OFFER TO SENATOR GARN

1. CAPITAL

Three points were in dispute.

a. Accounting issue in computing capital

We're willing to accept your staff's position: if an item is excluded from the numerator, it will also be excluded from the denominator. Likewise, if it is counted in the numerator, it will also be counted in the denominator.

b. Purchased mortgage servicing rights

The Senate bill requires a thrift to have:

-- a leverage ratio of 3% capital to assets; and
-- at least 1.5% tangible capital.

> The definitions of capital must generally be as stringent as those of the OCC, which has strict rules on purchased mortgage servicing rights.

We are prepared to make a limited exception for purchased mortgage servicing rights: thrifts with at least 1% tangible capital could count such rights for the remaining part of both the leverage ratio and the tangible capital standard, if COSA so allows.

There would be the following additional rules (acceptable to your staff):

-- Mark to market quarterly
-- Take 15% off the resulting value ("haircut") for an extra margin of safety
-- COSA's rules must be as stringent as the FDIC's rules (but could be looser than the OCC's rules on mortgage mortgage servicing rights)

c. Effective date; COSA's authority to grant exceptions

New capital standards would take effect upon enactment.

COSA could make exceptions case by case for institutions that meet strict statutory criteria (e.g., positive net operating earnings; no dissipation of assets; no history of insider abuse).

2. QUALIFIED THRIFT LENDER TEST

I would be willing to modify the QTL test in the Senate bill so that all home-equity loans count towards the test (even if they are used for purposes other than housing finance).

But I need a commitment from you that you will stick with me against watering down the basic test any further (in negotiations with the House or among the Senate conferees).

> Here's what I mean by the basic test: 60% of adjusted assets, minus the 5% mortgage origination credit. This is equivalent to just 50% of total assets.

The House will want to increase the required percentage (e.g., to 70%).

We would respond with 65% -- and increase the allowable mortgage-origination credit to 10% from 5% (of adjusted assets).

To satisfy Gonzalez, double credit could be allowed for low-income housing (as in the House bill), but the extra credit would count only for the amount above the 55% core.

Thus there would be a 65% test, with a 10% basket for mortgage origination and the double-credit items.

Let's stick together on Federal Home Loan Bank advances to commercial banks. What I have in mind is that commercial banks could get advances if they had 35% of their assets in residential mortgage loans. (I understand that your staff has no objection to that approach.)

3. PRIMARY FEDERAL REGULATOR OF STATE THRIFTS

COSA, not the FDIC.

4. THRIFT POWERS

Same as in Senate bill, except for junk bonds.
I would rather not have any junk bonds either in the thrift or in a subsidiary.

But, as a compromise, I would be willing to accept the Administration's position: no junk bonds in the thrift itself, but a thrift would be free to hold junk bonds through a separately capitalized subsidiary.

[ca. 6-89?]

We should not really need to concede anything to Garn on issues involving capital. He has said all along that he wants the toughest possible capital standards. Unfortunately, his staff has been insisting on concessions.

We may well be able to get an agreement with Garn without permitting COSA to make exceptions to the capital standards. We we believe that we will need to include such a provision (as described in the attached document) to get an agreement with Gonzalez and the House Banking Committee.

Garn may well want to stick to off-budget financing in our initial offer to the House -- but realizing that our conferees will accept a House counter-offer of on-budget financing. If you go along with that approach (to help Garn save face), you should insist that the financing issue be dealt with separately from other issues. Otherwise, the financing plan would draw attention away from all the concessions we are making across the board to the House approach.