THE SECRETARY OF THE TREASURY
WASHINGTON

July 29, 1987

Dear Mr. Chairman:

The President has authorized me to inform you that he intends to sign H.R. 27 into law if the Congress presents him the bill with your proposed changes in three titles. Your agreement to secure these three improvements enables us to strengthen FSLIC substantially. The modifications help to protect depositors and taxpayers, enhance FSLIC's ability to sell ailing savings and loans, and preserve the regulator's authority to supervise the S&L industry. Of course, other important titles of H.R. 27 grant emergency acquisition authorities to the banking regulators and expedite the availability of depositors' access to their funds.

First, we are pleased the Congress will enact the FSLIC recapitalization mechanism we proposed on May 22, 1986. While we consider the long delay unfortunate, we are satisfied that Congress rejected unworkable alternatives and are encouraged that you will authorize a $10.825 billion infusion of additional funds into FSLIC. This is a crucial first step in a real recovery of the S&L industry.

Second, we also agree that Congress should sunset the regulatory forbearance sections. Those sections will lapse when this financing authorization has been fully exercised. The one exception would be the requirement that S&Ls move from the use of lenient regulatory accounting principles to generally accepted accounting principles by no later than 1993.

Third, your two proposed adjustments to Title I should help FSLIC sell large failing S&Ls to a variety of companies and draw more badly needed capital to this industry. These changes would: (1) drop restrictions on acquisitions of failing S&Ls (over $500 million in assets) by holding companies owning nonbank banks, and (2) remove the application of Glass-Steagall restrictions to purchasers of failing S&Ls with over $500 million in assets. (The application of Glass-Steagall to purchasers of smaller S&Ls would end in 1988.)

Unfortunately, other elements of Title I will still handicap FSLIC's ability to find purchasers for the many S&Ls in trouble. These counterproductive restrictions will boost FSLIC's costs, and we hope Congress will revisit soon the question of incentives to buy failing S&Ls.

Moreover, the Administration continues to believe that it is a serious mistake to exempt the Federal financial regulatory agencies from Presidential oversight through the apportionment process. The apportionment authority is a critical tool for protecting the integrity of the Federal Government's financial accountability.

We are, of course, disappointed by the Congress' unwillingness to permit the creation of new limited service banks to serve consumers and its moratoria on new authorities for banks. Time will tell if the contention is correct that these compromise restrictions are the condition precedent to an overhaul of our outdated banking laws. While we may be skeptical, we hope it is proven correct.

We definitely look forward to Chairman Proxmire's pledge to pursue comprehensive reform. The clock is ticking on the future of the banking industry. It has not been able to keep pace with its marketplace. Consumers and businesses that are not served as competitively pay the price for this delay. And in our view inaction also endangers the safety and soundness of the banking system -- because it is less profitable and less risk-diversified. The financial services industry will continue to progress, even if the banking industry remains chained in place by Congress.

Finally, I offer my compliments to you and Chairman Proxmire for achieving a compromise that addresses important concerns of the Congress and the Administration. At the end of last year each house passed our FSLIC recapitalization proposal, but it failed because of differences over extraneous amendments. It would certainly be distressing to the millions of Americans who entrust their savings to the S&L industry if final Congressional action were too little, too late, and again bogged down over contentious differences. I know you and the other members of the majority will ensure the passage of this compromise bill expeditiously and through the least controversial course.

Sincerely,

James A. Baker, III

The Honorable Fernand J. St Germain
Chairman
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