

FROM: Swenolyn *AT*
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JM → *GUP*
[Signature]

RE: Lincoln S&L's troubles with the FHLBB

As you know, Lincoln Savings and Loan has run into problems with the Federal Home Loan Bank Board (FHLBB). As you know, Lincoln is different from most other S&L's primarily because it does not concentrate on single family residential lending. Instead, Lincoln has concentrated primarily on real estate investments (mostly commercial, I think), and has also been involved in non-investment grade securities and direct investment. The FHLBB has been somewhat insistent in the past few years about keeping S&L's in the S&L business, and Lincoln's strategies run counter to the goals the FHLBB seems to have been pursuing, and as a consequence, the two entities have clashed.

This memo discusses the grievances, both general and specific, which Lincoln's accountant believes the S&L has against the FHLBB, and in which areas I believe they are justifiably upset. I also have made a recommendation which you might consider useful.

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I. Grievances

Special Counsel
Exhibit K-8

In general, Keating believes Lincoln has been poorly treated. Essentially, he says that appraisals have been inaccurately made; that Lincoln's assets have been unjustifiably classified, leading to a lower net worth; and that the FHLBB has misinterpreted and misapplied its own regulations.

The specific problem to which these problems have led is that Lincoln's net worth has been revised downward while its net worth requirements have been revised upwards. The difference between what Lincoln's accountants say it needs to have in net worth requirements and what the FHLBB says it needs is \$45 million.

II. Possible solutions

First, it may be appropriate for the issue of asset appraisals to be revisited. I think there is probably some truth to the charge that Lincoln's real estate holdings have been appraised at values below their market values. One holding in particular that may have been wrongly appraised is the Phoenician project in Phoenix. My understanding is that the FHLBB has evaluated the project to be valued at \$120 million while American Continental estimates it to be worth \$200 million. (I am not saying either or neither of the two are correct -- I think it may bear reinvestigation).

Lincoln's accountants believes errors on the part of Bank Board examiners may well be rooted in inexperience: The examiners are probably far more skilled and experienced in appraising single family units and the like than resort real estate which involves evaluating a host of variables that differ from traditional S&L projects. Moreover, they stress that there is a lot of broad interpretation and indiscriminate application of Bank Board regs which has adversely affected Lincoln, and possibly other S&Ls.

Second, the S&L has run into problems with the capital regulation that address capital/networth requirements. This regulation has a provision that addresses direct investments

subsidiary, securities, and real estate.

The regulation says that direct investments in excess of the FHLBB limit of 10% of assets that were made after 12/10/84 -- when the FHLBB moved to curtail direct investment by S&Ls -- should be included in part in net worth requirements. Lincoln has \$500 million in disputed direct investments with the FHLBB, and under the capital regulation 10% of the not permitted direct investments (\$60 million) must be added to the S&L's net worth requirement.

III Casework possibilities

This is clearly casework. I would suggest that some communication is made to the FHLBB that encourages a speedy resolution to the very lengthy examination of Lincoln, and that probably a good first step is reapproaching the issue of asset appraisals and classifications.

As you know, other S&Ls are concerned about appraisals as well, and for the most part, this has to do with general forbearance toward troubled thrifts.

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NOTE: The direct investment rule has been an area of conflict between the S&L and the FHLBB from the start. The FHLBB first issued a regulation that limited the type and amount of equity investments that federally insured, state-chartered thrifts could make with funds deposited with them. The regulation originally barred a thrift from investing more than 10% of its assets without Bank Board approval. Last month the Board also approved a new rule to take effect 4/14/87 that bases the limit on a

Lincoln has run into problems over a grandfather rule -- Lincoln says it qualifies for it, and the FHLBB says it doesn't (this is the \$600 million in disputed direct investments for which Lincoln is now supposed to come up with \$60 million in additional reserve requirements).