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THOMAS SPIEGEL
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Rich — attn — have read Spiegel's letter, pls see me R

February 28, 1989

VIA FEDERAL EXPRESS

The Honorable Donald W. Riegle, Jr.
Chairman, Senate Banking Committee
United States Senate
105 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for taking the time to meet with us earlier this month. I appreciate the time you spent with us and your customary candor in expressing your thoughts on S&L issues. I have attached the replies to the questions you and Kevin raised with us and I look forward to discussing them with you further.

I would like to make some general observations on some of the matters we discussed.

Your commitment to take on this problem quickly, and in its full scope, is very encouraging. But, to state the obvious, I am deeply concerned over your apparent goal of increasing the QTLT and denying deposit insurance for any state powers in excess of those permitted for federally-chartered thrifts. I honestly believe, for some of the reasons discussed below, that such a step could well set up a repeat of the current crisis.

Let me say first that, as I told you, we support the broad outlines of the Administration's S&L plan. We are prepared to pay more in fees and we think many of the regulatory changes make sense. We are concerned about some aspects of the plan which penalize the innovative and profitable thrifts, while at the same time, preserving the position of marginally capitalized and managed operations.

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In our view, the most important feature of the plan -- which the Bank Board is in the process of implementing -- is the doubling of required capital and type of capital to the riskiness of a thrift's investment portfolio. We must ensure that S&Ls are "investing with their own money," that significant private sector funds are put at risk in any investment before federally-insured deposits.

As someone who knows a great deal about the capital markets, you more than many must appreciate that these risk-based capital standards will go a long way toward eliminating risk-taking in this industry. Simply put, private investors will provide additional capital to meet the new requirements to those S&Ls with demonstrated expertise and sound investment practices; they will refuse it to the others.

The doubling of capital and tying it to risk is a radical change, and many in the industry are opposed either to the idea or its implementation by 1991. We think it is critical because it will impose precisely the sort of discipline on the industry that will drive the irresponsible players out of the business.

The second change the industry must have is increased supervision. The last two years have seen an enormous and positive change in this regard; the added weight of FDIC expertise and manpower will complete the process.

Frankly, many in Congress are ignoring the series of recent regulatory changes which make it impossible to repeat the systemic excessive risk taking and gross abuses which created this problem. In fact, the federal regulators have taken major steps in the past two years to regulate abusive activities at the state and federal level. The era of independent, unchecked "state powers" is over. Today, federal regulators are exercising substantial power over the activities of not only federally-chartered thrifts, but state-chartered thrifts as well. For example, new FHLBB regulations sharply limit direct investments, restrict growth, and regulate interest rate exposure. We have enclosed a background memorandum detailing

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many of these reforms. Moreover, new federal rules governing states have blocked off the easy entry, weakened capital, and rapid growth avenues of abuse. I am not for the moment asserting that there were not gross abuses at the state level. There were. But most of these abuses involved granting of easy charters, low capital standards, and horrendous supervision -- not the exercise of broader investment flexibility.

In sum, the federal regulators have effectively reined in any state operator seeking to replicate the growth of the "outlaw" S&Ls, largely eliminating the potential for abuse by state-chartered S&Ls. What remains is to provide them some additional supervisory expertise (the FDIC) and new enforcement tools to allow them to swiftly and effectively act against endangered S&Ls before the insurance fund is put at risk. We have attached a memo laying out a statutory framework of an early intervention statute that would give regulators this power.

The question is whether any state flexibility at all will continue to be allowed within this new federal structure. A very real cost of imposing rigid uniformity may well be to retard constructive and innovative changes within the industry. Over the years, there have been tangible consumer and financial services benefits realized because states have been allowed to permit S&Ls to exercise different powers than federally chartered institutions. Two of the most obvious examples are NOW accounts (pioneered by the New England state thrifts) and Adjustable Rate Mortgages (created by California state-chartered thrifts).

This brings me to the issue of state vs. federal charters. I know that you and others believe that state asset flexibility is a major cause of this crisis. But, Don, that is simply not true. Indeed, the December 1988 GAO report on the causes of the thrift crisis does not list misuse of broad state powers as a cause of the thrift crisis. Many of the most spectacular failures involved the exercise of <u>federal</u> powers, though the thrift itself may have been state-chartered. Many of the massive thrift failures such as American Savings, Gibraltar of Beverly Hills and First Texas/Gibraltar resulted from poorly underwritten commercial real estate loans and imprudent interest rate "bets" on supposedly "safe" investments like U.S. Treasury bills or Ginnie May securities. These activities were equally permissible under state or federal law.

The notion of rolling back the clock to the pre-Garn/St. Germain days by pushing the QTLT to 80 percent ignores the recent history of this industry. I strongly believe that the rationale that led to granting all S&Ls greater investment flexibility has not changed. Many thrifts simply cannot maintain a sufficient level of profitability if they are limited solely to home finance. The home finance market remains as subject to extreme cyclicality as it has always been; it remains much more subject to interest rate risk than virtually all other kinds of lending.

As Andrew S. Carron of First Boston Corp. testified before the Senate Banking Committee in January 1989, "thrifts cannot be viable if compelled to hold home mortgage loans as their principal assets because developments in the secondary market have lowered most mortgage rates below thrifts' costs." Thus, diversification is a prerequisite if the thrift industry is to succeed long term.

The 80 percent QTL and 50-mile lending limit suggestions getting widespread currency dilute the potential for asset diversification much of the industry requires for permanent health. While Columbia's own experience with defaults on the residential loans it originates (more than $1 billion per year) is among the best in the industry, we do not believe business line and geographical limits are a panacea. Massive local event and credit risk result from the inherently <u>non-diversified</u> foundation underlying these proposals. One only has to look at the default rate of such "good local loans" in Texas or the farm belt during our recent history of "rolling regional recessions" to comprehend the inherent risk beneath the surface appeal of these suggestions.

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It is beyond dispute that as a result of our ability to diversify into securities commercial lending, we are a healthy, profitable S&L. We are not only not part of the S&L problem, our ability and willingness to pay higher premiums is helping fund the solution for the failed S&Ls. Why you would want to pursue a policy that is likely to make us (and other innovative, successful thrifts) less profitable and less healthy is a source of puzzlement to me.

We hope you will look carefully at what the regulatory requirements are today (as opposed to what they were in 1983), and where and how thrifts make profits, before you take actions which will fundamentally affect the profitable part of this industry. There is no reason or need to throw out the baby with the bathwater in reaching a solution to this problem.

Please feel free to call on us at any time with any questions or thoughts you may have on any of these issues. As you know, we are prepared to provide you and your Committee with whatever assistance you desire.

Thank you again for spending the time with us.

Sincerely yours,

Thomas Spiegel

TS/jlo
enclosures

cc Kevin Gottlieb
Steve Harris