ASSOCIATION of BANK HOLDING COMPANIES

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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.