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Cranston's Crutch

We recently recounted how in 1987 five U.S. Senators intervened with federal regulators to ease up on Lincoln Savings & Loan of Irvine, Calif., a now insolvent thrift under criminal investigation. Estimates of the taxpayer losses in liquidating Lincoln approach \$2.5 billion, or \$10 for every American.

One of Lincoln's more unusual practices was the sale of its parent company's subordinated debentures—bonds outranked by the claims of other creditors—to the general public. Some 23,000 investors now hold what they are told is \$200 million in worthless paper. Many, led by a dentist named Don Mikami, are blaming part of their plight on one of their U.S. Senators, Alan Cranston. Mr. Cranston intervened with regulators on behalf of Lincoln on at least three occasions.

Senator Cranston insists he was only helping a "constituent" battle the federal bureaucracy, glossing over the fact that executives of Lincoln's parent company recently had showered him and his four Senate colleagues with large contributions.

Besieged by angry constituents, Senator Cranston now admits it may have been "politically dumb" to aid Lincoln. So to get the bondholders off his back he is suggesting that the Federal Deposit Insurance Corp. bail them out. Taxpayers thus would share an even larger part than now of the cost of Lincoln's follies.

Senator Cranston has asked the General Accounting Office to see if salespeople working out of Lincoln offices failed to tell purchasers the bonds weren't insured by the federal government. If so, he claims there is a 1986 precedent that would allow the FDIC to step in. In that case, a court found that customers of a small failed New York bank had been misled when they bought uninsured notes. The FDIC later covered their losses. But since most of the buyers were recent Chinese immigrants they plausibly could claim they were unable to read disclaimers in English.

An FDIC pay-out would establish the dangerous principle that incautious investors can get bailed out if they merely can show they weren't verbally informed of all the fine print. The FDIC already routinely pays off depositors in insolvent S&Ls, even if their deposits are beyond the \$100,000 insurance limit.

But one group of bondholders is interested in more than getting its money back. Ron Rus, an attorney who represents the group, says he would be "delighted" if the FDIC stepped in. "But only if then somebody, acting for the taxpayer, makes sure that those truly responsible for this pay for it." To some bondholders, that not only includes Lincoln executives but also Senator Cranston and his influential colleagues.