Excerpts from Golden West Letters to Regulators (2003-2006)

Throughout its history, Golden West's management regularly advocated for strong regulatory oversight of the banking system, in writing and in person, with legislators, regulators, administration officials, trade groups, the media and others. What follow are excerpts from some of Golden West's public letters to regulators from 2003-2006. The full letters can be found by clicking on the links after each excerpt.

- *We are alarmed by the prospect of a new Basel II capital regime that would give banks worldwide, including the nation's largest banks, the ability and incentive to sink to the lowest denominator of capital they can get away with. Such a regime is incompatible with promoting safety and soundness in the banking system… Simplicity promotes stability. When capital rules are understood by all interested parties, it becomes more difficult for the mischievous to fool the ignorant (complexity, by contrast, invites mischief, as evidenced in other complex areas such as derivatives and special purpose entities)… As a matter of sound public policy, we believe it is infinitely wiser for a capital accord to err on the side of overcapitalized banks, rather than giving banks worldwide the ability and incentive to reduce capital levels as low as possible.* (Letter to the Federal Reserve, FDIC, OTS and OCC, July 2003)

- *Minimum leverage ratios should be the foundation of any capital regime, with risk-based rules existing to impose additional capital requirements for riskier assets. Among other things, the leverage ratio ensures that, regardless of the risk-based model used by a bank or the manipulation we think will be endemic under Basel II, there is at least a base level of protection in the event of a crisis, rather than relying primarily on an insurance fund or a taxpayer bailout… Taking the residential mortgage industry as an example, Basel II would cause risk-based capital levels for residential mortgages to fall well below most leverage ratios. Such a result could be disastrous for the mortgage industry in the absence of a leverage ratio. While we agree that mortgage lending can operate at a high level of safety when prudently managed and supervised, complexities abound and significant downturns in the mortgage industry have occurred, and will continue to occur, when potential regulatory lapses are combined with low capital requirements… In addition, the existing regulatory capital ratios should be strengthened to prevent financial institutions from selling assets off-balance sheet and lowering their capital requirements even though the probability of loss remains the same.* (Letter to the Federal Reserve, FDIC, OTS and OCC, November 2003)

- *We have been around long enough, and have survived enough industry crises, to recognize Basel II as bad public policy pretending to be sophisticated risk management. Capital regulations that affect the stability of our nation's banking and financial systems should be simple, not complex, and should produce results that are transparent, not obfuscated. We believe it is inherently unsafe and unsound to adopt a capital regime that will be difficult, if not impossible, for regulators, boards, senior management officials, and other market participants to effectively monitor and supervise… We have seen time and again that earnings pressures combined with complex rules and models invite mischief (e.g. Long-Term Capital Management, Enron, the housing GSEs, etc.) There is* *no reason to expect that Basel II would be any different…Basel II would have us believe that [residential] mortgages are so safe as to require minimal amounts of risk-based capital, perhaps only 1% of mortgage assets or a fraction thereof. These levels would be lower than what thrifts were required to hold in the years preceding the savings and loan crisis when some mistakenly believed that mortgage portfolios were so safe that only minimum capital was needed. Although mortgage credit risk has been relatively benign in the past decade for reputable lenders, the industry has experienced high credit losses in the past and will surely do so again."* (Letter to the Federal Reserve, FDIC, OTS and OCC, January 2005)

- *Having witnessed, and survived, various financial crises in the past decades, we are acutely aware of the importance of capital to the viability of financial institutions. Accordingly, we have a strong bias in favor of regulations that ensure that institutions maintain adequate capital to provide a cushion against the primary risks associated with being a depository institution – namely credit risk, interest rate risk, and liquidity risk – and to also provide protection from mistakes and unanticipated events… All of the arguments about the problems of the U.S. leverage ratio are essentially statements that the leverage ratio might be a constraining factor for U.S. banks. Maybe we are old-fashioned, but we always thought that capital and the leverage ratio should be a protection against excessive growth and risk. One of the primary lessons from prior bank crises is that capital does matter – those who have it survive, and those without it struggle or disappear and in the process cause great harm to customers, employees, communities, surviving banks that bear the political and economic costs, regulators, the FDIC, the U.S. financial system, and ultimately the U.S. taxpayer. This lesson must not be forgotten or, as they say, we will be doomed to repeat it.* (Letter to the Federal Reserve, FDIC, OTS and OCC, January 2006)

- *We think the regulators should be cautious about being too dependent on rating agencies to determine appropriate capital levels for certain recourse obligations and mortgage-backed securities (MBS). While it may be appropriate to continue to use credit ratings for debt or other instruments that are sufficiently well-understood, we question whether it is appropriate to delegate to the credit rating agencies the determination of regulatory capital levels for MBS and other complex instruments. Rating agencies have been criticized for reacting too slowly during crises, and the complexity of some instruments may delay a rating agency response. In addition, we think there is a high potential for gaming when virtually any asset can be churned through a securitization and transformed into a AAA-rated asset, and when a multi-billion dollar industry is all too eager to facilitate this alchemy.* (Letter to the Federal Reserve, FDIC, OTS and OCC, January 2006)

- *What has changed in the last few years, particularly since the emergence of a securitization market willing to acquire greater numbers of Option ARMs, are more aggressive practices by new [mortgage banker] Option ARM originators, many of whom lack a sophisticated understanding of the loan and appear focused principally on generating volume. These aggressive practices include deeper discounts between the loan's fully-indexed rate and the starting payment rate (referred to as the "payment* *discount"), diluted underwriting standards, and shortcut appraisal practices. It is these emerging practices that have increased the visibility, and we believe the risks, associated with the Option ARM product… Time will tell if new Option ARM lenders who hold minimal capital and rely on the secondary market fare as well when they sell pools of loans, including loans with deep payment discounts. We think the potential risks are certainly worthy of greater regulatory scrutiny.* (Letter to the Office of Thrift Supervision, March 2006)