interest rates on deposits caused by the funding needs of these insolvent savings associations.
- Because FSLIC did not have sufficient funds to pay these parties all at once to take over insolvent institutions, they entered into agreements with the acquiring companies promising to make certain payments over a period of time.
- In the Southwest, 79 insolvent institutions were merged into 15 institutions and sold to new investors, curbing losses and assisting the stabilization of the Southwest financial industry.
- In the heat of the political battle over FIRREA, these acquisitions, along with 81 other acquisitions (the so-called "88 Deals") came under heavy criticism, under the theory that the Government promised to pay too much.
- Now, many outside experts think that overall the deals were fair to all parties. In some, the Government made out better, in others, the private acquirers made out better. This is what should be expected when negotiating a number of transactions with the private sector.
- William Ferguson, a noted expert in the area, is quoted in the *New York Times* as saying "Not many of these deals look like windfalls" (May 25, 1990, p. C1). Another analysis in the *American Banker* states, "Despite widespread criticism, a review of the deals indicates that the government is better off for having done them" (March 15, 1990). Last year, the *American Banker* reported, "Veribank, a nationally known bank rating firm, conducted a study that concluded that the 1988 deals saved the government at least $6 billion" (November 24, 1989).
- Of the 15 Southwest acquisitions, 2 are providing generous rates of return for the acquiring companies, 8 have returns comparable to industry averages, 3 have below-average returns, and 2 are losing money.

# Criminal Prosecution

- On June 25, 1990, the Administration announced a beefed-up Justice Department initiative to crack down on fraud and other criminal activity in the thrift industry. It would mobilize "rapid response" teams of Federal agents, would create a special coordinator position and interagency working group, and called for legislation giving prosecutors new legal tools and more resources to address the problem.
- Attorney General Thornburgh estimates that there was criminal activity involving at least 25-30 percent of insolvent savings and loans.
- There are almost 7,100 pending FBI investigations involving bank fraud and embezzlement, over 3,000 of which involve amounts over $100,000.
- There are 530 insolvent institutions currently under investigation.
- These cases are extremely complex, with paper trails and thousands, if not millions of documents. Investigations can easily take up to 4 years to complete.
- Justice and the FBI have been steadily increasing the resources devoted to investigation and prosecution of bank and thrift fraud.
- Congress has already appropriated $110 million in 1990 for the criminal prosecution of bank and thrift fraud. Deliberations are occurring in Congress to increase the funding even further this year to handle this problem.
- Already this year there have been 368 new positions allocated in Justice to financial institution fraud, including 202 FBI agents and 120 prosecuting attorneys.
- These resources are beginning to pay off. In fiscal year 1989, there were 791 convictions in major cases. Court ordered restitution has increased from $123 million in 1987 to $361 million in 1989. The amount of funds recovered has jumped from $284 million in 1987 to $456 million in 1989.
- The 1989 legislation substantially increased penalties for fraud. Prison sentences went from 5 to 20 years. Fines were increased to $1 million per day, up to $5 million, or the amount of gain to the individual or loss to the institution, whichever is greater. New civil and criminal forfeiture provisions were added to enable prosecutors to seize assets stolen from insolvent institutions.

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*Briefing Material*

**THE SAVINGS AND LOAN CRISIS**

1. Talking Points -- The Savings and Loan Cleanup.
2. Talking Points -- The S&L Crisis: Major Administration Accomplishments.
3. Backgrounder -- Letter of Deputy Secretary of the Treasury John Robson on the origin of the Savings and Loan crisis (August 2, 1990).

July 29, 1990

# THE SAVINGS AND LOAN CLEANUP

## THEMES

- President Bush inherited the S&L problem that was many years in the making.

- Only 18 days after taking office, President Bush stepped forward with a comprehensive solution to the S&L crisis.

- The solution is working; the job is getting done.

## FOUR PRINCIPLES HAVE GUIDED THE ADMINISTRATION:

1. This is no bailout of S&Ls or owners. We are making sure that insured depositors get their money back.

2. S&Ls are now required to operate under tough new rules to protect safety and soundness.

3. The cleanup is proceeding expeditiously and responsibly.

4. Crooks are being prosecuted.

FOUR PRINCIPLES HAVE GUIDED THE ADMINISTRATION:

1. PROTECT DEPOSITORS.

- Make sure all government-insured depositors get their money back.
  - -- The government is not bailing out thrifts; in fact, hundreds of bankrupt thrifts are being closed down.
  - -- The money goes to millions of Americans who put their savings in insured financial institutions.
  - -- In the first year, the government has paid out $62.8 billion, representing 5.8 million accounts.
  - -- The average account protected is about $10,000.

2. REQUIRE SAFETY AND SOUNDNESS

- Reform the system and require a new level of accountability so the mistakes of the past are not repeated.
  - -- Tough new capital standards require thrift operators to put their own money at risk ahead of the taxpayers'. Two-thirds of the industry now meet those tougher standards.
  - -- Thrifts were barred from holding junk bonds and required to keep 70% of assets in residential real estate.
  - -- The Office of Thrift Supervision (OTS) has "quarantined" S&Ls that were not operating in a safe and sound manner, requiring 664 institutions to enter into binding agreements terminating unsafe and unsound banking practices.

3. GET THE JOB DONE EXPEDITIOUSLY

- o Clean up the S&L mess expeditiously and responsibly so that taxpayer costs are minimized.

- o In the past year:

  - -- Taken over 463 insolvent thrifts, more than one per day.

  - -- Closed or sold 211 bankrupt S&Ls, an average of one every 48 hours.

  - -- Sold or liquidated more than $65 billion worth of assets, a rate of $178 million per day.

- o By moving quickly and dependably, we have "grounded the unsafe aircraft" to ensure that additional fraud, mismanagement and misuse of depositors' money cannot occur.

4. PUT THE CROOKS IN JAIL

- o Aggressively prosecute the crooks who stole the taxpayers' money.

  - -- Tougher civil penalties -- up to $1 million per day -- and 20-year jail sentences for S&L fraud were enacted.

  - -- Since October 1988, the Justice Department has obtained more than 200 convictions for cases of major savings and loan fraud.

  - -- The FBI currently is conducting 530 active investigations of fraud in both banks and thrifts. This is an increase of 88 percent from 1987.

  - -- Settlements and judgments by FDIC/RTC from civil cases during the first half of 1990 will produce recoveries in excess of $200 million.

August 2, 1990

# THE S&L CRISIS: MAJOR ADMINISTRATION ACCOMPLISHMENTS

Eighteen days after taking office, President Bush stepped forward with a comprehensive solution to the S&L crisis. In the year since the Congress passed his legislation, the Financial Institution Reform, Recovery, and Enforcement Act (FIRREA), significant progress has been made.

## 1. The Depositors Have Been Protected.

- All federally insured depositors have been protected against loss.
    - Six million accounts, representing the savings of millions of American families, have been made whole.
    - Depositors have received protection on $62.8 billion of deposits that would have experienced losses without federal deposit insurance.
    - The average account protected is about $10,000.
- The integrity of the deposit insurance system has been preserved.
    - No insured saver has lost a dime due to the failure of a federally insured savings and loan.
    - The U.S. Government is standing behind its commitment to protect the federally insured savings of Americans.
    - Confidence in the Government's guarantee remains strong.
    - The Government's commitment and the resulting public confidence have kept the financial system operating continuously and efficiently.

## 2. The System Has Been Reformed.

- Savings and Loans now have higher, more stringent capital requirements.
    - Real capital requirements have been put in place to require thrift owners and operators to give greater protection to depositors and put more of their own money at risk.

- The key reform in FIRREA -- requiring standards for genuine and substantial capital invested by owners of thrift institutions -- has been implemented.

- Regulatory oversight has been tightened.

  - The regulatory function has been isolated from the depositors' insurance fund to provide greater protection and objectivity.

  - The thrift examiners have been absorbed by the Office of Thrift Supervision and placed under the general oversight of the Treasury Department.

  - The thrift insurance funds -- Federal Savings and Loan Insurance Corporation (FSLIC) and the Savings Association Insurance Fund (SAIF) -- have been brought into the Federal Deposit Insurance Corporation (FDIC).

- High risk thrift investment practices have been curtailed.

  - Most thrifts that are insolvent and losing money have been identified and placed in conservatorship, or resolved, while protecting depositors.

  - 664 institutions have entered into binding agreements to alter high risk banking practices.

  - The lending activities of thrifts have been refocused on the business they know best-- residential mortgages -- and credit is granted based on economic merit, rather than speculative risk.

  - Thrifts can no longer engage in direct real estate or equity investment without 100 percent capital, and junk bond investments have been prohibited.

3. **Unsound Institutions Are Being Cleaned Up Expeditiously.**

- Insolvent institutions have been taken over.

  - The RTC has taken over 463 insolvent thrifts, more than one per day.

- 211 bankrupt S&Ls have been closed or sold. In the latest quarter, 155 institutions -- or a dozen per week -- have been shut down.

o The cost to the taxpayers is being minimized.

- The Resolution Trust Corporation (RTC) began business the day the legislation was signed. In less than a year, the Government created the largest financial institution in the country, which involved enormous efforts to staff and to develop appropriate policies and procedures.

- The assets of the RTC are being liquidated in the most prudent manner to maximize return to the taxpayers by proceeding quickly but in a manner so as to avoid disrupting real estate markets.

- Regional advisory boards have been established to provide guidance to the RTC on local real estate conditions and aid in maximizing value recovery.

4. **The Individuals Responsible Are Being Penalized.**

o Those who engaged in criminal activity are being prosecuted.

- Since October 1988, the Justice Department has indicted over 328 people involved in fraud and other criminal activity.

- 231 people have been convicted and ordered to pay $56.6 million in restitution.

- Over three-quarters of those sentenced have received prison terms running as high as 30 years.

o Criminal enforcement capabilities have been strengthened.

- An incremental $50 million has been appropriated to prosecute S&L crimes.

- 148 additional Federal prosecutors have been hired.

- The FBI has added over 200 new agents to investigate S&Ls.

THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON

August 2, 1990

The Honorable Bob Michel
Republican Leader
U.S. House of Representatives
Washington, D.C. 20515

Dear Bob:

This is in response to your request for information regarding the origin of the savings and loan crisis.

This is a question which the Administration, academicians, economists, and the Congress have been exploring for some time. The Treasury Department is pleased to share our information with you because we believe it is important that as many people as possible have a thorough understanding of the events which began long ago and led to the current crisis.

The savings and loan industry was created in the early 1930's through charters which restricted their activities to fixed-rate, long-term mortgage loans and the acceptance of short-term deposits. Without a diversified portfolio, thrifts were, from their very inception, particularly vulnerable to the "ups and downs" of the real estate market and any substantial increases in interest rates. Because the interest rates these savings and loan institutions charged were primarily locked into long-term residential mortgage loans, significant increases in market rates meant thrift institutions would likely be paying out more in interest to depositors than they were receiving in interest payments from loans.

In 1966, Congress attempted to address the industry's particular vulnerability to increasing interest rates by creating "Regulation Q." This regulation imposed ceilings on the amount of interest that S&Ls could pay on deposits. But as market interest rates increased, depositors who had their money in low-rate S&L accounts began to take their money out of S&Ls and put their savings in other financial instruments, which were paying market interest rates (higher than S&L rates). S&Ls were then faced with massive deposit outflows, while their assets were primarily tied up in long-term, fixed-rate, low-interest mortgage loans.

In the late 1970's, inflation and interest rates soared, and eventually the prime interest rate skyrocketed as high as 21 percent. The combination of high inflation and high interest rates, along with Regulation Q, put extreme financial pressure on the thrift industry. During the period 1978-80, thrifts suffered significant declines in deposits, and their capital positions deteriorated to the point where a substantial part of the industry was bankrupt on a mark-to-market basis.

In 1979, President Carter formed a special Task Force to study the problem. The Task Force recommended deregulation. In 1980, the Congress passed and President Carter signed, the Depository Institutions Deregulation and Monetary Control Act (DIDMCA). The principal features of that Act included:

-- Providing for the phased elimination of Regulation Q, allowing thrifts to attract more deposits with higher interest rates.

-- Raising deposit insurance from $40,000 to $100,000 per account, an increase of 150 percent, which increased the government's liability should an institution fail.

-- Expanding the ability of federally-chartered thrifts to engage in commercial lending, including commercial real estate loans.

-- Lowering capital requirements for thrift institutions.

From 1980-82, the regulator of the S&Ls, the Federal Home Loan Bank Board (FHLBB), an independent regulatory agency, was also attempting to find ways to permit some expansion of thrift industry activities. The intention was that thrifts could "grow" their way out of their financial crisis. For example, in 1981, the FHLBB loosened restrictions on the ability of S&Ls to use brokered deposits. Taking advantage of the huge increase in deposit insurance coverage and this new ability to aggregate deposits on a nationwide basis, S&Ls gained access to large pools of money.

In 1984, the FHLBB reversed itself and proposed regulations limiting the use of brokered deposits. However, the courts overturned the FHLBB regulations, and Congress refused to provide the authority needed for FHLBB to proceed with the regulations limiting brokered deposits.

Higher interest rates continued to cause more thrifts to become unprofitable and seriously depleted their capital, but they were allowed to stay in business. Thrifts with low capital had a perverse incentive to make riskier investments, without risking their own capital, in order to gain higher returns. Any profits from the riskier investments could be used to shore up their capital, while any losses from these investments would be absorbed by the taxpayer because of the higher insurance coverage. The huge pools of money -- made available through brokered deposits and deposit insurance --added to the motivation for thrift operators to expand their risk of loss.

However, even with interest rate deregulation, increased deposit insurance, and brokered deposits, thrifts continued to struggle because the bulk of their assets were still held in low-interest mortgage loans.

In response, Congress passed the Garn-St Germain bill in 1982. The bill allowed federally-chartered thrifts to become more like banks and further expanded authority granted in the 1980 act to make commercial loans. It also continued the 1980 practice of lessening capital requirements. Many believed these actions were necessary in order for thrifts to make higher returns on investments to offset lower returns on mortgage loans. Prior to the passage of Garn-St Germain, states began to greatly broaden the powers of state-chartered, but federally-insured, thrifts to make direct equity investments in speculative ventures, from windmill farms to precarious real estate developments.

As early as 1984, the FHLBB attempted to curb abuses by state-chartered savings associations. The FHLBB was opposed by many in Congress, and in particular by the House of Representatives. For example, in 1985, a resolution calling on the FHLBB to delay its tighter regulation of direct real estate and equity investment by state-chartered institutions was co-sponsored by over one-half of the House of Representatives. In 1987, amendments in the House Banking Committee to regulate these aggressive real estate practices of state-chartered institutions were defeated by overwhelming margins.

In 1982, the FHLBB was losing examiners because their pay rate was low compared to other financial examiners, and the FHLBB believed that more examiners were needed. In 1985, the FHLBB was finally successful in adding additional, higher-salaried examiners by funding them out of the Federal Home Loan Bank system, which was not under the budgetary control of either the Congress or the Office of Management and Budget (OMB).

Now S&Ls could attract more deposits because they could pay higher interest rates on those deposits, offer higher insurance levels, and attract depositors from across the country. And thrift institutions, particularly state-chartered thrifts, could invest those deposits in highly risky ventures, particularly commercial real estate ventures. And all the time, the U.S. Government's promise to insure every depositor's savings up to $100,000 kept looming as a larger and larger potential liability.

From 1982-1984, then-Vice President Bush led an Administration task force on regulation of financial services. The task force recommended comprehensive reform of the financial regulatory system, including:

-- Higher capital and accounting standards for S&Ls making riskier loans and elimination of phony accounting standards.

-- More effective regulation through the elimination of archaic and overlapping regulatory structures.

The task force recommendations were endorsed by the Reagan Administration's Cabinet Council on Economic Policy in 1985 and forwarded to the Congress.

Meanwhile, sharp declines in oil prices and weakness in the agricultural sector contributed to devastating economic declines in certain regions, particularly the southwest. Real estate values plunged. Large numbers of thrifts that had invested in commercial real estate and other ventures became insolvent, requiring deposit insurance protection from the federal insurance (FSLIC) fund. When the FSLIC insurance fund ran low, the Reagan Administration requested $15 billion to recapitalize FSLIC in the spring of 1986.

The request encountered strong opposition on Capitol Hill. Some Members of Congress feared that providing $15 billion in deposit-insurance funding would encourage S&L regulators to close down more unsafe institutions. The savings and loan industry forcefully lobbied the Congress in opposition to this legislation, and it was killed at the end of 1986.

Finally, in 1987, Congress passed a bill which provided $10 billion to recapitalize the insolvent FSLIC fund -- a year and a half after the Administration requested $15 billion. The final amount authorized was only two-thirds of the amount requested by the Administration. In addition, Congress added forbearance provisions making it harder for regulators to close down high-flying S&Ls. Specifically, those provisions permitted additional questionable accounting techniques which allowed thrifts in trouble to make their levels of capital look better than they were. They also allowed thrifts to count "goodwill" toward meeting capital requirements.

The delay in funding the FSLIC prevented regulators from closing insolvent institutions when the cost of protecting depositors would have been much less. Instead, the problem continued to grow, and so did the U.S. Government's liability to make good on its promise of insurance coverage for deposits.

In February 1989, just 18 days after taking office, President Bush proposed a comprehensive solution to the savings and loan industry crisis -- The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). Four principles have guided the Administration in developing and implementing the savings and loan cleanup effort:

-- Protecting the savings of Americans who made deposits in thrift accounts, relying on the U.S. Government's promise of deposit insurance.

-- Restoring safety and soundness to the thrift industry, especially through tougher capital requirements.

-- Aggressively prosecuting the crooks who stole the taxpayers' money through fraud and mismanagement.

-- Cleaning up the S&L mess as expeditiously and responsibly as possible.

After seven months of debate, Congress passed FIRREA, and President Bush signed the bill into law on August 9, 1989.

FIRREA provided not only the initial funds for remedying the current crisis in the thrift industry and protecting depositors' savings, but the legislation also put into place the mechanisms needed to prevent similar occurrences in the future. Of those mechanisms, we consider the most important to be those which provide a buffer between the deposit insurance fund and possible risky practices of individual institutions.

Tougher capital requirements which mandate that savings and loans must meet the same capital requirements as banks will require thrift operators to put their own money at risk ahead of the taxpayers. New authority for the federal government to deny federal insurance coverage to state-chartered S&Ls allows the federal government to protect taxpayer dollars from riskier ventures which may be allowable under individual state regulations. In addition, a study of deposit insurance, required by the legislation and currently being drafted by the Treasury, will provide additional proposals to deal with one of the critical causes of the current crisis.

With these protections in place, as well as provisions proposed by the Administration to enhance the Government's ability to prosecute those guilty of financial fraud and mismanagement, we believe we have the basic framework necessary to clean up the savings and loan crisis in an expeditious and responsible manner.

In the year since FIRREA was enacted, the government has paid out $62.5 billion in deposit insurance obligations, representing 5.8 million accounts -- about $10,000 per account. The RTC has seized 463 insolvent thrifts -- more than one per day; closed or sold 211 bankrupt thrifts -- one every 48 hours; and sold or liquidated more than $65 billion of assets -- $178 million per day. By moving expeditiously and responsibly to quarantine sick thrifts, the Administration has stemmed the losses and given the healthy segment of the industry an opportunity to succeed.

Since October 1988, the Justice Department has obtained more than 200 convictions for savings and loan fraud. Settlements and judgments from civil cases during the first half of 1990 will produce recoveries in excess of $200 million.

Let me reiterate that the purpose of the cleanup effort is not to bail out financially unsound S&Ls or S&L executives responsible for the crisis. The sole purpose is to protect the savings of those Americans who have insured deposits in savings and loan institutions. The U.S. Government made a promise to insure those deposits, and the Government is now living up to that promise.

We hope this is useful in tracing the causes of the thrift crisis and describing the considerable progress made under FIRREA to address the problem and prevent its recurrence.

Sincerely,

John E. Robson

FOR IMMEDIATE RELEASE
July 12, 1990

**Remarks by Edward J. Rollins**
**Co-Chairman, National Republican**
**Congressional Committee**

Good afternoon. It's a relief to be with you today. Reading the Democrats' accounts of our political party lately, it's clear some would like to think we Republicans have become an endangered species.

That's not all bad. When you're an endangered species, the Democrats want to take care of you. They draw boundaries and create a nice preserve for you where you're forever safe from harm. Sort of like reapportionment and Democratic gerrymandering.

Well, here they go -- again!

Back in 1985, returning to the White House on the presidential helicopter, Marine One, I sat next to President Reagan. Above his seat he used to keep a photograph of his ranch in Santa Barbara, Rancho del Cielo.

As we talked he eyed the photograph. I figured he was thinking he'd rather be out there clearing brush, chopping wood, and riding.

"Mr. President," I said, "this will all be worth it. History will be kind to your presidency."

"Ed," he answered, looking me straight in the eye, "I don't care about history. I'll be dead when they write it, and then they'll distort it. All I care about is my country and leaving it a better place than I found it."

"Well Mr. President, you're half right. You're not dead, and they're already distorting it anyway."

Well, ladies and gentlemen, the rumors of our demise are greatly exaggerated.

The obituaries are premature.

Not only does this patient have a pulse, but to quote a recent Republican president who -- like his party -- was also often underestimated, "You ain't seen nothin' yet."

A wise professor I once knew told me that when you want to understand history, don't start with the historians. Go back and read the contemporary chronicles, so you know what people were thinking and feeling at the time.

That way you avoid the pitfall of collective amnesia.

I took his advice with the savings and loan fiasco. Lately our Democratic friends have been trying to saddle us with that dead weight.

In fact, no sooner had President Bush agreed to meet Democratic Speaker Tom Foley's, Democratic leader George Mitchell's, and Dick Gephardt's demands to include revenue increases in the budget negotiations than Ron Brown came out of hiding to bushwhack him.

Brown says we Republicans will only raise taxes to bail out wealthy savings and loan speculators. He says the Reagan-Bush Administration created this crisis.

I say -- Ron Brown is proof that America's educational system needs reform.

If Ron Brown thinks the Republican Party wants to bail out the Democratic campaign contributors, who caused the savings and loan mess, he must be dreaming and praying.

From the Washington Post, June 13, 1987. This is so good I need to read it to you straight. Unabridged.

"In a spectacularly dangerous example of misguided sympathy, Congress is hard at work on legislation to make S&L regulation weaker than ever. It has nothing to do with Reaganite enthusiasm for deregulation. The impetus is coming from Democrats, and mainly from Texas."

"The House has passed a bill that would make it harder for an S&L to foreclose on delinquent loans, of which there are many in Texas, and very much harder for federal regulators to close an S&L that is insolvent."

"The chief regulator says that the bill, if enacted, 'will shut down effective enforcement.'"

That was in 1987, when President Reagan, Vice President Bush, and Treasury Secretary Jim Baker asked for $15 billion to halt the S&L losses -- not $130 billion, or $300 billion, or $500 billion, or whatever estimate of the cost you want to accept today.

More than three years ago, Secretary Baker wrote Congress to object to the Democrats' plan, and said that if they had their way, quote "Congress is just setting up the taxpayers to bail out FSLIC" unquote. Congress' own watchdog, the General Accounting Office, agreed with the Administration.

Guess who stopped them?

The Democrats, Mr. Brown.

If you can't believe the Post, who can you believe?

Maybe Common Cause, Ron.

Remember Jim Wright? He's the guy who was your Speaker of the House of Representatives. You Democrats gave him a standing ovation after his farewell speech. Do you remember why he said goodbye that day? Sleazy ethics, Ron. Graft and corruption.

Democrats are always giving standing ovations. When Washington D.C. Mayor Marion Barry was indicted on drug and perjury charges, the Democratic mayors gave him a standing ovation.

What does that tell you about Democratic ethics?

Common Cause says Jim Wright took $82,640 from S&L interests in the eighties.

Remember Tony Coelho? He was chairman of your Democratic Congressional Campaign Committee. Your chief fundraiser. And a member of the House leadership, to boot.

Now Tony may have had more foresight than Jim Wright. He didn't wait around for an Ethics Committee grilling, a farewell address, and a standing ovation from his fellow Democrats. He just resigned after it was revealed he cheated on his financial disclosure forms, borrowed from Thomas Spiegel who was just fined $24 million -- one of those S&L executives you've excoriated, Ron, to do -- guess what? -- buy junk bonds from Michael Milken!

Tony took $16,950 in contributions for his own reelections from the S&L hustlers -- and raked in another $212,825 for the DCCC.

Like in the old Westerns, Tony didn't wait around to be tarred and feathered and ridden out of town on a rail. He just packed up and vamoosed in the dead of night.

Oh -- I almost forgot to mention something that happened two months before that Washington Post editorial.

Freddy St Germain.

He was the Chairman of the House Banking Committee. He got $144,400 from S&L interests.

You remember St Germain. He's the one who the Ethics Committee says violated the rules by taking gifts like free travel from the S&L industry. Cash just wasn't enough.

Unlike Jim Wright and Tony Coelho, Freddy decided to take his case to the voters.

They tossed him out in '88.

The S&Ls were broke -- and the Democrats refused to fix it.

St Germain, Wright, and Coelho were the three stooges of the S&L industry. They may prove Mark Twain's contention that Congress is home to the only "distinctly native American criminal class."

Mark Twain explains why Jim Wright got a standing ovation even though he left the Congress in disgrace. Wright may be gone, but his Democratic cheerleaders are still there.
Ever heard of "cash-for-trash?" No, it's not a Democratic fundraising slogan.

That's where a borrower gets cash for one loan, takes out a second to buy real estate owned by the S&L at inflated values -- looting cash out of the S&L in exchange for trash. According to James Ring Adams' authoritative book, The Big Fix, this was a specialty of Democratic contributors.

Heard of "land flips?" That's where investors bought at low prices, sold land back and forth amongst themselves inflating the price each time, getting the loans from friendly S&Ls. Another specialty of Democratic contributors.

These are only the more savory forms of graft. Not the alleged cocaine-snorting, shifting money to Mafia-controlled banks, or dalliance with prostitutes by executives of People's Savings of Llano, Texas.

Or the millions Thomas Spiegel -- Coelho's friend -- allegedly spent on guns, fireworks, rock concerts, wine, vacations, luxury cars, or the $2.8 million in bonuses he gave himself while Columbia Savings and Loan was going under.

And while Columbia was sinking, three-quarters of its PAC contributions went to Democrats such as Senators Riegle, Cranston, Wirth, Simon, Kerrey, and Congressmen Barnard and St. Germain. The cost to the taxpayers of Columbia's bailout: $590 million.

Or take David Paul's CenTrust Savings and Loan in Miami, with its $25 million conference room, Tiffany ashtrays, gold-rimmed Baccarat crystal, a 95 foot yacht, and a $12 million Rubens painting paid for with depositors' money Paul hung in his own home.

Ron, do you remember David Paul? Your party called him "Chairman of the Democratic Trust" in 1988.

Some trust.

Paul was chairman of the top contributors of the Democratic Senatorial Campaign Committee. He was a major contributor to Joe Biden's presidential bid. And when Biden's campaign collapsed in a pile of plagiarism, David Paul moved on to raise money for House Majority Leader Dick Gephardt. The Democratic Senatorial Committee got $30,000. The DCCC got $19,000. And the Democratic Presidential Campaign Convention got $50,000.

You may wonder how he could afford all those contributions. Well, as you pay the bills for the S&L bailout over the next decade, think of David Paul, Chairman of the Democratic Trust and his Democratic friends.

Because every man, woman and child in America who pays to bail out the busted thrifts is footing the bill for political graft.

David Paul could afford to contribute lavishly, because he gave himself $800,000 in salary and bonuses and $2.76 million in stock dividends from CenTrust in 1988. And the next year, when the thrift's earnings dropped, he gave himself $950,000 a year in salary and bonuses.

It may take the taxpayers $2 billion to bail out CenTrust.

Thank you Ron Brown, Senator Biden, and Congressman Gephardt. It's the taxpayers who will have to make up the missing cash you shoveled into your campaign coffers.

Ever heard of the "Texas High Flyers?" No, it's not a country and western band. That's what they called the good old boys who lived high on the hog on S&L money in the Lone Star State.

Don Ray Dixon and Thomas Gaubert were the kings of the High Flyers. Gaubert was finance chairman for the Democratic Congressional Campaign Committee.

Dixon bought a yacht -- the 112 foot "High Spirits" -- with S&L money, put it on the Potomac, so Tony Coelho and the Democrats could
use it for fundraisers for Democratic House members. Gaubert has bragged about raising $100,000 to help buy the election of Congressman Jim Chapman in Texas -- and $250,000 in soft money.

I guess that's one boat Democrats would have to admit a rising tide lifted -- a rising tide of S&L sleaze. Bailing out the S&Ls of these two High Flyers will cost $2 billion.

The late Big Daddy Jesse Unruh, Assembly Speaker and State Treasurer from my home state of California, liked to say that money is the mother's milk of politics. Unruh was Tony Coelho's political godfather.

If money is the mother's milk of politics, the Democratic fundraisers who were getting rich by looting the S&Ls were the milkmen. They delivered the goods right to the doorstep of the Democratic Party. Right to the door of the Speaker's office.

Of course, we don't know how much the Democrats got in soft money from the S&L interests, because Ron Brown and his Democratic allies refuse to release their soft money list.

Now Common Cause says we can only clean up this mess with campaign finance reform. They want taxpayer-financed elections. Well, the Democrats already have them. Thanks to S&L subterfuge, the taxpayers are going to foot the bill for all those Democratic campaigns.

What about the soft money?

I challenge Ron Brown and the Democratic Party to really open their books on the soft money accounts. Maybe then we'll understand
why Jim Wright, Steve Neal, St. Germain, Tony Coelho, Banking Chairman Frank Annunzio, Alan Cranston, Dennis DeConcini, Don Riegle, and John Glenn fought so hard to keep Reagan and Bush from shutting off the river of corrupt S&L dollars.

For a few million dollars in campaign contributions, they sold out the taxpayers. For the sake of their own reelections, they left us a bailout legacy that could reach a cost of thousands for every taxpayer for generations.

Here's how Adams sums it up in <u>The Big Fix</u>:

"Ultimately," he writes, "Jim Wright's circle turned a $20 or $30 billion savings and loan debacle into a $300 billion disaster..."

<u>Now</u> the Democrats are saying make the crooks pay. Frank Annunzio, right here in Chicago, wears a button that says "Jail the S&L Crooks."

Seriously, Frank it's a good idea. Why don't <u>you</u> start by paying back the $6,000 Charles Keating gave you and the $2,000 Thomas Spiegel gave you? And why don't you tell the voters of Chicago why <u>Congressional Quarterly</u> rated you the S&L's best friend in Congress? And why don't you explain why out-of-town S&L executives gave money to your campaigns?

Now if you don't want to answer, that's fine. It's your right.

But Frank, maybe you'll tell us why you gave your vote to the S&L crooks to gut the 1987 Reagan bill when we could have stopped the bleeding?

Congressman Steve Neal should explain his dirty S&L money. Congressman Barnard of Georgia should explain why he won't repay the $20,000 he took from Keating.

Speaker Foley should explain his contributions from the bad S&Ls. House Majority Leader Gephardt should explain the $6,500 he took from corrupt S&Ls like CenTrust. And the Democrats who are members of the DCCC might explain the $303,000 in contributions they took.

And if they won't, maybe they should all just stand up en masse on the Capitol Steps, take a vow of silence, and wrap themselves in the Fifth Amendment.

It's no accident that the Republican leadership in the House didn't get money from the bad S&Ls. That's because the S&L crooks knew which party voted to let their good times roll, and which party voted to bring an end to the predator's ball.

This is just the tip of the iceberg.

There are probably hundreds of mini-Charles Keatings and mini-David Pauls around the country. Their incompetence cost billions, so we've heard about them. They're what's considered newsworthy. After all, the savings and loan industry had 149 federal PACs. The overwhelming majority of the money went to Democrats.

But what about the S&L sleaze artists who only ripped off $10 or $20 or a $100 million from the taxpayers?

Hundreds of S&Ls went bust, and we've only heard about a handful. The more we learn, I'm confident the more the taint will stick to the Democratic Party. That's why Ron Brown and the others want us to forget who should be blamed.

Collective amnesia.

It's the Democrats' only hope.

Well, if I were a hometown reporter looking for a Pulitzer today, I wouldn't let the Wall Street Journal or the Washington Post or the New York Times get all the glory on this story.

I'd go right down to my local S&L and start looking into the pattern of cozy relationships. You know who has the political grease in your communities; you know who got the big loans from the S&Ls; and you can trace the money trails better than anyone else.

This isn't a story that happened only in Los Angeles, or Miami, or Dallas. It happened on Main Street, U.S.A.

You have an obligation. The public has a right to know. This -- not flag burning -- is what the First Amendment is all about. And I'll bet the stories you'll write will conclude -- it was broke, and the Democrats wouldn't fix it.

No wonder Ron Brown wants us to forget what the eighties were all about.

Ron, a little remembrance is a good thing.

Let's start with taxes.

Exactly when did it become necessary to raise taxes, Ron? In 1984, when Walter Mondale promised to raise taxes?

In 1986, when the Democrats wanted a fourth income tax rate in the tax reform bill?

In 1988, when Michael Dukakis lost forty states campaigning on a program of tax increases and a Massachusetts Miracle that turned out to be a devil's brew of billion-dollar budget blunders?

In 1990, when the Democratic Congress' refusal to curb its appetite for spending finally caught up with us?

In November, 1980, and in November, 1984, and in November, 1988, the American people rejected the failed policies of the Democrat Party and their nominees -- Carter, Mondale, and Dukakis.

The politics and policies of the past fifty years had failed them, failed their parents, and failed their children.

They chose instead President Ronald Reagan and President George Bush.

For every tax increase since World War II, the Congress has spent $1.58 for every new dollar in revenue.

We cannot tax away the deficit. We have tried in the past and the deficit simply grows as new taxes slow down economic growth. The deficit will shrink to a manageable size when the American people demand that Congress exercise some courage and reduce the growth of federal spending.

I was there in the eighties when President Reagan signed a tax increase based on Tip O'Neill's promise to cut spending three dollars for every dollar in new revenue.

As Congress faces the challenges of 1990, the advocates of tax and spend policies will go all out to protect their piece of the taxpayer's pie. They view the federal budget as "their" money which is why they refer to tax cuts as "giveaways."

As they see it, what you and I pay in taxes is theirs -- what we manage to keep each year is negotiable.

The Democrats weren't serious about the budget then -- any more than two months ago, when the Democrats in the House voted a budget resolution adding $97 billion in new spending.

But I remember more about the eighties.

I remember President Reagan's 1982 speech to the London Parliament. Reagan foresaw the crumbling of the Soviet system, the hope for democracy in Eastern Europe, if the U.S. would stand tall for awhile.

If we had listened to the Democrats we would have frozen our defenses at a level barely above bows and arrows. The Brezhnev Doctrine would still be in force. The Soviets would still have Eastern Europe in a

No party which fails to censure a congressman like Democratic subcommittee chairman Barney Frank -- who allowed a male prostitution ring to be run from his Capitol Hill townhouse -- can claim the mantle of leadership.

No party which permits a congressmen like Gus Savage to maul the women who serve the Peace Corps, or to blatantly campaign on anti-Semitism, can claim a mantle of leadership.

And no party which harbors the architects of the nation's savings and loan disaster, while piously mouthing the empty slogan, "Jail the S&L Crooks," deserves to keep control of the national legislature.

In January the Poles sent over legislative interns to study our Congress . Here's what Congress showed them how to do one week -- produce sterile screwworms to sell overseas, change the name of a lake in Kansas, approve two new statues for the Capitol, and vote <u>another</u> national education study.

One Polish intern notes in contrast that it took Poland's new Parliament only two weeks to enact fourteen measures converting their country from socialism to capitalism.

The sorry state of the nation's legislature prompts <u>Business Week</u> to write that "on the eve of a new century, the U.S. is saddled with the problems of a superpower -- and the legislature of a banana republic."

Well, we can do something about it.

Let's start by throwing the rascals out. Half a century of Democratic dominance of the nation's legislature is enough.

They've become corrupt, complacent, and cocky.

Now it's time for a comeuppance.

We deserve better. Our children deserve better. And our grandchildren deserve better.

And the fledgling democracies around the globe, from Pakistan and Panama to Hungary and Poland, deserve to see a better example from this great democracy.

Last year we watched in awe as young East and West Germans spontaneously began chipping away at the Berlin Wall with hand-held hammers.

We watched in awe as Romanians in Timisoara picked up broken shards of glass from shattered shop windows, to fight the forces of a dictator armed with AK-47s and pistols.

We watched in awe as Violeta Chamorro defeated Daniel Ortega and the Nicaraguan communists at the polls.

We watched in awe as the new world forged from Republican policies of the eighties unfolded before us.

Are we now going to stand by and let a discredited bunch of Democrats lay claim leadership?
No. Not if we care about America's standing in the twenty-first century. We are on the threshold of a new world, and we've struggled a long and difficult way to get there.

I'd like to read a quotation from Abraham Lincoln, the founder of our party, that I think lays to rest the idea that expanding individual liberty, and getting the government out of our lives is somehow a new-fangled, un-American idea.

"You cannot bring prosperity by discouraging thrift. You cannot strengthen the weak by weakening the strong. You cannot help the wage earner by pulling down the wage payer. You cannot further the brotherhood of man by encouraging class hatred. You cannot help the poor by destroying the rich. You cannot establish sound security on borrowed money. You cannot build character and courage by taking away man's initiative and independence. You cannot help men permanently by doing for them what they could and should do for themselves."

Perhaps we Republicans aren't as good as our Democratic counterparts at those dramatic displays of symbolism or emotional gestures of concern.

But we care just as deeply about the poor, the sick, the jobless and the disadvantaged, and we have a positive program to help them. But we have something more:

We are a party that shows compassion for the taxpayer as well as the taxspender.

We are a party that respects the wage payer as well as the wage earner.

We are a party concerned with the rights of the victim as well as those of the accused.

A party that does not scorn the rich for being rich, anymore than we blame the poor for being poor.

We're a party dedicated to creating a bigger economic pie for all Americans, rather than simply dividing up the existing pie in a different way.

And we're a party devoted to bringing Americans together in unity and cooperation, instead of setting them apart, interest group by interest group, and category by category.

The Republican Party of the 1990s is a party for all citizens who want to reclaim the American dream that prompted our parents and grandparents to come to this land in search of freedom, hope, and opportunity.

The Democrats can campaign on class envy, pitting American against American, if they want.

We will not do it -- and we will beat their politics of envy.

One party can lead America into a bright new century: the Republicans.

One party can keep America's economy strong and competitive: the Republicans.

One party can make our children's world a better place: the Republicans.



One party can reclaim our streets from criminals and druglords: the Republicans.

One party can replace the corrupt lawmakers in Washington with honest leaders: the Republicans.

As we leave Chicago, we do so with a solemn burden.

As Ronald Reagan said on that helicopter ride:

"All I care about is this great country and I want to leave it a better place than I found it."

So do I.

And I know -- so do you.

We must work harder than ever.

For the first time in many years, the American people are very concerned about the future of their country. The future holds promise, but the path toward its fulfillment involves some sacrifice. But it's well worth it.

necklock. They would have saved billions of rubles they were instead forced to waste in a futile bid for military supremacy -- rubles that might have kept their bankrupt system afloat through the next century.

We Republicans led the free world out of the long twilight of Cold War. Morning in America?

Hell, we've given a new dawn to half the world.

We completed the rollback of communism some Democrats foresaw at the Cold War's birth -- a vision the liberals who took over the Democratic Party in the 1970s and 1980s abandoned.

You know the difference between John Fitzgerald Kennedy and the Democrats who control his party today? JFK believed in tax cuts and a strong defense and a brighter future in reward for hard work and sacrifice.

If the Democrats who followed him had their way, they'd have raised taxes in 1984, spent the money, raised taxes again in 1988, and still be back at the trough in 1990 for another feeding!

Page fourteen

Now here's something that amazes me. Mention that the Communist Party has had solitary and total control of the Soviet Union and Eastern Europe for the past fifty years, and that the party has grown corrupt, abusive of its power, and jealous of its privileges, and nobody seems surprised.

Doesn't power corrupt?

In fact in East Germany, what turned the tide against Honecker and Egon Krenz were widespread revelations of the graft of the party elite. That as much as anything sparked the popular revolt. But that graft was dwarfed by the magnitude of the Democratic S&L rip-off.

Now reflect that for fifty-six of the past sixty years, the Democrats have controlled the House. For forty-eight of the last sixty years, they've controlled the Senate.

Yet now they're trying to present themselves as blameless. They want no responsibility. They want to be seen as an opposition party, not a governing party.

Call it what they will, the Democrats who oppose President Bush offer the same old alternative.

If it's income, tax it.

If it's commerce, regulate it.

If it's a budget, break it.

Tax more, spend more.

So the bills mount, the deficit mounts, incumbents get reelected, challengers lose, and democracy suffers.

What we need now -- an apt commemoration of the two-hundredth anniversary of the Congress -- is a second Revolution.

It needs to begin with the recognition that reform is overdue. Just as our forefathers objected to taxation without representation -- we need to object to representation that is undemocratic.

First, we need passage of President Bush's package of campaign reforms so that challengers can face incumbents on a level playing field. That will restore democracy to our congressional elections.

I wonder. Did the Democrats look at East Germany? Did a shiver run up their spines at the power corruption has to mobilize people against a monopoly of power?

There's something hollow in their "make the crooks pay" rhetoric, their efforts to revise the history of the eighties. Sort of like Nikita Khrushchev pinning the blame on Joe Stalin.

Call it the Big Lie.

Well, my friends, you can fool some of the people all the time. They're the ones who vote the straight Democratic ticket.

You can fool some of the people some of the time. They're ticket splitters. Just enough Democratic House and Senate candidates manage to run away from the national party to fool them.

But you can't fool all the people, all of the time.

We've got the Democratic Party's number.

Another example of the Big Lie.

Crime. The Democrats say they're tough on it. But watch what they do.

In the House of Representatives they've bottled up President Bush's crime bill for more than a year. Meantime, the FBI reports crime rates soaring -- especially crime against women. Over the past ten years, rapes have increased four times the total crime rate.

Republicans care about the rights of victims of crime; Democrats care about the rights of criminals.

There's another Big Lie coming. You can smell it in the air. You can be sure the Democrats will try to blame us for any entitlement cuts that come out of the budget summit.

What they won't do is admit that Republican leadership has given us the longest period of sustained economic growth in peacetime history. We've created tens of millions of jobs. Incomes for average working people -- what's left after taxes -- have gone up steadily. The dream of home ownership has been restored.

We led in the eighties. We're proud of our record, and we won't run and hide from it.

You won't catch us trying to salvage our future by savaging our past.

And we'll lead in the nineties.

We'll lead, because we want parents and communities in control of our schools, not educational bureaucrats and remote unions.

We'll lead, because we want to control crime by punishing criminals, not by depriving honest Americans of their rights or making them in fear of walking the streets.

We'll lead, because we believe that the working people deserve to keep the money they earn, not fork it over in taxes to pay for Congress' waste.

Ron Brown says the Democratic Party is on a roll.

Is he right, or is he wrong?

Here's his idea of a roll -- the recent "urgent, dire, emergency" supplemental spending bill -- that's what they called it.. Three-quarters of a million dollars to buy an 800-ton ferry for Samoa. $6 million to fund a fish farm, in Iowa. And in this time of high deficits, $20 million for Congress' own private art collection.

Maybe they got that idea from David Paul. With $20 million, they can buy David Paul's $12 million Rubens' painting at CenTrust's fire sale.

**You and President Bush will make it happen.**

**The question is: "Can we win?"**

**The answer is: "We have no choice. We can and we must."**

**Our economy requires it.**

**Our future demands it.**

**--30--**

Bank

AGREEMENT BY AND BETWEEN
THE FIRST NATIONAL BANK OF TOMS RIVER, N.J.
TOMS RIVER, NEW JERSEY
AND
THE OFFICE OF THE COMPTROLLER OF THE CURRENCY

IN THE MATTER OF )
THE FIRST NATIONAL BANK )
OF TOMS RIVER, N.J. )
TOMS RIVER, NEW JERSEY )

DRAFT

WHEREAS, The First National Bank of Toms River, N.J., Toms River, New Jersey (hereinafter BANK), and the Comptroller of the Currency of the United States of America (hereinafter COMPTROLLER) wish to protect the interests of the depositors, other customers, and shareholders of the BANK, and, toward that end, wish the BANK to operate safely and soundly and in accordance with all applicable laws, rules, and regulations; and

WHEREAS, in the Report of Supervisory Activity of the BANK, dated December 31, 1989 (hereinafter REPORT OF SUPERVISORY ACTIVITY), incorporated herein by reference the same as if fully set forth, the COMPTROLLER, through his appointed National Bank Examiner, has criticized certain practices of the BANK as being unsafe or unsound within the meaning of the Federal Deposit Insurance Act, as amended by the Financial Institutions Supervisory Act of 1966, and the Financial Institutions Regulatory and Interest Rate Control Act of 1978 and the

Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 1818); and

NOW, THEREFORE, IT IS AGREED, between the BANK, through its duly elected and acting Board of Directors (hereinafter BOARD), and the COMPTROLLER, through his duly authorized representative, the Deputy Comptroller, Northeastern District (hereinafter DEPUTY COMPTROLLER), that the BANK shall operate at all times in compliance with the articles of this AGREEMENT.

ARTICLE I

AGREEMENT

(1) This AGREEMENT shall be construed to be a "written agreement entered into with the agency" within the meaning of 12 U.S.C. 1818(b)(1).

ARTICLE II

COMPLIANCE COMMITTEE

(1) Within ten (10) days, the BOARD shall appoint a Compliance Committee comprised of at least five (5) non-officer directors. The Compliance Committee shall be responsible for monitoring and coordinating the BANK's adherence to the provisions of this AGREEMENT

(2) Within thirty (30) days of the appointment of the Committee and monthly thereafter, the Compliance Committee shall submit a written progress report to the BOARD setting forth in detail:

(a) actions taken to comply with each Article of this AGREEMENT; and

(b) the results of those actions.

ARTICLE III

MANAGEMENT

(3) The BOARD shall forward a copy of the Compliance Committee's report, with any additional comments by the BOARD, to the DEPUTY COMPTROLLER for review.

(1) Within sixty (60) days, the BOARD or a designated committee thereof, shall conduct an in-depth analysis of the BANK's management and organizational structure. This analysis shall be in writing and shall include:

(a) an evaluation of the effectiveness of the BANK's organizational structure, including lines of authority, responsibility, and accountability of each committee and senior executive officer position (division head and above);

(b) the development of an organization chart and position descriptions outlining specific duties and responsibilities for each senior executive officer position (division head and above);

(c) an evaluation of the experience and qualifications of each incumbent senior executive officer to determine the individuals possess the skills required to effectively perform assigned duties;

(d) a detailed review and staff adequacy analysis of the responsibilities and capabilities of officers participating in major lending functions, with particular emphasis on loan administration, commercial, real estate and construction lending, loan review, and loan workout departments; and

(e) the development of an effective program for timely, periodic performance evaluations for senior executive officers, including procedures to identify and address deficiencies, establish remuneration, and promote sound management.

(2) Upon completion, a copy of the written analysis including all supporting materials, a written report on the conclusions reached, and specific time frames for implementation, shall be forwarded to the DEPUTY COMPTROLLER for review.

(3) The BOARD shall take appropriate action to ensure each officer position identified in paragraph (1) above is filled by a qualified individual. The employment of any individual as a senior executive officer may only be made in accordance with the provisions of Section 914 of the Financial Institution Reform, Recovery, and Enforcement Act of 1989, codified at 12 U.S.C. 1831i.

(4) The BOARD shall, within thirty (30) days, review all employment and severance contracts entered into with BANK officers and employees and make recommendations whether or not it is in the best interests of the BANK that such contracts be continued and/or terminated. The BOARD shall provide the DEPUTY COMPTROLLER with a copy of its recommendations for each contract.

(5) The BANK shall not make any payments pursuant to or enter into any new employment or severance contracts without providing thirty (30) days prior written notification to the DEPUTY COMPTROLLER for review.

ARTICLE IV

CRITICIZED ASSETS

(1) The BANK shall take immediate and continuing action to protect its interest with regard to each asset criticized in any subsequent REPORT OF SUPERVISORY ACTIVITY or by any internal or external loan review process.

(2) The BOARD shall immediately adopt and implement a written program designed to eliminate the basis of criticism of each asset that may be criticized in any subsequent REPORT OF SUPERVISORY ACTIVITY as "doubtful", "substandard", or "other assets especially mentioned". A similar program shall be adopted for each criticized asset within these areas that may become criticized by the BANK's loan review process.

(3) The BANK's written program for each loan shall include, at a minimum:

(a) an identification of the expected sources of and time frame for repayment;

(b) the current appraised value of supporting collateral and the position of the BANK's lien on such collateral where applicable;

(c) an analysis of current and satisfactory credit information, including cash flow analysis where loans are to be repaid from operations; and

(d) the proposed action to eliminate the basis of criticism and/or otherwise strengthen the credit and the time frame for its accomplishment.

(4) Once adopted, a copy of the program for each criticized asset equal to or exceeding one million dollars ($1,000,000) shall be forwarded to the DEPUTY COMPTROLLER.

(5) The BOARD, or a delegated BOARD Committee of which a majority are outside directors, shall conduct a review, on at least a monthl basis, to determine:

(a) the status of each criticized asset or criticized portion thereof equal to or exceeding one million dollars ($1,000,000)

(b) management's adherence to the program adopted pursuant to this Article;

(c) the status and effectiveness of the written program; and

(d) the need to revise the program or take alternative action.

(6) A copy of each review shall be forwarded to the DEPUTY COMPTROLLER on a monthly basis.

(7) The BANK shall not extend credit, directly or indirectly, including renewals, extensions or capitalization of accrued interes to any borrower whose loans or other extensions of credit may be criticized in any subsequent REPORT OF SUPERVISORY ACTIVITY or loan review and whose aggregate loans or other extensions of credit excee one million dollars ($1,000,000).

(8) The immediately preceding paragraph shall not apply if:

(a) the BANK's failure to extend further credit to a criticizec borrower would be substantially detrimental to the best interests of the BANK;

(b) a comparison to the written program adopted pursuant to thi Article shows that the BOARD's formal plan to collect or strengthen said criticized asset is not compromised; and

(c) prior to renewing, extending, or capitalizing any additional credit, a majority of the full BOARD (or a delegated committee thereof) approves the credit extension and certifies, in writing, the specific reasons why failure to so act would be substantially detrimental to the best interests of the BANK. A copy of the BOARD certification shall be maintained in the credit file of the affected borrower(s).

## ARTICLE V

## ALLOWANCE FOR LOAN AND LEASE LOSSES

(1) The BOARD shall immediately review the adequacy of the BANK's Allowance for Loan and Lease Losses (ALLOWANCE) and establish and adopt a methodology and program for the maintenance of an adequate ALLOWANCE. This review and program shall be designed in light of the comments on maintaining a proper methodology for maintaining the ALLOWANCE found in the COMPTROLLER's Banking Circular No. 201 dated May 31, 1985, and shall focus particular attention on the following factors:

(a) results of the BANK's internal loan review and REPORT(s) OF SUPERVISORY ACTIVITY;

(b) an estimate of potential loss exposure on each significant credit;

(c) concentrations of credit, particularly in the commercial real estate area;

(d) general economic trends within the BANK's market areas;

(e) trends of delinquent, non-accrual, and non-performing loans as well as charge offs;

(f) peer group analysis; and

(g) areas of credit administration weaknesses.

(2) The program shall provide for an immediate review of year-end 1989 and the first quarter 1990 ALLOWANCE by the BOARD, and, thereafter, a detailed review by the BOARD at least once each calendar quarter. Any deficiency in the ALLOWANCE shall be remedied in the quarter it is discovered by additional provisions. Written documentation shall be maintained indicating the factors considered and conclusions reached by the BOARD in determining the adequacy of the ALLOWANCE.

ARTICLE VI

LOAN ADMINISTRATION

(1) Within sixty (60) days, the BOARD shall develop and implement a written program to improve tho BANK's loan administration, with particular emphasis on the commercial real estate and construction loan portfolios.

This program shall include all matters discussed in the REPORT OF SUPERVISORY ACTIVITY including, but not limited to:

(a) obtaining and maintaining timely and detailed financial dat and performing credit analyses to document the borrower's financial capacity to repay debt;

(b) ensuring that unsecured loans are not granted unless they are supported by current net worth and repayment capacity of th obligor;

(c) initiating written officer file comments;

(d) monitoring sale and lease progress reports for each project financed;

(e) making formal progress reports to document the status of major construction projects being financed;

(f) ensuring that the terms of loan commitments comply with the conditions under which they were approved;

(g) obtaining independent and qualified appraisals and establishing prudent appraisal and reappraisal practices;

(h) ensuring that officers continually assign accurate credit risk classifications to their accounts, and that such changes are immediately reflected on the BANK's overall risk monitoring system and internal criticized loan reports;

(i) strengthening collection efforts to include specific plans to reduce delinquent and non-accrual loans and to improve recovery of charged-off assets; and

(j) adherence to applicable loan policy guidance, particularly as revised under Article VII of this AGREEMENT.

(2) Within sixty (60) days, the BOARD shall review loans and other transactions to any of its Executive Officers, Directors, and Principal Shareholders as well as their related business interests as

delineated in 12 U.S.C. 375b and 12 C.F.R. Part 215, for conformance with terms of the transaction when approved, and to ensure such loans or other transactions were made on substantially the same terms as those prevailing for comparable transactions with other persons who are not Executive Officers, Directors, or Principal Shareholders of the BANK.

(3) Upon completion, the program shall be submitted to the DEPUTY COMPTROLLER for review and approval.

# ARTICLE VII

## LOAN POLICY

(1) Within sixty (60) days, the BOARD shall review and revise the BANK's written policies as they apply to the BANK's commercial real estate loan portfolio. This process shall be directed toward providing correction of all underwriting and control matters discussed in the REPORT OF SUPERVISORY ACTIVITY. They are to include, but not be limited to:

(a) setting guidelines for managing the aggregate overall level of exposure to concentrations of credit, as defined in Section 216 of the Comptroller's Handbook for National Bank Examiners, particularly regarding construction real estate loans;

(b) establishing minimum initial levels of project equity provided by borrowers and maximum loan to value parameters;

(c) guarantee requirements;

(d) appraisal and reappraisal requirements;

(e) officer and managerial responsibility and accountability;

(f) identifying and properly accounting for other real estate owned and "In-Substance Foreclosures" on a timely basis, in order to ensure the inclusion of independent qualified appraisals for such real estate;

(g) requirements for the periodic review of adherence to policy; and

(h) correcting documentation, policy, and credit information exceptions identified by internal loan review.

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(2) Copies of all of the BANK's revised policies shall be forwarded to the DEPUTY COMPTROLLER for review and approval.

ARTICLE VIII

NON-ACCRUAL LOANS

(1) Within sixty (60) days, the BOARD shall adopt and implement written policies and procedures governing the reporting, supervision, and control of non-accrual and non-performing loans and accrued interest receivable. Such policies and procedures shall:

(a) be consistent with the accounting requirements contained in the Instructions for Preparation of Reports of Condition and Income;

(b) consider the appropriateness of continuing accrual of interest on loans where the collection, in full, of principal plus interest is in doubt;

(c) provide for ceasing accrual of interest on loans deemed as "In-Substance Foreclosures" as guided by SEC Financial Reporting Release Number 28;

(d) address the limited circumstances under which accrued interest due on a loan may be added to the outstanding principal when the loan is renewed or restructured;

(e) require that any exceptions to the policy be approved by the BOARD or a committee thereof, each month, for the duration of the exception;

(f) ensure that all loans returned to accrual status comply with the accounting requirements contained in the Instructions for Preparation of Reports of Condition and Income; and

(g) require the monthly presentation to the BOARD of a report detailing all loans that meet the criteria for non-accrual according to the revised policy.

(2) Upon completion, a copy of the written policies and procedures shall be forwarded to the DEPUTY COMPTROLLER for review and approval.

## ARTICLE IX

## LOAN REVIEW

(1) Within sixty (60) days, the BOARD shall review the BANK's internal loan review program to ensure the timely and effective identification of developing loan problems. This review shall include, but not be limited to, the following activities:

(a) ensuring the accuracy of assigned loan classifications;

(b) ensuring the adequacy and independence of loan review staffing, giving consideration to the risk profile of the BANK's loan portfolio and the number and complexity of credits therein; and

(c) ensuring the desired degree and frequency of coverage by type and size of loan.

(2) Upon completion, a copy of the review shall be submitted to the DEPUTY COMPTROLLER for review and approval.

## ARTICLE X

## CAPITAL PLAN

(1) Within sixty (60) days, the BOARD shall develop and implement a capital plan to ensure adequate capitalization of the BANK. At a minimum, this plan should address:

(a) the primary source(s) from which the BANK will strengthen its capital structure to meet the BANK's needs for its risk profile and level of operations;

(b) contingency plans which identify alternative methods should the primary source(s) under (a) above not be available;

(c) the dividend policy of the BANK, to include consideration of the prohibitions set forth in 12 U.S.C. 56 and 12 U.S.C. 60;

(d) methods to improve earnings performance, with particular emphasis on reducing non-interest expense;

(e) detailed balance sheet and income statement projections;

(f) any plans to expand activities, markets, and business locations; and

(g) the BANK's plan for achieving compliance with the risk based capital guidelines effective January 1, 1991 and beyond.

(2) Upon completion, a copy of the BANK's capital plan shall be forwarded to the DEPUTY COMPTROLLER for review and approval.

## ARTICLE XI

## MONTHLY PROGRESS REPORTS

(1) Within fifteen (15) days of the end of each month, the BOARD or a designated committee thereof, shall submit to the DEPUTY COMPTROLLER the following reports:

(a) copies of minutes of all BOARD and BOARD Committee meetings;

(b) comparative statement of condition;

(c) comparative statement of income and expenses with comparisons to budget;

(d) status of criticized assets;

(e) a reconcilement of the Allowance for Loan and Lease Losses and quarterly analysis; and

(f) past due and non-accrual loan reports.

ARTICLE XII

RESPONSIBILITIES

(1) Although the BOARD has agreed to submit certain programs and reports to the DEPUTY COMPTROLLER for review and approval, the BOARD has ultimate responsibility for proper and sound management of the BANK.

(2) It is expressly and clearly understood that if, at any time, the COMPTROLLER deems it appropriate in fulfilling the responsibilities placed upon him/her by the several laws of the United States of America to undertake any action affecting the BANK, nothing in this AGREEMENT shall in any way inhibit, estop, bar, or otherwise prevent the COMPTROLLER from so doing.

(3) Any time limitations imposed by this AGREEMENT shall begin to run from the effective date of this AGREEMENT. Such time requirements may be extended by the DEPUTY COMPTROLLER for good cause upon written application by the BOARD.

(4) The provisions of this AGREEMENT shall continue in full force and effect unless or until such provisions are amended, excepted, waived, or terminated by mutual consent of the parties to the AGREEMENT.

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(5) IN TESTIMONY WHEREOF, the undersigned, authorized by the COMPTROLLER, has hereunto set his hand on behalf of the COMPTROLLER.

Paul C. Belhorn
Director, New York Field Office
Northeastern District

Date

IN TESTIMONY WHEREOF, the undersigned, as duly elected and acting Board of-Directors of the BANK, have hereunto set there hands on behalf of the BANK.

| Signature of Directors | Date |
|---|---|
| John C. Fellows, Jr. | |
| Elbert L. Hall | |
| William T. Hiering | |
| Hirair Hovnanian | |
| Joseph P. Iaria | |
| David Johnson | |
| Douglas E. Johnson | |
| Irene F. Kramer | |
| Roger N. Lane, Jr. | |
| Leonard G. Lomell | |
| Jack Meyer | |
| Jacqueline F. Pappas | |
| W. Blair Rogers | |
| John F. Russo | |
| Richard Sambol | |

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Signature of Directors (Continued) | Date

| | |
|---|---|
| Floyd R. Smith, Jr. | |
| Richard D. Sutton | |
| Dr. Raymond A. Taylor | |

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# NEWS RELEASE

**Comptroller of the Currency**
**Administrator of National Banks**

Washington, D.C. 20219

NR 90-80

For: RELEASE UPON DELIVERY -- NOON EDT

Date: JUNE 1, 1990

Remarks by
ROBERT L. CLARKE
Comptroller of the Currency

Nashua, New Hampshire
June 1, 1990

I'm well aware of the economic environment in New England, in general, and in New Hampshire, in particular.

But I keep in mind that the regional slowdown follows what Wayne Ayers, chief economist at the Bank of Boston, recently described as: "a decade-long period of extraordinary, even unprecedented, growth for New England."

He noted that "this performance during the 1980's suggests that some special factors were at work which, together, pushed regional economic growth up at a rapid, but ultimately, unsustainable pace." These factors included the defense spending boom of the early-to-mid 1980's and the growth and maturation of the region's high technology industries.

As these areas -- and others like them -- slowed and weakened, so, too, did <u>the regional economy as a whole</u>.

As a Texan, I can identify with dramatic growth -- and empathize with the slowdown people in New England are feeling right now, too. But as a Texan, I want to stress that -- as things appear today -- no one expects New England to repeat recent Texas economic history.

One important reason that is likely to be the case is that the industrial mix is far more diversified in this region than it was in Texas a decade ago. As a result, analysts say that the economy of New England should slow far less than the Texas economy did in the mid-1980s and should rebound far faster.

As for New Hampshire, I recently read an analysis of the state's economic condition that was titled: What Goes Up Must Come Down -- a deterministic, even fatalistic, prediction that concludes far more than the facts warrant.

But that is not to say that the facts don't add up to a serious accounting of economic slowdown. In the Manchester-Nashua metropolitan statistical area alone, evidence of the slowdown is clear for anyone to see. Economic expansion stalled last year as a result of downturns in the computer and defense industries. Sanders Associates, Kollsman Instruments, Nashua Corporation, Prime Computer, Data General and Digital Equipment -- the last being the state's largest private employer -- all announced plant closings, layoffs, or restructurings in 1989. And the downturns in the computer and defense industries touch the lives of a significant portion of the people of the state: Almost one-third of the New Hampshire's residents live in the area and more than one-third of the state's jobs are located here.

Yes, I am aware of the problems here.

Just as I hope that you are aware of the critical role the banks of the region must play in any rebound.

I'm here today to make you aware of the role that we perform -- the role of assuring that national banks are in position to promote recovery and growth.

And I'm here to give you a clear sense of the direction in which the Office of the Comptroller of the Currency is going -- and why.

The OCC is the primary supervisor for the nation's 4,200 national banks -- about one-third of the total. Because this one-third includes most of the larger U.S. banks, national banks hold about two-thirds of the banking assets in the country.

I must warn you that my overview of what bank supervision concerns itself with will be very clear and logical. Logic is the method of thinking that allows you to cut through baloney -- however well intentioned that baloney may be.

A good friend of mine learned just how sharp logic can be a few months ago. After a lingering illness, his family's cat died.

His heart-broken little daughter came to him and exclaimed through her tears: "Daddy! Daddy! Whiskers is dead."

"Don't worry," consoled the father, "Whiskers has gone to heaven to be with God."

The little girl stopped crying and looked puzzled. After a moment she asked: "Daddy, what does God want with a dead cat?"

When we first look at banking supervision, we might be equally puzzled. The function of commercial banking is to make money, primarily by making loans -- and as the term "commercial" implies, the purpose of banking is to support the economy, in particular by funding business people.

The public prefers a growing economy to an economy that doesn't grow. The public preference for economic growth means that it wants businesses to be funded. At the same time, the public demands a safe and sound banking system to fund this growth -- a system that is backed by a sound deposit insurance fund -- a system that shareholders view as being a good investment. Sometimes the two wants -- economic growth and a safe and sound financial system -- appear to come into conflict, and there arises a temptation either to try to balance them or to give one precedence over the other. In the long run, however, giving in to either of those temptations will lead to disaster.

Why?

The two wants can never be in conflict in the long run. As a bank supervisor, the OCC operates under the principle that -- in the long run -- economic growth must rest on a firm foundation: a safe and sound financial system in general and a safe and sound national banking system in particular. All the theory in the world argues that this principle -- that economic growth must rest on a safe and sound banking system -- is correct. And in the laboratory called "real life," the recent experience of the savings and loan industry also supports that principle.

We put this principle into practice through strong and appropriate banking supervision, because a safe and strong banking system is too critical an element of our nation's economy to leave to chance!

Now one extraordinarily important point about banking supervision is often overlooked: Government's interest in assuring that the financing mechanism remains strong is a policy intended to benefit all of a financial institution's customers -- depositors and borrowers alike. In the last fifty-five odd years, we've tended to stress the benefits to the depositor -- a trend that has grown along with the growth in assets and importance of the federal deposit insurance funds.

But the rationale behind supervision is more than merely protecting the funds of depositors. It is also an attempt to assure that the class of bank customers known as borrowers -- who want to put credit to productive use -- have a long-term source of funding. Indeed, one might say that this interest in borrowers was what led the Federal government into a banking policy in the first place.

In arguing for the creation of a government-sponsored banking institution more than two centuries ago, Secretary of the Treasury Alexander Hamilton wrote: "Most commercial nations have found it necessary to institute banks; and they have proved to be the happiest engines that ever were invented for advancing trade."

In a report to Congress, Hamilton went on to say that: ". . . by contributing to enlarge the mass of industrious and commercial enterprise, banks become nurseries of national wealth -- a consequence as satisfactorily verified by experience, as it is clearly deducible in theory."

Hamilton's efforts led to the creation of such an institution: the First Bank of the United States. This institution didn't lend just any amount to anyone who walked through the door. It was managed prudently. But in the twenty years that its charter ran, the First Bank of the United States financed the expansion of post-Revolutionary America.

In the 1830s, the commercial banking business became a private-sector activity totally -- and has remained so, with a large dose of governmental direction. That's understandable. Because of their crucial role in financing the ventures of others, banks and bankers have long been viewed with awe and suspicion. And pressures for supervision of banks grew as people realized that the failure of a bank meant not only the loss of funds -- personal and business -- of its customers. When a bank fails, the repercussions can spread regionally, even nationally. The welfare of borrowers -- then the welfare of the public at large -- then the welfare of depositors: These are the three chapter headings in the history of bank regulation in the United States.

Now -- in the spirit of questioning reflected by my friend's little girl -- you may be asking yourself something like: "If Bob Clarke says that the Federal government got into the banking policy of promoting a safe and sound banking system to assure business people a source of credit, why do banks turn down loans?"

This question reminds me of the time I was shopping in the small town where I grew up and I overheard two men I knew -- Joe and Jim -- talking.

Joe said to Jim: "At her request you gave up drinking?"

Jim said: "Yeah."

And Joe said: "At her request you gave up smoking?"

And Jim said: "Yeah."

Joe said: "For the same reason you gave up dancing, poker, and gambling."

Jim said: "Yeah."

Then Joe said: "Well, then, why in the world didn't you marry her?"

And Jim said: "Well, I felt that after I'd improved myself so much I could probably do better."

You can demand quality to the point that the demands become counterproductive. We are quite aware of that. But we are also aware that in banking, an investment -- a loan -- is either performing to agreed upon terms or it isn't. If it isn't, something is wrong. It could be a little wrong -- it could be disastrously wrong -- or somewhere in between. Wherever it falls, it's wrong. Unlike the kind and forgiving school teacher, reality doesn't accept and reward the answer closest to the right one -- though the consequences reality imposes upon those with the wrong answer do often vary proportionately with their degree of error. In other words, the smaller the problem, the easier it is to fix -- usually.

At the OCC, we recognize reality -- and that means we recognize a problem when it is a problem -- and we expect bankers to recognize it, too. After all, bear in mind the simple fact that the OCC is not the only one that bank management has to answer to. Bank management must also be able to support its credit decisions to its board of directors and its shareholders. So we encourage, coax, caution, intimidate and compel national bankers into focusing on the quality of their investments and improving them if necessary.

How do we do that?

Our job of bank supervision includes three important tasks.
Our first task is to make sure that banks adopt and adhere to sound credit practices.

Our second task is to make sure that their books accurately reflect the value of their assets and liabilities.

In that regard, it has recently been charged that we have changed our supervisory standards toward real estate -- and especially toward real estate here in New England.

Those charges are reflect a lack of understanding.

Our standards haven't changed. As any brief glance at the New England economy will reveal, the environment has changed.

Because it has changed, we have done -- and continue to do -- targeted real estate examinations where we review loan portfolios <u>much more deeply</u> than would have been the case had the economic environment not changed.

The changed environment has forced us to look at the quality of individual loans <u>much more closely</u>.

Consider, for example, a hypothetical loan to develop a shopping center, a loan backed by a guarantor. Today, we would analyze that loan more closely than, say, five years ago. Today -- because of softer rents, higher office vacancy rates, declining values in real estate and softening in the economic picture overall -- we have to put a greater emphasis on the financial condition of the guarantor. And, today, we may even criticize the bank if it did not have or could not provide us with relevent information on guarantor's financial condition.

Our standards haven't changed -- we hold national banks to the same bench marks as before. But because the enviroment has changed, it takes more of an effort on our part to measure an institution's performance against those standards.

Our third task is to make sure that national banks establish management systems capable of tracking bank activities and reasonably anticipating and adjusting to changing market conditions.

In other words, we expect bankers to have mechanisms in place to conduct their own asset quality review to search for faults. And, ideally, examiners should then only have to check to see that the mechanisms exist and that they are performing as intended. But in the less than ideal world in which we live, we often find faults that bankers haven't recognized for whatever reason -- and we do what it takes to make bankers recognize the weaknesses in their loan portfolios.

In a nutshell, that is bank supervision.

Its goal -- as I have stressed -- is to make sure that bankers recognize reality.

Its goal is to make sure that a banker has an understanding of his or her financial institution's condition that is true and reasonable.

And its goal is to make sure that bankers make managerial decisions that reflect this true and reasonable understanding.

Nothing less. And nothing more.

We do <u>not</u> make individual credit decisions.

That is what bankers are paid to do.

We haven't told bankers: "<u>Don't</u> make loans."

We have reminded them to <u>take</u> <u>care</u> in making loans.

It is the banker's job to find the good loans and to make them. And it is the banker's job to be able to justify the loan -- not just, and not even first, to the regulators -- but to the banker's own board of directors.

And I just want to note that we haven't repealed the basic rules of banking -- including the practice of bankers working with customers during economic declines. That means working with customers to restructure loans, if necessary. When we classify a loan, we don't intend for the institution to walk away from the loan and the borrower. Rather, the banker would be expected to analyze the credit and the borrower, and restructure the credit where appropriate. That process has been the case historically. It is good banking.

And when we find problems in one sector -- say real estate -- we don't intend for an institution to paint all its customers with one brush -- in other words, to assume that there will be problems in other sectors, too. We are <u>not</u> telling bankers to cut off credit from good customers.

And we do <u>not</u> set monetary or any other type of economic policy. That is not our job.

Rather, our job is like that of a smoke detector -- to be constantly on guard for the signs of trouble and to sound an alert if those signs appear. Needless-to-say, when the smoke detector goes off, you don't blame the alarm for the fire. In fact, after you take care of the problem, you probably are thankful someone came up with the idea for the device.

A safe and sound banking system is essential and necessary for future economic growth. And we will continue to promote a safe and sound banking system in New England to provide the region with foundation on which to build future economic expansion.

In that regard I just want to add one personal observation. Until I became Comptroller of the Currency four-and-a-half years ago, I spent my entire working life in Texas. I personally witnessed what may have been the greatest economic boom in our nation's history. And, as Comptroller, I personally had to deal with many of the ramifications once that boom blew out.

Texas today is rebounding -- reaching out to achieve steady and sustainable growth.

One critical factor in this rebound is the leadership the bankers and the business community in Texas are providing.

You can take a deterministic -- even a fatalistic -- view of economic decline -- "what goes up must come down." Or you can recognize that economic growth is always the result of real, concrete, special factors. When some decline, you can seek others to replace them.

Every economic rebound begins when business leaders take the lead in finding opportunities. Texans are seeking them -- and finding them. And I am sure that New Englanders will, too.

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Bank.

# NEWS RELEASE

Comptroller of the Currency
Administrator of National Banks

NR 90-74

Washington, D.C. 20219

For: Release Upon Delivery -- Embargoed

Date: MAY 19, 1990

Remarks by
ROBERT L. CLARKE
Comptroller of the Currency

before the
National Association of Home Builders

Washington, D.C.
May 19, 1990

I am here today to give you a clear sense of the direction in which the Office of the Comptroller of the Currency is going and why. What does the OCC mean to you? And why are national banks important to homebuilders?

A few numbers give clear and unmistakable answers to these questions.

Over the last few years, the long-term dominance of thrift institutions in mortgage financing has eroded. That erosion has changed the mortgage lending business dramatically. In 1985, thrifts originated 44 percent of mortgages to purchase one-to-four family dwellings, banks originated 21 percent, and other financial servicers originated 35 percent. By 1989, originations by thrifts decreased to 39 percent. Originations by other financial servicers dropped to 27 percent. And originations by commercial banks rose to 35 percent.

Again, in just four years the percentage of mortgage originations made by commercial banks rose from 21 percent of the total to 35 percent -- thus putting commercial banks and thrifts on just about equal footing in the business.

The OCC is the primary supervisor for the nation's 4,200 national banks, about one-third of the total. But because this one-third includes most of the larger U.S. banks, national banks hold about two-thirds of the banking assets in the country. So the OCC is important to homebuilders because we supervise a source of mortgage funds that grows larger all the time and a source that continually represents more and more of the funds available for mortgages all the time: the national banking system.

Now I know who you are and why you are important, period. Prior to my accepting my current position as Comptroller, your president, Martin Perlman, and I were business associates. Indeed, when I was the member of a board of directors of a small bank in Houston, Martin was one of our best customers.

Through many discussions, Martin has given me a good understanding of your concerns. Now I would like to talk with you about mine. But I will warn you that my overview of what bank supervision concerns itself with will be very clear and logical. Logic is the method of thinking that allows you to cut through bunkum, however well intentioned that bunkum may be. A good friend of mine learned just how sharp logic can be a few months ago.

After a lingering illness, his family's cat died. His heart-broken little daughter came to him and exclaimed through her tears: "Daddy! Daddy! Whiskers is dead."

"Don't worry," consoled the father, "Whiskers has gone to heaven to be with God."

The little girl stopped crying and looked puzzled.

After a moment she asked: "Daddy, what does God want with a dead cat?"

When we first look at banking supervision as it is practiced at the OCC, we might be equally puzzled.

The function of commercial banking is to make money, primarily by making loans -- and as the term "commercial" implies, the purpose of banking is to support the economy, in particular by funding business people. The public prefers a growing economy to an economy that doesn't grow. The public preference for economic growth means that it wants businesses to be funded. And one such very important business is homebuilding -- because the public in our country has a great demand for new, bigger, and better housing. At the same time, the public demands a safe and sound banking system to fund this growth, a system that is backed by a sound deposit insurance fund.

But sometimes the two wants -- economic growth and a safe and sound financial system -- appear to come into conflict, and there arises a temptation either to try to balance them or to give one precedence over the other. In the long run, however, giving in to either of those temptations will lead to disaster.

Why?

The two wants can never be in conflict in the long run.

As a bank supervisor, the OCC operates under the principle that -- in the long run -- economic growth, business expansion, and, yes, the long-term health of homebuilding, must rest on a firm foundation: a safe and sound financial system in general and a safe and sound national banking system in particular.

All the theory in the world argues that this principle, that economic growth must rest on a safe and sound banking system, is correct. And in the laboratory called "real life," the recent experience of the savings and loan industry also supports the principle.

We put this principle into practice through strong and appropriate banking supervision. And our strong and appropriate banking supervision is one major reason, and perhaps even the primary reason, mortgage financing had a deep pool in reserve, the banking industry, when its major pool of funding, the savings and loan industry, began to evaporate.

There is an extraordinarily important point here, a point that is often overlooked: Government's interest in assuring that the financing mechanism remains strong is a policy intended to benefit <u>all</u> of a financial institutions customers -- depositors and borrowers alike.

In the last fifty-five odd years, we've tended to stress the benefits to the depositor, a trend that has grown along with the growth in size and importance of the federal deposit insurance funds. But the rationale behind supervision is more than merely protecting the assets of depositors. It is also an attempt to assure that the class of bank customers known as borrowers, who want to put credit to productive use, have a long-term source of funding.

Indeed, one might say that this interest in borrowers was what led the Federal government into a banking policy in the first place. For example, when he was Secretary of the Treasury two centuries ago, Alexander Hamilton sent letters to Congress and to President George Washington that argued for the creation of a government sponsored institution that would, in part, meet the needs of merchants for financing. As Hamilton argued in a report to Congress: ". . . by contributing to enlarge the mass of industrious and commercial enterprise, banks become nurseries of national wealth -- a consequence as satisfactorily verified by experience, as it is clearly deducible in theory."

Hamilton's efforts led to the creation of such an institution: the First Bank of the United States. This institution didn't lend just any amount to anyone who walked through the door. It was managed prudently. But in the twenty years that its charter ran, the First Bank of the United States financed the expansion of post-Revolutionary America.

In the 1830s, the commercial banking business became a private-sector activity totally, and has remained so, with a large dose of governmental direction. Which is understandable. Because of their crucial role in financing the ventures of others, banks and bankers have long been viewed with awe and suspicion. And pressures for supervision of banks grew as people realized that the failure of a bank meant not only the loss of assets -- personal and business -- of its customers. When a bank fails, the repercussions can spread regionally, even nationally.

The welfare of borrowers -- then the welfare of the public at large -- then the welfare of depositors: These are the three chapter headings in the history of bank regulation in the United States.

Now -- in the spirit of questioning reflected by my friend's little girl -- you may be asking yourself something like: "If Bob Clarke says that the Federal government got into the banking policy of promoting a safe and sound banking system to assure business people a source of credit, why do banks turn down loans?" This question reminds me of the time I was shopping in the small town where I grew up and I overheard two men I knew -- Joe and Jim -- talking.

Joe said to Jim: "At her request you gave up drinking?"

Jim said: "Yeah."

And Joe said: "At her request you gave up smoking?"

And Jim said: "Yeah."

Joe said: "For the same reason you gave up dancing, poker, and gambling."

Jim said: "Yeah."

Then Joe said: "Well, then, why in the world didn't you marry her?"

And Jim said: "Well, I felt that after I'd improved myself so much I could probably do better."

You can demand quality to the point that the demands become counterproductive. We are quite aware of that. But we are also aware that in banking, an investment -- a loan to a small business or a family mortgage, whatever -- is either performing to agreed upon terms or it isn't. If it isn't, something is wrong. It could be a little wrong, it could be disastrously wrong, or somewhere in between. Wherever it falls, it's wrong.

Unlike the kind and forgiving school teacher, reality doesn't accept and reward the answer closest to the right one, though the consequences reality imposes upon those with the wrong answer do often vary proportionately with their degree of error. In other words, the smaller the problem, the easier it is to fix -- usually.

At the OCC, we recognize reality -- and that means we recognize a problem when it is a problem -- and we expect bankers to recognize it, too. After all, bear in mind the simple fact that the OCC is not the only one that bank management has to answer to. Bank management must also be able to support its credit decisions to its board of directors and its shareholders. So we encourage, coax, caution, intimidate and compel national bankers into focusing on the quality of their investments and improving them if necessary.

How do we do that?

Our job of bank supervision includes three important tasks. One, we ensure that banks adopt and adhere to sound credit practices. Two, we ensure that their books accurately reflect the value of their assets and liabilities. And, three, we ensure that national banks establish management systems capable of tracking bank activities and reasonably anticipating and adjusting to changing market conditions. In other words, we expect bankers to have mechanisms in place to conduct their own asset quality review to search for faults -- and, ideally, we should then only have to check to see that the mechanisms exist and that they are performing as intended.

But in the less than ideal world in which we live, we often find faults that bankers haven't recognized for whatever reason, and we do what it takes to make bankers recognize them.

In a nutshell, that is bank supervision.

Its goal -- as I have stressed -- is to assure that bankers recognize reality. Its goal is to assure that a banker has an understanding of his or her financial institution's condition that is true and reasonable. And its goal is to assure that bankers make managerial decisions that reflect this true and reasonable understanding. Nothing less. And nothing more.

We do not make individual credit decisions. That is what bankers are paid to do. And we do not set monetary or any other type of economic policy. That is not our job. If a banker ever tells you that he can't make a loan because the examiners won't let him -- be suspicious. If a banker ever tells you he had to foreclose on a piece of property because the examiners told him to foreclose -- be suspicious. We haven't repealed the basic rules of banking, including the practice of bankers working with customers during economic declines. And that means working with customers to restructure loans, if necessary. We haven't told bankers not to make loans. We have reminded them to take care in making loans. Similarly, we're not telling them to cut off credit from good customers. And we don't tell bankers to foreclose on property.

Now let there be no misunderstanding -- I'm not here to bash bankers. The vast majority of bankers in this country manage their banks very well.

I think, however, that we must all recognize that banking is like any business. It has its ups and downs. And it has a wide range of managerial talent.

Weaknesses in real estate are not a new, different species that have just evolved. Along with agriculture and energy, just to name two other examples, real estate has long been recognized as a cyclical industry.

Bankers get paid for assessing risk, taking risks, managing risks and working out problems when they can.

They maintain capital -- and we require them to do so -- to provide a cushion against shocks. Capital allows banks to sail through rough seas without smashing the hull or foundering. The capital cushion that we require allows them to survive economic downturns -- just as well capitalized homebuilders can withstand cyclical slowdowns in the housing market.

Perhaps it was unavoidable, given the recent history of the savings and loan industry, but in thinking about what I would say to you today the Greek fable about the goose that laid the golden eggs kept returning to my mind. Sure, that may be a commonplace reaction. But it is an understandable one. For the moral of the story is true, and clear, and apt.

You remember the story: A farmer had a goose that laid golden eggs. Thinking to make himself rich, he killed the goose to get the whole stock of eggs at once. When he sacrificed future reward for present gain, he lost his regular source of supply.

Like the goose that lays golden eggs, the national banking system creates wealth. We intend to give it the nurturing care it takes to keep it safe and producing.

Our job at the OCC is to assure that the national banking system remains safe and sound; and that it remain safe and sound not just today, not just tomorrow, but next week, next month, next year, and on and on.

Just as the Comptrollers of the Currency in the 19th century worked to assure the strength of the national banking system in the 20th century, we work today so that business -- homebuilders, retailers, trucking companies, you name it -- will have a strong banking foundation on which to build in the 21st.

Thank you.

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Bank

# Oral Statement
# ROBERT L. CLARKE
# Comptroller of the Currency

BEFORE THE
COMMITTEE ON SMALL BUSINESS
OF THE
U.S. HOUSE OF REPRESENTATIVES

June 6, 1990

THANK YOU, MR. CHAIRMAN.

AS THE AGENCY RESPONSIBLE FOR SUPERVISING THE NATION'S 4,200 NATIONAL BANKS, THE OFFICE OF THE COMPTROLLER OF THE CURRENCY IS VITALLY INTERESTED IN MAINTAINING A SAFE AND SOUND BANKING SYSTEM THAT SERVES THE CREDIT NEEDS OF THE AMERICAN PUBLIC.

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, I HAVE A WRITTEN STATEMENT TO SUBMIT FOR THE RECORD.

RATHER THAN REPEATING THAT STATEMENT, I WOULD LIKE TO DISCUSS WITH THE COMMITTEE THIS MORNING SEVERAL WIDELY BROADCAST MISCONCEPTIONS CONCERNING <u>WHAT THE OCC DOES</u> AND <u>HOW WE DO IT</u>.

IN PLACING THIS DISCUSSION IN CONTEXT, IT IS HELPFUL TO REVIEW QUICKLY THE ECONOMIC ENVIRONMENT IN NEW ENGLAND, THE REGION WHICH HAS BEEN THE FOCUS OF MANY MISCONCEPTIONS CONCERNING <u>WHAT</u> THE OCC DOES AND <u>HOW</u> WE DO IT.

I AM WELL AWARE OF THE ECONOMIC SLOWDOWN IN NEW ENGLAND.

BUT I KEEP IN MIND THAT THIS REGIONAL SLOWDOWN FOLLOWS WHAT WAYNE AYERS, CHIEF ECONOMIST AT THE BANK OF BOSTON, RECENTLY DESCRIBED AS: "A DECADE-LONG PERIOD OF EXTRAORDINARY, EVEN UNPRECEDENTED, GROWTH FOR NEW ENGLAND."

HE NOTED THAT "THIS PERFORMANCE DURING THE 1980'S SUGGESTS THAT SOME SPECIAL FACTORS WERE AT WORK WHICH, TOGETHER, PUSHED REGIONAL ECONOMIC GROWTH UP AT A RAPID, BUT ULTIMATELY, UNSUSTAINABLE PACE."

THESE FACTORS INCLUDED THE DEFENSE SPENDING BOOM OF THE EARLY-TO-MID 1980'S AND THE GROWTH AND MATURING OF THE REGION'S HIGH TECHNOLOGY INDUSTRIES.

AS THESE FACTORS -- AND OTHERS -- SLOWED AND WEAKENED, SO, TOO, DID THE REGIONAL ECONOMY AS A WHOLE.

THE EFFECTS OF THE SLOWING ECONOMY CAN BE SEEN IN REAL ESTATE INDICATORS.

CONSIDER SINGLE FAMILY HOUSING STARTS IN NEW ENGLAND: THERE WERE 86,000 IN 1986; 74,000 IN 1987; 63,000 IN 1988; AND IN 1989, THERE WERE 42,000 -- ABOUT HALF THE NUMBER IN 1986.

OR CONSIDER OFFICE VACANCY RATES FOR BOSTON AND HARTFORD.

AT THE END OF 1983, THEY WERE 7 PERCENT AND 13 PERCENT, RESPECTIVELY.

AT THE END OF 1989, THEY HAD GRADUALLY GROWN TO 14.6 PERCENT FOR BOSTON AND 22.5 PERCENT FOR HARTFORD.

THESE FIGURES SHOW THAT THE ECONOMY AND THE REAL ESTATE SECTOR IN NEW ENGLAND DID NOT TURN DOWN SUDDENLY IN 1989 -- WEAKENING IN BOTH WAS EVIDENT THROUGHOUT THE LAST HALF OF THE 1980S.

AS IS THE CASE WITH <u>ALL</u> THE DATA THAT WE USE, THESE STATISTICS CAME FROM PRIVATE SECTOR SOURCES AVAILABLE TO EVERYONE.

IN OTHER WORDS, WE DON'T ORIGINATE THE DATA THAT WE USE IN MAKING DECISIONS -- OUR ACTIONS DON'T REFLECT SECRET INFORMATION KNOWN ONLY TO US.

AGAINST THIS BACKDROP, MR. CHAIRMAN, WE'VE ALL HEARD OR READ ABOUT THE CONCERNS OF BORROWERS WHO BELIEVE THAT THEY ARE BEING DENIED CREDIT THAT THEY WOULD HAVE EASILY RECEIVED IN JUST THE RECENT PAST.

WE SYMPATHIZE WITH THE PLIGHT OF SMALL BUSINESS PEOPLE WHO HAVE DIFFICULTY OBTAINING CREDIT, OR, IN FACT, MAY BE UNABLE TO OBTAIN CREDIT AT ALL, THROUGH NO FAULT OF THEIR OWN.

HOWEVER, ATTEMPTS TO BLAME THE OCC FOR THEIR CONDITION ARE UNWARRANTED.

CRITICS WHO ARE LINKING THE DIFFICULTIES OF SOME BORROWERS TO A SUPPOSED CRACKDOWN ON LENDING BY THE OCC ARE PROMOTING INCORRECT VIEWS OF WHAT WE DO AND HOW WE DO IT.

THESE ARGUMENTS ASSUME THAT THE OCC IS TELLING BANKS TO WHOM THEY SHOULD OR SHOULD NOT LEND.

NOTHING COULD BE FARTHER FROM THE TRUTH.

WE DO <u>NOT</u> MAKE INDIVIDUAL CREDIT DECISIONS.

THAT IS WHAT BANKERS ARE PAID TO DO.

WE <u>HAVEN'T</u> TOLD BANKERS: "DON'T MAKE LOANS."

WE HAVE REMINDED THEM TO TAKE CARE IN MAKING LOANS.

IT IS THE BANKER'S JOB TO FIND THE GOOD LOANS AND TO MAKE THEM.

AND IT IS THE BANKER'S JOB TO BE ABLE TO JUSTIFY THE LOAN -- NOT JUST, AND NOT EVEN FIRST, TO THE REGULATORS -- BUT TO THE BANKER'S OWN BOARD OF DIRECTORS.

WE HAVEN'T REPEALED THE BASIC RULES OF BANKING -- INCLUDING THE PRACTICE OF BANKERS WORKING WITH CUSTOMERS DURING ECONOMIC DECLINES.

THAT MEANS WORKING WITH CUSTOMERS TO RESTRUCTURE LOANS, IF NECESSARY.

WHEN WE CLASSIFY A LOAN, WE DON'T INTEND FOR THE INSTITUTION SIMPLY TO WALK AWAY FROM THE LOAN AND THE BORROWER.

RATHER, THE BANKER WOULD BE EXPECTED TO ANALYZE THE CREDIT AND THE BORROWER AND RESTRUCTURE THE CREDIT WHERE APPROPRIATE.

IF A LOAN BECOMES TROUBLED, THE FOCUS OF THE BANKER'S ATTENTION SHOULD BE HOW TO LOSE THE LEAST AMOUNT OF MONEY ON THE LOAN.

AND MINIMIZING OR ELIMINATING LOSS MAY BEST BE ACHIEVED BY CONTINUING TO WORK WITH THE BORROWER.

THAT PROCESS HAS BEEN THE CASE HISTORICALLY.

IT IS GOOD BANKING.

AND WHEN WE FIND PROBLEMS IN ONE SECTOR -- SAY REAL ESTATE -- WE DON'T INTEND FOR AN INSTITUTION TO PAINT ALL ITS CUSTOMERS WITH ONE BRUSH -- IN OTHER WORDS, TO ASSUME THAT THERE WILL BE PROBLEMS IN OTHER SECTORS, TOO.

WE ARE <u>NOT</u> TELLING BANKERS TO CUT OFF CREDIT FROM A GOOD CUSTOMER.

AND WE DO <u>NOT</u> -- AS SOME OF OUR CRITICS HAVE CHARGED -- SET MONETARY OR ANY OTHER TYPE OF ECONOMIC POLICY.

THAT IS NOT OUR JOB.

WHAT IS OUR JOB?

OUR JOB OF BANK SUPERVISION INCLUDES THREE IMPORTANT TASKS. ONE, WE MAKE SURE THAT BANKS ADOPT AND ADHERE TO SOUND CREDIT PRACTICES.

TWO, WE MAKE SURE THAT THEIR BOOKS ACCURATELY REFLECT THE VALUE OF THEIR ASSETS AND LIABILITIES.

AND, THREE, WE MAKE SURE THAT NATIONAL BANKS ESTABLISH MANAGEMENT SYSTEMS CAPABLE OF TRACKING BANK ACTIVITIES AND REASONABLY ANTICIPATING AND ADJUSTING TO CHANGING MARKET CONDITIONS.

IN OTHER WORDS, WE EXPECT BANKERS TO HAVE MECHANISMS IN PLACE TO CONDUCT THEIR OWN ASSET QUALITY REVIEWS TO SEARCH FOR FAULTS -- AND, IDEALLY, WE SHOULD THEN ONLY HAVE TO CHECK TO SEE THAT THE MECHANISMS EXIST AND THAT THEY ARE PERFORMING AS INTENDED.

BUT IN THE LESS THAN IDEAL WORLD IN WHICH WE LIVE, WE OFTEN FIND FAULTS -- IN ASSET QUALITY, IN MANAGERIAL CONTROLS, IN MANAGEMENT -- THAT BANKERS HAVEN'T RECOGNIZED FOR WHATEVER REASON, AND WE DO WHAT IT TAKES TO MAKE BANKERS RECOGNIZE THESE WEAKNESSES.

AND THAT MEANS THAT WE ENCOURAGE, COAX, CAUTION, INTIMIDATE AND, IF NECESSARY, COMPEL NATIONAL BANKERS INTO FOCUSING ON THE QUALITY OF THEIR INVESTMENTS AND IMPROVING THAT QUALITY IF THEY NEED TO DO SO.

IN A NUTSHELL, THAT IS BANK SUPERVISION.

ITS GOAL IS TO MAKE SURE THAT BANKERS RECOGNIZE REALITY.

ITS GOAL IS TO MAKE SURE THAT A BANKER HAS AN UNDERSTANDING OF HIS OR HER FINANCIAL INSTITUTION'S CONDITION THAT IS TRUE AND REASONABLE.

AND ITS GOAL IS TO MAKE SURE THAT BANKERS MAKE MANAGERIAL DECISIONS THAT REFLECT THIS TRUE AND REASONABLE UNDERSTANDING.

FOR EXAMPLE, IT IS <u>NOT</u> OUR JOB TO MAKE SURE THAT EACH AND EVERY BANK REMAINS IN BUSINESS.

IT <u>NEVER</u> WAS OUR JOB TO DO SO.

BANKS -- BEING PRIVATE ENTERPRISES, <u>NOT</u> PUBLIC UTILITIES -- ARE IN BUSINESS TO MAKE MONEY.

BANKS THAT DON'T MAKE MONEY OVER TIME GO OUT OF BUSINESS.

ONE COMMON MISCONCEPTION -- AND ONE NOT LIMITED SOLELY TO OUR CRITICS -- IS THAT WE ARE IN EVERY BANK EVERY YEAR TO REVIEW EVERY SINGLE LOAN OR ASSET.

NORMALLY, WE USE SOME CUT-OFF -- SAY EVERY LOAN OVER A CERTAIN SIZE -- AND THEN PERFORM AN ANALYSIS ON A SAMPLE OF OTHER LOANS -- LOANS THAT THE BANK HAS ITSELF CLASSIFIED AND LOANS THAT IT HASN'T.

IF A BANK APPEARS TO HAVE PROBLEMS THAT ARE SO SEVERE AS TO BRING ITS SOLVENCY INTO QUESTION, THE LOANS ARE THEN REVIEWED BY OTHER EXAMINERS.

IN THE LARGER BANKING COMPANIES -- WHERE THERE MAY BE SEVERAL SUBSIDIARIES AND MORE THAN ONE SUPERVISORY AGENCY INVOLVED IN THE EXAM -- THE PROCEDURE BECOMES MORE ELABORATE AND ALL THE DIFFERENT BANKING REGULATORS COOPERATE IN THE EXAMINATION.

I WANT TO STRESS HERE THAT WE DO NOT HAVE A "BLACK BOX" THAT MANY OF OUR CRITICS HAVE ASCRIBED TO US -- A COMPUTER MODEL THAT OUR EXAMINATION STAFF PURPORTEDLY USES TO DETERMINE CREDIT QUALITY THROUGH SOME SORT OF SIMULATION.

RATHER, OUR EXAMINERS REVIEW LOANS ON AN INDIVIDUAL BASIS BY TAKING AN IN-DEPTH LOOK AT THE INFORMATION AVAILABLE IN THE BANK -- NOT THROUGH A COMPUTER MODEL.

EVEN THOUGH WE DENY IT -- AND WE DENY IT BECAUSE IT ISN'T TRUE -- WE FREQUENTLY HEAR THAT WE ARE USING THIS "BLACK BOX" TO REVIEW EVERY LOAN.

SIMILARLY, THE CONCEPT OF THE "PERFORMING/NONPERFORMING" LOAN IS A MYTH.

A MISTAKEN CONCERN HERE IS THAT IT IS A NEW CONCEPT.

IT IS NOT A NEW CONCEPT -- IT HAS BEEN IN OUR CALL REPORT INSTRUCTIONS FOR YEARS.

AND THE MYTHOLOGY STATES THAT LOANS THAT ARE GOOD -- THAT IS TO SAY, BEING REPAID UNDER THE TERMS OF THE CREDIT AGREEMENT -- ARE BEING CRITICIZED BY BANK EXAMINERS IN SPITE OF REALITY.

WELL, THE LOAN MAY BE PERFORMING, BUT IN CRITICIZING IT THE EXAMINER IS <u>RECOGNIZING</u> REALITY, NOT DENYING IT.

LET'S LOOK AT AN EXAMPLE OF THE TYPE OF LOAN THAT MIGHT BE PLACED IN NONACCURAL STATUS.

A DEVELOPER OF AN INCOME-PRODUCING PROPERTY HAS BEEN ABLE TO MAKE INTEREST PAYMENTS ON THE LOAN TO KEEP IT CURRENT -- BUT THE DEVELOPER HAS BEEN DOING SO ONLY BY OBTAINING THE FUNDS FROM A CREDIT SOURCE, PERHAPS EVEN A LOAN AT THE SAME BANK THAT UNDERWROTE THE CONSTRUCTION LOAN.

WE HAVE TO LOOK AT THE FUNDAMENTALS.

IS THE PROJECT LEASING UP AS EXPECTED?

ARE RENTS WHERE THEY WERE PROJECTED?

IF THE ANSWERS TO THE QUESTIONS -- AND OTHERS LIKE THEM -- ARE NEGATIVE, THE EXAMINER IS REASONABLE IN QUESTIONING THE QUALITY OF AN ASSET, EVEN IF IT IS PERFORMING, BECAUSE THE PROJECT ITSELF IS NOT CAPABLE AT THIS POINT OF PRODUCING ENOUGH CASH FLOW TO COVER PRINCIPAL AND INTEREST.

TO UNDERSTAND WHY WE DO SO, IT IS HELPFUL TO KEEP IN MIND THAT WHEN A LOCAL OR REGIONAL ECONOMY IS CONSTANTLY ON THE RISE, WE DO NOT HAVE THE SAME CONCERN.

WHY?

BECAUSE FOR THE MOST PART CASH FLOW FROM THE PROJECTS ARE GENERALLY AT OR BETTER THAN PROJECTIONS AND DEBT SERVICE CAPACITY IS MOST OFTEN NOT A PROBLEM.

THE RELATED TOPIC OF GUARANTORS HAS ALSO BEEN UNDER MUCH DISCUSSION.

WHY DO WE LOOK AT GUARANTORS SO CAREFULLY?

WHEN A BANK MAKES A CONSTRUCTION REAL ESTATE LOAN, THE PRIMARY SOURCES OF REPAYMENT ARE THE SALE OF THE PROPERTY OR A PERMANENT REFINANCING.

BUT IF THE PRIMARY SOURCES OF REPAYMENT HAVE WEAKENED, THE BANK OFTEN LOOKS TO A GUARANTOR WHO MAY GUARANTEE ALL OR ONLY A PART OF THE DEBT.

PRUDENT BANKING REQUIRES THAT THE BANK HAVE ALL THE NECESSARY INFORMATION TO DETERMINE THE ABILITY OF THAT GUARANTOR TO MAKE PAYMENTS AND PERFORM ON THAT LOAN.

THIS HAS BEEN THE CASE FOR YEARS AND IT SHOULD COME AS NO SURPRISE TO ANY BANKER THAT EXAMINERS WILL ASK FOR AND REVIEW INFORMATION ON GUARANTORS.

JUST AS IT SHOULD NOT COME AS A SURPRISE TO ANY BANKER THAT OUR POLICY IS NOT TO USE LIQUIDATION VALUES IN JUDGING THE QUALITY OF A LOAN PORTFOLIO -- MYTHOLOGY TO THE CONTRARY.

MR. CHAIRMAN, I AGAIN JUST WANT TO STRESS ONE POINT: WE REVIEW EACH LOAN SEPARATELY AND ON ITS OWN MERITS.

WE JUDGE THE QUALITY OF THAT LOAN -- AND NOTHING BUT THE QUALITY OF THAT LOAN.

AS PART OF THE PROCESS OF OVERALL SUPERVISION, WE ALSO MONITOR ECONOMIC TRENDS THAT MIGHT PROVIDE SOME INDICATION OF EMERGING CREDIT PROBLEMS.

WHEN NECESSARY, WE CONDUCT TARGETED EXAMINATIONS OF CREDIT CATEGORIES THAT OUR ROUTINE MONITORING LEADS US TO BELIEVE CALL FOR SPECIAL SCRUTINY.

IN THAT CONNECTION, I WANT TO STRESS HERE THAT WE ARE <u>NOT</u> CONDUCTING TARGETED EXAMINATIONS OF SMALL BUSINESS LOANS.

NOR ARE WE MAKING THEM THE FOCUS OF ANY SPECIAL SUPERVISORY REVIEW.

THE RECENT REAL ESTATE EXAMINATIONS, WHICH HAVE BEEN ASSOCIATED WITH SUBSTANTIAL ADDITIONS TO LOAN LOSS RESERVES BY A NUMBER OF LARGE BANKS, HAVE GIVEN RISE TO SPECULATION THAT THE OCC IS TIGHTENING SUPERVISORY STANDARDS IN AN ATTEMPT TO DISCOURAGE ADDITIONAL REAL ESTATE LENDING.

THIS IS SIMPLY NOT THE CASE.

OCC EXAMINERS ARE APPLYING THE SAME RULES TO THEIR CREDIT REVIEWS THAT THEY HAVE APPLIED IN THE PAST.

IF OUR RULES HAVEN'T CHANGED, WHAT HAS?

AT THE BEGINNING OF MY TESTIMONY, I TALKED ABOUT THE ECONOMIC ENVIRONMENT OF NEW ENGLAND.

THE ECONOMIC ENVIRONMENT IN WHICH BANKS AND THEIR CUSTOMERS DO BUSINESS HAS DETERIORATED THERE AND IN OTHER LOCALITIES -- THAT IS TO SAY, THE ECONOMIC ENVIRONMENT HAS COOLED OR SLOWED OVER TIME.

THE DETERIORATION, IN TURN, DIRECTLY INFLUENCES OVERALL CREDIT QUALITY AND THE DEMAND FOR CREDIT.

MY WRITTEN STATEMENT DISCUSSES THE DETERIORATION IN SOME STATISTICAL DETAIL.

BECAUSE IT IS RELEVANT TO THIS ISSUE, I ASK, MR. CHAIRMAN, THAT THE ATTACHED ANALYSIS FROM THE WASHINGTON POST, TITLED: "CONCERN ABOUT CREDIT CRUNCH OVERBLOWN," BE INCLUDED IN THE RECORD.

I WOULD ALSO ASK THAT THE TEXT OF THIS SPEECH THAT I DELIVERED LAST FRIDAY TO A GROUP OF BANKERS AND BUSINESS PEOPLE IN NASHUA, NEW HAMPSHIRE, ALSO BE INCLUDED IN THE RECORD.

I WAS IN NASHUA IN RESPONSE TO AN INVITATION FROM GOVERNOR JUDD GREGG WHO ASKED ME TO COME TO DESCRIBE, TO DISCUSS, AND, YES, TO DEFEND OUR POLICIES.

MR. CHAIRMAN, WE ASSUME THAT PRUDENT BANKERS WILL EXERCISE CAUTION IN FINANCING PROJECTS THAT APPEAR TO EXCEED THE CAPACITY OF A WEAKENING ECONOMY TO ABSORB, EVEN WHEN THE BORROWERS HAVE GOOD CREDIT HISTORIES AND THE PROJECTS MIGHT BE CONSIDERED ATTRACTIVE LENDING OPPORTUNITIES IN A MORE FAVORABLE ECONOMIC ENVIRONMENT.

AND WE ASSUME THAT PRUDENT BANKERS WILL ALSO RECOGNIZE THAT DETERIORATING ECONOMIC CONDITIONS CAN ERODE THE VALUE OF ASSETS ALREADY ON THE BANK'S BOOKS, THEREBY REDUCING THE BANK'S CAPACITY TO EXTEND NEW CREDIT.

INDEED THE SUPERVISORY PROCESS IS DESIGNED TO REINFORCE SOUND DECISION-MAKING BY BANK MANAGERS IN THIS AREA.

CRITICISM OF LOANS BY THE OCC IS NOT THE CAUSE OF CREDIT CONTRACTION.

INSTEAD, IT IS AN EFFECT -- AN EFFECT OF -- AND A RESPONSE TO -- DETERIORATING CONDITIONS.

CRITICISM OF LOANS BY THE OCC IS THE RECOGNITION BY BANK REGULATORS OF CHANGES IN THE ENVIRONMENT THAT CALL INTO QUESTION THE QUALITY OF LOANS ALREADY ON A BANK'S BOOKS.

UNFORTUNATELY, A SOFTENING ECONOMY MAY REDUCE THE ANTICIPATED DEMAND FOR A SMALL BUSINESS'S PRODUCTS -- JUST AS IT MAY REDUCE THE DEMAND FOR ANY BUSINESS'S PRODUCTS.

AND A SOFTENING ECONOMY MAY ALSO MAKE A BANK LESS WILLING TO LEND TO ALL CUSTOMERS, INCLUDING SMALL BUSINESS.

FURTHERMORE, AS WE ALL KNOW, COMMERCIAL REAL ESTATE LENDING GREW TREMENDOUSLY AT BANKS IN THE 1980S -- THE GROWTH RATE MORE THAN TRIPLED IN NEW ENGLAND.

UNFORTUNATELY, THE INFRASTRUCTURE THE BANKS NEEDED TO SUPPORT THESE LENDING ACTIVITIES DIDN'T ALWAYS GROW ACCORDINGLY.

AS A RESULT, BANKERS NOW HAVE TO DEAL WITH NON-ACCRUALS AND OTHER TROUBLED LOANS THAT TAKE UP A LOT OF TIME AND MANPOWER.

SO BANKERS CAN'T SPEND AS MUCH TIME DEVELOPING NEW BUSINESS.

AND, AGAIN, SMALL BUSINESS CUSTOMERS ARE CONCERNED.

BUT, MR. CHAIRMAN AND MEMBERS OF THIS COMMITTEE, IT WOULD NOT BE IN THE INTEREST OF THE BANKING SYSTEM OR THE GENERAL PUBLIC FOR THE OCC TO IGNORE CHANGES IN A BANK'S CONDITION THAT MATERIALLY AFFECT THE BANK'S SAFETY AND SOUNDNESS.

ALTHOUGH ECONOMIC CONDITIONS CAN PLACE BURDENS ON BANKS AND THEIR CUSTOMERS, IT WOULD BE A MISTAKE TO RESPOND BY LOOKING THE OTHER WAY WHEN WE UNCOVER PROBLEM CREDITS, UNSOUND CREDIT PRACTICES, OR OVERSTATED ESTIMATES OF CAPITAL ADEQUACY.

WE HAVEN'T CHANGED OUR STANDARDS.

WE HAVE MAINTAINED OUR STANDARDS.

AND WE HAVE MAINTAINED THEM IN THE FACE OF PRESSURE FROM THOSE WHO SEEK TO FORCE US TO LOWER OUR STANDARDS.

IT IS TRUE THAT THE ECONOMIC ENVIRONMENT IN WHICH OUR STANDARDS ARE APPLIED HAS CHANGED.

CONSEQUENTLY, WE GIVE CREDITS A CLOSER LOOK THAN WE WOULD HAVE UNDER MORE FORTUNATE CIRCUMSTANCES.

IT IS A FACT THAT A SOFT REAL ESTATE MARKET OR A WEAK LOCAL ECONOMY OFFERS FEWER OPPORTUNITIES FOR SOUND BANK LOANS.

BUT BANK SUPERVISORS CANNOT ALTER THAT FACT.

AS A BANK SUPERVISOR, THE OCC OPERATES UNDER THE PRINCIPLE THAT -- IN THE LONG RUN -- ECONOMIC GROWTH MUST REST ON A FIRM FOUNDATION:  A SAFE AND SOUND FINANCIAL SYSTEM IN GENERAL AND A SAFE AND SOUND NATIONAL BANKING SYSTEM IN PARTICULAR.

ALL THE THEORY IN THE WORLD ARGUES THAT THIS PRINCIPLE IS CORRECT.

AND IN THE LABORATORY CALLED "REAL LIFE," THE RECENT EXPERIENCE OF THE SAVINGS AND LOAN INDUSTRY SUPPORTS THE PRINCIPLE.

AND WE PUT THIS PRINCIPLE INTO PRACTICE THROUGH STRONG AND APPROPRIATE BANKING SUPERVISION.

MR. CHAIRMAN, OUR JOB IS LIKE THAT OF A SMOKE DETECTOR: TO BE CONSTANTLY ON GUARD FOR THE SIGNS OF TROUBLE AND TO SOUND AN ALERT IF THOSE SIGNS APPEAR.

NEEDLESS-TO-SAY, WHEN THE SMOKE DETECTOR GOES OFF, YOU DON'T BLAME THE ALARM FOR THE FIRE.

IN FACT, AFTER YOU TAKE CARE OF THE PROBLEM, YOU PROBABLY ARE THANKFUL SOMEONE CAME UP WITH THE IDEA FOR THE WARNING DEVICE.

THANK YOU FOR THE OPPORTUNITY TO SPEAK ON THIS IMPORTANT TOPIC.

I WOULD BE HAPPY TO RESPOND TO ANY QUESTION.

*******************************

Massachusetts Bankers Association

May 18, 1990

Mr. Robert L. Clarke
Comptroller of the Currency
490 L'Enfant Plaza East, S.W.
Washington, DC 20219

Dear Mr. Clarke:

Thank you for your assistance in providing one of your senior bank examiners as a speaker at our upcoming seminar, **"Supervisory Examinations: What to Expect; How to Prepare."** As I discussed with Frank Maguire, the program is scheduled from 9:00 a.m. to 12:00 noon on Thursday, June 14, at the Best Western Royal Plaza in Marlboro, Massachusetts.

As outlined in the enclosed seminar announcement, the purpose of this session is to review current regulatory practices through case study analysis and to facilitate a bank's self-examination techniques. Once the actual representative from your agency is selected, I can discuss specific program format and content. In light of economic conditions, I believe this seminar will be most timely.

Once again, your time and assistance are greatly appreciated.

Best regards,

Daniel J. Forte

Daniel J. Forte
Executive Vice President
Corporate and Federal Policy

DJF/lvg
Enclosure

Massachusetts Bankers Association, Inc.
Prudential Tower, Suite 550
Boston, Massachusetts 02199
Telephone 617-437-1801

90

# SUPERVISORY EXAMINATIONS: WHAT TO EXPECT - HOW TO PREPARE

Best Western Royal Plaza Hotel
Marlboro, Massachusetts
Thursday, June 14, 1990

Much has been written and discussed regarding the New England real estate market and its implications for the Massachusetts banking industry. More specifically, regulatory examination procedures have been clouded by war stories and misinformation. Borrowers and lenders fear that excessive regulatory oversight may precipitate a credit crunch, thus ensuring an economic downturn. The regulators maintain that the rules have not changed, however, they must respond to a softened economic environment.

This program, which is a result of recent Association meetings with the regulatory agencies in Washington, D.C., will provide a detailed commentary on current supervisory practices during examinations of business loans and real estate loan portfolios. Through case-study analysis of generic/non-specific bank examples, key bank examination staff will offer guidelines to improve your bank's self-assessment techniques.

## You Will Learn:

- Whether examination standards have changed for New England
- What economic models are used and whether they are utilized to target specific regions or banks
- How "rate caps" are calculated and when they are challenged
- The factors used to determine loan classifications and how to test reserve adequacy
- How to respond to examiner recommendations and comments

## Who Should Attend:

This program will benefit chief executive officers, senior loan officers, compliance officers, and personnel responsible for regulatory procedures and controls. Please route to appropriate departments.

## Invited Speakers:

Senior examiners from the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Reserve Board, and the Massachusetts Division of Banks will be featured.

**DIRECTIONS:** Take Route 495 to Route 20 WEST towards Northboro. The hotel will be on your right approximately 1/2 mile from the exit. For further information, please call the hotel (508) 460-0700.

**Massachusetts Bankers Association**
Prudential Tower, Box 169 Boston, Massachusetts 02199 Telephone (617) 437-1801

Bank

Washington Post
June 4, 1990

RUDOLPH A. PYATT JR.

# Concern About Credit Crunch Overblown

With the summit out of the way, President Bush can now turn his attention to a long list of domestic problems, including the budget deficit, the savings and loan crisis and the liquidity crisis in metropolitan Washington.

Liquidity crisis in metropolitan Washington?

There could very well be one, according to the Greater Washington Board of Trade. The area's leading business advocacy organization is so concerned about the possibility, in fact, that it has asked the president's help in preventing one.

The Board of Trade is absolutely convinced that federal regulators are pressuring banks to tighten credit to business borrowers, thus hurting the area's economy. So 60 directors of the Board of Trade signed a letter last week informing Bush of their concern.

Although the Board of Trade's action may have been well-intentioned, sending the letter to the president seems a bit premature, if not ill-advised, given the strength of the area's economy and the absence of any overwhelming evidence that a liquidity crisis is emerging.

Growth in the local economy has slowed and the area's commercial real estate market is wobbly from being overbuilt, to be sure, but not even bankers envision a liquidity crisis. If there is a crisis, it's in the loan portfolios of a number of financial institutions that became heavily exposed in a real estate market that has softened considerably.

Nonetheless, the board's letter to Bush urged "a more measured approach" in enforcing federal regulation of commercial banks. More specifically, the Board of Trade wants the president to rein in bank regulators, whom it blames for what is being described as a credit crunch in metropolitan Washington.

Business borrowers here and elsewhere in the country are finding it more difficult to obtain bank loans and lines of credit. Real estate developers in particular are being subjected to more stringent loan requirements because of the area's overbuilt office market. No one—not regulators, not bankers and surely not the area's business leaders—want to see financial institutions here collapse under the weight of risky real estate loans as in the Southwest and in the Northeast.

But tighter controls on bank loans could eventually hurt the local economy, according to the Board of Trade, which early last month wrote to Comptroller of the Currency Robert L. Clarke, complaining about stricter regulatory oversight of bank lending. Clarke denies there has been a change in policy, though he stresses the need for banks to exercise greater caution in approving loans in soft real estate markets.

That's not good enough for the Board of Trade, so it's taken its case to the White House, hoping to impress upon Bush that "ill-conceived actions" are having "adverse effects on both large and small businesses—particularly the real estate market, which is in a period of adjustment."

Notwithstanding the urgency of the letter and dire warnings of a liquidity crisis, the Board of Trade fails to make a persuasive case that the stability of the local economy is threatened. In fact, the Board of Trade's bullish assessment of the area's economy may be the strongest argument against intervention by the president. With its repeated emphasis on the strength of the region's economy, the Board of Trade may have sent Bush mixed signals, in effect minimizing the concerns that prompted the letter.

"Ours is a strong economy," the Board of Trade assured Bush. "We have come through a period of almost unprecedented robust expansion," it noted before ticking off an impressive list of factors that help make the local economy as strong as it is.

"Our unemployment rate is 2.5 percent, the lowest of any metropolitan area in the United States," the board said. "Our commercial office space market last year led all other metropolitan areas in the United States by leasing more than 12 million square feet of space . . . Three-fourths of the world's multinational corporations have offices in our market . . . Almost 10 percent of all biotechnology companies in America are located in our region."

Still, the area's business leadership worries about the possible effects of bankers' decisions to be more cautious about lending to certain loan applicants. Uncertainty, says the Board of Trade, "threatens to choke off business activity that relies on efficient and accessible

(Continued)

Credit Crunch.. (Continued)

credit markets. ... We can quickly find ourselves in intensive care."

Although two bankers signed the letter to Bush, not all agree that the situation is as bad as business leaders say it is. Not only did a prominent local banker dismiss the notion that there is a credit crunch, but emphasized in a recent conversation with reporters that stricter loan approval policies went into effect at least two years ago. Real estate developers in particular, he said, are being asked to provide more information about cash flow, their net worth and their ability to repay loans. Building owners not only must show that their properties are substantially leased but must demonstrate the ability of tenants to pay the rent, he said.

That's the norm and not the exception. And it's not so much regulatory pressure to curb lending as much as it is market forces. Not only did some financial institutions in the area recently report losses because of sour real estate loans, but several have added substantially to their reserves for possible losses from the same types of loans.

The stricter loan policies certainly aren't being applied only to real estate industry borrowers. "If you are a small- to medium-sized company and you hit a bump in the road, you might see your banker react differently than he would have a year ago," a local banker recently told a reporter for The Washington Post. "The ones that are shaky are getting the hardest hit."

Even if the president intervenes and orders bank regulators to back off, Washington area banks will continue to follow a more stringent policy when it comes to making loans, especially to high-risk borrowers. The pressure to do so won't come from regulators but from stockholders and battered loan portfolios. ■

1990



# Agreements Reached at Summit Appear to Be More Favorable to U.S. Than Critics Maintain

By WALTER S. MOSSBERG
And GERALD F. SEIB
*Staff Reporters of* THE WALL STREET JOURNAL

## ADVANTAGE: U.S.

Under the likely terms of the Strategic Arms Reduction Treaty currently being negotiated, the Soviet warhead total is estimated to fall about twice as much as the U.S. total by the late 1990s.

| | UNITED STATES | | SOVIET UNION | |
|---|---|---|---|---|
| | CURRENT | FUTURE | CURRENT | FUTURE |
| BALLISTIC MISSILES | 7,474 | 4,900 | 10,172 | 4,900 |
| BOMBS | 3,000 | 3,440 | 400 | 2,000 |
| CRUISE MISSILES | 1,950 | 2,720 | 640 | 2,230 |
| OTHER | 0 | 576 | 0 | 528 |
| TOTAL | 12,424 | 11,636 | 11,212 | 9,658 |
| CUTS | (6.3%) | 788 | (13.8%) | 1,554 |

*Source: The Arms Control Association*

WASHINGTON—President Bush's summit meeting with Mikhail Gorbachev had hardly begun when the cries arose: Mr. Bush was selling out by making concessions on strategic arms and by signing a trade pact without forcing an end to the Kremlin's crackdown on Lithuania.

The drumbeat of criticism is coming mostly from conservatives, led by former Pentagon officials Richard Perle and Frank Gaffney, who has an active fax machine and extensive contacts in the press. Some liberals, such as Senate Majority Leader George Mitchell (D., Maine), have picked up some of their points.

But a closer look at the arms and trade moves suggests that Mr. Bush didn't give away nearly as much as the attacks suggest, according to analyses not only inside the administration but by outside analysts. In some cases Soviet benefits are illusory and in others the U.S. seems to be the clear winner. Accordingly, the political dangers to Mr. Bush may be considerably less than would be the case if there were a full-scale conservative attack. "In the immediate post-summit climate, the attacks are meaningless," says Kevin Phillips, a Republican political theorist.

The summit did fail to advance Mr. Bush's key foreign-policy goals: unifying Germany in the West and rolling back Soviet troops in Europe.

### Agreement Favors U.S.

But on strategic-arms control, the treaty nearing completion will be lopsided in most respects in favor of the U.S. And on Lithuania, Mr. Bush has shifted to a strategy of using congressional pressure to force Mr. Gorbachev into easing his crackdown before the pact is ratified. That ensures that months, at least, will pass before real trade benefits flow to Moscow.

"On START [the Strategic Arms Reduction Treaty], we got most of the restrictions we were looking for," maintains Michael Mandelbaum, an analyst at the Council on Foreign Relations. And on Lithuania, says Rep. Jim Leach, an Iowa Republican, Congress is "making very clear that the Baltics matter," leaving Mr. Bush free to avoid "backing Gorbachev into a corner from which there is no maneuverability."

Among those who disagree, the drumbeat of criticism began the week before the summit, when Secretary of State James Baker went to Moscow to settle key arms-control provisions that made up the joint summit statement on strategic weapons.

In the following days, influential conservative commentators blasted Mr. Baker for caving in to Soviet demands. Actively pushing the attack is the Center for Security Policy, a small think tank run by Mr. Gaffney, an informed and articulate conservative who was a top Pentagon arms-control official from 1983 to 1987. Mr. Gaffney has established a reputation for quickly providing journalists and analysts with pointed commentary on foreign-policy issues.

The center's final judgment on the Washington summit accused Mr. Bush of making "the worst strategic miscalculation on the part of a president of the United States since the Yalta conference of 1945," when Franklin Roosevelt agreed to a Soviet sphere of influence in Europe.

Columnists William Safire and Rowland Evans and Robert Novak, and an editorial in this newspaper, all complained. The conservative Washington Times carried a banner headline declaring: "Baker 'sell-out' in arms talks feared." Mr. Perle strongly sounded the same charges in commentaries before, during and after the summit.

Some lawmakers echo the complaints about Lithuania, with Senate Republican Leader Robert Dole of Kansas warning after the summit that "if the Lithuania or the Baltic problem isn't resolved, then I think it will become a matter of great concern."

In an interview, Sen. Malcolm Wallop (R., Wyo.) concedes congressional conservatives haven't raised much of a ruckus so far about the arms-control deals. But he called the recent arms concessions "a serious error that will tie us down on military technology." He said "it's arms control as a political process, not a strategic process," adding that "the administration has decided that there is but one overriding U.S. national interest, and that is Gorbachev's survival. They're willing to subordinate all other goals to that."

On arms control, the critics have many gripes but have zeroed in on two key issues: long-range cruise missiles, where the U.S. has an edge; and "heavy" multiple-warhead, land-based, ballistic missiles, where Moscow has a monopoly.

The critics charge that, by agreeing to an upper limit of 880 sea-launched cruise missiles, Mr. Bush wrote off a major U.S. advantage, and tempted Congress to cut the programs.

But the deal worked out by Mr. Baker in Moscow, and sanctioned at the summit, actually meets an American demand that sea-launched cruise missiles be excluded altogether from the legally binding treaty limits and verification procedures. Instead, they are to be covered only by "politically binding declarations" in which each side will merely state how many it will build. In return, Mr. Baker—with Pentagon and White House concurrence—agreed that the U.S. wouldn't declare an intention to build more than 880 of the weapons, well above the total of 758 the Navy says it needs.

On air-launched cruise missiles, fired from the wings of bombers, the critics lambaste the administration for agreeing to count all such weapons with a range of more than 600 kilometers and for making promises about a new conventional cruise missile code-named "Tacit Rainbow."

But the U.S. actually won the right to exclude as many as 1,500 of the weapons from treaty limits vs. 840 for the U.S.S.R. And Mr. Baker managed to exempt the exotic "Tacit Rainbow" missile merely by stating that the Air Force only plans a non-nuclear version.

On heavy missiles, the critics complain that the U.S. has agreed that some modernization of the Soviets' huge SS-18 will be permitted. They contend that by upgrading the SS-18s, Moscow could fully offset cuts in the number of missiles.

## Slashing Heavy Missiles

But the treaty as it stands would slash the SS-18 force in half, from 308 missiles to 154. And no amount of improvement is likely to offset that cut, according to former defense secretary Harold Brown, because nuclear-war planners generally seek to aim two warheads at each target. Further, the U.S. is still pressing to effectively cut off further SS-18 modernization after 1992.

Overall, experts estimate that the treaty will widen the U.S. lead in nuclear warheads and deprive Moscow of its historic edge in ballistic missiles.

On the trade issue, there isn't any doubt that Mr. Bush gave Mr. Gorbachev a symbolic political prize by signing the trade pact while the Kremlin is still squeezing Lithuania. But in more substantive terms, Mr. Bush has made it clear to the Soviets that he won't send the trade deal to Congress for approval, and won't take the related step of granting the Soviets most-favored-nation trade status, until the Soviet legislature passes a new law guaranteeing Soviet Jews expanded rights to emigrate.

Beyond that, Mr. Bush and Mr. Baker drove home to the Soviets the need to keep the trade pact from becoming entangled in a fight with Congress over Lithuania. To make the point, Mr. Bush used a congressional action he initially didn't like: a May 1 Senate resolution declaring that the president shouldn't even bother sending Congress a new trade deal for approval until the Kremlin's economic crackdown on Lithuania is eased.

As a result, both U.S. and Soviet officials suddenly find it convenient to put off implementing the trade pact. Soviet officials now are hinting that passage of their new emigration law, the next step in the process, won't occur until at least September. In the meantime, U.S. officials hope that, by dangling a signed but unactivated trade treaty before Mr. Gorbachev's eyes, they are giving a positive incentive to get moving by then on Lithuania.

By giving Congress the bad-cop role, Mr. Bush has let others tie trade to the Baltics while avoiding formal linkage that might rear its head again and again as ethnic issues boil up in the future. Some think that's useful in the long run. "I think we ought to think twice before we tie our economic relationship to the Soviet Union to the satisfaction of each and every grievance" by ethnic groups, says Mr. Mandelbaum.

S+L


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WRITER'S DIRECT NUMBER:

July 19, 1990

Roger Ailes
Ailes Communications
440 Park Avenue South
New York, New York 10016

Dear Roger:

It was nice to see you at the Four Seasons the other day. You seemed very much at home, and the food there, as we both know, is terrific. Now on to business.

Since you are a close advisor to President Bush, I would like to share with you some proposals I have for solving the Savings and Loan crisis. I have written several columns on the subject which I am enclosing.

Unless new legislation is passed, the United States taxpayer will be saddled with a huge debt, to be paid over a 30 year period, of at least $500 billion. In addition, current tax laws allow for tax setoffs against profits earned elsewhere in the purchase of a failed S&L bank and give the big boys who are able to make these new deals huge profits, adding to the cost of the S&L bailout. It is an intolerable burden for the American taxpayer, and it has to be stopped.

As a confidant of the President, I urge you to consider and recommend to him the following proposals:

1) The appointment of a special prosecutor to have total charge of all criminal matters stemming from this

scandal. This special prosecutor would not be limited to examining the actions of Neil Bush but would have the authority to investigate investors, S&L officers, directors and regulators, Congressmen and any other individuals involved in possible criminal activity in this matter.

2) Limiting the indemnification of all depositors to a maximum of $100,000 per individual, no matter how many accounts they hold in different S&Ls; consider lowering that limit so as to simply cover the average S&L depositor who deposited approximately $8000; and consider setting off before indemnification of any kind the unreasonable and speculative profits made by any depositor over and above the prudent return of 8 percent that would have been available to them if they had invested in United States securities.

3) Changing the IRS tax laws and regulations so as to prevent additional losses to the Treasury through tax setoffs. In just one case in Texas involving the largest failed S&L, tax setoffs will allow the new owner an unconscionable profit of between $300 and $500 million.

I believe the political party that convinces the American public that it is truly concerned and wants to protect them, will gain their confidence and benefit from it come election time. And, while I am a Democrat and want to help my party, my country, trite as it may sound, comes first, and neither party is presently doing enough regarding this horrendous crisis. So see what you can do.

All the best.

Sincerely,

Edward I. Koch

enclosures

NEW YORK POST
June 29, 1990

# ED KOCH

SOMEONE in Congress should stand up every day at the beginning of each session and, like Cato's daily admonitions to the Roman Senate that Carthage be destroyed, demand swift and just action in the S&L bailout crisis.

This scandal involves corruption at the highest levels in our government. And the activity that wasn't corrupt was highly unethical. It is like a tar baby. Everyone who has touched it is stained.

## S&L stink keeps getting worse

The New York Times, in its best investigatory style, depicted one amazing transaction in the S&L mess. Robert Strauss and his son Richard (you remember Bob as a confidant of Democratic presidents and one-time chairman of the Democratic Party) owned, as principal shareholders, First Texas Savings. Along with the Gibraltar Savings Association, it financed a huge real-estate development project near Dallas, called Stonebridge, at a cost of $330 million. This highly speculative deal caused Gibraltar to become insolvent. The federal government had to take over not only the bank but the Stonebridge Ranch development, auctioning it off.

Robert Strauss, who bears a major responsibility for the development and its failure, wanted to buy back the project at a knock-down price. Apparently, this caused such a stench that he eventually withdrew his bid, and the property was sold to a Japanese industrialist at an incredible bargain — $61 million. That left the taxpayers to cover a loss of $270 million on Stonebridge alone.

Overall, the cost to taxpayers for bailing out Gibraltar is estimated at $5.1 billion over 10 years.

The bank itself was sold to a new investor group headed by Ronald O. Perelman, who is the chairman of Revlon Inc. The group paid $315 million for a bank with $12 billion in deposits. It is now the largest savings-and-loan in Texas. Perelman is one of the great corporate raiders. He salivates when he sees a cadaver. He knows how it can be trussed up, made to walk at government expense, and ultimately resold at a huge profit.

## We all pay and pay as others profit

Under existing tax law, he's allowed, at a minimum, to set off his payment of $315 million against profits that he makes from his other companies having nothing to do with savings-and-loan institutions. That guarantees him, tax-free, $315 million in other commercial profits. Because the tax law is so arcane and the records so secretive, it is not clear that his profit is limited to $315 million. I have been told it may, in fact, approach $500 million.

This kind of legal plunder is going on throughout the country. No one knows whether the estimated cost of the S&L bailout — $500 billion over 30 years — includes additional tax write-offs like Perelman's.

Congress can change tax write-offs. It does so all the time. It should do so now. But knowing this, Ronald Perelman's group is seeking a superb lobbyist, former Philadelphia Mayor Bill Green, to help keep the write-offs as they are. Bill Green was once a member of the very Ways and Means Committee that decides these tax breaks. As a former member of Congress, he is allowed to walk on the floor of the House when it is in session and sit in the cloakrooms and chat with his former colleagues. Members of the committee like him, as do most members of Congress, so he will have tremendous access. He will do a superb job for Ronald Perelman. But who will do the lobbying for the taxpayers?

When you look at a savings-and-loan disaster like Gibraltar and Stonebridge Ranch, you realize just how many ways the American taxpayer is getting ripped off. First he is made to insure the money that the savings-and-loan foolishly invested in the Stonebridge deal. Then he has to stand by as a foreign investor snaps up the property at bargain rates. In addition to that, he has to countenance the government sale of the failed savings-and-loan to a wealthy entrepreneur who, in addition to getting it at bargain rates, also receives tremendous tax breaks.

This is intolerable. Isn't there a modern-day Cato who will rise up in the legislative chamber and incant, *"Foedi extrudantur indignissime at portas"*? Roughly translated, it means, "Show the scum the door."

NEW YORK POST
APRIL 13, 1990

# ED KOCH

**THE federal bailout of the savings-and-loan industry could ultimately cost $500 billion. That's $2,000 for every man, woman and child in this country. And it's being paid to bail out some of the biggest high-rollers and gamblers in the land.**

The savings-and-loan crisis recalls the Teapot Dome scandal of the 1920s. For those who don't remember, Teapot Dome involved the secret sale to speculators of leases on government land containing the Navy's oil reserve, which was to be tapped only in wartime. It resulted in the first conviction and imprisonment of a presidential Cabinet member — Secretary of the Interior Albert Fall — as well as the resignation of a secretary of the Navy and the disgrace of President Warren Harding.

## *Bailout of S&Ls is likely to hit $500B*

But Teapot Dome, long known as the worst governmental financial scandal in U.S. history, will now have to stand aside. It is dwarfed by the S&L scandal.

The savings-and-loan industry is in trouble because it gambled on highly speculative investments. Those investments have been failing at an alarming rate, forcing the federal government to step in to save investors' accounts. The cost of the bailout is truly shocking. At first, the Bush administration trumpeted that it would cost a "mere" $160 billion over a 10-year period. Then they upped the estimate to $200 billion. But now some experts are warning that the S&L bailout will cost the nation $500 billion. That's more than the cost of World War II. Guess who will have to pay for this folly. The American taxpayers, Mr. and Mrs. Chump.

How did this happen? Savings-and-loan institutions used to make conservative investments in residential homes. The federal government insured their depositors up to $40,000. But S&L industry leaders got greedy for the kinds of profits other investors were making in land deals and junk bonds. So Congress changed the law to deregulate S&Ls and allow them to play with the big boys. Congress also increased the guarantee on deposits to $100,000 per account (with some restrictions) instead of per person. The bottom line is that a savvy investor, who knew how to do it, could make deposits in various savings-and-loans, and have all his money insured, without limitation. The new rules also allowed S&Ls to solicit national investors instead of local ones, by offering them interest rates as high as 16 percent. This ultimately became a Ponzi scheme that allowed sick savings-and-loan institutions to offer huge yields.

## *Guess who will get stuck with the tab*

With all that money pouring in, S&Ls began to invest in risky ventures like shopping malls, luxury hotels and junk bonds. They no longer had to be prudent, because nearly every investment was 100-percent guaranteed by federal insurance. And as long as investors received large returns, they never questioned what the S&L directors were doing with their money.

Eventually, the bubble burst. The huge investment portfolios, built on overvalued land and start-up companies with minimal credit ratings, became nearly worthless. Suddenly, everyone was asking the federal government to make good on its guarantees.

We don't yet know the extent of the corruption — how much was stolen by directors, officers and others during this orgiastic speculation spree. But you can be sure it was plenty. Very few who engaged in fraud have been prosecuted, and very little has been recouped by the government, which has now taken over dozens of S&Ls. Meanwhile, the government is guaranteeing each depositor up to $100,000 for almost every separate account that depositor holds.

Why has there been so little outcry in Congress? Because senators and members of the House of Representatives from both parties are up to their belly buttons in the affair. A number of Washington's most influential elected officials are in disgrace — it's been revealed that they importuned federal regulators not to exercise oversight early on, at the first signs a crisis was brewing. Had the regulators stepped in earlier, they might have been able vastly to limit the S&L losses.

Who are these elected officials? Primarily five senators: Dennis DeConcini (D-Ariz.), Alan Cranston (D-Calif.), John Glenn (D-Ohio), John McCain (R-Ariz.) and Donald Riegle (D-Mich.).

Who are their friends? Well you can start with

# Guess who's paying S&L tab

**KOCH** *from Page 2*

Charles H. Keating, Jr. As the man behind the Lincoln Savings and Loan of Irvine, Calif., Keating donated over $1.3 million in gifts and contributions to five senators. In turn, they helped keep the regulators away from Keating's door.

These five senators are not the only deeply implicated public officials. Former House Speaker Jim Wright of Texas and former Majority Whip Tony Coelho of California also had close ties to savings-and-loan directors. But these men resigned from Congress rather than face the music and spill their guts under oath — or have their guts spilled for them.

In addition to Wright and Coelho, there is also the former chairman of the House Banking Committee, Ferdinand St. Germain, a Rhode Island congressman who lost his bid for re-election in part due to his links with the directors of financial institutions.

Even the president's family has been tarred by the S&L brush. The president's son, Neil, was a director of one of the most disastrous S&Ls, the Silverado in Denver. Federal regulators have reprimanded Neil Bush because the Silverado made loans to one of his business partners.

Neither political party will attack the other over this issue, because they're both too deeply involved in the mess. Indeed, it would take an extraordinarily brave senator or congressman to stand up in Congress, like Cicero inveighing against Carthage, and demand that the leadership protect the taxpayers and prosecute those who betrayed the public trust.

The investors who engaged in risky ventures for high profits ought not to have been insured beyond $100,000 per *person*, instead of $100,000 per *account*. And those who made huge profits before the collapse of the S&L industry should have their profits deducted from their insurance coverage.

Is there a better solution than the one Congress has chosen? I think there is. Why not pass legislation to allow the Federal Savings and Loan Insurance Corporation — the corporation which insured all S&L depositors — to go into bankruptcy?

Let the FSLIC pay out its limited funds to all those covered under its insurance provisions. Then form a new corporation, which would limit the insurance coverage, perhaps, to $100,000 per person, perhaps to the average amount deposited by the average American, which I'm told is $8,000, or, perhaps, something in between.

I am advised that the federal government did not provide its full faith and credit to the Federal Savings and Loan Insurance Corporation. It is, therefore, not obliged to pony up additional money to cover the FSLIC's losses. Allowing the FSLIC to go into bankruptcy would be much fairer to the ordinary taxpayer, who has no moral or legal obligation to save investors from losing their investments — especially those investors who were out for quick, large profits.

The lives of many Americans are buffeted by forces they cannot see, let alone control. They need the government's help and protection. Yet, they are denied it. Shouldn't they benefit from the $500 billion the S&L bailout will probably cost? Five hundred billion dollars could provide essential services like housing, Medicare and education. Instead, in many cases, it's going to save rich speculators.

If we guarantee each investor his or her first $100,000 of deposit, we are being generous. Let's not be fools.

5K

## Crisis in Structure of Financial Institution Industry

FIRREA (1989 Financial Institution Reform Recovery and Enforcement Act) has done little or nothing to correct the structural problems of the banking industry. Indictment and public emphasis on prosecution is a dangerous two-edge sword. You may give voters the impression someone is going to "pay", but you simultaneously reinforce the growing international perception that the U.S. banking system is not a rational place for funds to be concentrated. The continuation of Henry B. Gonzalez' televised hearings plus the prospect of prolonged and complex bid procedures by RTC keeps before the global banking market an international advertisement that the U.S. does not have the safest financial system in the free world ... even with <u>insurance</u>.

Yes, the insurance system needs a major overhaul and eventual privatization. I would not do anything more than minor or symbolic tinkering at this time given the fragile nature of the entire system.

RTC is hopelessly out of control and no team of regulators can make it work with its present game plan notwithstanding their joyous announcement today of last week's "sales". For example, one way they are disposing of problems is what they call "an insured deposit transfer". Eligible bidders do a very quick and limited due diligence and theoretically agree to pay RTC a fee for being awarded a pool of "core deposits". Core deposits are, by RTC definition, those with balances of less than $80,000 that are not brokered or belong to other financial institutions. Of course, most older financial institutions know that many of their largest depositors are the least fickle and most stable. In many cases, jumbo depositors understand the financial markets better and are more capable of analyzing the risks in a bank's balance sheet. Some of the least stable deposits and most sensitive to interest rate are those of less than $80,000. Therefore RTC has a flawed formula for trying to get "top" dollar for core deposit sales. In fact, the so-called premium RTC receives from the highest bidder is simply transferring capital from an insured institution to the RTC.

Most of the sickest thrifts have such a poor deposit mix already that there is little, if any, economic value to "core deposits". That is to say that the current policy of trying to "attract the highest bid" may, in fact, be decapitalizing what regulators consider an already undercapitalized banking system. The latest example is Security Pacific's purchase of Gibraltar. Security Pacific is one of the few really strong and well managed banks in the country. The regulators run a big risk of destabilizing Security Pacific if they extract too much from the First Gibraltar deal. Yet, the RTC policy and FIRREA require them to try to make the best deal for the government. RTC cannot win in the present format, just as the previous administration's Southwest Plan has proven to be a failure but for generous tax benefits afforded the winners. RTC is only considering a current crisis, not the longer term implications of each transaction.

As I mentioned, we have tried to buy from RTC small portfolios of 1 to 4 family mortgage loans for over six months and still have not been allowed to look at the loans -- In fact, we were told by RTC to go buy mortgage backed securities. For a learning experience, we requested and performed a due diligence in a small failed thrift in our primary market. Although under the RTC sale-of-deposits guidelines the prospective buyer does not have to take any of the loans or other assets, the buyer gets options or calls and puts on those assets for different periods of time. We were more interested in the home loan portfolio than the deposits, so we did a due diligence on a large sample of loans. We found almost 100% had incurable violations of Regulation Z (a Federal Reserve regulation that mandates disclosure of specific information before a loan is funded.) Once the loan is made, there can be no cure for a failure to disclose. I am certain that a high percentage of the huge pool of the 1 to 4 family home loans made by the sickest thrifts have many Reg Z and other violations. After all, the business of making home loans was a bothersome piece of business for a thrift whose management, undisciplined by the market because its deposits are unconditionally guaranteed by the U.S. Government, was focused on "big deals", joint ventures, mortgage-backed securities speculation, etc. After RTC "sells" all the deposits, what will they do with the remaining loans and other real estate if prospective buyers do a proper due diligence as they should?

In addition, the current pricing guidelines on the sale of small packages of loans would not be attractive to a serious mortgage lender who is conservative. The discount is inadequate for the long-term risk.

RTC field and regulatory staff are simply not capable of making decisions necessary to an orderly disposition of either liabilities or assets. At least, based on our experience in talking to Washington, Dallas and Denver, most of the staff have little understanding of the complex issues or of the U.S. banking system even if they had previously been with some financial institution regulator for a number of years.

The big problem is that the thrifts went under because of inadequate supervision by FSLIC and FHLB after they were showered with "deregulation" and insured brokered deposits. There are today simply not enough experienced, capable regulators available to continue the present RTC effort without numerous catastrophic events for many years to come at an absolutely intolerable expense to the government.

The litigation that will result from transactions being booked today is unquantifiable.

Mistakes are not confined to deposits and mortgages. Many of us in the U.S. banking community believe in and cooperate with the enforcement authorities on money laundering matters, yet RTC awards bids to banks that IRS considers "uncooperative", or in fact, an obstacle in the war on drugs. In yet another case, the FDIC was prepared to pass control of a national bank to people directly involved in large money laundering transactions and people who had no qualifications for running a national bank. The regulators are afraid to deny undesirable people access to management and/or ownership of insured institutions.

Thus, we find an inherent conflict of interest between the interests of the FDIC in promoting solvent, conservative banks and their charge of "selling" the bad banks.

## Analysis of Supervisory Agencies

### I. The Federal Reserve System

The Federal Reserve System has not really been in the bank examination business for the past 20 years. The Fed has a very small staff of, for the most part, very inexperienced or "light" examiners. Our small holding company in Laredo has had one strong examiner out of the past six years of exams, he being the most recent. The all-important regulatory decisions are made by the Board of Governors staff and Washington rather than in the region. The entire Fed system has only 32 or 35 attorneys. The No. 2 and 3 have no idea of the difference between a strong bank and a weak one nor do they really feel safety and soundness issues are their main charge. Complying with complex regulations is their entire focus. There are huge regulatory turf battles between the Fed staff and the Comptroller of the Currency...Ask any first-class bank regulation private attorney.

The Fed bank examiners are only required to examine state chartered Federal Reserve member banks (very few as a percentage of all banks) and all bank holding companies. They have a proven weak record at regulating holding companies, or the Dallas and Houston banking markets would not now be dominated by holding companies based in North Carolina, Ohio, and California. The regulatory presumption (flawed) must be that bank markets are homogeneous when, in fact, only submarkets may be. Regional credit markets and conditions differ from area to area and it may take years of expensive lessons to learn a new area.

As we discussed, unless there has been a change in the past few months, the absurd Fed approach to the regulation of bank holding companies makes our small company the third largest holding company regulated by the Dallas Fed even when there are banks in Dallas and Houston twenty times our size.

The largest Texas bank holding companies are examined by the Ohio Federal Reserve Bank or the Fed wherever the parent is based. The Fed has an obsolete approach. Examination responsibility should rest in the office closest to where the risks may be concentrated, or where the staff should be most familiar with economic conditions. In fact, the Fed never should have allowed RepublicBank Corporation and InterFirst to merge, since neither was in a position to strengthen the other. The same failed policy continues by allowing NCNB to grow in geometric increments. They may become the biggest single problem in the history of the system. Theoretical economies of consolidation are dangerous in a fragile banking system -- which is exactly what we have today. There is an anxiety on the part of regulators to coax the best earnings banks into purchasing big sick thrifts for whatever price the RTC can negotiate.

## II. The Federal Deposit Insurance Corporation (FDIC).

The FDIC has had a very good man in Mr. Siedman and some of his top staff; however, their field staff nationwide is very thin and now concentrated on bad banks, not good ones that could go bad if unsupervised. Their focus is on getting rid of problems, not supervising the banking system. There is no depth in the exam force.

## III. Federal Home Loan Bank Board and Federal Savings and Loan Insurance Corp.

The FHLB and FSLIC never had a pool of sophisticated examiners and still do not. They were considered a regulatory joke by other agencies.

## IV. U.S. Treasury - Office of the Comptroller of the Currency (OCC)

The OCC has by far the most capable and experienced group of financial institutions regulators in the United States. Bob Clark is not a friend of mine; in fact, I have only met him once, but he is quite capable. I read with some astonishment that the smartest regulator I have ever met in my 25 years of banking, Robert J. Herrmann, is being transferred to the Chicago Fed from the No. 2 position in OCC, Washington. He was Senior Deputy Comptroller for Policy. The industry gossip was that he was the sacrificial lamb for disgruntled bankers and their congressmen in the Northeast because of recent severe loan classifications on the part of OCC examiners. Even if the rumor is untrue, the smart foreign financial institutions and analysts will eventually view his untimely departure as a further weakening of an already too weak regulatory structure. Herrmann has a wealth of knowledge and experience in important regulatory turf battles that Mr. Clark will not readily replace.

Between 1982-1985, our bank was undercapitalized and going through a difficult period because of loan problems related to the Mexican and Texas economies. I am sure my life span was shortened because of frustrating arguments with the OCC staff. There were some really bizarre characters on the Dallas staff. Clark has pretty much purged them from the system. However, notwithstanding the emotional imbalance of a few on the OCC Dallas staff, <u>their policies and guidelines for examining banks</u> and the <u>focus of exams was then,</u>

and is today, sound. In fact, in retrospect, many of the OCC-mandated changes at our bank helped make it what it is today -- the best capitalized, most liquid bank over $1 billion in the U.S! I would have never dreamed then that I would someday be promoting OCC as the superior bank supervisory agency.

The U.S. banking system is now phasing in the European system of appraising capital adequacy -- Risk-based Capital Guidelines. The only regulatory body capable of making capital adequacy judgements at the federal level is OCC. Almost every OCC region has had, until recently, experienced bank examiners who understand complex regulatory issues or have the intelligence to understand them. Most examiners are well trained and are knowledgeable about local economies in which their banks operate.

A few states have capable state exam teams, but many depend on FDIC to do their exams for them.

## Major Concerns of Possible Crisis on the Horizon

I am very concerned about the possibility of a liquidity crisis in the money center banks and super regionals if the current process of declaring to the whole world the severity of our financial institutions' crisis continues to be televised and micro-analyzed by every member of Congress and the press. As I said in our visit, the Bank of England has a far more civilized approach even though they regulate only a fraction of the banks we do. They do what we used to do -- that is, frequent and thorough background, character, and financial checks on those people awarded a bank charter. When they hear rumors of irrational behavior in a financial institution, they summon the managers, owners, etc., to Bank of England for a warning of removal or revocation of license! We do the same thing at or about time of failure which is usually several years into the deterioration of the insured institution.

Some suggested solutions:

1. Have a quiet summit with key Congressional leaders, (Henry B., etc.) both Democratic and Republican bankers (active or retired), the Secretary of the Treasury, the Chairman of the Fed, the Comptroller of the Currency, the Chairman of FDIC, RTC, and other appropriate Treasury people and perhaps some senior CPA Big Eight firm participation.

   The President must be involved. After three days, you must make some though decisions... behind closed doors!

2. Determine to quickly consolidate all financial institutions operational regulation into the Office of the Comptroller of the Currency. Transfer good examiners and top regulatory officials that were lost by OCC to RTC, et al, back to OCC. If enabling legislation is needed -- get it. I doubt it is needed since existing regulatory legislation gives various agencies a lot of latitude.

3. Agree to adopt temporary reduced capital guidelines for selected institutions, large or small, capable of absorbing the sickest thrifts and banks, just as was done in the banking crisis of the '30's. <u>Direct</u> certain banks to assume <u>all</u> operations and assets and liabilities of failed institutions. Develop a broad indemnity agreement and long-term payout to RTC or FDIC based upon a new and simple formula. This may require the Government to purchase capital notes or preferred stock of certain holding companies or banks with or without permission of shareholders to facilitate the liquidation and transfer of all thrift assets and liabilities. The whole regulatory approach to capital adequacy is flawed. There can never be enough capital in a bank if the depositors want most of their money back. Liquidity is more important in a crisis than capital. Supervisory action can be a better interim discipline than capital! As market perceptions change, capital will increase.

4. Change 12US29 to allow 10-year holding period of all Other Real Estate Owned (OREO).

5. Use outside accounting firms approved and supervised by OCC as an important supplement to OCC field staff examiners. Make public accountants approved by OCC responsible by regulation for their opinions. (The industry will scream but also make a lot of money with new requirements.) Many of the large accounting firms have a wealth of bank examining-type talent that is virtually wasted because bank regulators duplicate their work or ignore it. Tap this resource immediately.

The only way the monetary and human capital of the U.S. banking system can improve is by having bank regulations that are "protective" of the system, not antagonistic to it or ignorant of it. Many of the Don Regan era "we-hate-the-banks" regulations must be modified! A properly supervised system does not need the additional deterrent in FIRREA of millions of dollars per day of fines or the absurd criminal liability we place upon an honest but naive bank trainee. Ask your friends how many want their sons or daughters to pursue a career in banking in today's environment of money laundering wars, etc. E.g., see attached Article 1, page 84 The Economist. If the current environment continues, then the least ethical and experienced bankers will grab the moment to make a quick profit and get out. We need a more mature, longer looking financial industry policy and need it now. We should be trying to attract our most capable graduates to a financial institution industry that wants to be No.1 globally, not No.10.

The Japanese are now financing the environmental clean-up of Mexico City which has one of the world's worst smog problems. Mexico will buy Japanese technology and equipment, pay Japanese banks, and ultimately give the Japanese credit for healthier Mexican children. We can and should be in a position to do the same. Today, our banks can't even buy token participations in such projects.

6. Change the tax code to encourage equity and loan loss reserve buildup and the use of bank lines vs. brokerage houses securitized transactions such as have developed including high-yield bonds. The Fed has lost a lot of control because companies don't need to "borrow" from banks.

7. The Glass Stegall Act needs to be changed, but perhaps not until we have a proper regulatory structure. I would love for our bank to be able to sell insurance and compete with Merrill Lynch, but I firmly believe that bankers have not yet been able to master their traditional markets because of disjointed supervision, so don't throw a bunch of new business risks at them like we did the S&L's -- not yet. What we must do, though, is build up the overall profitability of the insured banking system at the expense of the other uninsured financial intermediaries who have been given bank powers over the years. After a few years of capital buildup, powers can be expanded more aggressively.

8. Change the Debts Previously Contracted doctrine guidelines to encourage OCC and the Fed to approve debt for equity swaps during a recovery period of time. Could later expire.

9. Recognize the economic impact of the loss of power of the U.S.-owned banks in the world markets. Develop a strategy to re-establish our banks as the strongest, most active in global markets! It is not that difficult.

10. The political heat can be controlled when both sides of the aisle understand the gravity of the situation and the size of the black hole. Congress should also understand the potential problem facing insurance companies holding pension funds, etc., and that a strong banking system could see other

industries through periods of crisis rather than exacerbate the crisis.

There was nothing wrong with the fractured community banking system we had before. There were only timing and temporary problems with the thrift industry that Congress ultimately destroyed. The current policy of sweeping the problem under the NCNB, BankOne, or First Interstate rug while ignoring thousands of well managed banks that could absorb most pieces of the problem is a fundamental structural mistake. Breaking up the thrifts and forcing a broad spectrum of banks to take the pieces is a sound approach.

11. There is no constituency with any money or votes left in the U.S. that would justify saving the remnants of the thrift industry. We should quickly consolidate all insured failed or failing institutions into a national banking system regulated by OCC. If state banks want to participate, they must pay for OCC supervision!

    Deregulatory philosophic rhetoric should not intimidate the Bush Administration from adoption of bold regulation and supervision of an industry we must foster, promote and expand to finance us out of the budget deficit and into expanding markets.

Deregulation of the U.S. financial institutions has been and continues to be a disaster. The theoretical consumer savings Congress hoped to create by increased competition for deposits has ended up costing a large fortune!

**The Budget Deficit Issue and Tax Increase**

Budget deficit is an overblown issue and not the single issue that could cause a change in the occupants of the White House. The S&L issue and structure of the financial system are issues for which we not only do not have solutions -- we have not even identified the structural components of the problems.

Strong financial institutions are capable of taking more risks in their loan portfolios. That is how HP, Compaq Computer etc., got started. Strong aggressive lenders in an intelligently managed system greatly diminish the need for new taxes. You can grow your way out of the deficit, but not with all the banks chasing the consumer instead of the entrepreneurs, and not with all of Wall Street stretching for junk and competing with banks with brokered insured deposits. The U.S. cannot continue to be a world economic force if its banking system only caters to "consumers" and credit card fanatics. The Germans, Japanese, Dutch, UK and Hong Kong and Shanghai will capture all the serious commercial relationships.

We have no Banking National Policy, which I would like to see us develop soon. This policy should be the cornerstone for new domestic manufacturing growth, new levels of international trade for U.S.-owned companies, working capital for new technology developed in the U.S., etc. You can increase bank profitability and capital in the near term without giving banks broad new powers like the S&L's were given. Some conflict will, of course, arise with the brokerage community. We must take money market accounts away from Merrill Lynch, et al, and push the commercial borrowers back to the banks over which the Fed and OCC have control.

After and only after a period of adjustment and stability, then we should begin to privatize deposit insurance. Do not lower the $100,000 insurance deposit amount until the dust settles. It should be changed to eliminate the unconditional guaranty, but not today. So there is no doubt of my objectivity, our bank does not even need FDIC. We can pay all of our insured deposits from our own liquidity and could probably get private insurance for the excess, but all banks cannot be structured like ours.

This letter was written on a plane after I saw you, so it could obviously use some polish, but it appears that the writers in the July 3 issue of The Wall Street Journal are reading over my shoulder. The big thing that Paul Drake, Jr., in the Journal missed is "brokered deposits". (See attached WSJ July 3 article.) The real evil of the system was not so much $100,000 vs. $40,000 of insurance. The Congress, regulations and regulators that allowed and continue to allow brokered deposits can take credit for 80%+ of the damage! For a bank to be able to take reasonable loan or investment risk, they must have a fairly predictable and stable funding source. The traditional source was called "core deposits". Core deposits (prior to RTC) were usually deposits of the businesses and citizens in the trade area of each bank. If Merrill Lynch did not have the capability to "place" deposits from the Bronx into an insured deposit in Vernon, Texas, then Vernon Savings would have been a fraction the size it became. Even if the more creative promoters who ran the most reckless operations figured out how to gather deposits through national advertising, they could have been easily controlled and discouraged by regulators. Brokerage of deposits and the huge sales force of the brokerage community were the honest co-conspirators with Congress and the regulators in the creation of the monster. Prosecution will concentrate on a few who only represent a symbolic part of the problem. The grossly negligent regulator and congressman will go unscathed. The energy should not now be so much on prosecution -- you have a 10-year statute toll under FIRREA. The energy has to be to stop RTC and build a new system or rebuild the old. The Justice Department has its work cut out, but they will not solve the problem.

I hope you and the President's other capable staff will have a "Top Secret" mini-summit to discuss the structural solutions to the restructuring of our banking system before it is too late.

Respectfully submitted,

Gary G. Jacobs

been less well served than those in Britain. Warburg Investment Management International (WIMI), Mercury's American fund manager, has performed dismally. Despite this, WIMI has held onto its market share in America, where it is the fifteenth-largest international fund manager, with just over $2 billion of clients' money.

Until recently MAM's offshoot in Japan has not done much better. Yet despite a bad record, MAM Japan has been helped by the Warburg name and some pushy marketing. Lately Mr Zimmerman has concentrated on international matters. Outsiders say that this is why the group is doing better in America and Japan.

MAM's big expansion is likely to be in Europe. It has three countries, West Germany, Holland and Switzerland, in its sights. It plans to manage Dutch pension funds from London; it will use Soditic to woo more private clients in Switzerland; and in West Germany it may build a fund-management business from scratch. It has an alliance with Munich Reinsurance, the world's largest reinsurance company, which could be expanded instead.

MAM is notoriously stingy with its money, so it is unlikely to go on a buying spree, though it has $100m in cash to spend. If it spends wisely, and brings the same discipline to fund management as it has done in Britain, Siegmund Warburg might be proved wrong once and for all.

### American banks and the environment

# Turning green—with worry

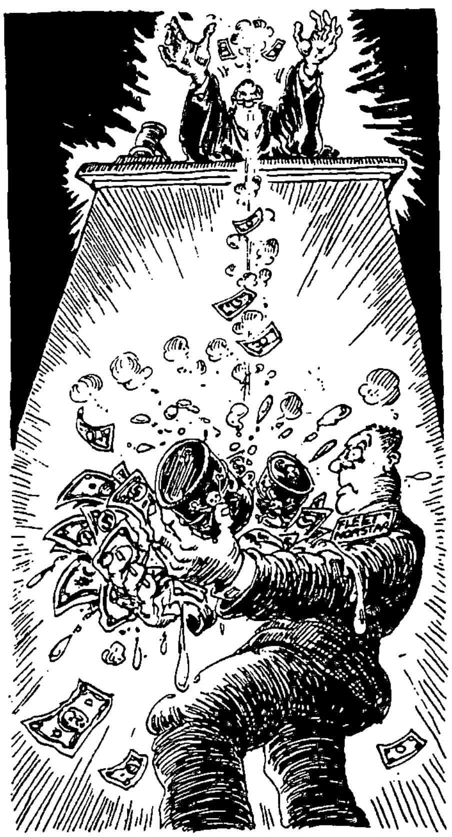
**In America since 1980 those who "own or operate" a company that pollutes have had a statutory liability to pay for the clean-up. Bankers to polluters have been exempted from such law, even though the terms of loans may influence the running of the company. That exemption is now in doubt, facing banks with potentially huge bills for clean-ups**

AMERICA'S bankers are pinning their hopes on legislation to rescue them from the dire consequences of an appeals-court ruling earlier this month. Bankers' yelps of protest have turned into howls of pain as they have grasped the full implications of the judgment: lending money to companies that turn out to be polluters may involve the banks with such huge potential legal liabilities that they dare not make any loans to industrial firms.

The court that has caused all the worry is the 11th United States circuit court of appeals in Atlanta. On June 1st it announced its judgment in a case involving Fleet/Norstar, a big regional bank, and Swaisbro Print Works, one of the bank's customers which failed. During the liquidation period, to reduce its loans to the company Fleet/Norstar used money owed by Swaisbro's clients and auctioned some of the company's equipment (the bank had a charge on accounts receivable and others of the company's assets). After the auction, toxic chemicals were found on Swaisbro's property. The court had to decide if actions Fleet/Norstar took meant it had participated in the management of the company to an extent that made it liable for clean-up costs.

Under the Federal Comprehensive Environmental Response, Compensation and Liability Act 1980—the so-called Superfund law—owners and controllers are liable for the cost of cleaning up any hazardous waste on their properties. The federal Environmental Protection Agency estimates that settlements in clean-up cases totalled more than $1 billion in 1989. The Superfund law exempts banks and other lenders with loans to polluters, say secured on the firm's assets, if they are just protecting their banking interests and are not taking part in the firm's management.

It is now established in American law



that foreclosing on a loan, ie, calling in the security, makes a lender an owner and therefore liable. But federal district court cases over the past five years have protected lenders if they have not foreclosed but have merely participated in the financial management of a company to protect their loans, and have not taken over the day-to-day running of the business. The Atlanta appeals court, one step up the judicial ladder from the district courts, overturned these cases.

The court ruled that a lender is liable if its role in the financial management of a company is broad enough to make it possible for the lender to influence the company's treatment of toxic waste, if it so desired. The court decided that Fleet/Norstar had done enough to make itself liable. This new standard puts lenders in a tricky position.

Say a bank decides it will not lend any more money to a company because dangerous chemicals have been found on its property, and the bank is afraid of any liability. Under the new ruling the bank could arguably be hindering any clean-up, and is therefore liable. But if the bank lends the money, it will almost certainly be deemed liable. Mr Alan Vollman, a partner with Morrison & Foerster, a firm of lawyers based in Washington, DC, reckons the decision is "a disaster for banks." He thinks the only kind of lending that could be protected under the new standard would be passive, long-term lending such as that by life-insurance and mortgage companies.

On June 12th Fleet/Norstar announced it would be appealing against the decision to a full sitting of all the judges of the Atlanta appeals court. If this fails, Fleet/Norstar can appeal to the Supreme Court. A simpler way of solving the problem would be for Congress to pass new legislation.

A bill now before the House of Representatives—a parallel bill is before the Senate—is a perfect vehicle for any changes. The bill deals with the liability of lenders for mopping up hazardous waste. Its aim is to restore the right of banks to foreclose on loans without making themselves liable for any environmental clean-up costs. The bills' backers say this was the original intention of the exemption in the Superfund law.

The bill went before the House Small Business Committee two weeks ago. Testimony from witnesses such as Mr Robert Egerton, president of the Farm Credit Association of New York, revealed that many banks are now frightened of calling in the security on their loans. He cited a string of cases where banks had lost money by refusing to foreclose on loans because of worries about liability for environmental clean-up costs. The Atlanta court's decision makes bankers fret even more. Unless Congress acts, the courts' search for deep pockets to pay for clean-up bills could rebound on them.

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★★ SOUTHWEST EDITION TUESDAY, JULY 3, 1990 BEAUMONT, TEXAS

# Financial Fracas

## S&L Mess May Spark A Thorough Overhaul Of Deposit Insurance

### Adminstration Seeks Ways To Cut Federal Exposure, But Bank Industry Is Split

### A Fight Over Too-Big-to-Fail

By PAUL DUKE JR.
*Staff Reporter of* THE WALL STREET JOURNAL

WASHINGTON—The Bush administration isn't saying so publicly, but it is looking for ways to trim the federal insurance on deposits in banks and savings and loan associations.

One Treasury official privately predicts that the department will recommend rolling back the official insurance ceiling from $100,000 to perhaps $50,000. Says another administration aide: "We have to find a way to limit the costs to the taxpayer."

In a switch from the past, Congress, chastened by the cost of the savings-and-loan disaster, is receptive to some type of deposit-insurance revision, though not necessarily along the lines Treasury plans to propose by year end. "Nobody wants to even remotely believe we would have to face this again," says Sen. Alan Dixon, an Illinois Democrat who sits on the Senate Banking Committee.

Overhauling the system of "insuring," or guaranteeing, deposits could be the most important aftershock of the $150 billion savings-and-loan ballout. It would be likely to reshape U.S. financial institutions, most notably by causing some big depositors to lose money and endangering many of the country's 12,000 small banks and thrifts. But some say major reforms are the last, best hope to prevent another S&L-type blowout.

**Political Minefield**

"I don't think the problems in the S&Ls are attributable to anything other than deposit insurance," says Peter Wallison, a banking lawyer who served as the top attorney at the Treasury and the White House during the Reagan years. Although that ignores the widespread fraud and the Reagan administration's policy of deregulation without adequate supervision, it's true that the problem would have been far smaller without insurance on big deposits. And many agree with Mr. Wallison's conclusion that "if we don't fix the system, it will fail again in the banking industry."

Yet even tinkering with deposit insurance remains politically explosive, and reforming it is far from a sure thing.

The issue splits the banking industry bitterly. Two of the three most important banking trade groups favor exposing corporate or wealthy individual depositors to a loss in bank failures. But the third, representing small banks, is dead-set against it. Small banks fear that they will lose many depositors and be crippled if deposit insurance is slashed, so they are proposing instead that the government openly insure all deposits, no matter how large. In preparation for the looming confrontation, rival banking lobbyists already are working Capitol Hill door-to-door.

**Role of 'Jumbo' Deposits**

"The battle for the soul of the Treasury is on," says Kenneth Guenther, who runs the small-bank group, the Independent Bankers Association of America.

The Treasury Department is contemplating turning around a train that has been roaring in the same direction since 1934. Congress responded to the failure in the early 1930s of more than a third of the nation's 25,000 banks by protecting $2,500 per account. Partly to adjust for inflation, Congress gradually jacked up that amount, with the biggest increase, from $40,000 to $100,000, in 1980. The program now covers everyone from children to savvy investors who scour the nation for the highest rates on "jumbo" deposits.

In the 1980s, $100,000 deposits flew like needles to a magnet to get the highest yields, and thus many of them ended up in the riskiest, most fraudulent S&Ls in the country. Thrift executives drew giant salaries from the taxpayer-backed deposits. Then they rolled the dice and invested the rest in thousands upon thousands of crazy real-estate projects, junk bonds, luxury-car dealerships and expensive artwork. If the investments paid off, they made more money. But the dice often came up snake eyes. And now all the losing propositions are in the hands of those who really paid for it—the taxpayers.

**Growth Made Easy**

By attracting deposits with above-market rates and a government guarantee backing them up, "Thrifts were essentially printing money through deposit insurance," says William Seidman, chairman of both the Federal Deposit Insurance Corp. and the new agency running the S&L cleanup, the Resolution Trust Corp. Richard Breeden, a key architect of the cleanup and now chairman of the Securities and Exchange Commission, agrees: "The institutions that grew 2,000% or 3,000% weren't getting those funds because investors thought they were well-run businesses. Deposit insurance made those funds available."

Yet there's more to the Alice-in-Wonderland quality of deposit insurance. Most important, the $100,000 insurance ceiling is really an apparition. Since the then-ailing Continental Illinois National Bank & Trust Co. was rescued in 1984 on the theory that its collapse might severely damage the financial system and perhaps the whole economy, the government—under a policy dubbed "too-big-to-fail"—has covered almost all deposits by arranging sales of

*Please Turn to Page A12, Column 4*

# Financial Fracas: S&L Mess's Cost to Government May Spark a Revision of Federal Deposit Insurance

*Continued From First Page*

broke banks. And, out of fairness to smaller banks, "too big to fail" has been extended to protect virtually all depositors from losing money. (In most cases, the only depositors cut off at $100,000 are those in small banks that the government can't sell and liquidates instead.)

The upshot: Deposit insurance is like an auto-insurance fund where 16-year-old drunks and Sunday drivers pay the same premium and everybody gets fully paid off in an accident. Some are asking why anyone other than accident-prone people should favor that.

## Treasury's Tradeoff

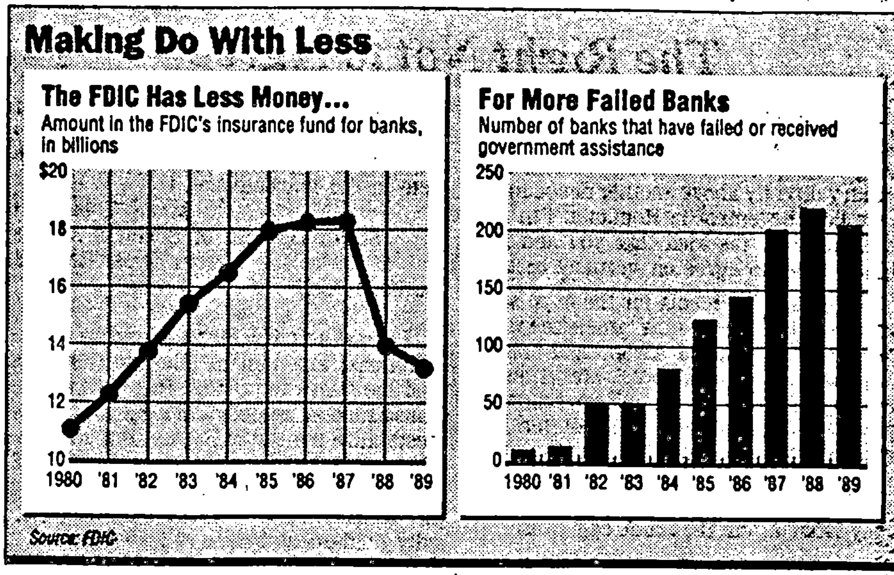
Treasury officials don't. So they are preparing a package that would rework deposit insurance and expand the businesses that banks can enter. Treasury is also considering a call for further dropping the barriers to interstate banking, aiming to give the banking system more stability by spreading risk. Although the outcome of their deliberations could be influenced by political pressure, their basic thinking seems set. "An industry that can't make profits is doomed to operate in an unsafe and unsound condition," reasons a top official overseeing the study.

He and other Treasury officials worry that big U.S. banks could become shaky if they fall behind in competition with foreign banks, many of which enjoy broad powers not permitted U.S. banks, such as selling insurance, underwriting securities and forging close links with commercial businesses. "Diversifying the activities of banks can decrease risk," he says.

Many banking experts agree, but the trouble is that this smacks of financial deregulation, which rattles Congress these days. Anticipating such fears, Treasury will probably propose stringent rules to ensure that the deposit-insurance safety net isn't stretched to include the new business activities. So-called firewalls, for example, would prevent insured money from being used in the areas to be opened to banks.

In sum, Treasury is likely to propose to Congress a quid pro quo: Prevent a future bailout by giving big banks broader powers while cutting deposit insurance.

Conspicuously absent from that equation are small banks—possibly the fatal flaw in the Treasury's approach. Big banks wield huge financial clout, but small banks, with offices in every congressional district, carry more political weight on Capitol Hill. To thousands of small banks and thrifts across the country, the Treasury proposal will look like a tradeoff without a payoff. They are uninterested in getting new powers. And they fear that a cutback in deposit insurance would send their depositors running to big banks viewed as "too big to fail" and thus 100%-insured, no matter what the government says.




## A 'Haircut' for Depositors

So the banking industry has cooked up a compromise: Impose a little "depositor discipline." The American Bankers Association, which represents both big and small banks, proposes shaving off a percentage—say, 10%—on reimbursements beyond the first $100,000, which would be fully covered. A person with $200,000 in a failed bank, for example, would recover $190,000. The size of the haircut would increase as bank failures increased.

The haircut idea appeals to a Congress fearful of antagonizing politically potent bankers but eager to limit the government's liability. "I feel too many people have been made whole," says Sen. Jake Garn of Utah, the ranking Republican on the Banking Committee.

The sticking point here is that small bankers simply don't believe that regulators would force depositors in a big bank to actually take a loss. They want Congress to make the "haircut" mandatory. "That is kind of a linchpin," says William Brandon, president of a small bank in Helena, Ark., and a member of the ABA committee on deposit insurance.

Small banks are right to be skeptical. Because of the damage a big-bank failure might do, says Federal Reserve Board Governor John LaWare, "I don't know how you can altogether get rid of 'too-big-to-fail.'"

## Insuring Everything

If you liked the S&L mess, you'll love the small banks' response to it. They want the government to insure everything.

Actually, the idea isn't as crazy as it may seem. All it would do is formally extend the too-big-to-fail doctrine to all banks and thrifts. The Independent Bankers Association of America, the small-bank group, is canvassing Capitol Hill for full coverage, and although legislators aren't exactly lining up to support the idea, some are sympathetic. "I think the radical tinkering should be on the regulatory side," says Rep. Jim Leach, an Iowa Republican. "Modest tinkering should be considered for deposit insurance."

If Uncle Sam is on the hook for every dollar on deposit, how can he prevent another bailout? Big banks fear that under 100% insurance, the public will start treating banks like utilities. And, in fact, those who propose covering all depositors suggest a slew of accompanying regulations.

Most important of such regulatory moves, the Fed's Mr. LaWare says, "is effective supervision and effective capitalization. That's better than cleaning up the mess after the bank has failed."

Mr. LaWare and other regulators argue that as long as banks maintain adequate capital—the bank owners' investment, which in a crisis is drained off before federal deposit insurance is tapped—major revisions in the insurance may be unnecessary. The S&Ls, they assert, wouldn't have risked those wild investments if the government hadn't let them operate with little or no capital. Without much investment at risk, thrift owners had every incentive to gamble for high stakes. The regulators add that although depositors now are being paid off in full, shareholders and bondholders lose their investment, and they demand prudence from bank managers.

But critics of that view say regulations can be peeled back. If the thrift mess teaches us anything, they argue, it is that bank and thrift owners will always press the government to ease up, imperiling the deposit-insurance fund. "The worst ones will squawk the most," contends Bert Ely, a financial consultant. "That's the way the political process works." In fact, even as the thrift bailout metastasized in recent months, banks burdened with real-estate problems asked regulators for forbearance on capital requirements, to stretch out the on capital requirements, to stretch out the period in which the banks have to recognize real-estate losses. So far, regulators have rebuffed those requests.

Wary of the entire deposit-insurance thicket, some in Congress are looking for ways to tiptoe around it. Limiting depositors to one insured account apiece is a popular idea on the Hill, but no one has yet come up with a workable way to do that.

Another idea is to link the premiums banks pay to the riskiness of their assets. If a bank's managers took unusual risks, the thinking goes, premiums would rise to the point where its stock price and dividend would fall, and shareholders would apply pressure to lower the risk.

But some question whether insurers can properly judge the risk in a bank's portfolio. A decade ago, for example, many experts were positive that the oil boom had nowhere to go but up; but, of course, oil prices collapsed, taking down a lot of Texas banks.

Even so, the idea is probably the least controversial floating around Congress. Hoping to prod the Treasury to think seriously about risk-based premiums, Sen. Dixon soon will introduce a plan to require the FDIC to go to a private insurer to back up a small slice of its liabilities. The private insurer, with its own money at risk and presumably immune to pressure from Congress, would look over the FDIC's shoulder in setting premiums.

The wild card in the deposit-insurance debate is the public, which really hasn't been heard from yet. Congress could quickly lose its fervor for reform if depositors howled about reduced coverage.

"As depositors, the public has been treated handsomely," says Carter Golembe, chairman of the Secura Group, a bank consulting firm. "The government made a promise to depositors, and it kept the promise. The question is: Is the public more angry as taxpayers than it is happy as depositors?"

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# Japanese Seen Curbing U.S. Growth

## Some Tokyo Bankers Favor Voluntary Restraints

By JOHN EVANS

TOKYO — The aggressive, decades-long expansion of Japanese banks in the United States, which has brought control of 15% of the nation's banking assets, is nearing its limit, senior Tokyo bankers say.

Some Japanese bankers, fearing that further market penetration could prove politically unacceptable to Congress, acknowledged they may have to accept voluntary growth restraints similar to those adopted by their country's aggressive automobile industry.

Japanese banks increased their assets by about a quarter last year to reach the 15% figure. This brought the share of U.S. banking activity by all foreigners to about 25%.

### U.S. Banks Grew Slower

By contrast, U.S. banks grew by about 6% on average in their home market, and they control less than 1% of the banking assets in Japan.

The competitive advantage enjoyed by the Japanese banks is a sore point with the Bush administration, which is pressuring Japan to liberalize its banking and financial system.

Tomatsu Yamaguchi, vice president of Bank of Tokyo Ltd. predicts that after the "tremendous" growth by Japanese banks in the United States in recent years, a slowdown should see them expand by less than "10% in North America this year, probably by about 8% or so."

### Competition Called Vital

While Japanese banks can freely expand overseas, "foreign banks can't break easily into Japanese banking," conceded Mr. Matsuno, deputy director-general of the ministry's banking bureau. "Unless we are open to foreign competition, Japan could stand isolated in the world."

While other Japanese commercial bankers provide plentiful assurances that their growth in the United States will be sharply curtailed from now on, foreign bankers warn that expansionism is deeply ingrained in the Tokyo banking psyche.

Japanese bankers argue that new constraints such as the Bank for International Settlements guidelines and the Tokyo stock market slump earlier this year have left them looking for fees and other income that does not tie up capital.

### Asset Figure Called Misleading

At Industrial Bank of Japan Ltd., newly elected president Yo Kurosawa contends that the 15%-of-assets figure is an emotional one for the United States and is misleading. The figure includes activities such as Japanese banks' interbank business and related noncustomer business and so is a distorted indicator of Japan's competitive incursions into American banking, he holds.

**The competitive advantage enjoyed by the Japanese banks is a sore point with the Bush administration.**

In addition, Mr. Kurosawa points to an important change in Japanese banking attitudes in the United States, in part caused by economic problems and turmoil in the financial system.

"We're now keeping a low profile," he says. "Don't forget that in the last year, much of the big expansion in our market share came from the huge M&A and LBO financings, including the 40% Japanese participation in the RJR Nabisco deal. We're now much less aggressive in this field."

### Slowdown Is Expected

Taizo Hashida, chairman of the Federation of Japanese Bankers' Association, predicts that "you won't see such strong asset growth as in the past" by Japanese banks.

Mr. Hashida, who is also president of Fuji Bank Ltd., adds that his nation's banks now favor "an improvement in earnings and return on assets, including reducing our low-yielding assets." He insists that the days of Japanese banks' aggressive competition through sacrificing earnings margins are over.

Knowledgeable foreign bankers that while the Japanese face similar pressures on capital as their Western counterparts, in reality the Tokyo banks may take several years to wean themselves off growth-oriented policies in the United States and elsewhere.

### A Need for High Volume

Timothy McGinnis, senior vice president and general manager at Chase Manhattan Bank in Tokyo, believes costly overhead and low employee productivity at Japanese banks dictate that they will remain high-volume operators at home and overseas.

"Japanese banks have a lifetime employment policy for staff and high fixed costs," he says. Thus it's inevitable that "they've got to continue to be volume driven," seeking high market share in banking markets at home and abroad.

Alan E. Brown, director of Barclays Bank PLC in Tokyo, agrees. Building assets is ingrained among the Japanese banks, and "their managers are still judged, in terms of success, on how much they've increased their assets every year."

### Help from Regulators

Foreign bankers additionally doubt that Japanese banks will ultimately be deterred by the Bank for International Settlements guidelines and already are being assisted by Japanese regulators to supplement their resources. For example, Tokyo banks now have the ability to issue subordinated debt to reinforce upper-tier capital.

Also, Mr. Kurosawa of IBJ says his bank hopes that by next month it will start issuing equity again, becoming among the first to take advantage of a recovering Tokyo stock market.

What will really set back the Tokyo banks is the total deregulation of interest rates on small deposits in Japan, a move akin to the abolition of Regulation Q in the United States a decade ago, bankers agree.

This liberalization measure is being demanded by the United States on the ground that existing interest rate ceilings are anticompetitive, not only snarling foreign banks trying to build business in Japan but giving Japanese banks access to cheap

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**Collection:**

**Record Group:** Bush Presidential Records
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| **Date Closed:** 12/11/2004 | **OA/ID Number:** 29171-001 |
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June 25, 1990

The Honorable George Bush
The White House
1600 Pennsylvania Avenue
Washington, D.C. 20500

Dear Mr. President:

I want to congratulate you for your recognition Friday that the prosecution of savings and loan crooks must be a top priority of the United States. I will support all efforts that will help put the savings and loan crooks in jail.

On Thursday, June 28, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance, which I chair, is holding hearings on the Administration's efforts to put the savings and loan crooks in jail. On May 25th, I wrote to Attorney General Thornburgh inviting him to testify at these hearings. To date, I have not received a response from the Attorney General. The Justice Department has indicated that Assistant Attorney General Edward Dennis will appear, but to date I have received neither an acceptance nor a rejection from the Attorney General. I hope that you will urge the Attorney General to use this opportunity to present your plan for increased efforts against the savings and loan crooks to Congress.

Last year you sent your comprehensive savings and loan bill to Congress and asked for prompt action. Treasury Secretary Nicholas Brady and Office of Management and Budget Director Richard Darman both appeared before the Subcommittee on behalf of the Administration. The Subcommittee worked hard and moved the legislation within the timetable you had requested. The prompt action on the legislation, moving with bipartisan cooperation, led to the passage of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA).

You may recall that last year you wrote to me from Brussels on your NATO trip to commend me on my work on FIRREA. I received a similar letter from Secretary Brady as well.

FIRREA strengthened enforcement provisions designed to give the Justice Department the tools it needed to go after the savings and loan crooks.

On Friday, you called the United States Attorneys to Washington to outline to them your efforts to go after the savings and loan crooks. I hope you will encourage Attorney General Thornburgh to appear before this 46 Member Subcommittee, which is larger than virtually all Full Committees in the House, to explain your plan and to discuss what additional tools the Administration feels it needs.

The appearance of Secretary Brady and Director Darman last year underscored the Administration's seriousness regarding the passage of FIRREA. The appearance of Attorney General Thornburgh on June 28 would show a similar commitment toward the prosecution of savings and loan crime.

With every best wish,

Sincerely,

Frank Annunzio
Chairman