Originally Processed With FOIA(s):
1998-0004-F[1]; 1999-0550-F

FOIA Number:
S

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Record Group/Collection:	George H.W. Bush Presidential Records
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Series:	Sununu, John, Files
Subseries:	Issues Files

OA/ID Number:	29171
Folder ID Number:	29171-002

Folder Title:
Savings and Loan Industry (1990) [2]

Stack:	Row:	Section:	Shelf:	Position:
G	15	25	4	2

Sdh

ASSOCIATION of BANK HOLDING COMPANIES

THOMAS LUDLOW ASHLEY
PRESIDENT

730 FIFTEENTH STREET, N.W., WASHINGTON, D.C. 20005
(202) 393-1158

June 21, 1990

THE CHIEF of STAFF
has seen

To: President Bush

From: Lud Ashley

As I mentioned in our chat yesterday, I worry that an all-out partisan fight over who caused the thrift debacle will find few winners and will seriously jeopardize a responsible approach to such other important matters as the budget and bank reform. All the same, I agree that Democrat efforts to pin original sin on Republicans leave no alternative but to put a shot across their bow, as Marlin did on Tuesday, and if necessary to fire for effect.

Frankly, I'm appalled at the bad judgment of the Democrats involved. What should be clear to everyone at both ends of Pennsylvania Avenue is that some terrible mistakes were made on a nonpartisan basis, most of which occurred out of equally-shared ignorance or poor judgment. It simply is impossible to indict Republicans without naming Democrats as codefendants and vice versa. Sooner or later the public will learn that it was mistakes made by government — both Congress and the Administration — that allowed the imprudent lending, fraud and theft that destroyed the savings industry at such cost. To your credit, you and most Members of Congress have been willing to let the story tell itself without seeking political advantage. But in a body of 535 it only takes a few who seek to advance their own partisan agenda to scuttle such efforts, divisive and destructive as the consequences may be.

What were the government mistakes that led to the collapse of the thrift industry? There are five that get star billing, as follows.

- A product of the Depression era, the Federal Home Loan Bank System established a national thrift industry with built-in government protection and favoritism, all on the irresistible pledge of the American dream: home ownership. Under the FHLB System, the people responsible for regulating the thrift industry were the same people responsible for promoting it. The conflict inherent in this dual role was essentially dormant until a decade ago. Then, forced to choose between regulation to protect the safety and soundness of the system or promoting the industry by relaxing regulation, the latter course was chosen, with all parties concurring.

- To assure low-cost mortgages, the Administration and Congress placed a ceiling on the rate of interest thrifts were permitted to pay depositors. This insulation from market discipline, which was to encourage the disastrous practice of borrowing short and lending long, was supported by all parties.

• When inflation drove interest rates up in the late 1970s, the Administration and Congress responded by phasing out the Reg Q ceiling limiting interest on deposits. The government then acquiesced to the thrift lobby by raising deposit insurance from $40,000 to $100,000 and permitting the use of brokered deposits. Efforts to provide funds to assure minimal supervision over thrifts' new, far-ranging activities were squelched. This was largely the doing of then-Treasury Secretary Don Regan and OMB Director Stockman, but it got little static from a Democratic Congress.

• Again responding to pleas from the thrift industry, the Administration and Congress in 1982 agreed on a nonpartisan basis to give thrifts broad authority to make loans unrelated to housing without adequate supervision. This led to high-risk lending backed by you-know-who.

• Because thrifts historically had borrowed short and lent long, high market interest rates resulted in negative yields that produced widespread thrift insolvencies. Again, both political branches of government responded to thrift industry pleas by adopting "forbearance" legislation which propped up ailing institutions with phony capital, thus permitting them to continue operations and to engage in ever-riskier lending in an effort to regain profitability.

What must be understood, if the thrift fiasco becomes a finger-pointing exercise, is the role of the U. S. League (of Savings Institutions), the principal trade association for the savings and loan industry. Over the years the League, through superb grass-roots organization, generous campaign contributions and a sophisticated Washington operation, could count on broad bipartisan support for any legislation it might suggest. Nor do I recall any quarrels between the League and any Administration, Democrat or Republican. Indeed, Kathleen Day (for the WASHINGTON POST) and others have traced a relationship between the League, the Home Loan Bank Board, Congress and the Executive Branch that is nothing short of incestuous.

As far as individual behavior is concerned, there is no question that Congressional culpability goes far beyond the Keating Five (three?) and includes prominent members on both sides of the aisle of the two banking committees, not the least including Frank Annunzio. This is a matter of record for anyone who takes the time to check campaign contributions, review Committee transcripts and voting records and figure out how much Freddie St Germain's American Express card cost the League over a period of 20-plus years.

At the same time, it won't take long for Don Regan's role to come under scrutiny. Here the problem is not only his direct role in the understaffing of thrift examiners but also his complicity (and I use the word advisedly) in the appointment of Lee Henkel to the three-man Bank Board. Simply stated, Henkel was a mole for Keating. In point of fact, Keating first tried to engineer the appointment of George Bentsen, an academic, to the Board but he was an anathema to Bill Proxmire. Failing that, he managed the appointment of Henkel who, it turns out, was not only an attorney for Keating but had an unsecured letter of credit from him for $1,000,000 or so. It's all part of the record.

8' sgk

THE CHIEF of STAFF has seen

============== FOCUS ==============

*19 NO S&LVERADO LINING

CNN's "Special Assignment" last night continued its S&L investigation. Ken Bode showed clips of ex-Silverado director Neil Bush testifying on Capitol Hill, and then pointed out two seeming conflicts of interest (failure to disclose the Good loan and the Walters interest in his company to fellow directors). Bode: "Walters defaulted; now taxpayers are responsible for those loans." Bode intoned, "Fishy is the word -- highest profile is Neil Bush. ... [and] not everyone agrees with Neil Bush's definition of conflict of interest. ... Is Neil Bush getting all this attention because he's the son of the president? Of course. But he wouldn't have been put on the board of a high-flying savings and loan in the first place had he not then been the son of the vice president. In October of 1988, the final days of the presidential campaign, regulators in Colorado wanted to close Silverado, the S&L on whose board Neil Bush had served. But from here in Washington came the message, 'delay it.' So the day after George Bush was elected president, the order ... finally was issued. And the taxpayers will pay $1 billion."

OTS Director (and Bush appointee) Tim Ryan has said he alone will make the decision on whether to subject Neil Bush to a disciplinary hearing (WASH. TIMES, 6/26) and he is considering rule changes "that could make public" the investigation into the president's son (DENVER POST, 6/26). Meanwhile the Resolution Trust Corp. was further embarassed to discover its Denver office had hired a former excutive of Silverado "to run its asset marketing section." Discovering the mistake, "it tried to fire him -- quietly. But government policies don't allow such dismissals." So now he is on administrative leave collecting his salary but doing nothing "while officials in Washington ponder what to do next" (Steven Wilmsen, DENVER POST, 6/26). Dem consultant David Doak: "Neil Bush is sort of a case study of what the savings-and-loan mess is all about. He's not responsible for the whole thing but if you take 700 Neil Bushes together, you've got the S&L crisis" (Deborah Orin, N.Y. POST, 7/27). In the same column Orin says the DNC has "quietly circulated to Democratic leaders, under an 'FYI' cover" news stories on the president's brother Prescott Bush having "$6 million riding on construction of China's first golf and tennis resort" (6/27).

Part of the administration's problem is the difficulty in making legal cases against S&L figures (see James Bates in L.A. TIMES 6/26, Paul Barrett in W.S. JOURNAL, 6/26), although the Department of Justice yesterday announced that "four senior executives of Midwest Federal Savings and Loan [in Minneapolis] have been indicted on 40 counts of receiving millions of dollars in fraudulently obtained funds and lying to federal regulators" (DOJ release 6/26).

SELLING ASSETS: In the CNN Special Assignment, Bode noted the 1,800 holdings in CO that the government has taken over (including 444 commerical properties worth $650 million), and Gov. Roy Romer was shown: "Well, if they dump it, it'll knock the prices out from under Colorado real estate, and that's very very difficult upon the whole of the economy." But Bode points out the reason for such auction "dumping": "The object is to stop that $20 million a day it's costing the taxpayers to hold on to those properties ... but for now, everybody is losing." FDIC's William Seidman: "We have yet to find the first person that wants to buy these properties out of a sense of patriotism." Today's BALTIMORE SUN describes the case of the sale of a "huge" TX complex called Stonebridge Ranch to a Japanese buyer for $61M, when it had been valued at $330M (6/27). Today's ST. LOUIS POST-DISPATCH writes of a case of $3.3M in furniture in a TX thrift being sold for $57K (6/27). All of this is contributing to why, in the words of the C.S. MONITOR headline: "Political Shots Fired Over Cleanup; A federal agency is moving faster to dispose of failed thrifts, but not fast enough for some" (6/27). In the midst of it all Charles Keating himself is planning to offer to buy back the Lincoln S&L assets from the government for $500M plus interest -- but "with no money down and gaovernment financing, and [to] manage the assets so the U.S. doesn't lose any money on them" (Paul Duke Jr./Jill Bettner, WSJ, 6/25).

*20 PRINT COVERAGE OF TAX "FLIP-FLOP": "READ MY LIPS ... I LIED"

HEADLINES: N.Y. POST monster front-page headline: "READ MY LIPS ... I LIED! Bush breaks campaign vow, says he must hike taxes." Inside headline: "READ HIS FORKED TONGUE: NEW TAXES!" (6/27). The POST prints nine of his past "promises" not to raise taxes. W.S. JOURNAL front-page headline: "Flip-Flop" (6/27). N.Y. DAILY NEWS headline: "Bush: Don't read my lips" (6/27). WASH. TIMES front-page headline: "President backs away from campaign vow." Inside headline: "Bush bites his lip at taxing breakfast." TIMES also lists his past pledges (6/27).

GOP HOUSE REAX: Rep. Claudine Schneider (running for RI Senate) called Bush's announcement "terrible." Rep. Bill Schuette (running for MI Senate) called himself "deeply disappointed" and "absolutely opposed." Rep. Lynn Martin (running for IL Senate) called it "an idea whose time has not come" (Taylor & Schwartz, WASH. POST, 6/27). Rep. Robert Walker (R-PA) called the move a "dumb trial balloon" and collected 75 signatures from House GOPers by yesterday afternoon for a letter telling Bush "we were stunned by your announcement that you would be willing to accept tax revenue increases" and "we will not vote for" it (PHILA. INQUIRER, Baltimore SUN, 6/27). Rep. Gerald Solomon (R-NY): "The president has to stick to his guns. No new taxes, period" (Bedard & Harvey, WASH. TIMES, 6/27). House Minority Whip Newt Gingrich: "He very explicitly didn't say, 'Raise taxes.' He said, 'Seek new revenues'" (Richard Berke, N.Y. TIMES, 6/27).

OTHER GOP REAX: Ex-Reagan aide Lyn Nofziger: "If I were a Republican senator or congressman seeking re-election this year, I would feel like I had been betrayed." Sen. Charles Grassley (R-IA): "if the president goes back on his tax pledge, it's going to be very bad for his credibility personally ..." Sen. Gordon Humphrey (R-NH): "Without [Atwater], there is no political rudder to this ship" (Ralph Hallow, WASH. TIMES, 6/27). "Conservative consultant" David Keene fears Bush's move is "very dangerous" and may surrender a "key defining issue." RNC's Mary Matalin on the GOP: "No one's panicking or freaking out" (N.Y. TIMES, 6/27). HUD's Jack Kemp: "When he talked about tax revenue increases, I don't think he was violating his pledge. I think he was acknowledging that we need revenues to grow. And he thinks ... that getting the economy back on track ... will do a lot more for added revenues than putting a surtax on the backs of the American people." Conservative Caucus chair Howard Phillips called Bush's statement "really stupid," saying it "cut the ground out from under every Republican candidate for the Senate and House. ... We've seen Bush move toward pro-abortion, funding homosexual groups, embracing Nelson Mandela ..." (Jack Nelson, L.A. TIMES, 6/27). Bush spokesman Fitzwater "refused to concede that Bush had abandoned his campaign pledge," saying, "Are you crazy?" (Carl Leubsdorf, DALLAS MORNING NEWS, 6/27).

DEM REAX: DNC's Mike McCurry: "A lot of Republican candidates are going to have to wake up tomorrow morning and find another reason for running for office" (WASH. POST, 6/27). Consultant Claiborne Darden said Bush "realizes that the buzzards are coming home to roost" (INQUIRER, 6/27). DNC's Ron Brown said "It's no time for partisan gloating" -- in a statement the DNC entitled a response to Bush's "reversal on taxes" (MORNING NEWS, 6/27). DCCC's Rep. Beryl Anthony (D-AR) notes NRCC's Ed Rollins "has said this admission by Bush will result in Election Day losses. The politics of deception practiced by the GOP ... has now deeply divided" the GOP (DCCC release, 6/26). Rep. Robert Torricelli (D-NJ): "Any Bush tax initiative is certain to include new privileges and tax breaks for the wealthy" (JOURNAL, 6/27). VA Dem chair Paul Goldman says the "hard earned wages" of VA families "must not be used as a 'Bailout Fund' to save President Bush" from "ten years of Republican addiction to debt and deficit spending" (VA Dem release, 6/26). NE Dem Party release notes Gov. Kay Orr (R-NE) also "broke her promise to Nebraskans not to raise taxes" (6/26).

1992: Conservative activist Richard Viguerie: "Read my lips: Bush blew it. ... This essentially guarantees a conservative challenge to Bush in 1992" (WASH. POST, 6/27). Cuomo: "I don't think anybody, any Democrat should have any words for the President but congratulations" (N.Y. DAILY NEWS, 6/27). Wilder: "Taxes should not be on the table, period" (WASH. TIMES, 6/27). Yesterday's W.S. JOURNAL editorial: "If Washington now adds to a tax burden already building again in economic bellwhether states," e.g. NY, NJ and CA, "voters in elections from now through 1992 may go looking for politicians and parties to tag with the blame" (6/26).

*21 TAXES ON TV: '88 FOOTAGE COMES BACK TO HAUNT BUSH

OLD LIPS: ABC's lead last night showed Bush at the '88 GOP convention saying, "Read my lips, no new taxes," and Peter Jennings followed with, "Not any more." NBC led with the same clip and Tom Brokaw answered, "Translation: your taxes are about to go up." Brokaw: "Campaign promised are made to be broken."

NEW LIPS: Bush, asked in the Rose Garden if he was breaking

FACT SHEET

UPDATE ON THE FIGHT AGAINST
FINANCIAL INSTITUTION FRAUD

This Administration has aggressively pursued financial institution fraud. In February 1989, during the first month of the Administration, the Attorney General identified fraud against financial institutions as one of the Department of Justice's highest enforcement priorities. That same month, the President proposed a major financial fraud legislative initiative which included stronger civil and criminal tools and major increases in penalties. The following month, March 1989, the President submitted a $36.8 million supplemental budget request for FY 1989 to meet the escalating problem of financial institution fraud. Congress twice denied the extra funding.

Prosecution Efforts Against
Financial Institution Fraud

Even without new resources, the Department of Justice has aggressively pursued financial institution fraud achieving impressive results:

- 791 major fraud (losses over $100,000) convictions for financial institutions fraud in 1989, including both banks and savings and loans.

- 530 active FBI investigations of failed financial institutions in 1990, an increase of 88% from 1987.

In 1987, the Department had established the Dallas Task Force, using existing Criminal Division resources and the resources of other agencies to supplement the work of the U.S. Attorney's Office. Today, the Task Force consists of 22 Assistant U.S. Attorneys and Fraud Section attorneys, 3 Tax Division lawyers, 36 FBI agents, 16 IRS Special Agents, and 3 Office of Thrift Supervision examiners.

In three years, the Task Force has achieved substantial results. It has:

- brought criminal charges against 77 persons

- obtained 52 convictions, 40 of which relate to savings and loan institutions.

It currently has 42 separate savings and loan associations and 560 persons under investigation. Based on the success of the

Dallas Task Force, the Attorney General is expanding the task force concept to a total of 27 cities.

In late November, 1989, the Congress appropriated almost $50 million, which the President had sought earlier that year. As the Department has received these additional resources, it has increased its enforcement efforts and worked to ensure that sufficient resources are focused on the most important cases -- those involving high losses, the weakening or failure of an institution or potential insider fraud. These funds will support:

- 153 FBI agents.
- 118 Assistant U.S. Attorneys.
- 24 Fraud Section attorneys.
- 100 accounting technicians.

In addition, the FBI has already shifted 49 agents to augment the FIRREA financial institution effort and 18 more agents are in the process of being shifted. Thus, a total of 220 agents are being added to the fight against financial institution fraud.

Additional Administrative Efforts Against Financial Institution Fraud

The Attorney General has taken additional administrative steps to address this important problem. He has established the position of Special Counsel for Financial Institutions, reporting to the Deputy Attorney General. The Special Counsel's sole responsibility is to coordinate all matters concerning the investigation and prosecution of financial institution fraud. Additionally, the Special Counsel will ensure that the resources are properly allocated to the most significant financial institution fraud cases. The Attorney General directed the creation of a Financial Fraud Coordinating Unit within the Deputy Attorney General's Office to support the work of the Special Counsel.

The Attorney General and Secretary of the Treasury have formed an interagency group of senior officials from the Department of Justice, Department of Treasury, Federal Bureau of Investigation, Office of Thrift Supervision, Federal Deposit Insurance Corporation, Comptroller of the Currency, Board of Governors of the Federal Reserve System, Resolution Trust Corporation, the National Credit Union Administration, and the Attorney General's Advisory Committee of U.S. Attorneys. This group will prioritize the significant savings and loan cases to be investigated and prosecuted. Chaired by the Special Counsel, this group will enhance interagency coordination and assist in accelerating the investigation and prosecution of these financial institution fraud cases.

To further assist in this effort, the Attorney General and Secretary of the Treasury have directed the creation of a "flying squad" of specialized attorneys and auditors drawn from the Department's Civil and Criminal Divisions, the Office of Thrift Supervision, the Office of the Comptroller of the Currency, the FDIC, and the RTC to concentrate immediate and joint enforcement efforts on selected financial institutions victimized by potentially criminal activity. Upon short notification, this squad will take all appropriate action to preserve assets of an institution, protect the vital documents and records, and undertake an immediate investigation.

The resources of other agencies will also be brought to bear on this problem. The Resolution Trust Corporation has established an Office of Investigations and a national network of investigative teams. Approximately 300 new investigative staff will be added by the end of this year. The IRS will continue to prosecute aggressively individuals who commit tax fraud involving failed financial institutions. The Office of Thrift Supervision has recently opened a new regional enforcement office sited in its Jersey City, New Jersey, office to enhance its enforcement capabilities. OTS intends to open at least two additional regional enforcement offices before the end of 1990.

Additional Legislative Efforts <u>Against Financial Institution Fraud</u>

The Administration supports the package of legislative proposals that provide important additional enforcement tools to attack, civilly and criminally, financial institution fraud. The Departments of Justice and Treasury worked closely with the legislative sponsors in the development of these measures. The proposals will mobilize government-wide resources by allowing the Department of Justice to use, without reimbursement, attorneys, investigators, accountants, and other personnel from appropriate agencies. Also included is a provision to allow law enforcement agencies to request court-authorized wiretaps to investigate bank fraud, false statements to financial institutions, bribery of bank officials, and related offenses for which wiretap authority is not presently available.

The legislative package contains other significant measures. Cases brought by the FDIC and the RTC will receive priority consideration by the courts. Also, procedures for expedited appeals of these cases will be established. The Department of Justice, the FDIC, the RTC and Office of Thrift Supervision will be authorized to seek court orders to freeze the corporate and personal debts of defendants in civil financial institution fraud cases. In addition, the claims of the Federal Government will receive priority over those of creditors in bankruptcy and other claimants in suits against parties responsible for losses due to financial institution fraud.

Victims of financial institution fraud will receive enhanced protections when the legislation is enacted. The legislation authorizes courts to order payment of restitution to all victims of financial institution fraud schemes even where they were not identified in the charges underlying the conviction. Perpetrators of financial institution fraud will be prohibited from using the bankruptcy laws to avoid payment of damages, penalties and forfeitures that are used to reimburse victims.

These new measures will be especially effective when combined with the authority granted in FIRREA. Enacted in August 1989, FIRREA authorized a number of expanded enforcement powers, increased penalties, and procedural improvements to facilitate financial institution investigations and prosecutions. The new law provided (a) increased and expanded civil penalties of up to $1 million (with $5 million for continuing violations) and criminal penalties of up to 20 years' imprisonment; (b) extended forfeiture authority to 18 financial institution related offenses; (c) amended grand jury secrecy protections to facilitate the use of grand jury information in seeking civil actions related to financial institution offenses; (d) made bank fraud a RICO predicate offense; and (e) amended the Right to Financial Privacy Act to prohibit financial institutions from disclosing that records were being sought pursuant to a grand jury subpoena related to financial institution offenses.

DRAFT

THE WHITE HOUSE

Office of the Press Secretary

FOR IMMEDIATE RELEASE   June __, 1990

FACT SHEET
Fighting Financial Institution Fraud

The Administration today announced further steps to intensify the fight against fraud in our nation's financial institutions. These steps include:

- Targeting the most significant S&L and bank fraud cases -- those involving high losses, potential insider fraud, and weakening of the financial institution -- and focusing investigative and prosecutorial resources on these priority matters.

- Upgrading interagency coordination, under the leadership of the Department of Justice, to ensure that all available government-wide resources are properly allocated and deployed in the fight against financial institution fraud.

- Seeking additional legislation in cooperation with Senators Robert Dole and John Heinz to enhance the government's ability to locate and prosecute savings and loan fraud.

Background

In February 1989, the first month of this Administration, the Attorney General identified fraud against financial institutions as a serious problem and one of his top enforcement priorities and called upon Congress for additional investigative and prosecutorial resources. Congress turned down the Administration's March 1989 request for a supplemental appropriation of $36.8 million to combat financial institution fraud. Instead, in FY 1989 Congress cut the FBI request for 40 Special Agents and cut $1 million from the Criminal Division Fraud Section budget.

Even without new resources, the Department of Justice has been aggressively pursuing financial institution fraud, achieving substantial results.

- 791 major convictions for financial institution fraud in 1989 (losses over $100,000)

- 530 failed institutions currently under FBI investigation (up from 282 three years ago)
- 184 major S&L indictments since 1987, with 159 convictions

In 1987, the Department established the Dallas Task Force, using existing Criminal Division resources and the resources of other agencies to supplement the work of the U.S. Attorney's Office. Today, the Task Force consists of 22 Assistant U.S. Attorneys and Fraud Section attorneys, 3 Tax Division lawyers, 36 FBI agents, 16 IRS Special Agents, and 3 Office of Thrift Supervision examiners.

This Task Force to date has brought criminal charges against 77 persons, obtaining 52 convictions, 40 of which involve savings and loan institutions. The Dallas Task Force currently has 42 separate savings and loans and 560 individuals under investigation.

Based on the success of the Dallas model, the Attorney General is expanding the task force concept to 27 other key cities.

In December 1989, the Congress appropriated the money for FIRREA. Part of this appropriation was for enhanced resources. To date, 153 FBI agents have been hired; 90 of 118 Assistant U.S. Attorneys; 22 of 24 Fraud Section attorneys have been hired (or are in the process of being hired); and 100 FBI accounting technicians will be hired. In addition, 12 of the 24 Fraud Section lawyers will be added to the Dallas Bank Fraud Task Force.

Additional Steps

In April of this year, a senior interagency group was established to identify and prioritize the most important cases to be investigated and prosecuted. The focus will be on cases that involve failed or severely weakened financial institutions, where the losses result from insider fraud and manipulation. This group is comprised of representatives from the Department of Justice, FBI, Office of Thrift Supervision, FDIC, Comptroller of the Currency, Board of Governors of the Federal Reserve System, the National Credit Union Administration, the Attorney General's Advisory Committee of U.S. Attorneys, and the Department of Treasury. It will also make recommendations concerning the streamlining and accelerating of the investigatory and prosecutive functions.

The Attorney General has established a new position, Special Counsel to the Deputy Attorney General for Financial

Institutions. The sole responsibility of the Special Counsel will be to coordinate all matters concerning the investigation and prosecution of financial institution fraud and to ensure the implementation of all forthcoming policy initiatives. Additionally, the Special Counsel will ensure that the resources devoted to financial institution fraud prosecutions are properly allocated.

The President, the Attorney General, and the Secretary of the Treasury are expected to meet on Friday, June 22, 1990, with the U.S. Attorneys to underscore the Administration's commitment to continue to address this critical issue. According to the Attorney General, this is the nation's highest economic crime and __________.

The resources of other agencies will be brought in to bear on this problem. The Resolution Trust Corporation (RTC) has established an Office of Investigations and a national network of investigative teams. Approximately 300 new investigative staff will have been added by the end of this year.

Over the last three years, the OTS and its predecessor have required 664 institutions to agree to terminate unsafe and unsound practices, removed over 150 senior thrift officers and directors, and issued 111 cease and desist orders to stop unsafe and unsound practices The IRS is expected to _______.

The Administration will support an amendment to the crime bill sponsored by Senators Dole and Heinz, developed in conjunction with the Departments of Justice and Treasury. This proposal will:

- Enable the Department of Justice to utilize, without reimbursement, the very best legal minds and investigators from other government agencies.

- Allow law enforcement agencies the ability to request the use of wiretaps to investigate ongoing bank fraud, false statements to financial institutions, bribery of bank officials and related offenses for which wiretap authority is not presently available.

- To provide cases brought by the Federal Deposit Insurance Corporation (FDIC) and the RTC priority consideration and to establish procedures for expedited appeals.

- Protect taxpayers by (a) authorizing the Department of Justice, the FDIC, the RTC, and the Office of Thrift Supervision (OTS) to seek court orders to freeze the corporate and personal assets of defendants in civil cases; and (b) providing that claims of the Federal Government have priority over those of other creditors in actions against parties responsible for losses at financial institutions where fraud is alleged.

- Protect victims of fraud by authorizing courts to order payment of restitution to victims of financial institution fraud even in cases where all victims were not identified in the count of conviction.

- Protect victims of fraud by prohibiting the use of bankruptcy as a strategy to avoid damages, penalties, and forfeitures. This would apply to any debtor who committed fraud while acting in a fiduciary capacity to an insured financial institution.

- Provide one uniform, fair, and effective national procedure for the collection of Federal debts and enable the Federal Government to collect criminal and civil judgments through such means as attachments and garnishments and draw on the best features of debt collection laws found in the states.

These measures are support by the President to augment vigorous Administration efforts to root out fraud at financial institutions, protect victims, and bring to justice those who have violated the law.

Withdrawal/Redaction Sheet
(George Bush Library)

Document No. and Type	Subject/Title of Document	Date	Restriction	Class.
01. Note	From Nicholas F. Brady to John Sununu Re: Reaction to Savings & Loan Crisis (2 pp.)	n.d.	P5	

Collection:

Record Group: Bush Presidential Records
Office: Chief of Staff, White House Office of
Series: Sununu, John, Files
Subseries: Issues Files
WHORM Cat.:
File Location: Savings and Loan Industry (1990) [2]

Open on Expiration of PRA
(Document Follows)
By JP (NLGB) on 1/19/09

Date Closed: 12/13/2004	**OA/ID Number:** 29171-002
FOIA/SYS Case #: 1998-0004-F[1] **Re-review Case #:** 2005-0426-S **P-2/P-5 Review Case #:**	**Appeal Case #:** **Appeal Disposition:** **Disposition Date:**
AR Case #: **AR Disposition:** **AR Disposition Date:**	**MR Case #:** **MR Disposition:** **MR Disposition Date:**

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P-1 National Security Classified Information [(a)(1) of the PRA]
P-2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P-3 Release would violate a Federal statute [(a)(3) of the PRA]
P-4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P-5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P-6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.

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Freedom of Information Act - [5 U.S.C. 552(b)]

(b)(1) National security classified information [(b)(1) of the FOIA]
(b)(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
(b)(3) Release would violate a Federal statute [(b)(3) of the FOIA]
(b)(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
(b)(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
(b)(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
(b)(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
(b)(9) Release would disclose geological or geophysical information

SaL

Summary #2

The Secretary of the Treasury

THE CHIEF of STAFF
has seen

John

This is more than you asked for and if you want it condensed into one page that can be done.

The essence of all this discussion is that no one can really prove anything about the S&L situation except that it is expensive. So, the public wants its pound of flesh in terms of prosecutions.

To get the heat off the President the Attorney General

OVER

2/ needs to really energize the ~~D.A.~~ U.S. ATTORNEYS. This is simply a question of what the AG forces his ~~DA~~ U.S. attorneys to concentrate on.

The President should put it to him in a fashion that makes him understand that it is a question of whether he shouldn't help The President

WFB

SaL

Sunnyvale #2

The Secretary of the Treasury

John

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WFB

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02. Memo	From John Robson to John Sununu Re: S&L Fraud Enforcement and Prosecution (3 pp.)	6/19/90	~~P5~~	

Collection:

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Subseries: Issues Files
WHORM Cat.:
File Location: Savings and Loan Industry (1990) [2]

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(Document Follows)
By JP (NLGB) on 5/12/05

Date Closed: 12/13/2004	**OA/ID Number:** 29171-002
FOIA/SYS Case #: 1998-0004-F[1]	**Appeal Case #:**
Re-review Case #: 2005-0426-S	**Appeal Disposition:**
P-2/P-5 Review Case #:	**Disposition Date:**
AR Case #:	**MR Case #:**
AR Disposition:	**MR Disposition:**
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THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON

June 19, 1990

MEMORANDUM FOR JOHN SUNUNU

FROM: JOHN E. ROBSON JER

SUBJECT: S&L Fraud Enforcement and Prosecution

It is worth considering this issue against the background of the Democrats having tried and failed on two other issues related to the S&L crisis: first, that the organizational structure and management system was screwed up; and second, the cost of the S&L cleanup. While the cost issue obviously hasn't been put gracefully to bed, the astronomical and incomprehensively large numbers being tossed around have numbed the physical nerves of the body politic. This has driven the Democrats to seize on an issue that anyone can understand -- catching S&L crooks and putting them in jail.

A few overall points might be made concerning the S&L fraud effort:

- The success we have in prosecuting S&L crooks will not depend as much on the provision of additional resources as it will on the redirecting of priorities of the Justice Department and, in particular, U.S. attorneys. A U.S. attorney has a broad menu of possibilities to which he can devote his limited resources and, unless we put S&L fraud at the top of the list, we can expect only modest results. The extra money we are seeking in the Dole-Heinz legislative package is really more symbolic than substantive, but I think the politics of the present situation require that we go for that extra funding.

- S&L fraud cases are complex and consume considerable investigative resources and time. Some estimate that the time-line of an S&L or bank fraud case from commencement of the investigation to trial may be around four-years. Putting together a solid criminal case is demanding and convictions are considerably less certain than in other sorts of crime. These are factors that have influenced the relatively low appetite of the U.S. attorneys to invest their resources in these kinds of cases.

- To some degree, we are being measured against our own rhetoric. A few months ago the financial institution regulatory agencies started advertising the fact that they had referred some 15,000 to 17,000 S&L fraud "cases" to the Justice Department. The fact is that there aren't anywhere near 17,000 real criminal cases that have been referred to the Justice Department (there is much duplication in the referral statistics and a lot of the "cases" have had no evaluation or investigation before being referred). We need to shift perception away from using that as a calibration of our progress.

What actions are underway to address these and other issues:

1. The legislative package is now essentially agreed upon between the Administration and Senators Dole and Heinz. The package contains a variety of strengthening provisions such as wiretap authority, power to freeze assets of defendants, limitations on bankruptcy discharges for liabilities of perpetrators of S&L fraud, and other measures.

2. Stepped-up activity by the Justice Department on indictments and prosecutions. Just last week, Justice indicted one of the notorious figures in the S&L fraud business and another indictment is expected this week. Justice has had success in these cases with the Dallas Task Force, a multi-agency group which has indicted and convicted 40 individuals connected with S&L's. The Dallas Task Force concept is being expanded to 27 additional cities.

3. We have urged Justice to get a steady drumbeat of indictments, prosecutions and convictions of S&L crooks and see that these are well publicized. On the last point, Justice is now beginning a practice of announcing every indictment and conviction of an S&L fraud case in Washington as well as elsewhere around the country.

4. All of the U.S. attorneys from around the country are being called into Washington this week to get the message from the Attorney General that S&L fraud cases need to be at the top of their list. The President and Secretary Brady are planning to appear at that session.

5. Deputy Attorney General Barr has assembled in his office a special team to continuously monitor and pull the threads together on S&L fraud matters and make sure that

there is a constant flow of communication outward from Washington to the U.S. attorneys' offices so that they stay focused on these cases.

6. This week there will be a meeting by the bank regulatory agencies for the purpose of reaching consensus on the top 100 S&L fraud cases and to present these to the Justice Department as their "most wanted" list. The objectives here are to focus Justice Department resources on the cases that matter and to get public preoccupation away from the 17,000 so-called criminal referrals.

7. At Treasury, we are forming an internal group of the various agencies with law enforcement responsibility and financial institution expertise (Comptroller of the Currency, Office of Thrift Supervision, IRS, Secret Service) so that we are focusing our resources on high probability S&L and bank fraud cases and are using our resources effectively. In addition, we have set up a series of regular meetings between Secretary Brady and Attorney General Thornburgh and their senior staff for the express purpose of collaborating with Justice in pursuing these S&L fraud cases.

For your information, there is attached a fact sheet that Justice is working on which gives you some additional data on what is going on in the S&L fraud area.

In the final analysis, our success is going to rest on the priority and resources which the Justice Department and the U.S. attorneys pour into these cases. We will all benefit by continuing to encourage the Department of Justice to press forward every way possible to produce indictments and convictions and to publicize them widely.

Let me know if you want anything further.

Attachment

DRAFT

THE WHITE HOUSE

Office of the Press Secretary

FOR IMMEDIATE RELEASE

June __, 1990

FACT SHEET
Fighting Financial Institution Fraud

The Administration today announced further steps to intensify the fight against fraud in our nation's financial institutions. These steps include:

- Targeting the most significant S&L and bank fraud cases -- those involving high losses, potential insider fraud, and weakening of the financial institution -- and focusing investigative and prosecutorial resources on these priority matters.

- Upgrading interagency coordination, under the leadership of the Department of Justice, to ensure that all available government-wide resources are properly allocated and deployed in the fight against financial institution fraud.

- Seeking additional legislation in cooperation with Senators Robert Dole and John Heinz to enhance the government's ability to locate and prosecute savings and loan fraud.

<u>Background</u>

In February 1989, the first month of this Administration, the Attorney General identified fraud against financial institutions as a serious problem and one of his top enforcement priorities and called upon Congress for additional investigative and prosecutorial resources. Congress turned down the Administration's March 1989 request for a supplemental appropriation of $36.8 million to combat financial institution fraud. Instead, in FY 1989 Congress cut the FBI request for 40 Special Agents and cut $1 million from the Criminal Division Fraud Section budget.

Even without new resources, the Department of Justice has been aggressively pursuing financial institution fraud, achieving substantial results.

- 791 major convictions for financial institution fraud in 1989 (losses over $100,000)

- 530 failed institutions currently under FBI investigation (up from 282 three years ago)
- 184 major S&L indictments since 1987, with 159 convictions

In 1987, the Department established the Dallas Task Force, using existing Criminal Division resources and the resources of other agencies to supplement the work of the U.S. Attorney's Office. Today, the Task Force consists of 22 Assistant U.S. Attorneys and Fraud Section attorneys, 3 Tax Division lawyers, 36 FBI agents, 16 IRS Special Agents, and 3 Office of Thrift Supervision examiners.

This Task Force to date has brought criminal charges against 77 persons, obtaining 52 convictions, 40 of which involve savings and loan institutions. The Dallas Task Force currently has 42 separate savings and loans and 560 individuals under investigation.

Based on the success of the Dallas model, the Attorney General is expanding the task force concept to 27 other key cities.

In December 1989, the Congress appropriated the money for FIRREA. Part of this appropriation was for enhanced resources. To date, 153 FBI agents have been hired; 90 of 118 Assistant U.S. Attorneys; 22 of 24 Fraud Section attorneys have been hired (or are in the process of being hired); and 100 FBI accounting technicians will be hired. In addition, 12 of the 24 Fraud Section lawyers will be added to the Dallas Bank Fraud Task Force.

Additional Steps

In April of this year, a senior interagency group was established to identify and prioritize the most important cases to be investigated and prosecuted. The focus will be on cases that involve failed or severely weakened financial institutions, where the losses result from insider fraud and manipulation. This group is comprised of representatives from the Department of Justice, FBI, Office of Thrift Supervision, FDIC, Comptroller of the Currency, Board of Governors of the Federal Reserve System, the National Credit Union Administration, the Attorney General's Advisory Committee of U.S. Attorneys, and the Department of Treasury. It will also make recommendations concerning the streamlining and accelerating of the investigatory and prosecutive functions.

The Attorney General has established a new position, Special Counsel to the Deputy Attorney General for Financial

Institutions. The sole responsibility of the Special Counsel will be to coordinate all matters concerning the investigation and prosecution of financial institution fraud and to ensure the implementation of all forthcoming policy initiatives. Additionally, the Special Counsel will ensure that the resources devoted to financial institution fraud prosecutions are properly allocated.

The President, the Attorney General, and the Secretary of the Treasury are expected to meet on Friday, June 22, 1990, with the U.S. Attorneys to underscore the Administration's commitment to continue to address this critical issue. According to the Attorney General, this is the nation's highest economic crime and __________.

The resources of other agencies will be brought in to bear on this problem. The Resolution Trust Corporation (RTC) has established an Office of Investigations and a national network of investigative teams. Approximately 300 new investigative staff will have been added by the end of this year.

Over the last three years, the OTS and its predecessor have required 664 institutions to agree to terminate unsafe and unsound practices, removed over 150 senior thrift officers and directors, and issued 111 cease and desist orders to stop unsafe and unsound practices The IRS is expected to _______.

The Administration will support an amendment to the crime bill sponsored by Senators Dole and Heinz, developed in conjunction with the Departments of Justice and Treasury. This proposal will:

- Enable the Department of Justice to utilize, without reimbursement, the very best legal minds and investigators from other government agencies.

- Allow law enforcement agencies the ability to request the use of wiretaps to investigate ongoing bank fraud, false statements to financial institutions, bribery of bank officials and related offenses for which wiretap authority is not presently available.

- To provide cases brought by the Federal Deposit Insurance Corporation (FDIC) and the RTC priority consideration and to establish procedures for expedited appeals.

- Protect taxpayers by (a) authorizing the Department of Justice, the FDIC, the RTC, and the Office of Thrift Supervision (OTS) to seek court orders to freeze the corporate and personal assets of defendants in civil cases; and (b) providing that claims of the Federal Government have priority over those of other creditors in actions against parties responsible for losses at financial institutions where fraud is alleged.

° Protect victims of fraud by authorizing courts to order payment of restitution to victims of financial institution fraud even in cases where all victims were not identified in the count of conviction.

° Protect victims of fraud by prohibiting the use of bankruptcy as a strategy to avoid damages, penalties, and forfeitures. This would apply to any debtor who committed fraud while acting in a fiduciary capacity to an insured financial institution.

° Provide one uniform, fair, and effective national procedure for the collection of Federal debts and enable the Federal Government to collect criminal and civil judgments through such means as attachments and garnishments and draw on the best features of debt collection laws found in the states.

These measures are support by the President to augment vigorous Administration efforts to root out fraud at financial institutions, protect victims, and bring to justice those who have violated the law.

STENY H. HOYER
CHAIR

VIC FAZIO
VICE-CHAIR

Democratic Caucus

U.S. HOUSE OF REPRESENTATIVES
718 ANNEX #1 HOUSE OFFICE BUILDING WASHINGTON, DC 20515 (202) 226-3210

Penny Gentilly
EXECUTIVE DIRECTOR

June 18, 1990

Dear Democratic Colleague:

This week's Democratic Message to the American people focuses our attention on the Bush administration's lack of leadership in cleaning up the S&L mess.

As Democrats, we share the growing concern of our working families about the ever-escalating amount of tax dollars the Administration estimates it needs to bail-out insolvent S&Ls. In the past several months, the President's top advisors have **more than doubled** the estimate they intend to apply to the bailout, and then cautioned that even these projections were soft . Yet rather than putting a stop to this hemmoraging, . the Bush administration is continuing to allow hundreds of failed savings and loans to remain open — further compounding the costs of the S&L bailout by billions of dollars.

It is the costs unseen that truly alarm and dismay America's working families. Our youngest working families are now confronting the first effects of this fiasco when they apply — and are denied — their first home mortgage. And our children will bear the brunt of the President's foot-dragging well into the next century. The schools that will go unbuilt, the bridges that will go unrepaired, and the educations that will go unfunded are the real toll of Bush mismanagement.

I have attached an excellent package on the S&L bailout, which includes S&L facts and Democratic talking points, prepared by DNC Research. I hope that it is helpful as you talk with your colleagues and constituents this week, and in the weeks ahead.

With warmest personal regards, I am

Sincerely yours,

STENY H. HOYER

MESSAGE BULLETIN

Talking Points on the S&L Issue

1. There is no need to pick over the bones of the S&L scandal--we know what happened. What we need to do is fix the S&L mess.

2. Bush is foot-dragging on the S&L cleanup and is already repeating the costly mistakes made by the Reagan Administration. The result is a doubling in taxpayer cleanup costs to $500 billion -- in just 7 months.

3. Bush supports hiding the costs of the S&L bailout from taxpayers by keeping it "off-budget" and out-of-sight. Democrats, it must be remembered, supported "truth-in-budgeting" on the Bush bailout last year by margins of 181-67 in the House and by 47-6 in the Senate.

4. Public discontent with President Bush's mishandling of the S&L bailout is growing. The mid-February Harris Poll which gave President Bush a 70 percent approval rating also found that 60 percent of Americans disapproved of his plan to bailout the S&Ls.

Hey George, How Much Will It Cost?

Every time you look the other way, it seems like the Bush Administration is revising its projections on how much Bush's S&L bailout will cost U.S. taxpayers.

- In August, 1989, Bush declared that it would cost taxpayers $166 billion to make sure "these problems will never happen again." (Weekly Compilation of Presidential Documents, 8/89)

4/5 [illegible] how much cost to taxpayers

- In March, 1990, the Bush bailout squad quietly requested an additional $100 billion in "working capital" from the U.S. Treasury to finance new S&L bailouts in 1990 (WSJ, 3/6/90).

- In May, 1990, the Bush Administration admitted the bailout will cost over $300 billion in the years ahead -- double the amount predicted by Bush just 7 months ago (WP, 5/24/90). That same month, the General Accounting Office estimates that the bailout will cost a little bit more -- between $325 and $500 billion.

- On June 14, 1990, Administration officials warned that this latest estimate was as perishable as sour cream on a hot summer day. Treasury Secretary Nicholas Brady explained that the Administration was "in the midst" of calculating how much money the Administration would need. (NYT, 6/15/90)

- Federal Reserve Chairman Greenspan put it another way: "the size of this hole is astronomical." (NYT, 6/15/90)

- Bush's S&L black hole: just how much will it cost?

You Too Can Own an S&L

- Desperate for working cash to bailout additional S&L's, the RTC is selling off control of S&L deposits at firesale prices -- to corporate raiders like Ronald Perelman.

- On March 15, 1990, the Resolution Trust Corporation (RTC) actually gave North Carolina National Bank $700,000 to take Bankers S&L of Galveston and its $104 million in deposits off the agency's hands (RTC Releases).

- Three other S&L's -- with $154 million in deposits -- have been sold for the price of a new Buick Le Sabre automobile (RTC releases).

- S&L buyers are being allowed to pick over the assets of acquired thrifts for months -- creamskimming the best assets and returning unwanted, worthless properties to the U.S. taxpayer.

- Asset buyers are paying the U.S. taxpayer an average of 60 cents on the dollar for the properties they do want (Southern Finance Project).

- And who are getting these "bargain basement" deals? People like corporate raider Ronald Perelman, who was recently awarded the $2 billion San Antonio Savings Association for just $10 million (RTC).

Isn't This Taking Kinder and Gentler A Bit Too Far?

U.S. taxpayers may be a bit surprised to find out that President Bush isn't just paying off insured deposit holders -- under the Bush bailout, everybody in line is getting paid off.

- o Unless something is done, the Bush Administration is planning to pay off millions -- perhaps billions -- in uninsured S&L deposits and liabilities (RTC, Southern Finance Project).

- o So far, the RTC has already paid out $50 million to investors whose accounts were above the $100,000 insured limit (RTC).

- o And because the Reagan and Bush Administrations dragged their feet on closing down failing S&L's, U.S. taxpayers may be forced to pay off some $26 billion in mortgage-backed bonds issued by S&L's during the late 1980s (Business Week, 4/23/90).

- o Most of these bonds were issued by high-flying S&L's who had no business being in business -- but investors flocked to buy these high-interest bonds because they knew that the federal taxpayer would ultimately foot the bill.

- o The added cost of President Bush's "generosity" to uninsured investors will be enormous -- driving up the cost of the bailout by as much as 33 percent.

1 Out of 21,000 Is Not a Good Batting Average

The Don Dixon indictment last week was a long overdue first step in bringing S&L thieves to justice.

Unfortunately, the Justice Department is still dragging its feet on more than 21,000 S&L fraud and embezzlement cases (Washington Post, 3/27/90).

Maybe this isn't surprising given that George Bush decided to spend only $50 million of the $75 million appropriated by Congress for the S&L crimes. Mr. President, what's the holdup?

One out of 21,000 is not an unacceptable batting average when it comes to recovering stolen taxpayer funds.

Don't Let History Repeat Itself: Close'em Down Now

Ignoring the lessons of the 1980s, the Bush Administration is allowing hundreds of failed S&L's to remain open -- compounding the costs of the S&L bailout by billions of dollars.

<u>700 More Failing S&Ls: Are They Being Ignored</u>?

In May 23 testimony to Congress, Treasury Secretary Nicholas Brady understated the true size of the S&L problem, saying that at most 1,000 thrifts will have to close down.

By contrast, the non-partisan Congressional Budget Office predicts that as many as 700 additional thrifts will need to be shut down -- at an additional cost to taxpayers of up to $100 billion (NYT, 6/14/90).

<u>The Costs of Ostrich Mentality</u>

Losses at insolvent thrifts ignored by the Bush Administration will soar because thrift owners, having nothing to lose, often gamble taxpayer funds on risky new investments to try and recoup their losses. These thrifts stay open by paying interest on deposits not from any profits on investments, but from new deposits lured in by excessively high interest rates. And who guarantees these new deposits? Why taxpayers, of course.

Mr. President what are you waiting for? Take your head out of the sand and learn the lessons of the past. Stop the S&L bleeding today.

FOR FURTHER INFORMATION, CONTACT:
DNC RESEARCH
863-8000

Minimum Funds Needed to Resolve The Savings and Loan Crisis

(All amounts in billions)

Estimate Based on OMB's July 1989 Funding Summaries:

FSLIC Assistance Transactions	$ 56	
RTC Resolutions	50	
REFCORP Interest Expense	69	
Financing Corporation (FICO) Interest Expense	31	
Establish Savings Association Insurance Fund (SAIF)	9	
Post-RTC Resolutions	24	
Non-RTC Administration and Other	9	
Subtotal - Direct Funding Needs	248	
Lost Tax Revenues From FSLIC Transactions	9	
Total Based on OMB's July 1989 Estimates		$257[a]

Additional Funds Needed For:

FSLIC Assistance Transactions	$ 12	
RTC Resolutions	13	
RTC Administrative Expenses	10	
Interest on RTC Working Capital	28	
Additional REFCORP Interest Expense	5	68[b]
Minimum Funds Needed		$325

[a]This estimate is based on OMB's estimates of the funds needed during fiscal years 1989 through 1999. However, funds will be needed in later years to pay interest on REFCORP and FICO bonds. OMB assumed that they would issue 30-year bonds. Therefore, our estimate included the entire amount of interest that would be incurred over the 30-year life of the bonds.

[b]These additional funds will be needed over different periods of time. Most of the funds ($63 billion) will be needed before the end of fiscal year 1999. The additional interest is primarily due to an extra 10 years of interest because REFCORP issued 40-year bonds instead of 30-year bonds.

Source: OMB July 1989 funding summaries and information from FSLIC, FDIC, RTC, and REFCORP.

JIM LEACH
MEMBER OF CONGRESS

6/18/90

THE CHIEF of STAFF
has seen

John –

Per your request, attached are some perspective statements on the S+L mess, with particular emphasis on Congressional accountability.

Best,

Jim

THE SAVINGS AND LOAN SCANDAL:
A CONGRESSIONAL WATERGATE

Comments Prepared for Delivery by
Representative Jim Leach
at the Midwest Republican Leadership Conference
August 26, 1989
Minneapolis, Minnesota

The signal scandal of this year, this decade, this century, is the S&L mess. To put it in context, let me relay an episode that occurred last Spring in Ames, Iowa.

At the end of the basketball season a star forward on the Iowa State University team walked into the campus Burger King carrying a rifle without a mask and asked the high school sophomore at the counter to hand over the money in the cash register. The team's picture, featuring this strapping 6'9'' forward, was on the wall. The girl at the cash register greeted him as he approached: "Hi Sam". He looked up and said "It's not me!"

What we have with Congress and the S&L scandal is another kind of robbery, the biggest bank heist in history -- one that goes beyond individual vaults to pick the pocket of every American. And the team picture is on the wall. It is the bi-yearly snap shot of Congress. Congress should and must be held accountable. Not Congress alone, but in particular, because loose laws led to loose regulation which led to loose banking practices.

We are confronted in essence with a problem so large that it hasn't sunk in with the American people. Everybody in Iowa understood the couple of hundred dollars that Sam Mack wanted to take from that Burger King, perhaps to buy a pair of sneakers. But once we get into millions and then billions, the greed is more difficult to comprehend. We have a bailout larger than Lockheed, plus Chrysler, plus New York City, times a factor of ten. We have a fraud scandal that is equivalent to Teapot Dome to Abscam times a factor of 100. And one might ask, "What happened?"

Basically speaking we had too cozy a relationship between the regulated and the regulators and too cozy of a relationship between the regulated and the oversight body, the lawmakers, particularly Congress. It got magnified in state legislatures, particularly in growth states, where for parallel reasons legislators decided to give more powers to the S&L industry, powers which had never been granted to financial institutions in the history of the country.

State legislators understood that we have a national insurance fund and that if mistakes were made, it would be the federal taxpayer who would bail them out. Under the dual system -- federal and state -- of chartering and regulating, the American people have found that legislators elected in states like Texas and California had the power, not only to tax their own residents, but through egregious failures of oversight of state institutions, to tax citizens of Iowa and Minnesota as well.

Every man, woman, and child from Iowa, Minnesota, Wisconsin and North Dakota are on the line for between $500 and $2,000, almost half of which will go to bail out the states of Texas and California. The Midwest and Northeast, in other words, have not only transferred their wealth on a one shot basis to the Southwest and West, but they have, with this transfer, built an infrastructure of homes and modern offices that will stand as a government-induced incentive for internal American migration.

It is a criminal, and I use the word advisedly, criminal transfer of wealth from one region of the country to another. It all occurred because legislative bodies lost their grip on representing the national interest and instead came to represent particularist regional and industry interests.

Let me give a couple of examples. Largely unreported, the influence of the thrift lobby in growth state legislatures and governor's offices is legion. At the national level, according to public reports in the 1987-88 election cycle, thrift lobbyists gave about $1.8 million to candidates for Congress. Also according to public reports, the industry in that time period lost about $18 billion. It is probably double that if honest accounting were applied. If by the wildest stretch of the imagination the public might conclude that the giving of money ensured that laws would be kept weak and enforcement lax, thrift lobbyists received a ten to twenty thousand to one return on investment.

I think it is time for the American people to recognize that a scandal has occurred and that this scandal continues to be in the making. What we really have is a Congressional Watergate. I raise this analogy for a couple of reasons.

Interestingly, when you look at the historical circumstances that surround Watergate, one of the questions that people did not pay a lot of attention to at the time was: Why Watergate? What did the President have in mind by sending a band of idiots to attempt to break in to someone named Larry O'Brien's Watergate office?

No one knows for sure because Mr. Nixon has yet to reveal, but circumstantial evidence indicates that O'Brien -- and this sounds as if it were a novel plot of unbelievable proportions -- had represented in the late sixties and early seventies America's most reclusive billionaire, Howard Hughes, who had apparently given an illegal $100,000 gift to Mr. Nixon to expand either his San Clemente or Florida White House.

At the same time, it is reputed that he may also have given $100,000 to a prominent Democratic Senator. The point is that at the heart of Watergate was dollars and the possibility that what the Watergate thugs were trying to get at is whatever paper trail might be in Larry O'Brien's safe that could become an issue in the 1972 election. This theory, while unprovable, is given certain credence by a break-in authorized by the same people in the same time frame of a Las Vegas newspaper editor who wa investigating the story.

I relate this story because at the heart of the S&L issue is the conflict of dollars with public policy values -- the greed factor influencing legislative bodies.

In Chinese history there is a theory of revolution based upon a mandate of heaven. A government can stay in power as long as it maintained a mandate not from the people but from heaven. The government may be overthrown when the mandate is removed as signalled by natural phenomena like droughts, floods, and hurricanes. My sense is that the American people are in the process of concluding that the mandate from heaven ought to be removed from the political party that has controlled Congress the past half century. Conflicts of interests that cost real people real money are of earthquake proportions. They imply it is time to remove the mandate of leadership from the majority party in Congress.

As we look around the world, it is remarkable that people are aspiring to greater independence and freedom, not only in closed societies like Poland and Hungary, but in democratic societies like Japan, where the alternative party suddenly has became viable because of scandal. The "ins" have been tempted so long that the "outs" have developed a credible case for change.

In this context, the obvious sometimes takes awhile to sink in. For example if you recall the Watergate circumstance, it occurred well before an election. It had no effect for six months, nine months, a year, and then suddenly people recognized the Constitutional unseemliness of what had occurred.

What we have in American politics is a legislative branch scandal of unprecedented dimension. What has to be thought through is what we as a public do about it.

The President has suggested that we ought to have campaign reform. The Democratic party in Congress has historically stood a little bit more for campaign reform than the Republican. But intriguingly, when it comes close to something happening, the Democrats have repeatedly backed off. They understand that the current system ensconces incumbency and that they are the incumbents.

The "cause celebre" of the S&L issue, as well as the lack of discipline that has led to the deficits, should be a demand for campaign reform. The Republican party ought to stake out the position as the party of reform in American politics, the party of righteous indignation. We ought to suggest to the world that we are a party that stands for and will deliver change; that we will return our legislative bodies to the people and remove them from the disproportionate influence of monied influence peddlars.

If America is going to remain the envy of the world, it is going to be awfully important that the party of governance becomes the party of fair rules as well as free enterprise. As the minority legislative party, we have been given an opportunity that has seldom been given a political party -- if we just recognize its symbolic significance and are willing to respond -- in policy terms as well as personal example.

Good people with good causes can change the world.

Thank you.

SILVERADO BANKING, SAVINGS AND LOAN ASSOCIATION

HEARINGS

BEFORE THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES

ONE HUNDRED FIRST Congress

SECOND SESSION

MAY 22 and 23, 1990

Printed for the use of the Committee on Banking, Finance and Urban Affairs

Serial No. 101–124

PAGE PROOF

U.S. GOVERNMENT PRINTING OFFICE

30–359 WASHINGTON : 1989

Mr. LEACH. Now, the reason, again, I raise this issue is that exponential growth in the financial community is something that most people look at pretty carefully if they are regulators, and apparently it wasn't looked at overly carefully here, and if we look at some of the dynamics of this, as I look at what happened at this particular institution, in 1985 the real estate owned by the institution grew 10-fold from 1.7 to $17.1 million.

In 1986 Silverado reported a RAP net loss of $15.7 million, while at the same time reporting a GAAP income of $15.5 million, partly because it reversed some $13 million in loan loss reserve allowances. Then in 1988, and this is in March of 1988, long after some of you said that you had indicated that you saw some problems, the rating was actually improved from a 4 to a 3. Is that correct?

Mr. SANDEFUR. What you are referring to is a limited exam that was done in March of 1988 where one of the five ratings that makes up the composite rating was upgraded from a 4 to a 3.

However, the——

Mr. LEACH. Which rating is this?

Mr. SANDEFUR. On interest rate risk management.

Mr. LEACH. Yes?

Ms. VAN CLEAVE. Actually the rating was downgraded from a 2 to a 3. Composite rate is a 4. They only rated risk management, and they rated it a 3.

Mr. LEACH. Let me just say my sense is that we had some misdoings on the board, but the regulators don't come out of this quite as nicely as I think the appearance today from your testimony would make it look.

My own sense is the gentleman from Illinois was looking at people that might be sued. It strikes me that the system that we set up from here in Congress ought to be suable. That is, we set up a system that allowed this kind of exponential growth and then allowed the regulators themselves to be part of an institution that itself was a bank that lent money to the regulated in a way that is not overly prudential.

Finally, let me just conclude because I have a little bit of background with one of the people that has been talked about today, I think we are focusing on an outside director when we should be focusing on the problem.

I know Neil Bush as a thoughtful young man who I think frankly was lured into becoming an outside director in a financial institution, which at the time was composed of inside directors who appeared to be good community citizens when, in fact, they may have been up to their ears in scheming conflicts.

It is conceivable that mischievous people with mischievous motives might have wanted to use the son of the then vice-president, but I frankly find it inconceivable that Neil Bush wittingly did anything wrong. I raise this mainly in the context of the calling of witnesses, this being the first panel that has been called bringing in outside directors. Reputations, after all, are at stake here.

Let me just say from the perspective of the minority, I have frankly disagreed with issues of almost everybody on this committee from time to time, and I have also disagreed with some of the past positions that I, myself, have taken, but I have been very careful not to raise individual names in an accountability sense. That is for other people to do.

Frankly, I think in assessing our work product of the past decade we have all flunked, but there is a great difference between flunking in judgment and failing in character tests, and I think we ought to discriminate between those very carefully. All of us have made mistakes, but as a former cabinet member once suggested when he was acquitted of an alleged crime, where do you go to get back your reputation?

I think we all ought to be very conscious of this problem and very concerned that the shadow of Charles Keating not come to fall over the wrong people because of misunderstood circumstances. Finally, let me just say, I think maybe Neil joins us all in Congress in not seeing the big picture soon enough, but he is a very fine young man with a fine future.

I hope we are not unfair to him in ways that are unfair to the system itself. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Leach.

Mr. Neal.

Mr. NEAL OF NORTH CAROLINA. Thank you, Mr. Chairman.

I would like to ask each of you to comment, if you would, briefly on this question. In trying to understand this problem in the broad sense, and I am not now focusing only on Silverado, but on the whole savings and loan mess or however you would like to characterize it.

I have come to think that, oh, 80 percent of it is the result of crooks, crooked activity, gross mismanagement, and then the supervisory regulatory structure simply not doing its job, either at the Federal or State level.

I say 80 percent because I recognize that the high inflation of the late 1970's and other economic conditions played a role in this. But 80 percent of it just was crooked activity and then the regulatory supervisory restructuring, and in many cases the Administration consciously deciding not to do its job.

Would you all agree with that characterization, and if not, how would you disagree?

Mr. HERSHKOWITZ. Congressman, I guess of the panel members here, I have the broadest breadth of experience seeing the whole country from Washington. Their view is limited to a portion of the country. Even so, because I am in enforcement, I only see the worst situations.

All the situations that I have seen obviously would involve some type of mismanagement or fraud, but I don't think any of us on the panel have a broad enough experience in the whole situation to be able to give you even an estimate of the percentage due to fraud.

Mr. NEAL OF NORTH CAROLINA. Would you take exception to my characterization of it based on your own experience?

Mr. HERSHKOWITZ. As I said in my experience, I only get the worst of the worst. I just don't have any basis for estimating what happens in the other ones.

Mr. NEAL OF NORTH CAROLINA. Well, based on what you have seen.

Mr. HERSHKOWITZ. I can tell you I have read the newspaper and I have heard other people guess how much it is. I believe Congress-have a chance to hear from the witnesses. We have witnesses that are, in goodwill and voluntarily, saying yes, we want to come and cooperate with the Congress and the committee.

We want to give you our side of the story, and that is what we are here for. Now, does any other member wish to speak?

Mr. Leach?

Mr. LEACH. Mr. Chairman, let me stress that I am pleased that you are continuing these hearings about Silverado. They are important, because they are similar to some of the other giant thrift failures, but they are also unique in their use of loan commitments to fund preferred stock. Having said, though, that the hearings should go forth, I must confess to some discomfort at the decision to include outside directors on the invitation list.

I raise this because while it is not unprecedented in the history of this committee, it was not done with thrifts such as Lincoln and Centrust. In this context, I would like to repeat what I said yesterday about the shadow-casting implications of quasi-investigative hearings of this nature, and the capacity of Congress, especially Congressional committees, to irrationally taint reputations.

I have reviewed carefully the information brought to this committee to try to put myself in the place of our principal witness this morning, a witness by the way who has shown the courage and grace to face adversity unlike the principles in this institution. And I would stress as strongly as I can my view that Neil Bush is a thoughtful, decent young man who was lured into becoming an outside director, whose inside directors appeared to be good community citizens and innovative thrift managers following the deregulation philosophy of a former administration and financial institutional designs of former Congresses.

The fact that inside directors were up to their ears in conflicts was not likely to be clear to a young man entering a new town and a new area of business when even the shrewdest in American finance, i.e., the outside auditors, were taken in.

I stress this aspect of hindsight in part because of the perspective provided in the testimony of witnesses yesterday. An extraordinarily principled and intelligent partner in a big eight accounting firm testified how his firm arrived at unqualified audits, how it reported profitable performance under generally accepted accounting practices for the institution. It appears now that such profits were largely smoke and mirrors.

But we have to understand that we are looking retrospectively. At the time many believed that this thrift was headed by one of the most brilliant financial managers in the country, a man who today may look a bit like Bert Lance, but who then held the ear and confidence of Federal regulators in the Topeka office.

It is conceivable that mischievous people might have wanted to use the son of the Vice President. It is inconceivable that Neil Bush wittingly did anything wrong.

I raise this in the context of the reputation of the Presidency and of the individual. With regard to the first, this committee knows better than any group of Americans that it is this President who immediately upon taking office, moved to close down thrifts like Silverado, throw out their leadership, and stem the red ink to the taxpayer. It is this President who pledged to bring thrift crooks to the bar of law.

As for the individual, the young son of the President, he appears to have been used just as were some of the world's best certified public accountants, some of the country's most approximate regulators, State and Federal, and the entirety of this Congress.

In this context, let's be clear that the shadow of Charles Keating falls in a lot of directions but it does not fall on the First Family. Neil Bush is a fine young man with a wonderful family and bright future. Let's be cautious about hinting or implying questions of character when primarily at issue is a giant public policy error which disproportionately got reflected in almost an entire region of the country.

Thank you.

The CHAIRMAN. Mr. Leach, if you will yield, we can't have it both ways. We can't prejudge either guilty, as I was trying to insinuate, or innocence in your case. I don't know that Mr. Bush has asked for any defense on our part. The record speaks for itself and this is what we are trying to get at.

I think we want to hear from him and then on the basis of the testimony of he and the other witnesses, make conclusions. But I think we can't have it both ways. We can't say, "You shall not condemn and prejudge," nor can we say, "Well, the man is holy and pure" and everything else.

Mr. LEACH. Mr. Chairman, let me just say that I think the Chairman of this committee has done a great public service in the entirety of the hearings that he has participated in. I do not want to raise doubt about that, but I do want to make it clear that we have invited a large number of witnesses to bring perspective and this hearing is not a quasi-judicial setting. We are simply trying to get at the facts of a circumstance, but the visage of what is happening here can be misleading to a large public audience.

I think that that visage has to be put in proper perspective.

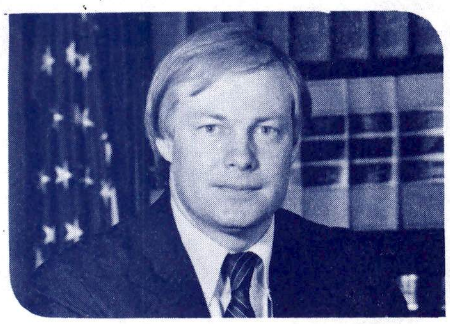
The CHAIRMAN. I understand.

Yes, Mr. Neal.

Mr. NEAL. I would just like to make a brief comment if I can. There was a story in the Washington Post this morning that implied that the hearings were essentially some sort of partisan exercise, and the reason I mention this is because I was quoted and I wanted to be clear that that is certainly not my intent. I don't think it is the intent of anyone else.

I have come to think—well, in the first place, these hearings are about trying to understand what is going on. Now, I have come to think that, I have come to understand the problem this way, that there was conscious decision on the part of the administration not to administer this law. That the idea was to get government off the backs of business in general including the savings and loan industry, and when a bunch of sharp operators and crooks figured it out, they stole the country blind.

Now, maybe this understanding is incorrect. I go to hearings and ask people about this understanding, and so far I think we are finding general agreement on it. But when we ask questions, it is not intended to be partisan.



JIM LEACH
IOWA'S CONGRESSMAN
FOR THE FIRST DISTRICT

SPEED UP S&L CROOK PROSECUTION, REP. LEACH URGES SECY. BRADY

FOR IMMEDIATE RELEASE
CONTACT: Joe Pinder 202/225-6576

WASHINGTON, D.C. (June 14, 1990) -- Rep. Jim Leach, in a House Banking Committee oversight hearing, today called on Treasury Secretary Nicholas Brady and Federal Reserve Chairman Alan Greenspan to accelerate the prosecution of white-collar criminals involved in the savings and loan scandal.

"Savings and loan executives have taught the world that you don't have to break into Fort Knox to steal the government's gold," Leach (R-IA First District) said at the hearing.

"Failure to move expeditiously against white-collar financiopaths risks a loss of public confidence and public monies," said Leach, the second-ranking Republican on the Banking Committee. "Whether a bank is robbed from within or without, justice must be pursued."

"The most blatant way to rob a bank may be with a rifle at the teller's window, but the lesson of the 1980s would appear to be that the easiest way to steal from the taxpayer is to own a federally insured financial institution," noted Leach.

Secretary Brady responded to Leach's comments by noting that the Justice Department has recently indicted a Texas S&L owner who, if convicted, would face 190 years in jail and $9.5 million in criminal fines.

Leach is a sponsor of two bills which would encourage and give the Justice Department more powers to investigate and prosecute crimes against S&L institutions. The bills also would assist the federal government in recovering funds misappropriated by S&L crooks.

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THE LESSON OF THE S&L DEBACLE: THE NEED FOR CAMPAIGN FINANCE REFORM

A Statement by
Representative Jim Leach
before the
U.S. House of Representatives
April 24, 1990

Mr. Speaker, of all the lessons of the savings and loan debacle, one stands out: the need for campaign finance reform. S&L-gate, the fact that every living American and a good many yet to be born will be required to put up $1,000 to $2,000 a piece over the next 30 years to cover up public policy mistakes, makes Teapot Dome and Abscam government scandals of peanut proportions.

What is so extraordinary is that so few in this body seem to recognize that the root of the S & L problem is weak law and that the root of weak law was not a collusive attempt of ill-willed legislators to defraud the public, but rather of well-intentioned solons operating under the rubric of politics as usual.

It is the system that has perverted judgment, not the individual who has perverted the system. Hence the need for reform of a campaign system that allowed an industry to give $1.8 million to candidates in the last election cycle while losing over 100,000 times that amount in federally-insured deposits over the last decade and 10,000 times that amount in the past year alone. Taxpayers who are being asked to pay the Congressional piper demand that this kind of return on political investments be stopped, once and for all.

Yet, tragically, news reports and rumors abound that America's senior political party -- a party in which the majority has rhetorically supported campaign reform for over a decade -- may again refuse to translate good public intentions into good public statute. The "no-limit" limit currently being bandied about by the party that used to claim so proudly it stood for the little man -- the prescription that PAC contributions to a House candidate be "limited" to $275,000 each election cycle -- defies any reasonable definition of reform. It represents an ensconcing of the status quo, an invitation to continued conflicts of interest.

What America needs is a Congress indebted to the individual citizens who click the voting levers, not to the monied groups which tilt the levers of power.

In the highest sense, politics should be the art of representation, not the art of electoral manipulation.

JIM LEACH

IOWA'S CONGRESSMAN
FOR THE FIRST DISTRICT

FOR IMMEDIATE RELEASE
Thursday, January 12, 1989

CONTACT: Joe Pinder
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LEACH BLISTERS CALIFORNIA LEGISLATURE OVER THRIFT CRISIS

San Francisco -- In a blistering attack on the California State Legislature, Iowa Congressman Jim Leach today pointed out that loose state laws impelled loose regulation in the California savings and loan industry which in turn placed a multi-billion dollar obligation on federal taxpayers.

Leach is in San Francisco to take part in House Banking Committee field hearings on the savings and loan crisis.

"While there is plenty of blame to go around for the savings and loan crisis, the accountability of several state legislatures, particularly California, for federal tax obligations represents an unprecedented kind of political scandal," Leach said.

"In essence, America is looking at an industry of cooked books with regulators serving as master chefs and legislators salivating as pot stirrers," Leach suggested.

"Because state-chartered and directed institutions receive federal insurance, it is the federal government and not the state government which carries the liability for egregious banking practices approved at the state level," Leach noted.

"California is crucial to the safety and soundness of financial institutions in savings-intensive parts of the country like the Midwest because California institutions have come to serve as the equivalent of money sieves. Fully one quarter of all thrift deposits in America end up in California, with resources coming from a direct transfer from savings and loans, as well as individuals, in areas of the country with less housing and general building demand.

"What has happened in a macro-economic sense is that when two comparable industries are incomparably regulated, excessive growth is impelled in the one with weaker regulations; and when individual states are incomparably regulated, growth is impelled in those with looser rules. Hence the triply-dual nature of regulation -- banking vs. thrift, state vs. federal, and state vs. state -- has precipitated investment resources to flow disproportionately away from commercial banks and into savings and loans, particularly in states with historically weak regulatory oversight like California.

"In a political sense, the public should demand to know how alleged advocates of the little guy could be duped so easily into writing laws that have changed an industry designed to serve the individual home owner into one where in too many instances private piggy banks have been sanctioned for private speculators.

"To this date, Congress and federal thrift regulators have abdicated responsibility to establish adequate accounting guidelines not only on direct investments but also on so-called goodwill.

-- MORE --

"In an industry that is two-thirds the size of commerical banking and holds more deposits in America's largest state -- California -- than commercial banks do, there now exists on the average a negative capital base, if intangibles such as goodwill and Bank Board net worth certificates are subtracted from industry balance sheets.

"The time has come not only to understand the reasons for the mess the industry is in, but to ensure that responsible regulation is re-established, so that those institutions which are rescued do not have to be rescued again."

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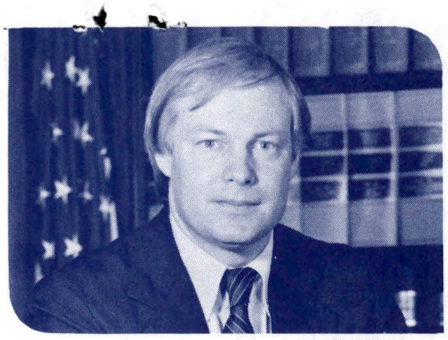

JIM LEACH

IOWA'S CONGRESSMAN
FOR THE FIRST DISTRICT

THE DEVIL LURKS IN THE DETAILS

REMARKS OPPOSING
CONFERENCE REPORT ON H.R. 1278
REP. JIM LEACH (R-IA First District)
HOUSE FLOOR AUG. 3, 1989

Mr. Speaker; it is with the greatest reluctance that I rise to oppose the bill in its present form.

Last February the President of the United States courageously took the lead and acknowledged governmental responsibility for the greatest legislative and regulatory mistake of the century. He outlined an approach requiring greater accountability in the industry and more disciplined regulatory oversight. The operating assumption was that crooks would be put in jail, legislators would shake their cozy ties to the industry, and the industry would shape up its books so that "never again" would this issue be revisited.

The bill before us represents a significant step forward in accomplishing these objectives, but I am constrained to dissent -- not because the legislation should necessarily be vetoed by the President, but because of my profound disappointment that Congress did not do better. Rather than "never again," the approach we have crafted assures a revisiting of the same issue with the same cost implications in the not too distant future, most likely in the next 18 to 36 months.

While $50 billion in new resources added by this bill to the insurance fund will help protect savers and make possible the liquidation of badly insolvent thrifts, the industry discipline called for and the resources provided are insufficient to cope with the true depth of the problem. It must be understood by this body that near-term liabilities of the thrift industry are in the eleven-, not ten-figure range. With interest, the cost to every man, woman, and child in America will exceed a thousand dollars. Now is not the time for a red-eared Congress to play games with the taxpayer and give in to industry and special-interest concerns.

Here, let me relate an event of tragi-comedy proportions that happened this spring in my state. In Ames, Iowa, a starting forward on the Iowa State University basketball team and a potential star defensive back on the football team walked into the campus Burger King with rifles, without masks, and asked the kids at the counter to clean out their cash registers. The picture of the basketball player was on the wall. One young girl is alleged to have called out to the basketball player as he came up to the counter: "Hi Sam." To which he is said to have responded: "It is not me." Shortly thereafter the police arrived and punctured the escapees with bullets to their legs. The potential of two young men hang in the balance.

Today we are revisiting the scene of another crime -- the largest bank heist in history, one that goes beyond the vaults of financial institutions and picks the pocket of every American. To paraphrase Pogo: "the robber is Us." None of us can say "it is not me." Our pictures are on the wall. It is Congress, after all, that passed the loose laws that led to the loose regulation that set loose the high-fliers in the S&L industry. Pin-striped crime cannot be battled with pin-striped laws.

In this context, it is impossible not to reflect profound disappointment about the following provisions of the bill:

1. The over-leveraging of other people's money by mismanaged savings and loans is the root of the problem before us. Yet the one-and-a-half percent capital requirement called for in this bill (three percent in five years), while stiffer than exists today, cannot be considered overly rigorous in this cooked-book industry. And the forebearances authorized for institutions with good business "plans" can only be considered incredulous. For the taxpayers to be protected, the industry should either be forced to raise massive amounts of real, tangible capital or face the music and shrink. Yet this bill envisions a greater-than-inflation, seven percent annual industry growth and no contraction for institutions with minimal net worth.

A more realistic target for capital standards would have been three percent in one year and five percent in three. A more realistic regulatory model would have been that of Bank of America. Five years ago, banking regulators recognized that the largest bank on the West Coast teetered on insolvency. They ordered the raising of greater private-sector capital or shrinkage of assets. Bank of America did both. It shrunk by almost a third and diluted its shareholder's holdings by raising more capital. Because of these prudential undertakings, the bank last year earned almost a billion dollars and today is no longer a likely candidate for taxpayer defense of its deposits. Why does the thrift industry think it is so privileged as to be above the prudential standards of America's commercial banks?

2. The bill before us is presented as if the resources -- as staggering as they are -- are adequate to right the current insolvency in the industry. The fact is:

a) The losses of the grossly insolvent thrifts are greater than was estimated just a few months ago.

b) Preliminary indications are that the second-tier problem institutions in the industry, many of which are rated well by the Federal Home Loan Bank Board, pose another $40 to $50 billion problem.

c) The costs involved in liquidation or getting outside parties to assume the risks of taking over sick thrifts are larger than originally projected.

d) The added costs imposed on the industry by this bill through the housing provisions of the Gonzalez amendment have multi-million-dollar implications for the taxpayer; in addition, the obligations implicit in the Frank "first-option" amendment potentially hold multi-billion-dollar costs for the same taxpayers. The social case for housing may be compelling, but the cost implications of the social engineering in this legislation cannot be ducked.

e) The assumptions upon which industry revenue streams are projected may be overly optimistic. No consideration is given to the possibility that the economy might suffer a significant downturn, be subject to renewed dollar inflation, or housing-asset deflation. An even keel is projected at a time when choppy waters loom on the horizon.

Alas, it would seem improvident not to authorize an additional $25 to $50 billion contingency draw on the Treasury, perhaps in the context of an on/off budget compromise involving the placement of part of the bonds sold on budget and off Gramm-Rudman and another part off budget and on Gramm-Rudman.

Here it should be stressed that the on-off budget issue is a close call, one which is amenable to compromise but even if not, one which should not produce partisan, institutional or philosophical rancor. What is impressive is not how far apart the sides are, but how close together the positions remain.

Both the Republican and Democratic positions, after all, involve the same amount of money and the principle of long-term bonding. The Democratic approach has the advantage of offering greater bond term flexibility and perhaps lower-cost Treasury, as opposed to agency, issuances. The Republican approach has the advantage of forcing greater discipline on Congress through the Gramm-Rudman process. It neither sets an unhappy Gramm-Rudman exclusion precedent nor causes other Treasury offerings to be subject to possible higher pricing because of taking S&L bonds off Gramm-Rudman. My personal preference, by a narrow margin, is for the Administration approach because it is tougher on Congress. It implies accountability; it forces us to instill greater budget discipline in recognition of the fact that it is we in Congress who have made extraordinary legislative mistakes and that these mistakes are not cost-free.

The Democratic approach at first glance appears more honest because it is declarative up front with regard to the deficit. But there is no discipline that goes with the declaration. Perhaps the way out of an impasse that is more psychological than economic is to authorize, as mentioned above, a hybrid approach to bond sales, part to be sold off Gramm-Rudman through Treasury offerings, part on Gramm-Rudman through agency issuances, with a substantial back-up line of credit authorized at the Treasury which would be on budget and off Gramm-Rudman. The really important issue, however, is not which way we go, but that we move off the precipice. It matters less whose views prevail than that public confidence in the safety and soundness of the financial system is restored.

3. In his February statement, the President asserted that white-collar criminals must be held accountable. Yet given the size of the crime, this bill provides minimal resources to the FDIC and the Justice Department to investigate and prosecute wrong-doers. Incredulously, an amendment I offered in committee to establish and fund a special thrift-fraud task force at the Justice Department was beaten back on jurisdictional grounds and opposed by the Justice Department. The American people are not going to countenance using taxpayer resources to protect depositors if criminals are not forthrightly pursued and deprived of ill-gotten gains.

4. It is indefensible that in the panoply of American finance, a catagory of institutions -- certain savings banks -- are separated out and given privileged status. Not only are they exempted from the Qualified Thrift Lender (QTL) provisions of this statute -- arguably defensible -- they, unlike commerical banks and thrifts, will be allowed to double-count investments for regulatory capital purposes and be authorized to make direct investments, the very practice that got so many S&Ls in trouble. Only a Sophist can argue the merits of such a privileged position for this industry.

5. In contrast with the Senate, the House originally adopted a provision I authored to give the FDIC primary responsibility to regulate state-chartered thrifts. This amendment was designed above all else to re-establish regulatory accountability and break the too-cozy relationship between the regulated and the regulator which has developed over the past several decades in the thrift industry. Unfortunately, the Senate position keeping the same people and the same leadership in place prevailed despite the fact that this is a leadership that frittered away billions in the December deals and hundreds of millions, if not several billion, in keeping one thrift -- Lincoln -- afloat despite regional Bank recommendations to close.

6. The bill not only does not adopt the approach I pushed to force greater capitalization of Government-Sponsored Enterprises (GSEs), it weakens public oversight of Freddie Mac by giving private stockholders control of the board. The prospect that it and Fannie Mae may become axpayer dependents at the same time they spin dividends to private-sector shareholders is unfortunate. There is simply no excuse that both of these secondary-market thrifts not be subject to prudential capital standards. With both being larger than Citicorp, there is no excuse that they should be pampered with special legislated dispensations.

7. As in so many compromises in the conference, taxpayer concerns were considered secondary to industry concerns when the issue of industry contributions to the insurance fund was de-indexed for inflation. The House position was designed to call on the industry first to support the insurance fund. In succumbing to Senate reservations the taxpayer implicitly will be asked to take a greater hit.

8. The tough conflict-of-interest rules applicable to the Resolution Trust Corporation (RTC), which were adopted by the House, were dropped in conference. At the moment, the ethics rules for the new institution are in limbo, weaker than those that apply to HUD.

9. The requirement advanced by the House that all federally insured financial institutions above a given size be required to undergo annual certified audits was dropped by the conference. Suggested by the GAO and proposed by the distinguished gentleman from Wisconsin (Mr. Roth), such requirements strike me as a particularly appropriate pre-requisite to granting institutions the right to offer federal deposit insurance.

10. Under the Administration's bill, the new thrift regulator (the Office of Thrift Supervision) was intended to come under Treasury supervision. Based on amendments stemming from the Senate, a more independent status has been carved out. For those of us who are concerned with the lack of rigor of federal thrift oversight, the case for giving the new director of the OTS (the chairman of the old Federal Home Loan Bank Board) more independent status than the Comptroller of the Currency is questionable.

11. While the majority of the most-egregious special-interest provisions have been deleted from the bill, it still is galling to note that a prominent insurance company that owns a thrift is exempt from the QTL test; that report language exempts Sallie Mae's thrift from the conversion moratorium; that a Memphis thrift is exempted from the same moratorium; and that exceptions are made to the capital-deduct requirements for certain institutions.

12. One problem that was hardly referenced in Congressional consideration of root problems in the thrift industry is the need for deposit insurance reform. The case at a minimum for restricting insurance to a single $100,000 deposit per depositor would appear overwhelming, but even minimalist deposit-insurance reform has been passed over. Lacking the will to reform the insurance system, Congress has a particular responsibility to establish firm regulation. The only way to protect the taxpayer if institutions become too big or too weak to fail is to insist they not become too big or too weak to regulate.

As for specific provisions of the conference report, the record should be clear on the following items:

1) That provisions of this act that permit thrifts to be converted to banks are not intended to allow banks resulting from such conversions to establish, retain, maintain, or operate branches that do not comply with the laws relative to establishment and operation of bank branches or offices in the respective states where such banks are operated. In other words, the Douglas or McFadden Acts are not intended to be circumvented or modified by this statute.

2) That in regard to the application of the conversion moratoriums of this act to thrift institutions that are exempt from the present moratorium on FSLIC-to-FDIC conversions imposed by the Competitive Equality Banking Act of 1987, it is my understanding that thrifts that were grandfathered under Sec. 306(h)(2) of the CEBA would lose their ability to switch insurance funds under the pending legislation if they did not convert to FDIC insurance prior to enactment, because the five-year conversion moratorium provisions of this act do not contain an exception for these institutions. This would be the case even if a thrift had applied to convert, had received an approval to convert or was involved in litigation with any of the federal regulators regarding a dispute over its grandfathered status before the bill was enacted, because in determining whether a proposed conversion is permissable, the government would be obligated to look to the law in effect at the time the conversion transaction was consumated, not what the law was when the application or lawsuit was filed or an approval was received.

3) That under Sec. 912, the FDIC is specifically authorized to take enforcement actions against any savings association, based on an examination of the association by the Corporation. Thus, it clearly is contemplated that the Corporation has the authority to examine any savings association to the extent the corporation deems appropriate in order to exercise its enforcement authority and to ensure safety and soundness.

4) That in regard to a provision in Sec. 217 that allows the FDIC to consider providing assistance to institutions prior to the appointment of a conservator or a receiver when certain conditions are met, proving that the institution has negative tangible capital, it is this Member's understanding that the granting of such assistance is within the complete

discretion of the FDIC, even if the institution meets the outlined conditions.

5) That Title II also includes a provision codifying the FDIC's current practice, which has been upheld by the courts, with respect to the valuation of claims against financial institutions in default. This provision embodies the very simple and straight-forward principal that creditors of an insolvent institutions are entitled only to their "pro rata" share of a failed institutions's assets. The bill also recognizes that if for purposes of carrying out a statutory mission and maintaining confidence in and the stability of the banking system, the FDIC may pay from its own resources additional funds to arrange for the assumption of all deposits and other liabilities.

6) That language in the manager's statement of the conference report, which appears to mandate that different institutions with equivalent tangible capital levels be treated equally by the FDIC even though one may meet the required total capital standards, does not reflect this Member's view. Obviously, the supervisory response to any capital-deficient institution will be determined not only by its tangible capital level but, among other things, by the capability of its management, the strength of its earnings, the riskiness of its activities and the quality of its assets. It may well be appropriate to treat one institution more stringently than another, based on these, or other, factors.

Finally, as a member of the minority, I feel compelled to comment on the process under which the bill has been developed. The chairman of the full committee -- the gentleman from Texas (Mr. Gonzalez) -- and the chairman of the relevant subcommittee -- the gentleman from Illinois (Mr. Annunzio) -- deserve credit for instituting a process of exhaustive open hearings in which an extraordinary number of perspectives were allowed to be aired on a timely basis. There is no doubt the House bill was more carefully crafted than the more hastily
put-together Senate counterpart. A contrast of the two work products vindicates the biases of those who believe that closed doors hide closed minds, and that the public spotlight has a salubrious effect on legislative decision-making.

There may, from time to time, be a place for closed discussion in the legislative process, particularly in the security arena, but to paraphrase Woodrow Wilson, open laws openly arrived at are preferable to laws negotiated in the dark.

Procedurally, however, the House did itself less credit when the bill came to the floor and the Rules Committee precluded the right of members to offer amendments on a number of controversial subjects, some of which represent reasons for my opposition to this bill at this stage of Congressional consideration. In addition, the conference methodology advanced by the House represents a civics lesson in how not to approach a serious negotiation.

The designation of one of the largest, if not the largest, number of conferees in the history of the House coupled with the breaking down of the conference into unmanageable, philosophically packed subsections had the effect of stultifying House capacities to deal with a five-man Senate contingency bent upon deciding a large number of thorny issues in closed, rather than open, settings.

The Senate's stonewalling of the House's intent to proceed more lugubriously precipitated a conference decision to reverse gears and centralize decision-making on each side among the chairmen and ranking member of the two principal committees of jurisdiction. It had the secondary effect of asserting the primacy of staff deliberation in closed settings, where activist concerns of a few individual members came to play a too-forceful, and sometimes mischievous, role

If there is a procedural lesson to be quarried, it is that a reasonably sized, disciplined conference committee operating in open session is preferable either to the cumbersome dimensions of the initial conference or the too-small, two-to-two approach which the Senate craftily maneuvered the House into adopting.

In bills in which the devil lurks in the detail, procedure too easily dictates result. In this case, the sum total of small decisions has produced a tentative step forward when bold strides were called for. Under the circumstances a good bill is not good enough. The House should direct a return to the conference table. In so doing, it should understand that not only is the bailout we are contemplating larger than New York City to Chrysler times a factor of ten, but that the legislative scandal we are attempting to right is the equivalnet of Teapot Dome to Abscam times a factor of a hundred.

The first title of this bill should be about campaign reform and the last title should be about ethics in government. Each is missing.

So is my vote.

can come from:

(1) Earnings
(2) Outside capital
(3) Balance sheet shrinkage and restructuring
(4) Consolidation between firms with excess capital and those with insufficient capital

Based upon the current state of the industry and its low level of profitability, earnings will only contribute a small portion of the $30 to $40 billion of capital needed in the next two years to meet bank capital standards. In the most recent seven quarters, the aggregate profitability of all GAAP solvent FSLIC-insured thrifts amounted to $7.26 billion, reduced by $1.79 billion of dividends paid to shareholders. Given the escalating cost of funds

The Inside View

Jim Leach

Since coming to Congress some twelve years ago, I have, with limited success — most notably amendments to the 1983 ILSA statue — taken the maverick perspective that stronger capital standards should be required for all financial institutions, especially thrifts and the larger money center banks which have substantial LDC exposure. As the $100-billion-plus price tag for resolving the thrift crisis indicates, deposit insurance with inadequate private capital at risk is unworkable. The temptation to leverage wantonly other people's money is so enticing in the game of deposit monopoly that there is simply no alternative to prudent regulation and stringent capital standards. Invested capital not only provides a cushion between an institution's balance sheet and the taxpayer, but also keeps lending and investment decisions grounded in disciplined market principles. While institutions with a large amount of their own resources at risk have built-in incentives to husband carefully their capital, those with negligible capital or a negative net worth have everything to gain and nothing to lose in speculative behavior and high salary overhead.

Some in Congress and in the industry have complained that the industry may be unable on a timely basis to meet the capital guidelines set forth in the Bush proposal. Higher capital requirements, they argue, will cause the industry to shrink. It is precisely because their concern is warranted that the Bush proposal should be adopted. The only thing worse for thrift managers than the six-letter word — "shrink" — is the nine-letter one: "liquidate." While the industry has more than doubled in size since 1980, its tangible net worth, as a percentage of total assets, has decreased from more than five percent to nothing today. If there were ever a textbook example of an industry which needs either to raise substantial capital or shrink, it is this one.

Whenever government plays a refereeing role between industries, one side or the other generally objects that the playing field is not level. In a macro-economic sense, when two financial industries are incomparably regulated, excessive growth is impelled in the one with weaker regulation; and when individual states are incomparably regulated, growth is impelled in those jurisdictions where looser rules are authorized. Hence the triply-dual nature of financial regulation — banking vs. thrift, state vs. federal, and state vs. state — has precipitated investment resources in the last decade to flow disproportionately away from commercial banks and into thrifts, particularly in states with weak regulatory oversight such as California and Texas.

In this context, the Bush Administration's push for comparable regulation between commercial banks and thrifts makes good sense. The call for comparable regulation is not new. In language I inserted in the 1987 CEBA bill, the FHLBB was instructed to promulgate accounting and regulatory standards comparable to those imposed on commercial banks. While the Bank Board has made hesitant steps in this direction for solvent thrifts, insolvents have largely been held harmless from regulation until the liquidation axe is unsheathed.

From a structural perspective, the proposed dissolution of the present Bank Board and the assimilation of thrift control by the Treasury also makes sense. When a governmental institution fails to meet its responsibilities, it should be held accountable. The Bank Board historically has given more attention to protecting the industry rather than to protecting the taxpayer. Given this skewed priority and the Bank Board's dubious constitutional decision in December to issue promissory notes beyond the industry's capacity to pay, it is imperative that political accountability be re-established. A broke FSLIC has behaved more like an insolvent thrift than an insurance fund. Therefore, it is only fitting that the first insolvent institution that should be taken over by the FDIC is the FSLIC.

No doubt Congress will want to make some refinements to the Bush approach. But the important objective is to act expeditiously so that the hemorrhaging stops and confidence is restored in our financial system. Delay is mischief.

Congressman Leach (R - Iowa) is a member of the House Committee for Banking, Fincance and Urban Affairs.

THE 13-DIGIT THRIFT BAILOUT MAKES THE CASE FOR DEPOSIT INSURANCE REFORM

Special to the Scripps-Howard News Service
by Rep. Jim Leach (R-IA First District)
Nov. 3, 1989

The oldest joke in finance is that the best way to rob a bank is to own it. With the $1,000-per-citizen ransom savings and loan executives have de facto demanded from the American public, unreal humor has turned into surreal reality.

There is no greater evidence of the need for reform of the deposit insurance system then the 13-digit taxpayer bailout of the thrift industry. Any system which has been allowed to privatize profit but socialize loss must be prudently constrained. The only way to protect the public and ensure that the biggest bank heist in history isn't followed by a bigger one is to muster the practical will to regulate more carefully those who have been granted charters to offer deposit insurance and to make sure that the right to offer insured deposits isn't wantonly abused.

The most effective way of reining in the artists of overleveraging is to require the maintenance of prudential capital ratios. As the savings and loan debacle indicates, deposit insurance with inadequate private capital at risk is unworkable. The temptation to leverage wantonly other people's money is so enticing in the game of deposit monopoloy that there is simply no alternative to requiring stringent capital standards.

All financial institutions allowed to offer deposit insurance ought to have at least $5 -- and preferably $7 or $8 -- of real capital invested for every $100 they accept in deposits.

Invested capital not only provides a cushion between an institution's balance sheet and the taxpayer, but also keeps lending and investment decisions grounded in disciplined market principles. While institutions with a large amount of their own resources at risk have built-in incentives to husband carefully their assets, those with negligible capital or a negative net worth have everything to gain and nothing to lose in speculative behavior and high salary overhead.

In recent years government policy-makers have increasingly come to consider some institutions too big to fail. Whatever the merits of this view, no institutions should be too big to regulate. All must be held accountable for losses incurred when they occur.

A bank is only as strong as its customer base. If customers become unable or unwilling to repay -- as in the developing world today -- regulators must insist that institutions making loans covered by deposit insurance either recapitalize or fold. Shareholder accountability for management misjudgments must be evident and immediate.

On the deposit side of the ledger, bank customers should be given incentive to put their money with stronger, rather than weaker, institutions. In the current system where all deposits up to $100,000 are insured 100 percent, depositors have incentive simply to seek out those institutions which offer the highest rates of interest, rather than those which are the most soundly managed. But weak institutions which pay premiums for capital are the likeliest candidates for public bail-out.

Hence, two common-sense reforms would appear in order:

1) A limitation on deposit insurance to a single, rather than multiple, $100,000 account; and

2) The provision of insurance coverage up to 95 percent, rather than 100 percent, of amounts deposited.

These modest reforms in the deposit insurance system would go a long way toward protecting the taxpayer. Rather than being offered perverse incentives to invest in imprudently run institutions, depositors would become subject to some market discipline and responsibility to protect their own savings.

The only way to avoid putting the fate of the American saver into the hands of a capricious Congress, which has voted one multi-billion-dollar bail-out but may not vote another, is to bring the individual depositor into the accountability equation, to make the banking system more prudential and to make the deposit insurance system more self-reliant.

JIM LEACH

IOWA'S CONGRESSMAN
FOR THE FIRST DISTRICT

**Statement of Rep. Jim Leach (R-IA)
on the Introduction of the
"Savings Association Regulatory Restructuring Act of 1990"
March 13, 1990**

Mr. Speaker, today I am introducing the "Savings Association Regulatory Restructuring Act of 1990" to abolish the Office of Thrift Supervision and transfer its authorities and responsibilities to existing federal bank regulators.

Last year, with the passage of FIRREA, Congress transformed the old thrift regulator, the Federal Home Loan Bank Board, into a new agency, the Office of Thrift Supervision, under the umbrella jurisdiction of the Department of Treasury. During consideration of FIRREA, the Senate rejected an amendment of mine which the House had accepted giving the FDIC, as the federal regulator of state-chartered banks, primary jurisdiction over state-chartered thrifts. If it had been accepted by the Senate, this provision would have made the regulatory structure for thrifts similar to that of banks, thereby protecting the historical dual system of banking, giving more regulatory authority to the insurer -- rather than the charterer -- and preventing expensive and redundant duplication in regulatory oversight.

It is becoming increasingly apparent that in an effort to acquiesce to the siren calls of over-stretched thrift managers who preferred to maintain a semblance of the old "clubbish" regulatory apparatus and the concerns of those in the political arena who wanted to protect a single regulator's job, Congress erred.

Today, less than a year after passage of FIRREA state-chartered thrifts are rushing to convert themselves into federally chartered thrifts. In my home state of Iowa, for example, there are only a handful of state-chartered institutions left, and in California, where approximately one quarter of all thrift deposits exist, the state thrift regulator is being dismantled because so few institutions prefer to retain their state charters.

The state-chartered thrifts that do still exist in some cases have been subject to examination by three different regulators -- the FDIC, the OTS, and the state regulator -- and thus have to pay for extra costly examinations. At a time when thrifts are working hard to bring their capital levels up, these extra examinations are an unwelcome expense and, as importantly, a redundant regulatory burden.

Accordingly, I am introducing legislation not only to give the FDIC supervision of state-chartered thrifts, but also to dissolve the OTS and give the Office of the Comptroller of the Currency, which now regulates federally-chartered banks, supervision of federally chartered thrifts. The bill also gives the Federal Reserve authority over thrift holding companies.

These changes will provide a symmetrical regulatory framework more in tune with changing market conditions and the need for effective governmental oversight. The changes, in addition, will help propel more homogenous regulation between two industries more alike than dissimilar.

Philosophically, these changes underscore the principle of institutional accountability. In the private sector, when mistakes are made, businesses go out of existence. In the public sector, analogous discipline is lacking. In the wake of the biggest institutional failure in modern history -- one that will cost every man woman, and child in America upwards of $1,000 each over the next 30 years -- Congress moved not to dismantle, but to re-name; not to take authority away from a failed regulator, but to give him more power.

The 1980's have taught us that comparability of financial regulation is an imperative social goal because deposit growth will always be impelled in institutions with the weakest regulatory oversight. A system in which the strongest are restrained and the weakest given a green light to grow is a system which puts the taxpayer most at risk.

Competition should be the hallmark of the private sector, not government agencies. When regulatory agencies develop too close ties to the institutions they regulate and a vested interest in their growth, a tendency develops to acquiesce to imprudential rules, regulations and oversight. Hence, the appropriateness of regulatory comparability. Hence, too, the appropriateness of rewarding the regulatory institutions with firmer rules and holding accountable those responsible for forcing the taxpayer to pick up a multi-billion dollar tab for a macro-economic peace-time, recessionless mistake.

The introduction of the "Savings Assocciation Regulatory Restructuring Act of 1990" is not intended to imply that the thrift industry should be abolished. While Congress in FIRREA clearly mandated the goal of making thrift and bank standards and regulation symmetrical, it wisely did not call for abolition of the industry. There still is a place in the American financial services sector for a locally oriented lending institution the primary mission of which is the making of home mortgages.

Neither does introduction of this bill reflect unhappiness with the vast majority of employees at the OTS. Line employees are not responsible for "too" political appointments at the top or the loose laws passed by legislative bodies. Consequently, this bill encourages quality employees to transfer to the appropriate federal banking agencies.

Finally, let me underscore a point made earlier: Enactment of this bill is intended to send a signal to the American public, and to all government bureacracies, that if an agency fails in its mission, it will be held accountable. That is the way it works in the private sector; it should be no different in the public.

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Remarks prepared for Delivery
National Council of Savings Institutions
1990 Government Affairs Roundtable
Rep. Jim Leach (R-IA)
Feb. 27, 1990

The general consensus seems to be that Congress will be reluctant to enact any major banking legislation this year, including any corrections to FIRREA. I know that some of the banks are still calling for new powers legislation and that some thrifts and the home builders are calling for changes in FIRREA, i.e. relaxing the loan-to-one-borrower requirement and the qualified thrift lender test. I, myself, would like to abolish the OTS and give the OCC regulatory authority over federally chartered thrifts, the FDIC authority over state chartered thrifts and the Federal Reserve authority over thrift holding companies.

However, in the wake of legislating the biggest and most expensive bailout in U.S. financial history, Members of Congress are leery of further deregulation and wary of reopening debate on the thrift crisis just before an election. Instead, the Banking Committee will focus on its oversight role. Investigative hearings, such as the Lincoln hearings of last year, will continue as the Committee performs a cathartic role in studying why the savings and loan debacle occurred. The Committee also will be closely watching, and criticizing, the Resolution Trust Corporation as it tries to cope with the herculean task of liquidating, selling or merging more than 600 insolvent thrifts over the next seven years. Do not look for Congress to offer any constructive advice on how the RTC should perform its task, but will prefer to let the Administration take the fault for any problems the RTC will encounter.

Another issue which deserves and will probably receive attention is deposit insurance reform. A major shortcoming of FIRREA was its failure to reform the federal deposit insurance system. Ironically, a bill which provided for a 13-digit taxpayer bailout of the thrift insurance fund did little to reform the system. Instead, the federal government is still ultimately liable for a depositor's multiple accounts with each account insured up to $100,000. Reforms limiting the federal government's liability to only one account per depositor and in providing more market discipline for depositors would be two incentives to reduce the "moral hazard" of our present deposit system. Other reforms may be needed and in this regard Congress has a duty to review closely the studies mandated in FIRREA on deposit insurance reforms.

But the primary way to protect the taxpayer and our deposit insurance funds is for federally insured institutions to have adequate capital. If the insurance fund is the taxpayer's last line of defense, capital is the first line. Experience with the thrift problem has underscored two prejudices I have with regard to all financial institutions -- the need for sufficient capital and the equity demand for comparable regulation. As the savings and loan debacle indicates, deposit insurance with inadequate private capital at risk is unworkable. The temptation to leverage wantonly other people's money is so enticing in the game of deposit monopoly that there is simply no alternative to requiring stringent capital standards. Invested capital not only provides a cushion between an institution's balance sheet and the taxpayer, but also keeps lending and investment decisions grounded in disciplined market principles.

The thrift crisis also demonstrates the need for comparable regulatory standards. In a macro-economic sense, when two comparable industries are incomparable regulated, excessive growth is impelled in the one with weaker regulation. When thrifts, for instance, were required to have half the capital of commercial banks, they took on twice as much as deposits and exponentially larger liabilities.

Likewise, when two states have incomparable standards, growth is impelled in those states with weaker regulations. It is no coincidence that taxpayers lost billions in thrifts, largely in grossly under-regulated states. It is also no coincidence that the call for uniform, comparable, and stiffer standards should seem so compelling to policymakers today.

I understand that your association is supportive of the dual banking system. I, too, am partial to the dual banking system, which has been a major characteristic of the U.S. banking system since Andrew Jackson was President. When the U.S. taxpayer is backing up the deposit insurance system, however, some restraints on state-authorized powers may be necessary.

For instance, in FIRREA Congress no longer allows thrifts to invest in junk bonds, even though states like California had allowed carte blanche authority for thrifts to invest in such risky instruments. In an amendment, I offered in Committee, FIRREA also prohibited state thrifts from making direct investments in real estate or in securities, similar to the restrictions now imposed on federally chartered thrifts. Finally, FIRREA gives the FDIC power to restrict any activity of a thrift if it poses a threat to the insurance fund.

These restrictions on powers, and language requiring thrifts to comply with analogous capital and accounting standards to those imposed on national banks, demonstrate belated concern by Congress for comparable regulation.

Because of these restrictions, some believe there is no reason to have a state charter. The State of California is even reportedly thinking of eliminating its state chartering authority. I would be a little more sanguine about the future of the dual banking system for thrifts, if the amendment I had offered last year to make the FDIC the primary regulator over state chartered thrifts had been adopted. The FDIC has that function now over state chartered banks, and appears to have sufficient control to oversee the activities of state- chartered banks, and even certain savings banks. Why shouldn't the FDIC have the same power over thrifts?

The present system also provides expensive and duplicative regulatory oversight with some state-chartered thrifts telling me that the FDIC, the OTS and the state regulator all getting ready to examine them. This duplication of examination is one reason why I am proposing that the OTS be eliminated. The dual banking system is alive and well in the commercial banking industry and with some changes in regulatory structure it can continue to exist in the thrift industry.

In closing, I would just like to summarize the effect of FIRREA. From an industry perspective, the law is receiving more complaints than it deserves. Less than one week after the President signed FIRREA, press reports indicated that both the prices fo stock for well-capitalized thrifts had risen and that the cost of funds for all thrifts had decreased. While all of us have reservations about FIRREA, thrift managers and owners have reason to be far more pleased than disappointed with the legislation. On the plus side, the insurance fund is re-bolstered, confidence in the industry is restored, the most over-leveraged institutions are liquidated, some of the most egregious practices (such as direct investments in real estate, equities and junk bonds) are restricted, and modest increases in resources and authority are provided to the Justice Department to rid the industry of wrong-doers.

On the minus side, earnings from Federal Home Loan Bank stock are reduced, insurance fund premiums are increased, and capital requirements are made more stringent.

But, the industry escaped having to pay for most of the clean-up costs. While premiums are up and Federal Home Loan Bank earnings are diminished, its payments to the RTC are not indexed to inflation, as was originally provided for in the House-passed bill. Not only will the vast majority of the cost of the clean-up come from the taxpayer -- with the cost to every man, woman, and child in America likely to exceed a thousand dollars -- but the industry's assets in the regional Home Loan Banks were given preferential consideration to the taxpayers' pocketbooks.

Despite the fact that every Federal Home Loan Bank was insolvent due to the joint and several liabilities associated with the Texas bank, Congress chose not to exercise the government's clear right to tap the regional bank stock of every S&L in the country before turning to the taxpeyer.

In addition, even though insurance premiums will be increased, the differential between bank and thrift premiums, in the short-term will narrow. The industry not responsible for the problem -- commercial banking -- ironically will be in a less-good competitive position than before on insurance costs and remain at severe competitive disadvantage on capital ratios. This is particularly the case in states like Iowa, where state bank regulators have the stiffest (8 percent) standard in the country and the most scrupulous approach to classifying loans.

While surviving thrifts may experience some interim traumas in complying with the new law, healthy institutions ought to emerge from this experience stronger than before, competing in an environment where more prudential market forces, rather than the oxymoron of risk-free capitalism, apply.

In a national context, the $50 billion in new resources added by the bill to the insurance fund will help protect savers and make possible the liquidation of badly insolvent thrifts, but the strong liklihood is that the issue will need to be revisited in the next 18 to 36 months.

The industry discipline called for and the resources provided are insufficient to cope with the true depth of the problem. It must be understood that near-term liabilities of the thrift industry are in the twelve-, not eleven-figure range and that second-tier institutions in difficulty could cost the government an additional $40 billion to $50 billion. Not only is the bail-out that has commenced larger than New York City to Chrysler times a factor of ten, but the legislative scandal that precipitated taxpayer accountibility is the equivalent of Teapot Dome to Abscam times a factor of a hundred.

In summary, in the aftemath of the savings and laon debacle, all financial institutions are going to be under tougher oversight from Congress. Deposit insurance, unless adequately supervised, is a subsidy which can be quite costly. Furthermore, as evidenced by the recent collapse of the investment house of Drexel Burnham, we are seeing the deleveraging of the U.S. economy. Given that thrifts were one of the more leveraged industries, the industry will continue to contract. Furthermore, the country is overbanked with more financial institutions than are needed. In the future you will see fewer, better capitalized instituions.

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The Lure of Leveraging:
The Case for Prudential Regulation of Banking

by

Congressman Jim Leach

July 1, 1988

On the surface, the economy appears to be humming along, but below the thin crust of prosperity there's a pernicious disease eating away at the economic fabric of our society.

Symbolized by the thrift crisis at home and the developing country debt crisis abroad, the overleveraging of other people's money by high-flying financial institutions is the single greatest financial scandal in which politicians and regulators are complicitous. By comparison, the more celebrated conflicts of interest of Ed Meese and Cap Weinberger's defense contractors pale in significance.

Simply put, too-loose laws have led to too-loose regulations which have led to too-loose banking practices. The end result is that tax payers are on the line for billions of dollars of obligations made outside the framework of normal congressional budgeting decisions.

Two recent announcements tell the story.

In a report I initiated, the General Accounting Office (GAO) reported to Congress that America's money center banks are undercapitalized and underregulated and have failed to write down approximately $28 billion in uncollectable foreign loans.

In an "audit of the auditors", the GAO faults federal regulators -- the Office of the Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation -- for developing a lenient classification system for developing country debt.

Using today's secondary market as a guidepost, the GAO calculates that the average developing country loan is worth 54 percent of its stated value. At year-end 1987, American banks had reserved $21.1 billion of foreign loans, when, in the GAO's estimation, a more realistic regulation would have required a $49 billion write-down.

In spite of Treasury Secretary Baker's exhortation in the plan that bears his name that lending levels be held constant, U.S. bank loans to developing countries decreased from $139.7 billion in June 1982 to $107.6 billion in December 1987. U.S. bank capital, meanwhile, increased from $66.2 billion in June 1982 to $129.2 billion in December 1987. As a result, from June 1982 to December 1987 bank loans owed by developing countries decreased from 211 percent of bank capital to 83 percent. During this time developing country loans owed to the nine largest money center banks decreased from 323 percent of these banks' capital to 139 percent.

While these figures reflect a prudential improvement in circumstances for American banks, developing country loans are still substantial compared with bank capital and are disproportionately concentrated in a small number of money center institutions.

From the perspective of U.S. commercial banks, the international debt situation has markedly improved in the past five years, but this improvement has occurred during a period in which a bloated dollar assisted foreign borrowers, and hence U.S. money center banks, by encouraging Americans to import rather than export. Banks and regulators need to prepare for economic circumstances in which a weaker dollar makes American producers and manufacturers more competitive and in which a recession might need to be accommodated.

Defending itself from the criticism the GAO levied, the Federal Reserve Board committed regulatory hara-kiri. In a formal response to Congress, it opened the barn door to the speculative instincts of bankers with the incredulous assertion that individual "bank management is in the best position to determine the appropriate levels of reserves" that should be taken against developing country debt.

There is no nuttier cop-out of regulatory accountability than to give the regulated the definitional power to regulate themselves.

The developing country debt dilemma has precipitated a dual standard of regulation in American banking. When regulators come into a bank in a rural state like Iowa and find that neither interest nor principal is being paid on a farm loan, that bank is required to write down the loan. However, when a developing country loan becomes impaired, regulators have not only been reticent to require adequate reserving, they appear to be unwilling to accept the fact that they have the responsibility under law to set responsible levels of reserves.

Ironically, the biggest banks in America today are generally the weakest and the smallest, the strongest, with this phenomenon in no small part being due to the fact that smaller banks are more responsibly regulated.

Because of the too-big-to-fail syndrome that has been embraced with so much alacrity by politicians and regulators in recent years, taxpayer liabilities will be enormous unless policymakers make it clear that no institution is too big to regulate. The only way to avoid the prospect of public bail-outs of large financial institutions is for regulators to blow the whistle and require a greater infusion of private sector capital to bolster capital-to-asset ratios.

On the brighter side, there is some good news and some light at the end of the tunnel for commercial banking.

While the international debt issue is becoming increasingly intractable, the ramifications for U.S. banks are increasingly manageable. Not only does the Federal Deposit Insurance Corporation fund hold significant reserves (approximately $17 billion), but most developing country liabilities have been transferred to others. Foreign banks, various governments and international financial institutions now hold nine times more liabilities to developing countries than American commercial banks. By comparison, the American thrift industry with its weak insurance fund and large number of insolvent, money losing institutions appears by a quantum magnitude to be more jeopardized than American commercial banking.

In the thrift industry the trend line is worse because regulation is weaker than even that applied to money center banks. According to the Federal Home Loan Bank Board, the industry lost $3.8 billion in the first quarter of this year. This quarterly deficit means that the industry is losing money at a $15 billion annual clip. The weak are getting weaker, with Congress facing the prospect of a multi-billion dollar industry bail-out.

Commentators like to suggest that regional problems -- i.e., a weak economy in the oil patch and on the farm -- precipitated the savings and loan problem. Actually, there are more human culprits than abstract rationales. The root cause of the thrift problem is greed, the regulator-sanctioned capacity of high flyers to attract and overleverage other people's money because of receipt of federal or state charters to take deposits backed by federal insurance.

The quid pro quo -- prudential investment and lending practices -- has been ignored by a significant element of the thrift industry because regulators followed the pandering exhortations of legislators who themselves too often developed conflicts of interest with receipt of campaign and other contributions from the thrift industry.

If executive branch scandals -- some have gone so far as to suggest the presence of a sleaze factor -- may partisanly be ascribed to Republicans, thrift conflicts of interest can just as fairly be considered disproportionately Democratic. Such is the case because over the years in a battle for powers between savings and loan interests and commercial banks, thrift executives chose up sides with the Democrats, presumably on the assumption that bankers historically identified with the Republican Party. Just as large banks have come over time to be regulated less firmly than small ones, thrifts used their legislative power base within the dominant political party at both the state and federal level to see to it that they would not become as forcefully regulated as commercial banks.

In California, for instance, the thrift deposit base now exceeds that of the banking industry even though the capital base of many California savings and loans is negligible. Loose regulations stimulated excessive competitive leverage. If an individual or group, for instance, can put together around $10 million today, it is possible to obtain a bank charter in California with regulators allowing $150 million in deposits. With the same $10 million, a savings and loan can be chartered and allowed $2 billion in deposits -- with the taxpayer potentially on the line if imprudent loans or spending practices develop.

Another classic example of egregious thrift power is the regulatory rule that allows savings and loans, but not banks, to put 300 percent of their capital in direct investments. Alleged representatives of the little guy have encouraged thrift investors to use government insured deposits to speculate in real estate or the stock market rather than home loans.

The quandary regulators now confront is the problem of how to rein in overextended institutions when their primary resource is an overextended insurance fund. Ingeniously, the short-term answer appears to be a government-backed Ponzi scheme: the issuance of long-term capital notes on a fund with no capital. Incredulously, the long-term effect of such note issuances is the prospect of taxpayer accountability for the printing press of an independent regulatory agency. But no one in the executive branch desires to bite the bullet just now. Apparently afraid of offending powerful interest groups, the Reagan Administration wants to leave town before runs commence.

The only way it can do this is to give license to the licentious. Even though well capitalized and well managed thrift institutions have had record profits in recent years, the "Dr. Jeckyll" third of the industry is so poorly managed that losses not only exceed the deposit insurance fund for thrifts but for banks as well. These losses are almost certainly likely to multiply unless regulators learn just to say "no." Otherwise, a $50 billion headache today could become a $100 billion migraine tomorrow.

The best antidote to public bail-outs is the simple requirement that financial institutions be adequately capitalized. With a little luck, the greatest private sector banking mistake since the '30s -- the decade long spurt of developing country lending -- will not destroy the basic fabric of American banking. Time is healing. The problem is that while a strategy of putting problems off in commercial banking may in part have worked, the same approach for the thrift industry is unrealistic.

The advantage money center banks had and have over thrifts is four-fold: a) a substantially stronger capital base; b) tougher regulations coupled with more honest accounting; c) less dishonesty and personal conflicts of interest; and d) ready access to the Federal Reserve discount window. Despite one bit of accounting gimmickry -- the allowance of banks to consider a portion of their loan loss reserves as capital for regulatory purposes -- it is apparent that

Citicorp and Chase are more likely to survive into the 21st century than many thrifts.

Compounding the problem of weak regulation and a weak capital base in the thrift industry is the epidemic of greed that seems to exist with a number of overextended institutions in growth states. Thrift managers who are in a negative net worth situation understand that they have nothing to lose as they pay premiums to attract deposits insured by others. Hence, there is every incentive -- through dividends, salaries, and perks -- to live high on the hog today and make risk investments in the hope of striking gold tomorrow. Without stern regulatory oversight, imprudent circumstances are likely to breed more imprudent decisions.

If thrift industry extravagances continue to be countenanced, the country and the financial community have to be prepared for the greatest jolt in public confidence since the depression. A run up of interest rates sparked either by Congress' inability to constrain the deficit or an easing of Federal Reserve monetary policy could all too easily spark a run down in thrift industry spreads and assets. A cascade of thrift failures could have an avalanche effect on the economy leading to recession or, quite possibly, depression.

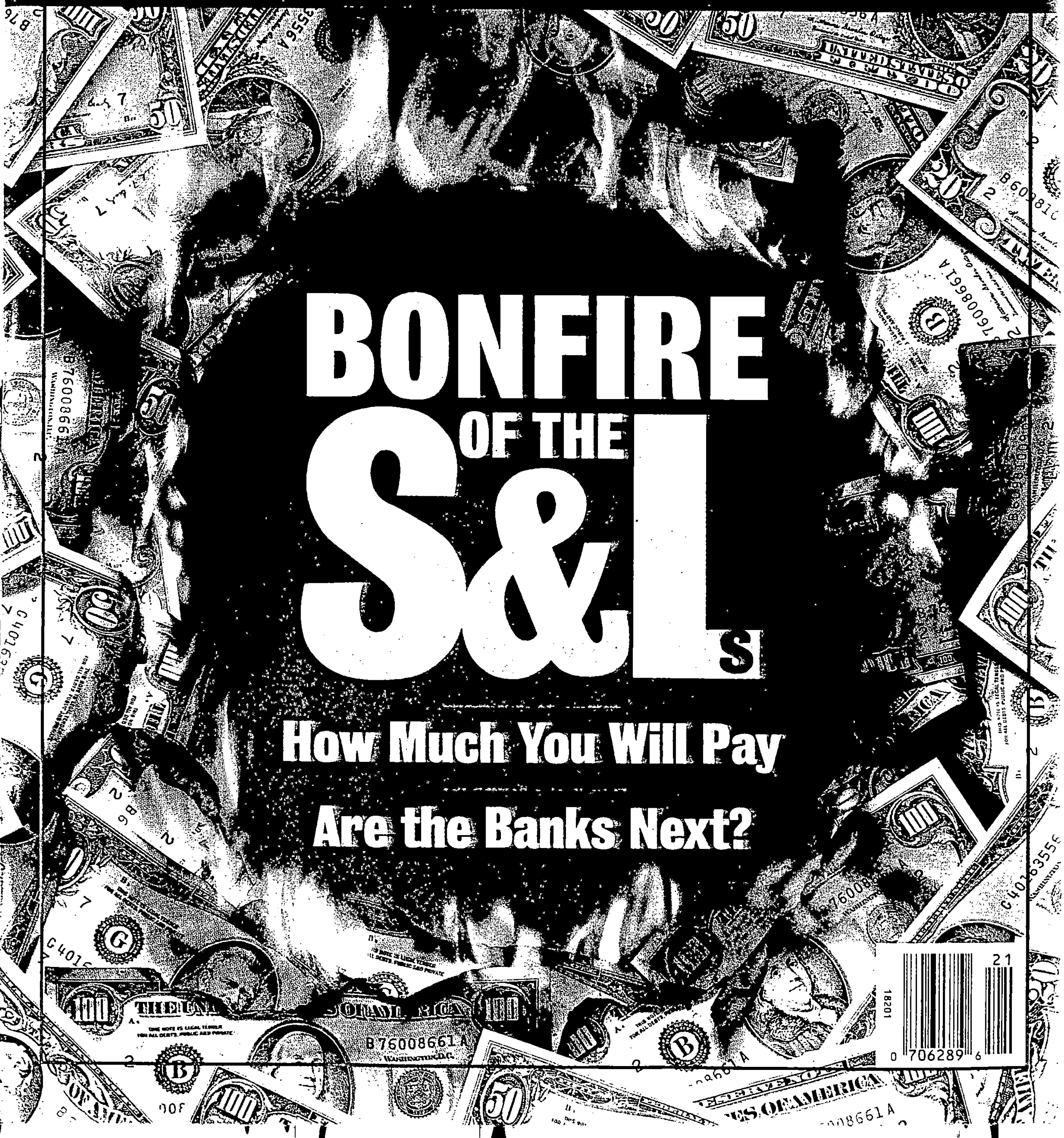
The time could thus not be more propitious for Congress to come to grips with the pressure group syndrome that precipitated the overleveraging problem in the first place. Despite the implications of interference with a free market, there is no substitute for prudent laws and regulation of financial institutions when the economy as a whole can be so dramatically affected by the decisions of so few.

* * * * *

BASEBALL'S GOLDEN ARMS
Pitchers Make a Striking Start

Newsweek

May 21, 1990 $2.50



BONFIRE OF THE S&Ls

How Much You Will Pay

Are the Banks Next?

How Did It Happen?

Some lessons from 'the single greatest regulatory lapse of this century'

BY STEVEN WALDMAN AND RICH THOMAS

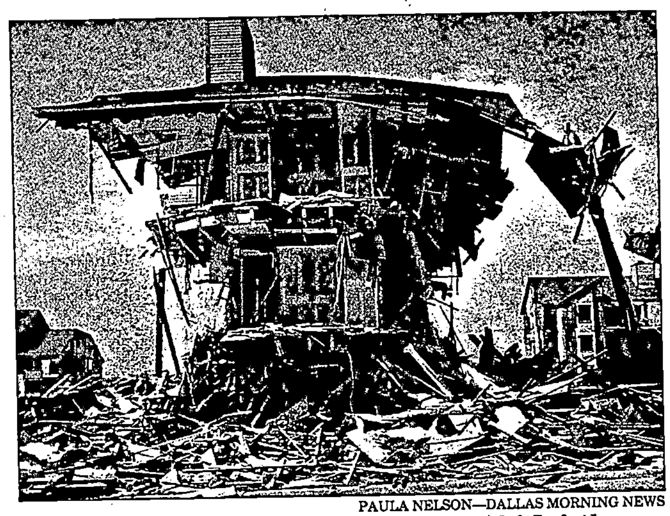
How could the savings and loan crisis *possibly* have happened? How could the government inadvertently lose $250 billion—an amount approaching the cost of the Vietnam War? "This is the single most grievous legislative error of judgment this century," says Republican Rep. Jim Leach of Iowa, a House Banking Committee member who warned in vain about the problem for years. "It's the single greatest accounting misjudgment this century. It's the largest lapse on the part of the press. It's the single greatest regulatory lapse of this century. It's the single greatest indicator of the defer-at-all-costs approach to government in this century."

It would be comforting to think the scandal occurred because of a conspiracy of unusual forces, the political equivalent of a rare planetary alignment. But actually the forces that caused the S&L problems to fester for so long are familiar parts of American political culture. The warped campaign-finance system, failures to police white-collar crime, ethical permissiveness—all contributed to the S&L crisis and all could, without dramatic reform, cause the next scandal.

A Failure of (De)Regulation

Before the 1980s, S&Ls were the most boring businesses in America. They loaned money to individuals to buy houses. Period. No loans for office buildings, none for breathtaking shopping malls or brash oil ventures. The motto was 3-6-3: offer 3 percent on savings, lend at 6 percent, and hit the golf course by 3 o'clock. The staid life changed with the high inflation of the late '70s as depositors pulled funds out of S&Ls to take advantage of higher-yield possibilities like money-market funds. The S&Ls were left holding long-term mortgages that paid them little. That left Congress with a choice: shrink the industry or let it fly free in the winds of deregulation. They chose the latter course—and the industry quickly became a lot more aggressive.

Congress took three key steps to revitalize the industry, all of which contributed to the fiasco. In 1980 it allowed S&Ls to pay much higher interest rates. The effect: S&Ls competed by offering savings-account rates as high as 13 percent. But to make up for the money they lost by paying more interest, they needed to generate extra income from investments. So in the early 1980s, Congress and many states allowed thrifts to invest in anything they wished. Effect: the thrifts bought everything from palatial estates for their owners to an Iowa plant that converted manure to methane. The government also permitted investors to open an unlimited number of accounts, each insured up to $100,000. That brought in more deposits—and gave irresponsible S&L managers more Monopoly money to spend. Together, these steps gave the industry the money and the freedom to fly high. "All in all," said Ronald Reagan when signing the 1982 deregulation act, "I think we've hit the jackpot."



PAULA NELSON—DALLAS MORNING NEWS

Razing an unfinished condo: *After the Empire S&L failure*

1984: Warning Signs

If the crisis had been tackled when the first major S&L collapsed, the rescue might have cost only $40 billion

Unfortunately, that "we" included a lot of high rollers with vivid imaginations. Don Dixon, head of Vernon Savings and Loan in Vernon, Texas, took his wife on a "gastronomique fantastique" tour of fancy European restaurants. But he defended the junket as a scouting trip for investments. "You think it's easy eating in three-star restaurants twice a day six days a week?" he protested.

Such behavior was allowed to persist because of a profound flaw in the Reagan administration's thinking about deregulation: that markets should be liberated not only by writing new laws but by weakly enforcing existing ones. Officials did this at other agencies, like the Occupational Safety and Health Administration, but the financial cost was greatest at the Federal Home Loan Bank Board, which regulated S&Ls. The three other regulatory bodies that oversee banks hired more examiners to monitor commercial banks, which had been partially deregulated in the early 1980s to compete with other financial markets. But while those agencies could pay for new cops by increasing fees on banks, S&L regulators had to go cup in hand to ask the White House budget office. The White House turned them down flat.

Adding insult to bureaucratic injury, the other financial agencies then picked off some of the Bank Board's most talented examiners. That wasn't hard: in 1983 the starting salary for an accountant at the Comptroller of the Currency, which regulates federally chartered banks, was $26,000; at the Bank Board it was $14,000. In the early '80s, the S&L overseer lost about half of its veteran examiner staff. Those who remained were told by Reagan's first S&L regulator, Richard Pratt, to adopt new accounting procedures that let thrifts pretend to be solvent until they worked their way back—or so they hoped—to real health. These gimmicks made things seem better, but in the same way a doctor can make a patient appear better by whiting out a tumor on an X-ray.

The Impact of Political Money

Debates about the role of money in politics often make the need for reform seem either abstractly moralistic ("an affront to democratic values") or oddly trivial ("we're trying to eliminate not wrongdoing but the *appearance* of impropriety"). The S&L scandal shows clearly the dangers of having legislators depend so heavily on campaign funds from interest groups and businessmen with dealings before the federal government. Quid pro quos can rarely be proven but we do know this: never has so much money gone to such key legislators who worked so hard for measures that cost taxpayers so dearly.

The biggest politician to fall was Jim Wright, who resigned as speaker of the House in 1989 as the House Ethics Committee zeroed in on his attempts to bully regulators on behalf of thrift operators. Tony Coelho, the House majority whip who raised hundreds of thousands of dollars from thrift owners for the Democratic Congressional Campaign Committee, also retired that year under fire for a deal with Columbia S&L. Fernand St. Germain, former chairman of the House Banking Committee, lost his bid for reelection after disclosures he was using the credit card of the U.S. League of Savings Institutions for his personal entertainment. Now the Senate Ethics Committee is investigating the Keating Five, a group of powerful senators (Alan Cranston, John Glenn, Donald Riegle, John McCain and Dennis DeConcini) who received a total of $1.4 million in contributions from Charles Keating, head of the Lincoln S&L. That's not to mention the $131,000 Keating gave to Arizona state politicians and the $255,000 he gave to politicians in the Phoenix area, according to a PBS "Frontline" documentary. Near Phoenix, Keating built the Phoenician, a lavish hotel with gold-leaf ceilings and $12 million in Italian marble.

Mostly what the S&Ls got from these politicians was delay. In 1986 Wright sat on a key piece of reform legislation that would have raised $15 billion in desperately needed bailout funds. During the ensuing delay, the bailout's price tag rose several billion dollars. The Keating Five helped push regulators into putting off action against the Lincoln S&L. The senators deny wrongdoing, but after their intervention the Bank Board waited another two years before shutting down Lincoln—a postponement that may have cost taxpayers millions more.

Responding to questions about whether his money had influenced the senators, Keating said, "I want to say in the most forceful way that I can, I certainly hope so." All five senators denied the money swayed them and Cranston said, "I never did anything to derail any investigation of anybody." Glenn argues that there's a difference between pressure and questioning: "I learned very quickly that as a senator I can ask any question that I want. How [the regulators] answer is their decision." The senators also say part of their job is to help constituents—whether it's Aunt Sally with her social-security check or Keating with his S&L. Yet as William Black, a top Bank Board enforcer, puts it, "there were lots of constituents that needed protecting. But the one constituent who put up more than a million bucks in contributions to the five senators is the only one that got the protection." The pressures of the campaign-finance system tempt legislators to define the "public interest" as the sum of narrow special interests—too often the special interests with the most money.

IRA SCHWARZ

Earmarking the funds: *The White House signing ceremony*

1989: Bailout Plan

By the time Bush signed a bill approving a rescue package, the price tag had risen to $166 billion

The Hired-Gun Syndrome

Follow the bouncing buck. Regulators eased off Charles Keating after intervention from the senators. The senators say that they interceded on behalf of Keating because they were persuaded by a letter written by Alan Greenspan, now chairman of the Federal Reserve and then a private consultant, vouching for Lincoln's health. And Greenspan was paid to write the letter by a law firm that was representing Charles Keating.

Greenspan claims he genuinely thought, as he wrote, that Lincoln's management was "seasoned and expert" and that the S&L itself was "a financially strong institution that presents no foreseeable risk." He says Lincoln was regarded as a sound thrift when he wrote his endorsement and he is now "surprised and distressed" by the S&L's demise. Financial consultant Bert Ely, who has studied the case, says that if Greenspan had objectively studied the existing data "there's no way he could have reached those conclusions. It was clearly an inappropriate letter."

Keating was also helped because Arthur Young, a big-eight accounting firm, diagnosed his S&L as sound and accused the government of harassment. DeConcini cited the Arthur Young study in his meeting with regulators, asking, "You believe they'd prostitute themselves for a client?" Michael Patriarca, chief thrift regulator in San Francisco, answered: "Absolutely; it happens all the time." Jack Atchison, the accountant who gave Lincoln a glowing report, soon afterward joined Keating's firm at a salary of more than $900,000. Atchison declined to comment. Arthur Young officials say the firm carefully considered regulators' arguments at the time but concluded they were wrong.

Other hired guns contributed to the mess. "Professional" real-estate appraisers valued a parcel of California land at $30 million even though most of it was on a sloped, completely undevelopable piece of mountainside. Margery Waxman, a lawyer in the Washington law offices of Sidley & Austin, helped get the Bank Board to take the Keating investigation out of the hands of the San Francisco office, which was leading the charge. "As you know," she wrote Keating, "I have put pressure on [then Bank Board chairman M. Danny] Wall to work toward meeting your demands and he has so instructed his staff." Waxman declined to comment last week, but a Sidley & Austin spokesman told Legal Times that the firm holds her "in high regard."

Lobbyists, corporate lawyers and consultants often compare their work to that of the noble public defender toiling in a grimy municipal court. Their point: society doesn't chastise a criminal-defense lawyer for representing a murderer—it's part of our adversary system, after all—so it shouldn't blame an advocate for representing an unpopular business client. But campaigning for government benefits should not enjoy the same moral standing as protecting constitutional rights. When professionals become, in effect, political lobbyists, they should be held accountable if their efforts succeed. That would force them to make some independent judgments about what they're advocating and provide an important check on irresponsible behavior.

Suicide by Fountain Pen

Cosigning someone else's loan is known in private business as "suicide by fountain pen." It is a simple problem of human nature: people are less careful if they know someone else will pick up the pieces after the crash. If Uncle Sam pays off any deposits if an S&L goes under, the depositors may be less careful about where they put their money. That is why the government's decision to allow large investors to open unlimited numbers of guaranteed $100,000 accounts is considered one cause of the catastrophe. Savvy investors started putting money in the S&Ls with the highest interest rates, which gave men like Charles Keating the money with which to build their dreams. Meanwhile, "the gamblers at least could reassure themselves that depositors wouldn't suffer," says Northwestern University economist Haskel Benishay. And the deeper in trouble the owners became, the less they had to lose by gambling some more.

This "moral hazard," as economists call the effect of government guarantees, has plagued other programs as well. Congress will soon have to spend $100 billion to $150 billion *on top of* the S&L bailout to cover losses from programs ranging from student loans to flood insurance to commercial banking. Ironically, Congress loves these programs because they seem so cheap. The cost becomes clear only years later, when the loan goes bad or the disaster happens.

Even though these programs often cover bad risks, they get lax scrutiny because they are off-budget. "Nobody dreamed we'd have to raise $120 billion to bail out savings and loan depositors," says Rep. J. J. Pickle. "Nobody dreamed we'd have to put up $4 billion for the Farm Credit System. Nobody dreamed. Why, all of a sudden we realize that there's a tremendous risk. We've handed credit cards to these folks without ever watching what happened."

RANDY GROTHE—DALLAS MORNING NEWS

Protesting the bailout: *An anti-RTC demonstration in Dallas*

The Culture of Financial Crime

Picture the following scene: five senators sit in a room with a local district attorney who is prosecuting an accused bank robber. The senators charge the D.A. with harassing the bank robber and a few help a Senate employee, friendly with the accused, to be appointed the new D.A. Even the most cynical observer cannot fathom this happening. Yet five senators didn't view inquiries on behalf of Keating to be improper—even though the Bank Board's investigation was attempting to protect taxpayers from huge losses and, as it turns out, alleged fraud.

In the private sector, people who would be outraged to see a thief snatch an old woman's purse become numb to the implications of a senior being ripped off through fraud. Such a double standard is reinforced by the criminal-justice system: an unarmed bank robber who steals $100,000 will get a sentence between 51 and 63 months. Someone who commits a $100,000 fraud gets between 15 and 21 months.

1990: Crisis Time

With the bailout floundering, it now looks as if the eventual cost could climb as high as $250 billion or more

Political and corporate culture can include pockets of permissiveness about crime just as ghetto subcultures can incubate violent crime. Until the insider-trading crackdown, Wall Street financial crime often went unpunished because it was so complicated—and in some cases so routine. The same sort of lapse in ethical standards lay at the heart of the HUD scandal, as Housing and Urban Development officials gave out grants on the basis of political ties instead of merit. People seem to forget that their gain comes at someone else's expense.

As part of his reform efforts, Rep. Henry Gonzalez, chairman of the House Banking Committee, required that regulators log contacts from congressmen. The S&L meddling suggests a further step: a ban on lawmakers privately lobbying regulators about the solvency problems of an individual bank or company.

The Big Denial

Adolf Hitler theorized that "the big lie" would work because human beings have a limited capacity to fathom deception on a grand scale. The S&L scandal provides a corollary that might be called "the big denial." When the facts present a situation so extraordinarily bad, human beings will devise brilliant ways to avoid reality. Congress and the regulators didn't face the S&L crisis early in part because they just couldn't believe it was as bad as people thought. The same has been true with problems like nuclear-waste disposal at the Department of Energy facilities, which will require an additional $150 billion in taxpayer funds to correct.

Facts weren't faced for more mundane reasons as well. To do so would have meant paying for a bailout earlier, which might have required an unpopular tax increase. Thrift watchers charge that Wall continually downplayed the size of the thrift problem to keep it from becoming an issue in the 1988 presidential election campaign, a claim Wall denies. Examiners within the Home Loan Bank Board feared that if they pushed too hard they would incur the wrath of their bosses who, in turn, were being browbeaten by the politicians.

The failure to confront the S&L crisis made a bad problem into the worst financial scandal in American history. The sicker S&Ls became, the more their managers threw good money after bad. If Congress had confronted the problem in 1984 it would have cost $40 billion, estimates consultant Bert Ely—a lot of money but a small fraction of what we'll end up paying. "It's like the government has been borrowing from a loan shark," Ely says. So if it depresses you to think of how much we'll be paying now that we're confronting the problem, think of how much we're saving by dealing with it now instead of in 1995.

CONGRESS: A COLLECTION OF SAM MACKS

Special Report to the Iowa League of Savings Institutions by Congressman Jim Leach.

Republican Congressman Jim Leach represents the First District of Iowa and has served that district since November, 1976. He is a ranking member of the Committee on Banking, Finance and Urban Affairs and serves on the Subcommittee on Financial Institutions Supervision, Regulation and Insurance.

The most captivating news story in Iowa this year relates to a robbery of tragi-comedy proportions that occurred in Ames.

Sam Mack, a starting forward on the Iowa State University basketball team, and a defensive back on the football team walked into the campus Burger King with rifles, without masks, and asked the kids at the counter to clean out their cash registers. Sam's picture was on the wall. One young girl is alleged to have called out as he came up to the counter: "Hi, Sam." To which he is said to have responded: "It is not me." Shortly thereafter the police arrived and punctured the escapees with bullets to their legs. The potential of two young men hangs in the balance.

The biggest story this year in Congress is analogous. With the S & L rescue package we revisited the scene of another crime -- the largest bank heist in history, one that goes beyond the vaults of financial institutions and picks the pocket of every American. To paraphrase Pogo: "the robber is US." No one in Congress could say "it is not me." Our pictures are on the wall. It is Congress, after all, that passed the loose laws that led to the loose regulation that set loose the high-fliers in the industry.

In this context, the conclusion is indisputable; in attempting over the years to do favors for the industry, Congress bedevilled the taxpayers and, to boot, put the financial services community through an unprecedented wringer.

The lesson is obvious: favoritism can be counter-productive. In its work-product this year, the question of counter-productivity remains, but there is no question whether Congress was more generous to the industry or to the taxpayer.

Less than one week after the President signed the Financial Institution Reform, Recovery and Enforcement Act of 1989, press reports indicated both that the prices of stock for well-capitalized thrifts had risen and that the cost of funds for all thrifts had decreased.

In that same week, the newly created Office of Thrift Supervision announced that in anticipating higher minimum capital requirements under the new law, thrifts reduced their assets by $7.6 billion in June, the second largest asset decline in history.

The three phenomena illustrate the different effects the new law already was having on the thrift industry; Ultimately, some institutions will prosper, some will shrink and others will be closed.

While I have reservations about the bill, Iowa thrift managers and owners have reason to be far more pleased than disappointed with the legislation. On the plus side, the insurance fund is re-bolstered, confidence in the industry is restored, the most over-leveraged institutions are liquidated, some of the most egregious practices (such as direct investments in real estate, equities and junk bonds) are restricted, and modest increases in resources and authority are provided to the Justice Department to rid the industry of wrong-doers.

On the minus side, earnings from Federal Home Loan Bank stock are reduced, insurance fund premiums are increased, and capital requirements are made more stringent.

But, the industry escaped having to pay for most of the clean-up costs. While premiums are up and Federal Home Loan Bank earnings are diminished, the Federal Home Loan Bank system is retained and its contribution to the Resolution Trust Corporation is not indexed to inflation, as was originally provided for in the House-passed bill. Not only will the vast majority of the cost of the clean-up come from the taxpayer -- with the cost to every man, woman, and child in America likely to exceed a thousand dollars -- but the industry's assets in the regional Home Loan Banks were given preferential consideration to the taxpayers' pocketbooks.

Despite the fact that every Federal Home Loan Bank was insolvent due to the joint and several liabilities associated with the Texas bank, Congress chose not to exercise the government's clear right to tap the regional bank stock of every S & L in the country before turning to the taxpayer.

In addition, even though insurance premiums will be increased, the differential between bank and thrift premiums will narrow. The industry not responsible for the problem -- commercial banking -- ironically will be in a less-good competitive position than before on insurance costs and remain at severe competitive disadvantage on capital ratios. This is particularly the case in Iowa, where state bank regulators have the stiffest (8 percent) standard in the country and the most scrupulous approach to classifying loans.

While surviving Iowa thrifts may experience some interim traumas in complying with the new law, healthy institutions ought to emerge from this experience stronger than before, competing in an environment where more prudential market forces, rather than the oxymoron of risk-free capitalism, apply.

In a national context, the $50 billion in new resources added by the bill to the insurance fund will help protect savers and make possible the liquidation of badly insolvent thrifts, but the strong likelihood is that the issue will need to be revisited in the next 18 to 36 months.

The industry discipline called for and the resources provided are insufficient to cope with the true depth of the problem. It must be understood that near-term liabilities of the thrift industry are in the twelve-, not eleven-figure range and that second-tier institutions in difficulty could cost the government an additional $40 billion to $50 billion.

Not only is the bail-out that has commenced larger than New York City to Chrysler times a factor of ten, but the legislative scandal that precipitated taxpayer accountability is the equivalent of Teapot Dome to Abscam times a factor of a hundred.

The first title of the bill should have been about campaign reform and the last title about ethics in government. Each is missing.

A Congressional "Watergate" is in the making, the implications of which remain uncomfortably and ignominiously unresolved. (9/15/89)

As Kerrey is propelled toward national stage will searchlights illuminate some corners?

by Jack Hart

High among the several issues being carved out by Sen. Bob Kerrey for leadership is the nation's mammoth crisis in the savings and loan industry. At last look, that horrendous condition is due to cost American taxpayers somewhere around a half a trillion dollars.

Kerrey's aggressive entrance into this issue — regularly critiquing the Bush administration's handling of the matter and offering a barrage of alternatives of his own — is both appropriate and ironic.

As governor of Nebraska, Kerrey presided over the collapse of three state-regulated savings institutions, sort of a minor league tryout for the calamity that descended on the federally-supervised firms a few years later. So the young Nebraska senator does have experience in this domain.

On the other hand, his experience is largely a textbook lesson on how NOT to manage S&Ls in crisis.

In any event, now that Kerrey has enthusiastically preempted the issue, he should honor the unwritten rule of legislative behavior that says: Any senator bidding for leadership over a powerful public issue should provide a detailed explanation of his or her own background and presumed expertise in the subject.

Untold story

Strangely, not even the people of Nebraska know the story of Kerrey's political, financial and very personal involvement in the demise of the thrift institutions, notably two large firms in Lincoln. That is because neither Kerrey nor the Omaha-Lincoln daily newspapers, which have sheathed the senator in their web of protection, want the story to be known.

The silence surrounding Kerrey and the Nebraska savings institutions is all the more astounding since a detailed account of the episode has been meticulously assembled, from official documents and sworn testimony, by a select committee of the Nebraska Legislature. Its findings are a matter of public record.

In January, 1987, the legislative investigators did issue a summary of their conclusions and some recommendations — which, although somewhat muted, were still shocking. The Omaha World-Herald and the Lincoln dailies issued perfunctory reports of the committee's allegations but then shoved the whole smelly business under the rug. The metropolitan press did not even pursue a final request by the investigating legislators that Attorney General Robert Spire take action to recover some of the depositors' funds that were lost as a result of actions by Governor Kerrey and some of his close associates.

Coverage denied

And when a citizens group, organized as a non-connected political action committee, tried to make the full story public during Kerrey's 1988 campaign for the U. S. Senate, they were given the back of the journalistic hand and denied any coverage of the assembled material. The Omaha and Lincoln papers even refused to carry the group's paid advertising account of the affair.

Instead, the newspapers took the material to Kerrey and his lieutenants and invited their response, which was a torrent of published invective against those daring to tell the story and a spate of television and radio ads about the "badmouthing" injected into the campaign. But never did Kerrey or his spokespersons ever deny the accuracy of the legislators' account or attempt to explain the strange happenings surrounding Commonwealth Savings Co. and State Security Savings Co., both of Lincoln.

Story in brief

Here, in brief, is the story of Kerrey's involvement in the downfall of Nebraska's state-regulated savings institutions during his time in the governor's office, taken from official records and sworn testimony before the legislative investigating committee:

The story begins on a night between Christmas and New Year's of 1982, after Kerrey had been elected governor but before he was inaugurated. On that night, Paul Amen, state banking director in the previous administration, was summoned to a late meeting by Governor-elect Kerrey. With Kerrey for that meeting was William F. Wright, Kerrey's chief political and business adviser, president of State Security Savings Co. and a director of the Lincoln Journal-Star Printing Company, publisher of the city's two daily papers.

They informed Amen that they wanted him to stay on in the new administration, which he agreed to do. Anticipating such an invitation, Amen had brought along what he later described to the legislative investigators as "our highly confidential, secret, sensitive list of problem (financial) institutions...just the ones we were working with to keep them from becoming insolvent."

Amen showed the document to the two men. Kerrey said he didn't even want to see it. Wright looked at it and commented that there were some major institutions on the list. There were, indeed, including Commonwealth and Wright's own State Security.

Late night meeting

The significance of that December night became more apparent less than a year later, on October 31, 1983. Amen was in Washington, D. C., seeking assistance from the Federal Reserve in clearing the way for City Bank of New York to take over the troubled Commonwealth Savings. On that very day, Kerrey gave the story of Commonwealth's problems to Ed Howard, Lincoln bureau chief of the Associated Press. The story was on television that night and in the next morning's papers. Not surprisingly, depositors were descending on the institution before it opened and the state quickly closed it and took it over.

In the Lincoln Star of November 1, Kerrey was quoted as saying that he was barred by law from publicly revealing how serious the Commonwealth situation might be — to avoid a run on the institution, of course. By that time, Kerrey already had given out the information that caused that very result.

Neither the World-Herald nor the Lincoln papers ever sought to learn why the governor would make such precipitous remarks to the press; nor did they pursue the state law that the governor himself implied made it unlawful for him to say what he was saying.

During the following months, Nebraskans were inundated by news reports fixing blame for Commonwealth's collapse and pursuing scapegoats. Heads rolled at the Statehouse. Amen and his deputy were fired; Republican Attorney General Paul Douglas came under intense fire and later was forced to resign. Kerrey cohorts were installed in key positions.

What was not made public until the legislative committee's report some three years later was that, in all the chaotic aftermath of Commonwealth's downfall, Kerrey's good friend and business partner, William Wright, was systematically "milking and draining" (in the words of the legislative report) assets of State Security Savings Co.

Kerrey partnership

By the time Commonwealth went down, Kerrey had entered into a partnership with Wright and others to use State Security as a vehicle to purchase commercial property at Lincoln's East Park Plaza. On April 13, 1983, Kerrey personally signed himself on as a partner in the American Investment Group, even though he had said that when he became governor he assigned all his business dealings to his sister and brother-in-law.

The purpose of the partnership was to acquire the East Park property, known as "Shoppers Fair," at a bargain price. Owners of the property, Lincoln developers Robert Rentfro and Jerry Joyce, were heavy borrowers of State Security and having problems making payments. Even though Shoppers Fair was not among the properties on which State Security held mortgages, State Security executives pressured Rentfro and Joyce to turn over the property over to the Kerrey-Wright partnership at a price somewhat lower than appraised value. The implication, as noted by the investigating committee, was that if they did not do so, the savings company would foreclose on all their outstanding loans.

Later, when Rentfro and Joyce became outraged by being "ripped off," as the investigating committee reported, they threatened to go public with the whole story, including Kerrey's involvement. Eventually, the two signed an agreement with AIG not to bring legal action or otherwise cause a public stir about the deal. In return, more than a million dollars of State Security loans to Renfro and Joyce were written off.

Depositor losses

Along with a $150,000 fee paid to Wright and other State Security officials, the loss on a preferential loan by State Security to AIG and other asset losses, the Shoppers Fair deal by the Kerrey-Wright partnership cost depositors some $2 million, as calculated from records assembled by the legislative investigators.

On the same day Joyce signed the agreement with AIG, July 9, 1984, Wright took State Security into Chapter 11 bankruptcy. Shortly after the bankruptcy, Wright suddenly moved to a fashionable suburb of San Diego, Cali. In 1988, he was living there in a home valued for tax purposes at just under one million dollars. Wright has since severed all his Nebraska business connections except to continue serving as a director of the Journal-Star Printing Co.

During investigation of the State Security collapse by the Legislature, a special committee was first appointed to look into the matter to determine if a full-scale study by the Banking Committee was warranted. That committee, headed by then-Sen. Bill Harris, now mayor of Lincoln and Democratic candidate for governor, recommended that a formal investigation be held.

Senators ask action

As the Harris committee probed deeper, four members became so alarmed that on May 28, 1986, just before certain statutes of limitation were to run out, they wrote to Kerrey-appointed Banking Director James Barbee suggesting that some actions were "not only improper, but perhaps illegal."

The letter was signed by Sens. Harris, Jerome Warner, Loran Schmit and Emil Beyer. Copies were sent to Attorney General Robert Spire, who had been appointed by Kerrey to replace Paul Douglas, and to Lancaster County Attorney Mike Heavican. Nothing was done.

To this day, that action by four leaders of the Nebraska Legislature, has never been reported in the Omaha World-Herald or the Lincoln Journal or Star. Nor have most of the other facts of this episode.

Wright was never pursued by the state to put any of his own money into the collapsed institution that investigators found he had "milked and drained."

On the other hand, S. E. Copple, president of Commonwealth for many years, was pressured by the Kerrey administration to put in some $8 million of his own money in an effort to keep that institution afloat. At more than 80 years of age, he was convicted, served time in prison and died a pauper.

Reprinted from the Omaha Metro Update