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# THE \$150 BILLION CALAMITY

Part of Series Articles

## For Texas S&Ls,

# a Long, Nasty, Corrupt Descent

DALLAS

Ed Gray, endorsed in the back seat of a ~~Rolls Royce~~ ~~Rolls Royce~~, concluded that the stereotype was accurate: Texans were brash, gregarious, larger than life. A different breed, they displayed a raffish gusto for making and spending money.

Gray glanced across the seat at his host, Spencer H. Blain Jr., beau ideal of the new high-rolling Texas thrift executive, seemed a case in point, right down to his \$5,000 Rolex.

Not that 47-year-old Edwin John Gray had anything against making money. As the new chairman of the Federal Home Loan Bank Board, part of his job as chief regulator of the savings and loan industry was to give the nation's thrifts an opportunity to earn an

honest buck. In Texas, it was clear to Gray on this Tuesday evening, June 7, 1983, they were seizing that opportunity with both hands. As the car glided toward the dollar-green neon skyline of downtown Dallas, Gray couldn't resist tweaking Blain.

"You know," Gray said dryly, "I don't know any S&L operators who drive Rolls Royces."

"Oh, well," Blain replied. "We're just very profitable down here in Texas."

Years later, when Texas was no longer bold and unbowed, when the nation faced its worst financial catastrophe since the Great Depression and the Texas thrift industry had become a virtual ward of the federal government, Gray recalled one other peculiar scene from that night.

A band of Lone Star thrift executives, who like Gray had come to Dallas for the Texas S&L industry's annual convention, met for a party in Blain's penthouse atop the Registry Hotel. They hooted and hollered and danced around the ornate fireplace and the mock 18th century French furniture. An odd, guitar-picking duo provided the music: L. Linwood Bowman III, the lanky, sedate Texas savings and loan commissioner, and chubby, ribald Durward Curlee, lobbyist for the industry that Bowman was responsible for regulating. The two crooned for more than an hour, serenading Gray with "I'm Walking the Floor Over You" and "Lovesick Blues."

Sometimes people look but do not see, hear but do not listen. So it was for Gray during that first visit to Texas. Perhaps the setting was wrong, or the timing, or his frame of mind. Context is the filter for everything. Whatever the reason, the Rolex and the Rolls became fixed in Gray's mind, but he brushed

aside a disturbing message, delivered during the same trip, about Spencer Blain and his operation at Empire Savings & Loan in nearby Mesquite.

Commissioner Bowman privately described for Gray how Empire, once a conservative thrift in suburban Dallas, was growing at an astonishing rate, doubling and redoubling in just a few months. Then he outlined a quick-cash scheme known as a "land flip" in which Empire and several other thrifts repeatedly sold a piece of property back and forth, pocketing big fees for each transaction. Finally, Bowman told Gray of Empire's mind-boggling condominium projects east of town, thousands of units.

Strange things are going on out there, Bowman suspect someone has been dragging cars out from a highway to make the projects look occupied.

This warranted closer inspection by federal regulators, but Gray did not pursue the matter. When his focus was elsewhere, an aide once remarked, Gray had the attention span of a doorknob. After all, Gray reflected later, he had not gone to Dallas to sniff out misdeeds. He had been on a different mission: To urge the Texas S&L operators to take advantage of new federal legislation that unshackled the industry, removing the traditional constraints on how thrifts could attract deposits and lend money.

As a former publicist for a California thrift and a long-time press aide to Ronald Reagan, Gray accepted the prevailing ideology of the time—that free markets and deregulation were salves for economic hard times. This applied especially to the savings and loan industry, which had been mired in a three-year slump triggered by increased competition from newfangled financial enterprises that paid higher interest rates than a Plain-Jane S&L account. What the industry needed was less regulation from Washington, Gray believed, and more opportunity to grow out of its problems, "A Sure Cure for What Ails You" as he had called his speech to the Texas conventioners.

But at the very moment that Chairman Gray and the band of Texans met in Dallas, they unwittingly stood on the brink of a disaster, one in which both the Texas economy and the deregulated S&L industry went down the tubes together, tugging and clawing at each other during a long, nasty and corrupt descent. Now, as the decade nears its end, here is the result:

The Texas savings and loan industry lies in ruins. Six years ago the state boasted 287 thrifts; today, there are 140 and the number is expected to dwindle to as few as 70. Federal investigators, meanwhile, are pursuing 7,000 criminal referrals across the country in what the Justice Department's fraud section chief, William-C. Hendricks III, calls "as big a systematic criminal problem as I have ever seen." Even the hundreds of thrifts innocent of wrongdoing have suffered, as an anxious and suspicious public withdraws \$1.5 billion in deposits every month. Finally, the nationwide bailout plan before Congress is expected to cost more than \$150 billion.

Like light years-and nanoseconds, \$150 billion suggests a unit of measure not easily comprehended. Perhaps the best way to think about the sum—to pare it to human scale—is to consider what else the money might have bought. It could have financed the U.S. Food for Peace program at its current level for 136 years or the Drug Enforcement Administration for 262 years or federal prenatal care programs for 717 years. It could have purchased, at current prices, 47 nuclear-powered aircraft carriers or 4,717 F-15 jet fighters. It could have built 53,571 miles of Interstate highway.

Four of the men who gathered in Spencer Blain's penthouse suite that night six years ago each contributed to the calamity in a different way. Each was forever changed by it. Bowman, forced out as commissioner of the Texas Savings and Loan Department, ended his career with remorse and self-recrimination. Curlee, his lobbying days over, saw his fortune disintegrate in a bankruptcy sale on the courthouse steps. The flamboyant Blain, stripped of his S&L and permanently barred from the thrift business, is on trial on fraud and racketeering charges, which he has denied.

But no one changed more than Ed Gray, and it was his transformation that told a larger tale of human frailty and the search for moral courage.

## A Fatal Flaw

Ed Gray was neither an economist nor a businessman by profession, but rather a born pitchman and cheerleader. After a brief episode as a reporter, working in the Madrid bureau of United Press International during the early 1960s, he went into public relations and made a career of saying positive things about his employers.

This decidedly average man—brown hair, square face, medium height and build—instinctively shunned controversy and conflict. He saw himself as the quintessential nice guy. His favorite sport was not tennis, but fly-fishing, alone, in the high country of his native California. He liked reading history, particularly accounts of the Dark Ages in Europe. He was seen as a close friend of the S&L industry, and when the Federal Home Loan Bank Board chairmanship opened in 1983, the industry pushed his candidacy.

Gray's attachment to Reagan began in 1966, when he helped run the press operation for Reagan's first inauguration as governor of California. When Reagan needed a Bible for the swearing-in, Gray was dispatched to Carmel to fetch the 200-year-old holy book used by missionary Junipero Serra. Gray served Gov. Reagan in Sacramento, then took his skills into private enterprise as an S&L executive.

At first glance these causes—Reagan and savings and loans—might not seem easily linked, but they fit together neatly in Gray's romanticized world view. He shared the thrift industry's self-image as the enabler of the American dream. From its inception in suburban Philadelphia in 1831, the business had portrayed itself as the benefactor of American home ownership. Nearly a century ago the thrift industry's principal trade association coined the slogan: "The American Home, the Safeguard of American Liberties."

To Gray, Reagan embodied wholesome American virtues, and that value system held the dream of home ownership. Gray thought of Reagan not so much as spokesman for corporate America but more as an average fellow, similar to the character Jimmy Stewart played in the 1946 Hollywood classic, "It's a Wonderful Life"—a small-town thrift executive who was patient and forgiving of his mortgage customers during hard times.

The industry that Gray joined in the mid-1970s had not changed much since the era portrayed in the movie. It remained a relatively simple business dedicated to making mortgage loans on single-family residences. Federal law capped the interest rates an S&L could pay its depositors, but thrifts lived comfortably on the consistent, seemingly immutable, profit spread of 2 or 3 percentage points between deposit and loan rates. Furthermore, since 1934, the system had been virtually risk free, with deposits guaranteed by the Federal Savings and Loan Insurance Corp. (FSLIC). Hence the industry's lighthearted motto: "Three Six Three"—pay depositors 3 percent interest, lend at 6 percent, and hit the first tee at the country club by 3 in the afternoon.

As the 1980s began, thrift executives were still playing golf—they would never relinquish the game, nor their framed pictures of Billy Casper and Arnold Palmer, nor their fairway lingo (Newark, one executive quipped, is "two woods and a nine iron from New York")—but their world had become more complicated and uncertain. The creation of money market accounts and other investment opportunities, offering higher interest rates and easily available to consumers, eliminated the advantage that thrifts had enjoyed for many decades. From a zenith in 1978, when S&Ls reported record profits, the industry went into a stunning tailspin: 18 straight months in which Americans withdrew more money than they deposited.

The first federal response, near the end of Jimmy Carter's presidency, was to remove restrictions on banks and savings and loans, eventually allowing them to offer any interest rate they desired. At the same time, Congress more than doubled the amount the FSLIC would insure in deposits, from \$40,000 to \$100,000.

This change was of more than passing interest to Gray. After working in Reagan's 1980 presidential campaign, he had moved to the White House domestic policy staff, where his territory included the savings and loan industry. Gray and others soon realized that deregulating the interest ceiling on deposits had a fatal

flaw. Thrifts now had no trouble attracting new deposits, but they were still losing money faster than ever. The thrifts were caught in a "negative spread," paying high interest on their deposits while collecting relatively low interest on the long-term mortgage loans that provided most of their income.

In Texas, inevitably, this condition was converted into an Aggie joke. Negative spread, one Austin economist said, was "like the Aggie service station owner who bought fuel at 50 cents a gallon, sold it at 45 cents, and hoped to make up the difference on volume."

## A Profound Revolution

But how to respond? That is where the first fissure appeared in the Reagan team. While the administration agreed that the financial world should be deregulated, there was no consensus on what to do specifically about the savings and loan industry.

Survival was as much an issue for the industry at the dawn of the '80s as it is now, at the end. A remarkable aspect of the calamity is that after so much activity—so many proposed solutions, so many transmutations, so much mismanagement, so much venality, so many delusions, so many failures of the regulatory system—there was a problem then and there remains a problem now.

Donald T. Regan, Reagan's first Treasury secretary, who had a large voice in the administration's economic policy, held less sway when it came to the S&L issue. Despite Regan's misgivings, Gray and the U.S. League of Savings Institutions succeeded in getting their candidate appointed chairman of the Federal Home Loan Bank Board in 1981. He was Richard Pratt, finance professor at the University of Utah, a fullback of a man with a thick neck, a deep rolling voice and a commanding presence; while he did not share Gray's romantic notions of the goodness of thrifts, Pratt did believe in their utility. Above all, he believed in the value of a free market.

In Pratt's perfect world, the savings and loan industry would be neither regulated nor protected with federal insurance. He sermonized on how deposit insurance, while reassuring to customers, provided S&L operators with a perverse incentive to take risks. But eliminating the insurance was too radical even in the free market fervor of the time, so Pratt went for what he could get: legislation and rules that had the eventual effect of provoking even more risk-taking. Deregulation was his shibboleth. When recruiting Robert Mettlen of the University of Texas for chairman of the regional Federal Home Loan Bank responsible for Texas, Pratt began: "Let me ask you one question. Do you fundamentally believe in deregulation?"

Working with a troop of assistants known as the "Mormon Mafia," Pratt sought to resolve the negative spread dilemma by easing restrictions on how thrifts could be run, who could run them, and how money could be invested. Central to this effort was the Garn-St Germain Depository Institutions Act of 1982, which encouraged thrifts to move away from the home mortgage business and toward riskier—but potentially more profitable—commercial and real estate loans, development loans, and subsidiary enterprises.

At the same time, Pratt's bank board issued an equally important set of rule changes. Accounting procedures for S&L examinations were eased. Thrift owners were required to put less of their own cash in a reserve fund intended to hedge against losses. The definition of cash, or capital, for that reserve fund was liberalized to include such assets as raw land. And the requirement that thrifts have at least 400 stockholders was eliminated, wiping out the concept of community involvement.

Yet, Pratt later recalled, there were "no substantive conversations" in the early '80s about beefing up the regulatory side of the operation. Ed Gray, from his vantage point at the White House, summed up the philosophy: "The general mentality was that the regulator was to be deregulated into oblivion."

The industry underwent a swift and profound revolution. From coast to coast, consultants held seminars on how to take advantage of the new commercial opportunities in the thrift business. In Los Angeles, a law firm put out a brochure raising the question, "Why Does

**It Seems Everyone Is Saying It's Starting a California S&L?** Among the answers: Developers operating under the thrift umbrella could tap cash resources and seize favorable deals while competitors were looking for financing.

When Pratt left office, replaced on March 24, 1983, by industry cheerleader Gray, the feeling in Washington and around the country was that Pratt had worked wonders. Nearly 750 thrifts had closed shop during his

tenure, victims, mostly, of negative spread. But those that survived reported good profits, even astounding profits. Pratt was credited with leading the industry out of the 19th century and preparing it for the 21st.

And no place in the world was more eager for the 21st century than Dallas. Oil prices had stabilized after a dizzying rush two years earlier and the energy centers of the Sun Belt—Houston and Midland—had flattened out a bit. But the whole world still seemed eager for a piece of Texas, and Dallas, real estate capital of the Southwest, was in a veritable mad frenzy. Before 1983 was over, nearly 20,000 residences would be built there, the most of any metropolis in the nation. Building permits in Texas quadrupled over the number issued in the late 1970s. Much of that enterprise was financed with cash borrowed from Texas thrifts.

The Washington of Ronald Reagan was ascendant as well. Interest rates had eased and inflation dropped to the lowest level in 15 years. Much of the country was emerging from a recession and the White House was willing to take credit for it. Reaganomics had been transformed in many minds from a dirty word to a magic one.

There was, then, in the spring of 1983, an unusual convergence of two worlds—freewheeling Texas and free-market Washington—at a time when each was thought to have reached a pinnacle of economic success. In Texas, boom times were taken as something more than mere luck or geographic circumstance. They were seen as a confirmation of Lone Star values: pioneer spirit, frontier ethic, anti-government bias and entrepreneurial style.

But in hubris there is self-deception. In this case it was monumental.

## A Cautionary Step

Back in Washington in the fall of 1983, Chairman Gray began to receive troubling reports from his staff at the Home Loan Bank Board. At the October meeting of the enforcement staff, he learned that thrifts around the country—especially those in Texas—had shown explosive growth in the previous four months. The suddenly resurgent S&Ls were using their newfound cash to make risky development loans, Gray was told.

By the end of the year, Gray had heard enough to take a mild, cautionary first step: requiring new thrifts to increase their cash reserves as a protection against loan losses. This provoked a harsh reaction from his friends at the U.S. League, as Gray later recounted the episode. Several league officials suggested that imposing restrictions on new thrifts would hurt the organization, which needed all the new members it could get.

The last thing Gray wanted was to displease the industry. League president William B. O'Connell, an occasional lunch partner and Gray enthusiast, had mentioned that the chairman might be a leading candidate to succeed him someday. The salary of \$275,000 a year rang loud in Gray's mind. He had spent his career being a nice guy. He wasn't used to being jostled, knocked around, criticized, especially by his friends. These guys have never seen the other side of me, he thought to himself, but then neither have I.

This insight troubled him, in no small measure because he realized that he wasn't going to be able to make everybody happy.

*NEXT: Diving off the deep end*

*Staff writers Kathleen Day and Charles R. Babcock and staff researchers Elizabeth Hudson and Melissa Mathis contributed to this article.*

## THE REGULATORS AND THE REGULATED



**EDWIN J. GRAY**, chairman of the Federal Home Loan Bank Board for four years, became the nation's top S&L regulator after stints as a Reagan aide and as an S&L public relations executive.



**L. LINWOOD BOWMAN III**, a former thrift executive who served as Texas S&L commissioner from 1982 until 1987, was the state's chief regulator during the rise and fall of the Texas thrift industry.



**SPENCER H. BLAIN JR.**, majority stockholder of Empire Savings and Loan until it was taken away from him, also served as vice-chairman of the Federal Home Loan Bank of Little Rock.



**DURWARD CURLEE** became the lobbyist for the Texas Savings and Loan League in 1973 and then went to Washington in 1984 on behalf of 20 Texas thrifts, most of which eventually failed.

**THE \$150 BILLION CALAMITY**

Second of Seven Articles

**Only Ambition Limited S&L Growth****Office's Move to Dallas Hampered Regulators as Key Staff Departed**By Rick Atkinson and David Maraniss  
Washington Post Staff Writers

DALLAS

In September 1983, after 50 predictable years in Little Rock, the Federal Home Loan Bank regulating the savings and loan industry in the Southwest succumbed to the inevitable by migrating to Dallas, money magnet of the American Sun Belt. The move went badly.

Thirty-seven of 48 employees in the bank's division of supervision, including the chief, quit rather than relocate. For months before the move, the booming thrift industry in the bank's five-state region received virtually no attention from federal watchdogs. Those supervisors who intended to resign began looking for new jobs in Arkansas; those remaining began looking for new homes in Dallas.

Most of the 11 employees making the move were secretaries or low-level assistants. Only two worked in the field as supervisory agents, and they faced a daunting task upon their arrival in Dallas. The district bank's 500,000-square-mile region contained 480 S&Ls; some were doubling or tripling in size every few months. Despite rules calling for annual examinations, many had not been scrutinized in years by federal examiners, who served as the supervisors' early warning system in detecting problems.

Forced to improvise, those two surviving field agents, Charles Brooks and William Churchill, split District 9 in two. They chose the Red River as their line of demarcation: Brooks would supervise all thrifts north and east of the Red—those in Arkansas, Louisiana and Mississippi—while Churchill supervised everything south and west of the Red, mostly in Texas and New Mexico. Each agent shouldered a caseload of roughly 240 institutions. (In later years, a supervisory load of two or three thrifts per agent was considered more than enough work.)

Some regulators would have been intimidated. But Brooks, Churchill and their colleagues felt little anxiety. For 50 years, the regulator and the regulated had lived harmoniously under a system built on trust, tradition and mutually accepted rules of the game. "We were naive," one supervisor lamented recently. "It was inconceivable to us that people could be doing [anything] to harm their own institutions."

Even before reaching Dallas, the little band of regulators could see that life in Texas was going to be different. Leaving Little Rock for the last time,

they drove southwest on Interstate 30, through Texarkana, and across the long, low bridge spanning Lake Ray Hubbard, where new housing tracts pushed to the water's edge. Beyond the west shore of the lake, as the Dallas skyline popped into view, the development grew ever denser, with thousands of new apartment buildings and condominiums crammed into a 10-square-mile corridor bracketing the interstate. An instant city had blossomed on the prairie, much of it financed by Empire Savings and Loan of Mesquite, which had sunk hundreds of millions of dollars into the enterprise.

"This," district bank official George Barclay told his wife as they whizzed past, "is like Brooklyn without the laundry lines."

But there was another difference, too. Brooklyn was solvent.

**A 'Dead Gut Cinch'**

Like its 11 sister institutions under the Federal Home Loan Bank (FHLB) system, the District 9 bank had two functions. The first was to lend money to thrifts in the region and provide other banking services. The second was to scrutinize those thrifts to be certain they were financially healthy and did not jeopardize the Federal Savings and Loan Insurance Corp. (FSLIC), which guaranteed S&L deposits. Member thrifts owned the district bank and elected the directors who ran it. This was a system constructed on conflict, since the thrifts were regulating themselves. To preserve some independence, the regulatory side of the Home Loan Bank was segregated from the banking side.

The district banks provided jobs and prestige. For 30 years Texas had resolutely tried to lure the District 9 bank to Dallas, arguing that the city had no peer in the Southwest as a financial capital; for 30 years, Arkansas just as resolutely resisted. In 1958, when the Texas Savings and Loan League voted—as it did perennially—to lobby for the move, the league president found a one-line telegram under his hotel door in Galveston that night. Signed by Sen. John L. McClellan, the powerful Arkansas Democrat who chaired the Senate Appropriations Committee, the message read simply: "You're whistling Dixie."

Eventually the influence of the Arkansas congressional delegation waned. In early 1983, when the issue arose again, Arkansas' two senators held up the nomination of Edwin J. Gray to become chairman of the Federal Home Loan Bank Board in an effort to obtain his support. But the directors of District 9 voted 11 to 2 to move, with the Bank Board's consent. Gray, three weeks after taking office, proudly cast his vote in favor.

To Gray, the move made great sense. A Home Loan Bank's business, he believed, was to know what was going on in the district, and perhaps nowhere in the country was more going on than in Texas. Fueled by a near quadrupling of oil prices to a peak of \$35 a barrel in 1981, the boom had provoked more than a little Lone Star arrogance. "Drive 70 and Freeze a Yankee," bumper stickers proclaimed. "90 in '90," the oilmen assured each other, meaning \$90 a barrel in 1990.

Behind the oil boom came the real estate boom. Developers rushed to build houses and condominiums for the masses who would surely emigrate to Houston, to Austin, to Big D. Texas real estate, in the local idiom, was a "dead gut cinch." Only the most incompetent fool could lose money. Texas was fated to become the new California, a Sun Belt Manhattan, where land prices climbed and climbed and kept on climbing.

Hundreds of savings and loan associations from around the country jockeyed to finance the developers, funneling billions of dollars into construction virtually overnight. "If you could walk, talk and say, 'I am a developer,'" one thrift expert said later, "you could borrow \$10 million." Often it was easier, much easier, for an ambitious builder to borrow that \$10 million—with less paperwork, little or no down payment, and no credit check—than for an ordinary working stiff to borrow \$100,000 for a traditional home mortgage loan.

A cozy symbiosis evolved between lenders and borrowers, as federal regulators later discovered. Frequently, a developer needing \$10 million instead received \$12 million from a friendly savings and loan. Ten million dollars went directly to the borrower, minus several hundred thousand in fees to the thrift; \$2 million went into an "interest reserve" account to cover interest payments for two years.

Each month, the S&L drew money from the reserve account as a "payment" on the loan; these payments showed up on the thrift's books as profits, nimbly misleading any nosy examiner and justifying large dividends and bonuses to the S&L executives. If the interest reserve dwindled, another sympathetic thrift refinanced the deal and began the cycle again.

The only business in Texas that was more of a dead gut cinch than real estate was owning your own savings and loan. After the grim period of the late 1970s and early 1980s, when the lethal surge in interest rates had felled more than 100 Texas thrifts, the industry bounced back smartly. Developers recognized that new laws and rules adopted in Washington meant that, with a relatively modest investment, a real estate man could own his own thrift and, by luring deposits with high interest rates, have millions of dollars at his disposal. The new rules permitted any S&L, whether owned by saint or sinner, to grow at a rate constrained only by ambition.

In 1982, for example, the Bank Board in Washington removed restrictions on an S&L's ability to attract "brokered" funds. A broker in New York or San Francisco could sit at a computer, go *click-click-click* on the keyboard, and the screen would flash a list of the 50 institutions paying the highest interest rates. With another *click-click-click*, the broker shoveled his customers' cash electronically into the most attractive thrifts. Usually, the broker packaged the money in deposits of less than \$100,000 to keep each account within the limits of federal insurance coverage. As often as not, the best interest rates could be found in Texas. Billions of dollars poured into the state's thrifts.

Bank Board Chairman Gray did not like brokered deposits. The phrase "gasoline on a bonfire" kept recurring in his mind. A thrift regulator was supposed to know what was happening to the money moving through the industry, and Gray had to admit that he possessed only the sketchiest notion. The best way to bring this blaze under control, he concluded, was to stop the flow of gasoline. Some skeptics believed Gray had taken this position only after sensing that he wouldn't offend the leadership of the U.S. League of Savings Institutions. Regardless, Gray proselytized against brokered funds with pulpit-pounding fervor; wheedling, exhorting, pleading, he convinced the Bank Board staff, as well as the two other Bank Board members, of the righteousness of his cause.

Yet he failed to convince the big Wall Street brokerage houses, and he certainly failed to convince the Texas thrifts, which faced the loss of a major revenue source. In the late fall of 1983, Gray made his second trip to Texas to drum up support. He was irritated to find that his opponents also included the Texas state commissioner, L. Linwood Bowman III, who thought Gray was misguided in focusing on the source rather than the misuse of the money. "You give a chain saw to an untutored man and he'll cut off his legs," Bowman explained in his folksy drawl. "But give it to a tutored man and he'll build houses with it." And anyone could see that Texas was building a lot of houses.

Ed Gray lost the brokered funds battle. A federal judge ruled that his attempts to curb the practice exceeded his authority as Bank Board chairman. For the first time, Gray had locked horns with the Texas thrift industry. It would not be the last.

Money continued to gush into Texas. Small thrifts became large, large thrifts became huge. As Dallas district bank Chairman Robert D. Mettlen later observed, "The temptation for a few folks to dive off the deep end was irresistible."

### Dangerous Growth

No institution dove deeper than Empire Savings and Loan, the thrift that had invested so heavily in the I-30 corridor east of Dallas. Once a small S&L headquartered in a suburban shopping strip, Empire had been purchased in the late 1970s by the son of a Mississippi sharecropper, D.L. (Danny) Faulkner, who first made his fortune by winning the contract to paint Texas Stadium, home of the Dallas Cowboys.

Faulkner evinced a magnetic charm that drew dozens of admirers to his Saturday morning breakfasts at the Wise Circle Grill on Bobtown Road east of Dallas. As the parking lot filled up with Rolls Royces and Mercedes Benzes, Faulkner—the very picture of ruddy bonhomie—held court inside over steak and scrambled eggs, giving speeches, cutting land deals, and handing out Rolex watches and diamond stickpins with a little "F" between two mountain peaks.

In the summer of 1982, Faulkner turned Empire over to his protege, Spencer H. Blain Jr., who became majority stockholder and soon showed his taste for Rolexes and Rolls Royces. Blain was one of the brightest stars in the Texas thrift firmament: president of an Austin S&L, vice chairman of the Home Loan Bank before the move from Little Rock, president of the Texas Savings and Loan League. Brusque, flashy and often cheeky, Blain on two occasions—including an ugly shouting match in a hotel lobby—had publicly rebuked the district bank's chief supervisor for suggesting that Blain's Austin thrift was growing at a dangerous rate.

Within months, Empire claimed to be the fastest growing, most profitable thrift in America. Deposits soared from \$17 million in mid-1982 to \$309 million in early 1984, largely on the strength of brokered deposits. But to afford the interest Empire paid to attract those deposits, Blain needed to invest the new wealth. Empire Savings and Loan became, in effect, a development company that could lend itself as much money as necessary.

Federal investigators later alleged that Empire also worked with other thrifts to artificially inflate real estate prices through "land flips." During one two-week

period in November 1982, for example, Empire and its partners sold one tract back and forth repeatedly, ballooning the price from \$3.2 million to \$96 million. Along the I-30 corridor, land allegedly was flipped so quickly that prices rose from \$1 per square foot to \$10 in a week. Such sales, sometimes expedited by compliant appraisers, permitted the S&L to make ever larger loans on each transaction, which in turn formed the basis for collecting ever larger fees and closing costs, according to federal investigators.

Several participants in the land flips were later convicted, some for filing false income statements to qualify for the loans. Blain said he had done nothing wrong and has pleaded not guilty to criminal fraud charges. "I'm not ashamed of anything I've done, don't believe I've broken any laws, believe that the theory [with which] I operated Empire was sound," Blain said during a deposition in a related civil suit.

If Empire was no longer somnolent, the regulators remained sound asleep. Empire had failed to notify the Bank Board, as required, when Blain took over. No action was taken. Empire's internal auditors, Coopers & Lybrand—which served as another early warning system against imprudence—struggled to complete an audit of the thrift's chaotic books in September 1982. Unable to meet the deadline, the auditors asked the Home Loan Bank for an extension, then another and another, until nine such requests had been made over the course of a year. The Home Loan Bank granted each.

In a pattern that surfaced repeatedly in subsequent years, federal examiners sensed that something was badly amiss at Empire, only to have their superiors not act upon the warnings. An October 1982 examination report, using such terms as "imprudent" and "risk" and "speculative," noted that in more than a dozen huge projects "borrowers had little or no funds invested." In reviewing 68 real estate loans, the examiners found that Empire had not obtained appraisals on more than half the projects to determine whether they were financially sound. Empire, the examination noted, had set up a subsidiary to help "service" its real estate deals, appointing none other than Spencer H. Blain Jr. as a consultant entitled to 25 percent of the company's net profits.

On a best-to-worst scale of 1 to 5, the examiners gave Empire a rating of 3, which was supposed to trigger a meeting between Home Loan Bank officials and Empire's directors. No meeting took place. "It is felt," the bank's supervisory agent wrote to Washington on Jan. 15, 1983, "that our . . . concerns can be handled through correspondence." On paper at least, the supervisor added, Empire looked immensely profitable.

But when federal agents wrote to Empire that month, asking the thrift to follow prudent practices—such as requiring borrowers to risk at least some of their own money—the thrift's executives did not answer for months. Finally, on April 6, Blain replied with "a bland and nonresponsive 'kiss off,'" as congressional investigators later characterized it.

Again, no action was taken.

### Forced to Act

Beyond institutional timidity and the confusion caused at the district bank by the move to Dallas, much of the blame for the dilatory federal response reflected

the inefficient structure of the regulatory system. Examiners, the green-eyeshade accountants who scrutinized a thrift's books, were segregated from supervisors, the field agents responsible for taking action on the basis of the facts unearthed by the examiners. They had been split since the late 1930s, when the S&L industry bitterly complained that the examiners were too tough in their critiques.

Consequently, examiners reported to the Bank Board as civil servants earning a starting salary as low as \$13,000, ripe for "cherry picking" by S&Ls offering \$40,000 salaries and a company car. (Approximately one-third of the 120 examiners working in the Southwest resigned each year.) Supervisors worked for the district banks as somewhat better-paid quasi-governmental agents. Communication between the two groups was poor and occasionally hostile. "You had an insane system," one Bank Board senior executive later noted, "that guaranteed rivalries and things falling between the cracks."

So it was with Empire. The examiners' reports arrived on the supervisors' desks, first in Little Rock, then in Dallas, and went into a deep stack of reports on dozens of other "troubled" institutions. A June 23, 1983, regulatory memo noted that Spencer Blain had purchased a 65-acre tract for less than \$1 million and sold it six months later—to a major Empire customer—at a \$15 million profit. Yet, congressional investigators subsequently wrote, "Nothing was done."

An examination conducted two months later, on Aug. 19, 1983, downgraded Empire's rating to a 4, noting land flips and other "unsafe and unsound" practices. Even then, state and federal regulators moved glacially, fearful of shutting down an institution that—on paper, at least—appeared to be the most profitable thrift in America.

At Bank Board headquarters in Washington, the "Empire problem" seemed eminently postponable. Chairman Gray had received three warnings about Empire—one from Texas S&L Commissioner Bowman in June 1983, and two from Dallas bank president Joe Settle—but none compelled his attention. Empire seemed to be just one of many thrifts trying to adjust to a deregulated industry.

Finally, the sheer weight of information suggesting fraud, imprudence and insolvency was too much to ignore. The state regulators moved first. Bowman recognized that Empire was in too much trouble to save itself, and on Jan. 12, 1984, the state seized control of the thrift.

Bowman's federal counterparts now were forced to act, 17 months after first detecting problems that, the examiners had warned, required "immediate, forceful supervisory action." The FSLIC dispatched a consultant, Frank Augustine, to Dallas to evaluate Empire's holdings. Within two weeks, he made detailed oral and written reports to Washington; yet verbal descriptions were not enough, Augustine decided. The Bank Board needed a graphic understanding of what was happening.

Hiring a former World War II bomber pilot, Augustine climbed into a small plane one day in late February, checked to be sure he had plenty of tape for his video camera, and headed toward the I-30 corridor.

*NEXT: The making of a zealot*

*Staff researchers Elizabeth Hudson and Melissa Mathis contributed to this report.*

# Turning Anger Into Action on Thrifts

By Rick Atkinson and David Maraniss

Washington Post Staff Writers

An unusual solemnity hung over the senior staff of the Federal Home Loan Bank Board as they filed into the sixth-floor conference room at 9:30 a.m. on March 14, 1984. The freezing drizzle of the previous day had stopped, but a wintry chill and pewter sky lingered above Washington, muting the morning light that ordinarily flooded through the wraparound windows overlooking Pennsylvania Avenue.

The agenda for this Wednesday meeting included a weighty decision: whether to shut down Empire Savings and Loan of Mesquite, Tex., by declaring it hopelessly insolvent. Such a radical action—the first ever taken against a Texas thrift—would mean the largest insolvency in the 50-year history of the Federal Savings and Loan Insurance Corp. (FSLIC), which stood to lose \$165 million. To help illustrate Empire's financial plight, an FSLIC consultant had prepared a videotape.

As the three Bank Board members settled into their chairs, a staff assistant wheeled in a large cart holding a television set and videocassette recorder. Positioning the cart a few feet from the chairman's seat, the assistant slid a black cartridge into the VCR.

For 20 minutes and 41 seconds, the small group in the conference room watched in stunned silence as the consultant took them on a tour, first by air, then on the ground. Thousands of apartments and condominiums—most of them vacant and many badly built—swept past the camera lens as the unseen narrator described the catastrophe in a leaden monotone:

"Looking west toward downtown Dallas, we can begin to see the hundreds and hundreds of units that are under construction, none occupied . . . Building after building, probably 24- to 30-plexes, all unoccupied . . . Other mature projects, probably complete for a year, and no occupancy . . . The problems of security, vandalism, fire, control,

completion—all are readily apparent from pictures like these.

"A project called Snug Harbor—vacant. On Faulkner Point North, numerous projects, numerous buildings, virtually totally vacant. No sales effort, no leasing effort, and across the street, more slabs and active construction.

"Notice the incredible waste, the total lack of contractor control . . . Evidence of arson is already available . . . In the distance, numerous projects, virtually 100 percent complete, no occupancy, and the land between the camera and the buildings is being prepared for more development . . . This particular series of buildings made up one project, apparently totally vacant, with severe freeze damage inside of each unit."

The tape ended and the screen went blank. Edwin J. Gray swiveled his chair back to the oblong conference table. For once, the usually loquacious Bank Board chairman had nothing to say; he had been up since 5 a.m. preparing to testify before a House subcommittee later in the day and had given little thought to the Empire matter.

But halfway through the video, he had shut his eyes, appalled, sickened by the vulgarity of this excess. Gray had been cautioned that Empire Savings was in trouble. But the warning had seemed distant, casual, easy to ignore. This 20-minute documentary was his first visceral comprehension that something dreadful was happening within the industry he was supposed to be regulating. He could not imagine a more graphic illustration of how hundreds of millions of dollars were simply evaporating. The video, he thought, was fiduciary pornography.

After the shock, Gray got angry. In a quick vote, the Bank Board voted to place Empire in receivership and forever ban majority stockholder Spencer H. Blain Jr. from the savings and loan industry. The Bank Board staff began legal proceedings, which led to fraud and racketeering charges against more than 100 companies and individuals. Gray, ablaze with indignation and alarm, rushed to Capitol Hill to show the tape to the House Banking Committee chairman, Rep. Fernand J. St Germain (D-R.I.). Another screening was held at the Bank Board for Paul A. Volcker, chairman of the Federal Reserve Board.

Banning Blain would help avenge FSLIC, but Gray wanted the scalp of a regulator. He turned his wrath on Joe Settle, president of the Home Loan Bank of District 9, which included Texas. A genial North Carolinian, Settle had spent 17 years in the commercial banking world before being recruited in 1979 to supervise the thrift industry in the Southwest. For several years, the Bank Board members had considered Joe Settle to be weak, but well-meaning; now Ed Gray looked on him as the personification of regulatory myopia.

"The man is not a regulator," Gray fumed during a Bank Board strategy session. "He's got to go."

Although Settle had been appointed by the District 9 directors, Gray effectively controlled the job because the district presidents also served as "principal supervisory agent," responsible by law to the Bank Board chairman. On April 14, precisely one month after Empire fell, the three Bank Board members summoned Settle—without telling him why—to Monterey, Calif., where they were attending a meeting. The unsuspecting Settle walked into a conference room at the Hyatt Hotel, where he found Gray and board members Mary Grigsby and Donald Hovde waiting for him.

"We're not satisfied with the supervisory functions going on in your district," Gray said bluntly. "We've decided to replace you."

Settle, stunned and heartsick, managed to ask, "It's only because of Empire, isn't it?"

"No, no, no, no," Gray quickly replied. "I specifically looked at other cases, too."

The sacking of Joe Settle—the first district bank president to be dismissed in 50 years—sent shock waves through the Home Loan Bank system and the Southwest thrift industry. Texans in particular had trouble understanding what Settle had done to deserve such treatment; he had always been a regulator the thrift executives considered to be fair and sympathetic. Many of his admirers believed that he was being scapegoated for shortcomings that could just as easily be laid at Gray's door. Settle himself couldn't believe the way he was being treated by the man he'd helped tutor in the intricacies of the S&L business; despite Gray's heated denials, Settle later asserted that he had twice mentioned Empire's troubles to the chairman.

The firing carried a clear message, which Gray promptly reinforced by rebuking the Dallas board of directors and demanding that they replace Settle with Gray's candidate, an Arkansas-born thrift executive named Roy Green.

## 'You're Going Too Far'

Gray's new assertiveness didn't sit well at the district bank. He and Robert D. Mettlen, the District 9 chairman, held a vitriolic cussing match over the telephone, which they continued in person by swapping four-letter unpleasantries in a hotel banquet room the next time they met.

"You can send me any name you want," Gray insisted, "as long as it's Roy Green's." Mettlen and the other Dallas board members eventually relented and Green arrived in Dallas that September.

If Gray could impose his will within the fiefdom of the bank system, he nevertheless found himself eating humble pie on Capitol Hill. With increasing frequency, congressional committees summoned him to explain why the U.S. government was facing the loss of millions, if not billions, of dollars. Publicly raked over the coals, first by the House Government Operations Committee, then by the House Energy and Commerce Committee chaired by Rep. John D. Dingell (D-Mich.), Gray returned to his Bank Board office humiliated, furious and determined to act.

Those working at the Bank Board and in the district banks agreed that something was happening to Ed Gray. "You've read the New Testament? Read the Apostles?" one regulator explained years later. "Ed Gray was Saul on the road to Damascus and when Empire went down it was like a bolt of lightning knocking him off his horse. When he got up off the ground, he got up as St. Paul, a zealot."

Every few weeks, another thrift toppled into insolvency. Usually the staff delivered the bad news to the Bank Board members late on Thursday afternoons, with the actual closings conducted on Friday. "I was tired of getting that knock on the door late on Thursday," board

member Hovde later recalled. "Knock, knock, knock. 'We got another one.'"

By December 1984, 15 S&Ls had gone down, with assets of \$1.45 billion. Particularly alarming was the collapse of San Marino Savings in California. At a cost to taxpayers of more than \$200 million, San Marino represented a bigger loss than Empire. Gray was beginning to realize that California thrifts, which held roughly one-third of the industry's \$1 trillion assets, included many S&Ls that were just as precarious as some in Texas. In Sacramento, the state regulatory commission had been eviscerated in the early 1980s and the legislature had adopted new laws permitting a state-chartered thrift to invest money in whatever enterprise struck its fancy, with deposits still guaranteed by FSLIC. In a two-year period, California had received more than 200 applications for new thrift charters, and more than a few were heading for catastrophe.

With increasing clarity, Gray and his staff recognized that Empire Savings was not an anomaly. Certain patterns of reckless behavior had become commonplace and repetitive, as though lousy deals were being punched out all over America with a cookie-cutter. Often, a strong individual would gain control of a thrift and quickly dominate a weak board of directors. Record-keeping grew shoddy, internal auditors turned a blind eye, and regulators found themselves overmatched.

Honest S&L executives occasionally ran into trouble for emulating the high-rolling lending practices of their imprudent competitors, a phenomenon known at the Bank Board as the "me, too" syndrome. But it was the dishonest and imprudent thrift owners who posed the biggest danger because of their ability to expose FSLIC to billions in losses. The prevailing mentality in Texas showed up in popular bromides, such as "A loan repaid is money lost forever" or "A rolling loan gathers no loss." Another Texasism described the practice by which several thrifts traded worthless assets back and forth to camouflage the S&Ls' true financial condition; this was known as "trading dead cows for dead horses."

Ed Gray, increasingly anxious to take action, felt himself fettered by his own timid enforcement officers and attorneys. Seizing control of a private institution required proof of insolvency or reckless behavior, they argued, and losing in court could set a disastrous precedent that would sap the Bank Board's power. Gray, a non-lawyer surrounded by lawyers, focused his attention on drafting regulations that would apply a brake to the runaway thrift industry.

After only a year in office, Gray also felt a growing sense of isolation at the Bank Board. Beyond his inner circle in the bank's executive suite and a few stalwart friends such as Paul Volcker, the chairman's coterie of allies seemed to be shrinking. Members of Congress harassed him, the district banks eyed him warily, and growing portions of the thrift industry saw him as a "re-regulator," bent on imposing restraints that had been lifted earlier in the name of deregulation.

When Gray proposed new rules in December 1984 to sharply limit the kind of investments permitted an S&L, William O'Connell, president of the U.S. League of Savings Institutions, called. "Ed, you're going too far," Gray quoted O'Connell as saying. "There's only so much the industry can take at one time. If you do this, you're really going to hurt your career." O'Connell, who vigorously supported a number of Gray's initiatives, said recently he did not recall this episode.

Gray's colleagues in the administration began to look askance, wondering whether he had abandoned President Ronald Reagan's vow "to get government off the backs of the people." Gray had intimate ties to fellow Californians who had followed Reagan to Washington, such as Edwin Meese III. But many of the Californians had left government service, and Gray often had no common ground or clout with their replacements.

A particularly contentious issue involved Gray's plan to beef up his poorly paid, undertrained cadre of examiners; Gray figured that to cover the nation's 3,300 thrifts he needed to more than double the examination force, to about 1,500 positions. But that cost money and smacked of re-regulation. The plan ran into immediate opposition at the Office of Management and Budget (OMB), where some officials believed that Gray had failed to get the most out of the examiners he had.

As in the battle over "brokered deposits," Gray wheedled, exhorted, pleaded. This time, he also schemed. If he could pluck the examiners from the civil service and transfer them to the 12 district banks, they could earn more money, work hand-in-glove with supervising agents, and sidestep OMB's hiring ceiling because they would no longer be federal employees.

After peddling his plan to the examiners and

vigorously cultivating support in the districts, Gray met OMB Associate Director Constance J. Horner in the White House mess one afternoon in the spring of 1985. Horner declines to discuss the episode, saying she has only vague recollections of her dealings with Gray and the Bank Board, one of 30 federal agencies with which she dealt.

According to Gray's account of their conversation, Horner told him: "You are violating the policies of this administration, Ed. You are re-regulating and taking these people from the control of the president. You want to add more examiners, when our policy ought to be fewer examiners."

Gray scoffed. This was precisely the sort of ideological looniness he had come to expect, a knee-jerk faith in the mystical power of laissez faire—even when the U.S. government was holding the bag for a trillion-dollar industry. "Are you kidding?" he told Horner. "You know who you're going to hurt? The president. Doesn't anybody care about the taxpayers of this country?"

### Gray's Choice

By securing grass-roots support in the districts and outmaneuvering OMB, which could hardly argue effectively against a plan to cut the federal payroll, Gray won the battle of the examiners. He moved the force out of Washington on July 6 and eventually doubled it.

But he wondered whether he was losing the war. Physically and mentally weary, he began contemplating resignation and a return to California.

Donald T. Regan, the White House chief of staff, thought that would be a good idea.

For Ed Gray and Don Regan, who met at the dawn of Ronald Reagan's presidency, it was dislike at first sight. Though both were gregarious, hail-fellow-well-met extroverts, the cultural chasm separating them was enormous. Gray realized that he appeared to embody the California pol, a public relations hack who had ridden Ronald Reagan's coattails for 20 years. Regan was Wall Street incarnate, evincing a disdain for the coddled, inefficient thrift industry.

From his days as a White House domestic policy adviser in 1981 and 1982, Gray had concluded that Regan viewed savings and loan associations as dinosaurs in double-knit, facing extinction under the glorious Darwinism of a free market. Gray recalled a conversation in August 1982, as he was leaving his White House job. "I'm not sure you're a team player," suggested Regan, who then was Treasury secretary. "You don't have to tell me about being a team player," Gray retorted. "I go back with Ronald Reagan since 1966." Not until he was stalking away, angry and offended, did Gray conclude that the secretary was talking about his team, not Reagan's.

In the summer of 1985, Gray began hearing through the grapevine that Regan wanted him out of the Bank Board. Regan still viewed the board as a captive of the industry it regulated and Ed Gray as a lightweight with little financial acumen. An informal search for a new chairman was launched, and there was talk of a sinecure for Gray, perhaps an ambassadorship. "This comes at an awful time for me," Gray told his old friend, Ed Meese, "because I wanted to leave anyway." Gray passed the word that he would go quietly if Regan promised not to gloat.

On Sept. 30, at 10 a.m., Gray walked into the West Wing of the White House to see Ed Rollins, another Californian who was leaving government service and who shared Gray's distaste for Regan. Rollins advised Gray that the chief of staff had renewed his efforts to find a new chairman. "You do whatever you want to do, Ed," Rollins recalled telling Gray, "but Don Regan wants you out. And I'm sure if he wants you out, he gets you out eventually."

Two weeks later, on a Friday night, a reporter called Gray and told him that she understood "on the highest authority" that he was announcing his resignation the following Tuesday. "You've got to be kidding!" the chairman replied. Hanging up, he muttered to himself, "It's that damned Don Regan and his twerps at the White House."

Gray counterattacked, leaking a story to the New York Times that made clear he wasn't going anywhere. Within a few days, a White House spokesman was assuring reporters of the president's foursquare support for his Bank Board chairman.

Nearly two years earlier, Ed Gray had dimly recognized that he had a choice to make: He could either remain a patsy of the industry or he could try to become the kind of regulator he knew the industry—and the nation—needed. Now, he realized, he had made that choice. Going home to California would have to wait. His job in Washington was not finished.

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*Staff researchers Elizabeth Hudson and Melissa Mathis contributed to this report.*

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# Hardening the S&L Battle Lines

**'You Can't Restrict Our God-Given Right to Make Profits!'**

By David Maraniss and Rick Atkinson

Washington Post Staff Writers

**E**dwin J. Gray was changing so fast during the closing months of 1985 that to follow him week to week was like watching a high-speed nature film: The bud blossoms into a flower, the tadpole becomes a frog. In this case the human metamorphosis was from optimist to cynic, congenial publicity agent to obsessed reformer.

All the romantic notions Gray once held about the savings and loan industry were evaporating as more thrifts plunged toward insolvency. Shannon

Fairbanks, his chief of staff, could see that he was becoming an active, even hostile, regulator. Gray had a tendency to view the world in simple terms, good and bad, Fairbanks thought, and the thrift industry had fallen into his bad category. The devastation wrought by Empire Savings and Loan in suburban Dallas had sparked a fire in him that could not be put out. Attempts by White House Chief of Staff Donald T. Regan to force him off the Federal Home Loan Bank Board only doubled his sense of self-righteousness.

Feeling isolated and abandoned, Gray often

worked late into the night at his headquarters one block from the White House. A siege mentality gripped the Bank Board. Gray posted a guard at the fifth-floor elevator to stop intruders who might slip past the security desk downstairs. Behind closed doors, he bickered endlessly over policy issues with the two other board members, Wisconsin real estate developer Donald Hovde and former Texas thrift executive Mary Grigsby. On one occasion, the exchange grew so heated that Gray locked his office and refused to admit Hovde, who was reduced to slipping notes to the chairman under the door. Grigsby, who had enduring ties to Texas, felt uncomfortable enough in the role of tough regulator to puckishly don a Groucho Marx disguise during a visit home.

Though sharing his views on the burgeoning savings and loan crisis, Gray's staff considered him autocratic, "a pill to be around," as one put it. He became ever more anxious and obsessed, particularly after Fairbanks—who had long absorbed some of the stress for Gray—was found to have cancer. Returning to work after surgery, Fairbanks brought a new outlook: Do what you can and don't worry about it. "Let it go," she would tell her boss. "Let it go."

But Gray could not let go, any more than his enemies in Texas could.

Ever since Gray had fired Joe Settle, the top regulator at the Federal Home Loan Bank of Dallas, many Texas thrift executives believed Gray had it in for them. His interference in the regional regulatory process, his efforts to restrict "brokered deposits," his move to impose growth restrictions—all appeared to them as vindictive attacks on the Texas entrepreneurial ethic. Instead of shutting down the worst parts of the industry, Gray seemed determined to strangle every thrift in Texas.

"You can't restrict our God-given right to make profits!" Texas thrift lobbyist Durward Curlee complained to Fairbanks in Dallas one day.

Trying to steer a middle course between the federal regulators and the Texas industry was L. Linwood Bowman III, the state S&L commissioner. A former thrift executive from the northeast Texas town of Greenville, Bowman couldn't understand Gray's *Us v. Them* view of the world. He had joined the Texas Savings and Loan Department in 1980, eager to find "a nice quiet little job with little controversy," and two years

later he ended up as commissioner. Bowman used the pronoun "we" interchangeably in describing his S&L department and the industry it was supposed to regulate; he regularly played golf and socialized with thrift executives, partly out of a conviction that he could keep tabs on them that way.

Not that Bowman turned a blind eye to the problems around him. He was, after all, the first to warn Ed Gray of the troubles at Empire, the first to decide that the only way to curb Empire was to take control of it, the first to take action against some of the industry's high rollers. But Lin Bowman was a man beset with second thoughts. As he moved against Empire and its powerful owner, Spencer H. Blain Jr., Bowman had been riddled with uncertainty, puzzled by the difficulty in distinguishing mismanagement from entrepreneurial wizardry. "What if I'm wrong," he asked himself, "and he's right?"

The hardest part of serving as commissioner, Bowman said later, was "waking up every morning and bringing myself to the level of arrogance where I was certain I was right."

## A Branch on the Moon

Bowman's self-doubt was aggravated each time he ventured from his Austin office into the streets of the Texas capital. In every direction, the sights and sounds of prosperity appeared to confirm the seemliness of go-go development. By late 1985, Austin had replaced Houston and Dallas as the real estate gold mine of the Southwest. Office buildings along the main thoroughfare, Congress Avenue, rose so fast that each month residents lost another view of their splendid, pink-granite Capitol. To slow-growth advocates, the situation seemed out of control; one lawyer, not realizing the prescience of his words, suggested that the best brake would be "to put the whole city in receivership." But to financiers, Austin was heaven.

And on its way to the heavens as well. At least that was the scheme of Stanley E. Adams, owner and chief executive of Lamar Savings Association, the fastest-growing thrift in Austin. Slow-talking and mysterious, an Orson Welles of a man, Adams conceived of the ultimate symbol for highflying Texas thrifts: He filed for permission to open a branch office on the moon. "It's got to be one of the best p.r. stunts of the decade," he boasted. Adams even picked out a site, noted on the application form submitted to Lin Bowman: Cayley Crater in the Sea of Tranquility.

"What the hell," Adams told Bowman when they met to discuss the venture. "They laughed at da Vinci, too."

Bowman sighed. "Aside from being a laughingstock," he replied, "I think we've got a jurisdiction problem. Since when did I get jurisdiction for the moon?"

If the lunar application suggested a certain sky's-the-limit ethic in Texas, Stanley Adams was an outsized embodiment of the state's pioneer spirit. Even when his ambitions remained earthbound, Adams thought big: He began negotiations to build the tallest skyscraper in China, a 62-story office tower at the Canton Trade Center. And, with lobbyist Durward Curlee and other investors, Adams planned a mind-and-body fitness center in Austin where executives could "take a holistic approach to mental fitness where your brain learns to accept unreality as real," in Curlee's words.

That concept already seemed well established in the savings and loan industry of Texas.

The rise—and subsequent fall—of Lamar Savings illustrated two characteristics at the heart of the savings and loan calamity. The first was a tendency by dozens of Texas thrift operators, contemptuous of government bureaucrats, to push beyond the limits of prudence. The second was the revolving-door relationships between regulators and those they were supposed to regulate.

Beginning in 1982, Adams had pushed Lamar into the real estate and construction business, convinced that was the key to survival in a mercurial financial world. Lamar bought two development companies, established a "national money desk" to lure brokered deposits, and shifted Lamar's portfolio away from the home loan mortgage business that had been its bread and butter for three decades.

In 1985, the remaking of Lamar appeared to be a stunning success. Adams toolled around Austin in a new Maserati, quadrupled the average salary of his executives and provided them with a fleet of 80 luxury automobiles—Lincolns, BMWs, Maseratis.

But federal regulators saw signs of trouble. Some of Lamar's real estate loans soured. The thrift's capital reserves, intended to cover the losses, began to dwindle. S&Ls were supposed to have capital—either cash or investments that could be converted to cash—equivalent to at least 3 percent of their deposits. Lamar's reserves, examiners discovered, had slipped below 2 percent.

On June 19, 1985, Lamar received a warning letter from the Federal Home Loan Bank of Dallas, notifying the thrift that the regulators would seize control of Lamar unless its capital reserves improved. "Instead of taking remedial steps," the government charged in a subsequent lawsuit, Lamar's executives "stepped up their efforts to deceive."

Between late June and December, Lamar bolstered its capital by going on a lending spree, taking in large fees at the front end of each loan. During three days in late June, for instance, the thrift closed seven loans for more than \$132 million, nearly twice the total for the year until then. By December, 64 deals had been executed, and Lamar was able to report a capital-to-net-worth ratio above the minimum 3 percent level.

This dramatic turnaround, federal regulators later charged, "had no basis in reality." Of the 64 deals, 60 borrowers went bankrupt, defaulted or hinted at defaulting. The transactions, federal officials said, involved numerous "unsafe" practices. Lamar's managers, the regulators concluded, seemed unconcerned about whether the borrowers could repay.

In the midst of this financial turmoil, Lamar displayed the kind of incestuousness between regulators and regulated that had become commonplace in the Texas thrift industry. From January 1983 to July 1985, Lamar's board of directors included University of Texas finance professor Robert Mettlen, who also served as chairman of the Federal Home Loan Bank of Dallas. For several months in 1984, the president of Lamar was Joe Settle, the Dallas Home Loan Bank president who had been fired earlier that year by Ed Gray. One of Lamar's stockholders was Dick Jameson, chief of supervision for the Texas Savings and Loan Commission.

Perhaps the paramount example of the revolving door involved Lamar's internal auditor, the man who reviewed audits and appraisals and served as the thrift's liaison to state and federal regulators. Felix Charles Rheams began his professional career in 1963 as branch manager for a San Antonio thrift; he lacked both a college degree and formal training as an accountant, neither of which was required for the job. Five years later he went to work for the Federal Home Loan Bank as an examiner in Texas.

Adams, whose S&L was one of those Rheams examined, hired him away from the government in 1982, rewarding the new employee with a Lincoln Town Car, a \$40,000 bonus and, eventually, a promotion. "Mr. Adams walked into my office one day and told me he was going to make me executive vice president. And I said, 'What for?' And he says, 'Well, I know you don't like titles, but I want you to be executive vice president.' I said, you know, 'You're the boss,'" Rheams later recounted in a deposition.

The promotion was short-lived. In June 1986, federal regulators finally seized control of Lamar, displacing Adams and firing Rheams.

Where did Rheams find employment next? With the Federal Home Loan Bank Board—as an examiner. In February 1986, the federal government filed a civil suit against Adams and other former Lamar officers and directors, alleging that they had conspired to deceive the regulators. Among the defendants was Felix Charles Rheams. Only then did government officials realize that he was on their payroll. They fired him, again.

When the suit was filed, Adams said he welcomed it. "We'll be able to see where the real mismanagement, misappropriations, dissipation of assets, fraud and conspiracy lies," he said.

Late in the fall of 1985, as Stanley Adams was trying to hold on to his thrift, Ed Gray and his senior staff at the Bank Board were coming to grips with the magnitude of the crisis facing them. The Federal Savings and Loan Insurance Corp. (FSLIC) was losing money at a rate that would soon lead to its own bankruptcy, and the industry had savaged Gray's plan to replenish the fund through a one percent fee on deposits.

On Oct. 18, during a joint meeting of the Dallas and Atlanta district banks at Bishop's Lodge, N.M., Gray asked for suggestions. George Barclay, then a vice president at the Dallas bank, offered a plan that would raise \$15 billion, mostly through the sale of government bonds—enough to allow FSLIC to shut down the growing number of insolvent thrifts and guarantee that depositors wouldn't lose any money. Gray liked the idea. For the next month Barclay and representatives from the 11 other regional banks refined the plan.

On Nov. 20, Barclay and Roy Green, president of the Dallas bank, flew to Milwaukee to pitch the concept to a critically important audience—a subcommittee of the U.S. League of Savings Institutions, the primary thrift trade association. Several industry executives pelted Barclay with hostile questions. You're exaggerating the crisis, they said; if you regulators had done your job right in the first place, there wouldn't be any problem. Then the U.S. League staff offered data showing that some credit unions and banks were in as much trouble as S&Ls. One senior executive suggested that the best course was a government bailout of the whole financial community.

### 'Come to Jesus'

The hostility intensified. One California thrift executive said he would not contribute "one more nickel" to help FSLIC. Milwaukee S&L owner Gerald J. Levy, newly installed president of the league, was particularly angry. He had just looked at computer printouts showing frenzied growth by many Texas thrifts, despite new Bank Board regulations—supported by the U.S. League—that supposedly restrained such expansion. These Dallas regulators, Levy thought, had the gall to propose drastic, nationwide solutions when they couldn't even control the problem in their own backyard. Levy vowed to "drive a stake into the heart" of the Dallas plan.

"Damn, did we get hammered," Green told Barclay as the two rode back to the airport. "This thing is dead."

Back in Dallas, Green and Barclay soon saw signs that the once-booming Lone Star economy had taken a turn for the worse. Oil, which had sold for \$24.53 a barrel in December 1985, would plummet to \$9.39 by May 1986. Foreclosure became a common word in Texas. Though no one then realized how profound the depression would get, one thing was immediately obvious: Developers, aided by the savings and loan industry, had gone wild during the boom. Houston and Austin had so much surplus office and housing stock that city officials feared it would take at least 10 years to fill the vacancies.

Real estate loans that once looked good now looked shaky. Those that had looked shaky now looked hopeless. Under new Bank Board regulations intended to show a more realistic picture of an S&L's financial health, regulators classified loans as good or bad not on the basis of collateral that might be received in foreclosure, but on the borrower's ability to repay. That was a tougher standard, one that imperiled scores of thrifts.

Supervisors in the Dallas bank held what they called "come to Jesus" meetings. During these emotional sessions of denial and recrimination, the regulators tried to get executives of insolvent S&Ls to "see the light and surrender the keys" to their thrifts, and thus avoid a protracted court battle. Among those who dropped his keys on a supervisor's desk in Dallas was Stanley Adams, the apostle of lunar branching.

One day in February 1986, Ed Gray's enforcement chief came to him with the bleakest news yet. Reports from the field based on the new loan classification rules showed that Texas was a disaster zone, with a number of thrifts in trouble. Regulators in Dallas couldn't begin to keep pace with the problem.

Gray called a meeting of his 12 regional bank presidents and asked 10 of them—the San Francisco office had enough problems of its own—to speed relief troops into Dallas for a six-week examination blitz. On March 20, 250 examiners arrived and began poring over the books of nearly every S&L in the Southwest. The discoveries were mind-boggling: mismanagement, fraud, losses in the billions.

The examination force—widely disdained in Texas as Ed Gray's carpetbagging "get Texas" squad—was a start, but it wasn't enough. Roy Green, president of the Dallas bank, realized he needed more than temporary help. He needed a tough, experienced chief of supervision to pound the Texans back into shape. In Washington, in the federal agency that regulated national banks, he found his man. They called him the Hammer.

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*NEXT: Sending a message*

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*Staff researchers Elizabeth Hudson and Melissa Mathis contributed to this report.*

**THE \$150 BILLION CALAMITY**

Fifth of Seven Articles

**Putting the Hammer  
To Lone Star Thrifts**By Rick Atkinson  
and David Maraniss  
Washington Post Staff Writers

DALLAS

**H**arry Joe Selby hardly cast an imposing shadow when he walked through the double doors of the Federal Home Loan Bank of Dallas on May 1, 1986. Plump and pink-cheeked, with snow-white hair and a fondness for bird-watching, he had a milquetoast demeanor that belied the image of the Hammer—which is what he called himself—and the Angel of Death, which is what his many enemies would soon call him.

Yet Joe Selby was a man with a mission: to restore law and order to the savings and loan industry in the Southwest. After 32 years serving the federal agency that regulates national banks, he had agreed to leave Washington to become the chief federal thrift regulator in Texas and the four other Sun Belt states of District 9.

Dallas appealed to Selby for two reasons. The first was money. Rejecting an offer of \$150,000 a year—twice his salary in Washington—he held out for \$165,000. Both Roy Green, the Dallas Home Loan Bank president who had recruited Selby, and Edwin J. Gray, the Federal Home Loan

Bank Board chairman, considered the deal a bargain. "I want to send a message to Texas that we mean business," Gray told his staff. Joe Selby, the Hammer, would be the messenger.

The other factor influencing Selby was the chance to return to his native Texas. He had grown up in Ganado, one of a string of villages—most featuring women's names—along Highway 59 in the oil and cattle country of the gulf plains. Traveling salesmen, Selby joked, liked to spend the night in Ganado so they could boast of sleeping between Edna and Louise. Selby's father, a prominent burgher who owned the local bank, often took young Harry Joe along to banking conventions. By the time his son was in seventh grade, the senior Selby had put him to work, first at the dreary task of filing canceled checks, later as a part-time teller on Saturdays when the cotton farmers walked in to deposit their weekly earnings.

At age 55, Joe Selby had come home. Although an expert on banks, he knew little about the savings and loan business; he knew even less about the industry in Texas, except that it had grown 1,200 percent in the past quarter-century. Before leaving Washington, he had heard of only one specific thrift in all of District 9. "You've got an institution down there," a banking acquaintance said one day, "called Vernon Savings. I hear they're over in Taiwan soliciting deposits." Puzzled but intrigued, Selby tucked the information away for future reference.

As he settled into the cramped temporary office assigned him on the third floor of the Dallas bank, he also was puzzled by the rumors that had preceded his arrival. The Joe Selby being whispered about by anxious thrift executives was a 10-foot-tall bogeyman with fangs, bent on destroying their industry.

Selby liked the image, hoping to put it to good use. "This is probably the best thing that can happen," he assured Roy Green. "I'm going to be the bad guy, cleaning up the system, getting rid of the crooks." You, he told Green, can be the good cop to my bad cop; we'll make a terrific team.

**'Let God Sort 'Em Out'**

There were, to be sure, disquieting portents. Selby was astonished to find that his examiners not only lacked computers, they even wanted for typewriters. Despite a \$30 million annual budget for regulatory activities in District 9, all 300 examinations then under way were scratched out in pencil and carried to a typing pool, just as they had been in the 1950s.

Selby also found that the bank was undergoing a \$12 million renovation. The place was bedlam. Scores of workers were adding a wing, complete with five-story garage, child-care center and health club; other workers clumped about the old building, noisily bolting new granite facing to the walls and installing a sprinkler system. Consultants and lawyers besieged the bank, selling their services whenever another thrift tottered toward insolvency.

Most alarming to Selby was the prevailing coziness between the savings and loan industry and regulators. Banks and thrifts, he soon concluded, were different creatures. Bankers would not dare refer to the federal insurance fund as "our FDIC" as thrift owners referred to "our FSLIC." Selby was appalled to learn that some Dallas supervisors had accepted mortgage loans from institutions they were overseeing. He also had the bank's general counsel fire a barrage of conflict-of-interest warning letters to former regulators who had quit the Dallas bank so they could take jobs with the Texas thrifts they once supervised.

Selby, soon working 12 to 15 hours a day, helped establish a triage system that gave priority to the sickest of the sick thrifts. Examiners evaluated a thrift's health on a 1-to-5 scale, but the system had become almost meaningless because a majority of Texas savings and loans now rated an unhealthy 4 or 5. (By March 1987, 191 S&Ls in District 9 would be classified as 5s.) Determined to send his own message to the industry, Selby created an "investigation unit" with a half-dozen gumshoes assigned to work with the U.S. attorney and Federal Bureau of Investigation. "We need to put somebody behind bars," he demanded again and again.

He urged his regulators to be tough-minded, aggressive. Gone were the days when a regulator could assume that if a questionable practice wasn't specifically forbidden, it was therefore permissible. Ed Gray's new rules for evaluating an S&L's true financial plight had to be applied rigorously, Selby insisted.

Equally frustrating for Selby was the pedestrian pace of state regulators, who often resented the feds for their imperious manner and apparent presumption that a Texas regulator was an inferior species. Selby shared the view, prevalent at the Bank Board in Washington, that the Texas Savings and Loan Commission had long been an underpaid, understaffed handmaiden of the industry. Yet he couldn't help but like the gregarious commissioner, L. Linwood Bowman III; Selby laughed heartily when Bowman presented him with a black T-shirt, inscribed "Kill 'Em All and Let God Sort 'Em Out."

To many thrift industry executives, Selby indeed seemed determined to "kill 'em all." Their initial whispers of alarm turned into rancorous maledictions. Selby was viewed as vengeful and arbitrary, "sinking ships to get the captains," as one former S&L executive put it.

One afternoon in the late summer of 1986, the telephone went dead at the home of supervisory agent Bill Churchill. When a repairman arrived, he found a three-inch black box clipped to the line outside; the device was a transmitter—a bug—that had malfunctioned and caused the phone to stop working. The matter was reported to the FBI, but never resolved. (A more ominous incident occurred earlier when a gunman shot out the windshields of two unoccupied Chrysler LeBaron station wagons owned by the Texas S&L Commission and parked outside the agency's suburban Dallas office. Local police investigated, to no avail.)

After discovery of the Churchill bug, the Dallas bank conducted regular sweeps for listening devices in the bank and at the homes of Selby, Roy Green and other senior officials. An elaborate security system was installed at the district bank, along with new procedures for entering and leaving the building after hours.

Bank officials began to worry about more sinister threats—particularly after hearing rumors of a plot to kidnap Selby. A security firm installed expensive burglar alarms in the homes of the bank's top executives. The systems included intruder detectors, special phone lines that notified police if the line was cut, and small, portable "panic buttons" that would trip an alarm if pushed. Keep one button hidden near the toilet in your house, the security consultants advised, since most kidnapers will let you use the bathroom before abducting you.

Only a few months after returning home, Joe Selby began to have second thoughts about the benefits of being the federal bogeyman, the "bad cop," the Hammer. The stakes—billions of dollars—were enormous

enough to compel desperate men to act desperately. What, he wondered, have I gotten myself into?

### 'Long Days and Hard Work'

Within weeks of his arrival in Texas, Selby began hearing a great deal more about that thrift supposedly peddling its services in Taiwan: Vernon Savings and Loan. What was happening at Vernon had happened in Texas and elsewhere a hundred times with varying degrees of stupidity, misjudgment, fraud and bum luck. Regulators had a nickname for Vernon: They called it Vermin.

Vernon, Tex., is a town of 13,000, two hours northwest of Dallas. Originally called Eagle Flats, it once straddled the old cattle trail leading to Doan's Crossing, where 6 million beeves had splashed across the Red River. Renamed in honor of George Washington's home, Vernon now boasted, among other local industries, a factory outside town that stitched Boy Scout uniforms.

Vernon Savings, one of the town's two thrifts, was founded in May 1960 by R.B. Tanner, who had been a bank examiner during the Depression and knew the virtue of caution. For 22 years, the S&L lived within its means on the profits earned by making home mortgage loans in Wilbarger County. In January 1982, Tanner sold out to a local boy turned Dallas real estate developer, Donald R. Dixon, son of Vernon's newspaper publisher. Promising to give something back to the community, Dixon took control of the \$83 million institution by putting up \$1 million in cash and another \$4.7 million in promissory notes.

Dixon expanded Vernon full bore. He moved the main office to Dallas and lured new deposits in the form of "jumbo" certificates of deposit—\$100,000 each—with high interest rates. He promoted his thrift aggressively; in 1983, one of Vernon's ads bested 750 competitors to win a national advertising prize. The winning entry showed a photograph of a Stetson, cowboy boots and work clothes heaped next to a bathtub: "Relax. A relaxing end to a hard day. We all need that, especially when we're putting our best efforts into our work. Vernon Savings employees understand long days and hard work . . . Relax with that assurance." The ad prominently displayed the logo of the Federal Savings and Loan Insurance Corp.

Within four years, Dixon had increased Vernon's assets by more than 1,000 percent, to \$1.3 billion. He also increased Vernon's liabilities by 1,500 percent, according to Bank Board documents. In 1982-83, Vernon made \$700 million in construction loans in an effort to earn enough cash to pay the high interest it was offering on deposits. Dixon declined to be interviewed for this series. His attorney, R. Stan Mortenson, said criticisms of Vernon are made with "20/20 hindsight . . . Most of the problems here have to do with the regulators and the economy and overreaction."

In a pattern repeated by other highfliers, according to federal officials, Vernon often took all the risk by financing not only the purchase price of the land and construction project, but also closing fees and future interest costs. It frequently skimmed on collateral, as in a \$24 million loan secured by a 99-acre tract, one-third of which was underwater, according to Bank Board documents. By 1985, the Bank Board documents conclude, 70 percent of the thrift's interest and fee income was "self-generated." In other words, Vernon was paying itself.

Vernon paid itself in other ways, too, as later documented by Bank Board investigators. The S&L bought a hunting club and three beach houses, including the \$2

million Del Mar "cottage" in California where Dixon and his wife lived for 18 months, running up a \$761,000 entertainment and expense tab. Vernon spent \$6 million for a fleet of five planes and six pilots, the so-called Vernon air force. Another \$5.5 million went to buy artworks for the thrift's offices.

The conspicuous consumption included pleasures of both palate and flesh: a two-week, \$22,000 "Gastronomique-Fantastique" dining spree through Europe; the flying of comely young women to board meetings in California for "sexual payoffs" that eventually led to the bribery conviction of a Vernon vice president; and the purchase of a luxury yacht, the High Spirits, which often plied the Potomac, carrying members of Congress and other officials who were wined and dined lavishly.

Vernon Savings also demonstrated how comfortably the foxes and chickens lived with one another in Texas. State S&L Commissioner Lin Bowman—who believed that proximity to thrift highfliers helped him keep tabs on them—had accepted a ride to California with the Vernon air force and had twice gone pheasant hunting in Kansas with Dixon. He also had an ongoing condominium development partnership—Cottonwood Investments—with Patrick G. King, who had left his post as state director of S&L supervision to work at Vernon; Bowman has defended the investment, which began when King still worked for the state, saying it did not influence his actions as a regulator.

Vernon also worked hard to conceal its financial shenanigans, the federal government alleged in a subsequent lawsuit. The thrift's books appeared "incomplete and in total disarray," with records deliberately distorted, the federal officials said. Vernon officers sold tens of millions of dollars in loan "participations" to other thrifts, thereby improving Vernon's financial picture by making it appear that other institutions shared some of the riskier investments; yet, according to a government suit, Vernon was able to peddle those participations only by secretly agreeing to buy them back later. Former Vernon officials have since contended that their actions would not have appeared imprudent had the Texas economy not gone bust.

### Grounding the Air Force

Within a few months of Dixon's 1982 takeover, regulators began to pick up hints of Vernon's questionable practices. In November of that year, a federal examiner lowered Vernon's rating from 1 to 2, noting several rule violations and "loan documentation deficiencies." A state examination in January 1983 observed that Vernon was accepting virtually all of the risk in construction loans. Another federal exam in October 1983 downgraded Vernon to a 4, citing "unsafe and unsound lending practices." In August 1984, Vernon's directors promised to reform, but a year later, examiners found that 29 of the 31 reform agreements had been violated. "Out of control," the examiners wrote on Aug. 2, 1985, and slapped Vernon with a 5, the lowest possible rating.

That should have triggered immediate regulatory action, yet nothing happened. Somewhere between the examiners' red warning flags and the Dallas supervisors' responsibility for acting on those warnings, Vernon slipped between the cracks. "I wish I had a good answer to why we didn't do anything," one Dallas supervisor lamented recently. "Vernon didn't get the attention it should have. It was one of the herd, one of the many."

In late summer of 1986, Joe Selby entered the Vernon fray. He discovered that the thrift had a bonus

plan—euphemistically known as the "bean program"—that had paid Dixon and others nearly 5 million "beans." "Gentlemen," Selby declared in a meeting with several Vernon officials and his own regulators, "the bean program is dead."

Because Vernon was state-chartered, the Texas Savings and Loan Commission could, in some respects, move more quickly than its federal counterpart. In September, the state seized supervisory control of Vernon with a team headed by Deputy Commissioner Earl Hall. To make a statement about who was in charge, Hall moved into Dixon's former office but promptly tripped near the ornate desk and broke his leg. Hobbling about in a cast for six weeks, Hall tried to take command. He grounded the Vernon air force—"Fire the damned pilots!"—and refused to pay \$12,000 to international playboy Philippe Junot for services in arranging the Gastronomique-Fantastique.

Yet Joe Selby suspected that more radical action was necessary, perhaps a federal takeover—or closing the institution altogether. Vernon was hundreds of millions of dollars in the red, a staggering potential loss to the federal insurance program.

The debacle at Vernon Savings made Joe Selby angry. Many regulators had gone about their business determined to see, hear and speak no evil. As they used 1950s techniques—scratching reports with lead pencils—so they displayed a 1950s mentality. Selby was determined to bring them into the '80s.

But many in the Texas thrift industry saw things differently; Selby was willing to run roughshod over everyone, solvent and insolvent, innocent and guilty, autocratically dictating how their businesses would be run. To Durward Curlee, who lobbied in Washington for 20 Texas thrifts, including Vernon, Selby resembled a fireman who demanded to know who had been playing with matches before he'd fight the conflagration. "Joe Selby," another lobbyist complained, "wants to close up every association in Texas."

By autumn, Texans were looking to Washington for a redress of their grievances. On Oct. 21, 1986, House Majority Leader Jim Wright, the Texas Democrat who was about to ascend to House speaker, arrived for a luncheon meeting and gripe session at the Ridglea Country Club in Fort Worth. Wright expected perhaps 15 real estate and S&L executives to show up; instead, 150 awaited him. More than a dozen recounted tales of what they considered to be arbitrary and capricious actions by the federal regulators. Wright listened attentively and, as the luncheon drew to a close, publicly asked his friend and business partner, George A. Mallick, to draft a report outlining "the real story" on District 9's problems.

News of Wright's interest spread quickly and his Washington office was bombarded with phone calls from others eager to recount their "horror stories." On Oct. 23, two days after the Ridglea meeting, Wright met in San Antonio with W.W. "Bo" McAllister, president of the Texas Savings and Loan League.

"I am convinced," McAllister subsequently reported in the league's magazine, "that Congressman Wright is taking this issue very much to heart and is dead serious about insuring that Texas financial institutions are given every opportunity for survival."

*NEXT: Dueling with the speaker*

*Staff researchers Melissa Mathis and Elizabeth Hudson contributed to this report.*

## THE \$150 BILLION CALAMITY

Sixth of Seven Articles

# 'Gray the Re-Regulator' And Wright Lock Horns

By Rick Atkinson  
and David Maraniss  
Washington Post Staff Writers

Ed Gray cupped the telephone receiver against his ear, nodding more in courtesy than agreement. For several minutes, the Bank Board chairman listened attentively, saying little beyond a few perfunctory "uh-huhs." He'd heard it all before: once again, House Majority Leader Jim Wright was complaining about how heavy-handed regulators were making life miserable for the savings and loan industry in Texas.

Chief of staff Shannon Fairbanks sat next to Gray's desk, eavesdropping on his end of the conversation. Calls from important members of Congress had become so commonplace that Fairbanks had worked out a routine for fielding them. As usual on this mid-November

afternoon in 1986, she had walked into Gray's office, shut the door and announced that Wright was on the line.

Five minutes into the call, Gray's countenance changed. He stopped nodding. His features tightened. "No," he interjected. "I was the one who recruited him. I think very highly of him. He is doing what I want him to do. He is being a tough regulator."

Gray hung up and wheeled toward Fairbanks, his face flushed. "No way!" he declared. "No way!"

The chairman summoned several other staffers who listened intently as Gray poured out his version of the phone call: Jim Wright wanted Joe Selby fired. Wright, a Texas Democrat, had claimed that Selby, the hard-nosed chief regulator for the Home Loan Bank of Dallas, was homosexual,

and had established a "ring of homosexual lawyers" in Texas who got preferential treatment in handling S&L legal matters. "Isn't there anything you can do to get rid of Selby, or ask him to leave or something?" Gray quoted Wright as saying.

It was nearly 6 p.m., but Gray called the comptroller of the currency's office, where Selby had worked for 32 years before taking the Dallas job in 1986. Have you ever heard anything about Joe Selby giving special treatment to homosexuals? Gray asked. No, he was told, nothing like that.

Suddenly, Ed Gray felt dirty. He had grown accustomed to queries and complaints from Capitol Hill about regulatory matters. On occasion, he even brought district bank officials to Washington so they could explain to this congressman or that senator why actions had been taken against a particular thrift. Yet Wright's call, Gray thought, went too far, even for someone as persistently eager as Jim Wright to insert himself into the regulatory world. Congressional investigators later reached the same conclusion and recommended that Wright be charged with conduct unbecoming a House member; for his part, Wright denied asking Gray to fire Selby.

Just a month before this phone call, Gray had met with Wright to explain the dilemma the Bank Board faced: how the Federal Savings and Loan Insurance Corp. (FSLIC), which guaranteed deposits, was heading toward bankruptcy because of the rising tide of S&L failures; how the FSLIC fund had dwindled to \$2 billion, with hundreds of thrifts—holding nearly \$100 billion in additional deposits—in serious trouble; how regulators could not close even the most insolvent institution because the insurance fund was dangerously low.

But Wright, Gray was convinced, did not hear. Instead, he petitioned the Bank Board on behalf of his Texas thrift constituents, including Thomas M. Gaubert, whose Independent American Savings Association was nearly half a billion dollars in the red. Gray also believed Wright had demonstrated his displeasure with the Bank Board by blocking a bill that would have injected \$15 billion into FSLIC. Now Congress had adjourned and new legislation would have to wait at least six weeks until the 100th Congress convened in January 1987.

If Ed Gray felt dirty, he also felt exhausted. For nearly four years as chairman, he had fought one battle after another, against the thrift industry, against Congress, against his enemies in the Reagan administration. Aides noticed that his hands often trembled now; he seemed distracted, jittery, graceless under pressure, a far cry from the hail-fellow public relations executive who had come to the job four years earlier. Chain-smoking, Gray hunched over his Selectric III typewriter far into the night, pounding out his own speeches and congressional testimony, pausing only long enough to order a pizza for supper or dash out to McDonald's.

Hardly audacious by nature, he drew strength from his heroes. Winston Churchill was a particular favorite, and, alone at night, Gray often pulled out "History of the English Speaking People" or listened to tapes of the great statesman's speeches. Seeking a moral azimuth to guide himself, he often wondered, "How would Ronald Reagan make this decision?" As often as several times a week, he called Paul Volcker at the Federal Reserve for advice and sympathy, dragging on his cigarettes and pouring out his troubles while the Fed chairman worked his ubiquitous cigar at the other end of the line.

For someone with a public relations background, Gray managed to garner unbelievably bad press for himself. Shortly after Wright's call regarding Selby, thrift executives leaked word to the press that Gray enjoyed an imperial lifestyle whenever he traveled. That triggered inquiries leading to stories such as this one in The Washington Post: "Bank Board Lived Well Off S&Ls—Industry Picked Up Tab." Gray, for example, had stayed in a \$649-a-night room at the Waldorf Astoria. He and board members Mary Grigsby and Don Hoyde had run up a \$4,000 limousine bill in Dallas, as well as a \$5,000 hotel bill in California, all paid for by the industry through its financial support of the district banks.

The revelations humiliated Gray and damaged his credibility, further weakening his clout on the Hill and in the administration. How could he campaign against profligate thrift executives if he appeared profligate himself? While acknowledging his own mistakes, he railed against the industry for disclosing his travels, sounding so bitter that a close aide admitted he sounded "wacko . . . off the deep end."

To make amends, Gray voluntarily repaid \$28,000 in personal expenses. Supporting two homes, he mailed his paycheck to his family in California and lived alone in a small, \$500-a-month flat near the Bank Board. Increasingly strapped for cash, Gray raided his daughter's college tuition fund, borrowed \$15,000 from his mother, and eventually plunged \$80,000 in debt.

His relations with the industry that had once championed him slid from bad to dreadful. The California thrifts, formerly the core of his support, passed the word that Ed Gray was not welcome at the state's 1986 convention. "Ed," one S&L executive explained, "they don't want to hear you."

### The Texans Fight Back

In Texas, the hostility toward Gray built to a fever pitch. He was seen as Gray the Unfair, Gray the Lightweight, Gray the Re-Regulator, the man who wanted to shackle the industry with a new set of draconian rules. After flying home to La Jolla for Christmas in 1986, Gray received yet another call from Jim Wright. The majority leader had a particular problem. The owner of Vernon Savings, Donald Dixon, was complaining that regulators were depriving him of the chance to find new capital to save his S&L.

Wright had met Dixon aboard his yacht, "High Spirits," but he was calling Gray at the urging of Rep. Tony Coelho (D-Calif.), who had become a regular aboard Vernon's corporate jets and on the yacht, which he used for fund-raising parties. Coelho sent Wright a memo, noting Dixon's concerns and reporting with a touch of apparent sarcasm that "a Joe Selby, with the Dallas Trouble Home Loan Bank Board, was specifically mentioned as desiring that [Vernon and Sunbelt Savings] be shut down."

In phoning Gray, Wright told the chairman that Dixon has "a week or three or four days that he can save [Vernon] and avoid foreclosure. Why don't you look into it?"

Once again, Gray was baffled by Wright. Vernon Savings, which had been under state supervision since September, was perhaps \$600 million in the red and was losing another \$10 million a month. Dixon had collected at least \$1 million in bonuses and millions more in dividends, as his institution slid ever faster toward insolvency, according to a subsequent federal lawsuit.

Vernon deserved to be shut down, Gray thought.

but that would require FSLIC to pay depositors a mind-boggling \$1.6 billion. As Gray later informed Wright's office, he could not afford to close Vernon; instead, regulators wanted a voluntary agreement placing the thrift under federal control.

What is it about these Texans? Ed Gray asked himself. Since his first meeting with the state's thrift executives back in June 1983, he had known that they were different somehow, oversized in their ambition to make money. But now they seemed to lack any sense of discipline. Much of the thrift business in Texas seemed obsessed with racking up colossal profits and letting the devil take the hindmost—all in the name of American entrepreneurship. Gray didn't buy it; the word "corrupt" came to mind frequently now.

The Texans had a different view. Durward Curlee, who lobbied in Washington on behalf of 20 Texas thrifts, thought Gray possessed a wide streak of the tyrant. "Why did Hitler go into Russia?" Curlee would demand, smiling slyly at the analogy. The chairman was five years too late and now seemed intent on strangling every thrift in the state.

The only hope for relief appeared to be through Congress, and it was Jim Wright, about to become speaker of the House, who seemed most receptive to the Texans' pleas. Wright sympathized with businessmen who stood on the verge of ruin because of the slumping economy; explaining the plight of such constituents to federal regulators, he believed, was a big part of his job.

On Jan. 6, 1987, as the 100th Congress convened, a bill to inject \$15 billion into FSLIC was introduced in the House. This "recapitalization" proposal immediately drew fire from the industry, which feared that \$15 billion in Ed Gray's hands would permit him to close thrifts willy-nilly and sell off their holdings, depressing real estate prices. The U.S. League of Savings Institutions endorsed a \$5 billion plan, with "forbearance" provisions that required regulators to ease up on "well-managed institutions in trouble due to local economic conditions."

Desperate to shore up the insurance fund, the Bank Board summoned top officials from the district banks to testify at hearings scheduled before the House Banking Committee on Jan. 21 and 22. The thrift industry's biggest guns also showed up, the regulators and the regulated often perched elbow-to-elbow in the audience. Dallas bank president Roy Green, sitting with Joe Selby, greeted a familiar figure in a nearby chair.

"Joe," Green said, "have you met Durward Curlee?"

"Oh, yeah," Curlee quipped as he shook Selby's hand, "I've heard of you through a mutual friend. From what I understand, he's the only friend you've got."

### 'The Speaker Hates Us'

After the morning testimony, several thrift executives, including W.W. (Bo) McAllister of San Antonio, Texas Savings and Loan League president Tom S. King and U.S. League president William O'Connell met for lunch with Wright and other members of the Texas delegation. "Speaker Wright indicated to us that he was considering 'slowing up' the FSLIC recap until he was satisfied with efforts toward forbearance," McAllister wrote in the Texas League's magazine two months later. "We encouraged him to take this action and that is exactly what happened." Wright later denied "holding hostage" any legislation, saying the bill went through "normal legislative channels" and that he later supported the full \$15 billion proposal.

In early February, the regulators decided to meet with Wright to make their case. The idea came from Selby and Green, who wanted to make peace with the speaker. Gray, though less sanguine, appreciated the session's importance, and made sure he was represented by two of his top aides. Gray thought Wright was ducking him, and he instructed his secretary to call the speaker's office every 15 minutes

for a week. If nothing else, Gray wanted to show that if the two men weren't communicating, it was not his fault.

As Selby and Green entered Wright's antechamber on Feb. 10, they were surprised to find a familiar face from Texas already there. It was George Mallick, the Fort Worth developer, Wright's friend and business partner. The regulators had brought along a sheaf of inside information to explain their actions against thrifts that had gotten Wright's attention. But there was no way they could go into details with Mallick in the room. So much for Plan A, Green thought to himself.

Wright sat behind his desk, facing a semicircle of regulators. To the sides stood George Mallick; Mallick's son, Michael, and a line of congressional assistants. Green began by outlining the general state of Texas thrifts and what the Dallas bank was doing to help them. He said regulators were trying to be lenient, but this was counterproductive in the long run. Sick thrifts could attract depositors only by offering high interest rates; healthy ones followed suit, reducing their profits and threatening their stability.

Selby spoke next. This was the first and only time in his life he would meet Jim Wright, his one chance to talk to the man who two months earlier had called him a homosexual and allegedly sought his removal.

"I just wanted to come and show you in person that we don't have horns," Selby said.

Wright let it pass, but later in the meeting he turned to Selby and said: "And you, you are the most feared man in the state of Texas. You carry the biggest hammer. Institutions tremble when they hear your name."

Much of Wright's information about Selby and the regulators in Dallas came from a report he had asked Mallick to prepare. That report reinforced Wright's perspective during the meeting.

Federal regulators in Texas, Mallick wrote, had been abusing their powers, making threats that they could close any thrift—insolvent or not. Why were they so tough on Texans, Mallick wondered, when New York bankers were being instructed to go easy on Third World debtors? Sick institutions were not offered the chance to get well, to "weather the real estate markets."

Mallick painted a picture of oppression: "A systematic thread of horror stories that involve unfair, unjust, intimidating, unduly expensive and illegal tactics has been the modus operandi of the regulatory agents in District Nine." He closed with an appeal to Wright as a champion of oppressed peoples and "people who are the single-family homeowners, the developers, the appraisers and the thrift owners themselves."

Wright took the floor. In two of the S&L matters that he had studied, Wright said, he found the regulators' behavior unsatisfactory. Particularly in the case of Vernon Savings, which one of the regulators had noted earlier, Wright said, Ed Gray had misled him by saying the institution would not be shut down.

William K. Black, one of Gray's top assistants, couldn't let that statement go unchallenged. The regulators hadn't shut down Vernon, he told Wright; its managers had signed a voluntary agreement placing it under federal control.

That, responded Wright, is a distinction without a difference. Black began to reply, and Wright lost his temper. His trademark bushy eyebrows twitched. His face reddened. "Wait just a goddamn minute!" he shouted. "I waited patiently for you and heard you represent your case. Now you listen to me! You're giving me a bunch of goddamn semantics!"

His outburst lasted 20 seconds, followed by a long silence. For all practical purposes, the meeting was over. What a disaster, thought Joe Selby.

Gray's aides, Black and William Robertson, had the same feeling. In the cab ride back to the bank board office, Robertson worked himself into a nervous frenzy. "What are we going to do now?" he asked. "The speaker hates us! Recap is shot! We'll all get fired!"

When Ed Gray heard about the meeting, he concluded that his dealings with Wright were over. More appealing the speaker to win support for FSLIC legislation. But that decision did not suit Gray; he was too depressed to feel free. His term as chairman was about to expire. If the federal insurance fund was to be saved, he realized, it would be after his departure.

He shifted his focus from the shadows of the present—Jim Wright, the Texan, leader of an industry that had once loved him—to safeguarding his place in history. He had been the bank board chairman during the most calamitous period in the history of American thrifts. His name would be attached to that, one way or another.

He began collecting every speech he had ever delivered, every piece of testimony he had ever written, every article he could find on his tenure. "Everything is for history," he told Fairbanks, his chief of staff. He organized his works into a chronology and placed them inside blue bindings. The anthology eventually reached 12 volumes. He was convinced that he had done the right thing, but that no one would recognize his accomplishments until he was gone. "Joe, one day we're going to be proved right," he told Selby. "We're going to be proved exactly right."

### A Bitter Victory

In the gloom of his final six months, Gray found joy for one day—Feb. 27, 1987, the day his nemesis, Donald T. Regan, was fired as White House chief of staff. Calling his staff to his office, the chairman popped open three bottles of champagne and they celebrated into the night. "I'm very proud I didn't give in to that guy," Gray said. "He wanted me to bow and scrape, and I wouldn't do it."

The next month Gray won another bitter victory. On the morning of March 20, more than 200 of his regulators entered the main office and 10 branches of Vernon Savings and Loan, seized the records, and placed the thrift into federal receivership. Vernon, an institution that provoked Jim Wright's call to Gray three months earlier, now had legal exposure on some deals of more than \$6 billion.

A certain symmetry was at play. The regulators planned the seizure the night before at the Grand Kempinski Hotel in north Dallas. Formerly called the Rialto Hotel, this was where Ed Gray had stayed in the spring of 1983 during his first visit to Texas as the new optimistic bank board chairman. It was there that S&L operator Spencer Blain, now permanently barred from the S&L business, had taken him for a spin in his Rolls Royce.

Gray stayed on the job three more months—he would not leave until the final minute of his final day, June 30—but there were no more battles for him to win. A compromise bill pumping \$10.8 billion into FSLIC, the issue that had consumed him for more than a year, would not be signed into law until Aug. 10. In his final days, Gray spent his time compiling his version of history. His internal turmoil seemed to manifest itself physically. His clothes became increasingly disheveled and his face became more pallid and drawn. "It was horrible," chief of staff Fairbanks later recalled. "There was no lightness to him."

On his final day, Fairbanks had to drag him away from his typewriter for a meeting in the second-floor auditorium. When they arrived, the place was packed with some 700 members of the bank board staff had gathered for a farewell party.

As Ed Gray, his clothes rumpled, his soul tormented, walked through the throng, Kenny Rogers' "The Gambler" pounded through a set of giant stereo speakers. "You got to know when to hold 'em, know when to fold 'em, know when to walk away. And know when to run."

NEXT: Crisis becomes calamity

Staff writer Charles R. Babcock and staff researchers Melissa Mathis and Elizabeth Hudson contributed to this report.

# Grappling With Aftermath of S&L Debacle

## Amid Bailout Effort, What Deregulation Should Mean Is Debated

By David Maraniss and Rick Atkinson  
Washington Post Staff Writers

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**S**o this is what you get, Joe Selby thought to himself. This is the thanks you get for doing your job as the chief supervisor here, for being the toughest regulator in the nation. You get fired. Your proteges get canned along with you. No phone calls of gratitude, no thank you letters, not one director of the Federal Home Loan Bank of Dallas expressing a hint of appreciation for the two years you devoted to purging the bad guys from the savings and loan industry in Texas.

At breakfast two days earlier, in the coffee shop of a downtown Washington hotel, Selby had faced his executioner: George Barclay, the new president of the Dallas district bank. "Joe," Barclay told him, "the process is not working the way it should. One of us is going to have to leave, and I would prefer it not be me." Forty-eight hours later, on Thursday morning, April 28, 1988, the two men were back in Dallas. One was packing. It was not Barclay.

The toughest regulator in the nation cleaned out his office. First, he packed the small figurine of a gun-toting muscleman in a space suit; mounted on a walnut base, the statue was a gift from a Texas thrift executive who had inscribed a moniker on the brass plaque: *H. Joe Rambo Selby*. Second, he put away a framed \$3 bill with the motto "In Don We Trust," a promotional gimmick immortalizing Donald Dixon, head of a savings and loan Selby had cracked down on despite intervention by then-Speaker of the House Jim Wright (D-Tex.). Third, came a gift from another savings and loan association manager with a sense of humor—the

gauntlet from a suit of armor. Finally, Selby packed the black T-shirt given him by Linwood Bowman, the good-natured Texas state regulator: *Kill 'em All and Let God Sort 'em Out*.

As he moved through his third-floor office for the last time, carefully placing the mementoes in cardboard boxes, Selby pondered his fate. When Ed Gray had chaired the regulatory system in Washington and Roy Green presided over the regional staff in Dallas, Selby felt secure. His bosses not only encouraged him, they also protected him from intense political and industry pressure. But Gray had been gone for a year, and Green for several months. Perhaps it was inevitable that Selby would not survive without them.

Who had done him in? When Barclay fired him, the Dallas bank president had accepted 30 percent of the responsibility and ascribed 70 percent to Gray's successor at the Federal Home Loan Bank Board, M. Danny Wall. Yet Selby believed a third factor had influenced the decision.

"Jim Wright got me, didn't he?" he asked Barclay repeatedly. In November 1986, Wright had asked Gray to fire Selby. The chairman refused. Now, with Gray gone, Wright had triumphed after all, Selby believed.

No, Barclay replied, it wasn't just Wright. The larger problem was that Selby seemed to demand that the staff be more loyal to him than to Barclay. Besides, his administrative talents left something to be desired. He had done an admirable job under difficult circumstances, Barclay explained, but times had changed. This was the dawn of a more optimistic era, and Harry Joe Selby had the taint of the bitter old one.

### Ducking the Hard Decisions

As the spring of 1988 yielded to a brutally hot summer in Texas and Washington, no one more personified that new epoch of optimism than Melvin Danny Wall. A one-time urban renewal czar—first in Fargo, N.D., then in Salt Lake City—Wall had migrated to Washington in 1976 on the staff of newly elected Sen. Jake Garn (R-Utah).

When Garn became chairman of the Senate Banking Committee in 1981, Wall became the panel's staff director. Months before Gray's term as Bank Board chairman expired, Wall began campaigning for the job so ardently that the bank staff lampooned him in their Christmas 1986 skit, belting out "If I Were a Chairman" to the tune of "If I Were a Rich Man" from the musical "Fiddler on the Roof."

Now, after a year in office, Wall was being lampooned publicly—ridiculed might be a better description—for his buoyant proclamations that the S&L crisis was less bleak than some experts claimed. After predicting that the Texas mess could be cleaned up for \$7 billion, Wall had since been forced to double that estimate. "His optimism for the business outstripped even the industry itself," said Tom S. King, president of the Texas Savings and Loan League, which presented the balding Wall with a gigantic comb as a symbol of his eternal hopefulness. Wall's House Banking Committee Chairman Rep. Henry B. Gonzalez (D-Tex.), began referring derisively to the "Wall-Number-of-the-Month"; within the agency he headed, he became known as M. Danny Isuzu, an allusion to the chipper prevaricator in a popular television commercial.

Such gibes, Wall believed, were deeply unfair. The Bank Board was making the best of a bad situation, he felt. Estimating the damage was nearly impossible, particularly in oil patch states like Texas, where the plummeting economy acted as a dead weight on the thrift industry. To stanch the bleeding in Texas, the board devised its so-called Southwest Plan, closing or merging more than 100 insolvent thrifts and attracting new owner-investors with federal subsidies and tax breaks. Water cooler wits dubbed the plan "McDeal."

Slowly, painfully, the American public was beginning to sense the magnitude of the fiscal calamity that had befallen the nation. Yet truly grasping what had happened was difficult, given the reluctance of politicians in both parties to confront the issue other than with occasional finger-pointing obfuscation.

Even that took place late in the presidential campaign. On Sept. 29, 1988, Democratic presidential nominee Michael S. Dukakis blamed the Reagan administration for permitting the disaster to unfold. Dukakis charged that Vice President George Bush, the Republican nominee, "could have headed off" the crisis as head of an earlier task force on financial deregulation, but instead had "walked away from a ticking time bomb [and] now, four years later, Mr. Bush's inattention will cost tens of billions of dollars."

For a day or two, Republicans and Democrats traded salvos. Then the guns fell silent and the savings and loan crisis largely vanished as an issue in the '88 campaign. Both parties, recognizing their vulnerability on the subject, tacitly decided to leave the hard decisions to the next president.

On Feb. 6, 1989, less than three weeks after taking office, President Bush unveiled his 500-page bailout package. Now working its way through the House and Senate, with a compromise version likely to land on Bush's desk later this summer, the legislation would dismantle the 57-year-old Federal Home Loan Bank Board system, transplant oversight responsibility to the Treasury Department, and fold the bankrupt Federal Savings and Loan Insurance Corp. (FSLIC) into the Federal Deposit Insurance Corp. (FDIC), which safeguards bank deposits. Estimated costs for the plan range from the breathtaking to the astronomical: \$157 billion, according to the administration; \$285 billion, according to the General Accounting Office.

The dollar figures are hardly more than guesses now, and so too are the estimates on how many thrifts will be left once the dust settles. Some analysts say another 800 to 1,200 savings and loans may topple in the next few years, leaving perhaps 1,500 S&Ls of the 4,000 that existed at the beginning of the 1980s. One critical factor—and an issue of bitter debate on Capitol Hill—is how much capital thrifts should keep on hand to be con-

sidered solvent. A prime element in the S&L debacle was the adoption of rules permitting high-rollers to control a thrift's assets despite risking very little of their own money; current efforts by S&L lobbyists to whittle away the capital requirements strikes some members of Congress as an invitation to replay the disaster.

On another level, the nation's lawmakers are grappling with several fundamental issues regarding commerce and government in the United States. In retrospect, it seems incontrovertible that deregulation cannot mean no regulation, at least when the full faith and credit of the U.S. Treasury is at stake. What deregulation should mean, however, is less clear, particularly in industries where the market seems to be faster, or smarter, or at least slicker than the regulators.

The crisis has spawned a cottage industry of civil litigation and criminal prosecution. An estimated 11,000 lawsuits have been filed by regulators, stockholders, directors and virtually everyone else whose ox was gored in the thrift industry. The Home Loan Bank Board has augmented its staff of 60 lawyers with attorneys from 100 outside firms. "The only profession to come out of this smelling like 20 acres of roses is the lawyers," said Robert Mettlen, former Dallas bank chairman.

Yet recouping even a modest fraction of the lost billions is unlikely. For one thing, reconstructing a paper trail is often difficult at best; FSLIC investigators involved in a suit against Lamar Savings of Austin, which once proposed opening a branch office on the moon, have identified 350,000 potentially relevant documents.

Even when the government's claim seems solid, collecting can be problematic. Spencer Blain, the flamboyant former owner of Empire Savings and Loan, agreed to repay FSLIC \$100 million as part of a civil lawsuit in which he acknowledged no wrongdoing. But federal officials hardly expect to recoup that amount since Blain's contribution to the settlement consists largely of his share in 132 Texas oil wells. Blain is on trial in Texas, charged in an 88-count indictment with systematically looting his thrift.

Bank Board officials estimate that some 170 officers, borrowers and other individuals connected to the thrift industry have been convicted of fraud and other criminal charges in the past six years. Much of the federal prosecution effort has centered on Texas. A special Justice Department task force thundered into Dallas two years ago and has notched 27 convictions. But compared to the hundreds of thrifts nationwide where past criminal activity is at least suspected, the public's thirst for vengeance—voiced daily on television and radio talk shows—may not be quenched soon.

"These are hard cases," said William C. Hendricks, chief of the Justice Department's fraud section. "Very few of these people have prior convictions . . . They're people who have lovely wives, lovely children and terrific character witnesses."

### 'The Black Hole'

Nowhere is the wreckage of the American thrift industry deeper than in Texas. The decade there dawned bright with the promise of limitless growth and now sets with the state mired in a profound depression. Property values have dropped 70 percent in places; office vacancy rates in places like Austin and Houston are among the nation's highest, with landlords collecting rents that are half of what they were just two years ago. Officials considering potential nominees to the Texas Business Hall of Fame find themselves drawn to the dead or retired because of concern about picking a Lone Star businessman who will turn out to be crooked, bankrupt, or both.

In 1987 and 1988, the S&L industry in Texas lost \$16 billion; about half of the state's thrifts went out of business in those two years. Of the ten U.S. thrifts suffering the most egregious losses, five were in Texas, which Bank Board chairman Wall calls "the black hole of the FSLIC." The Dallas Home Loan Bank now estimates it will cost at least \$45 billion to resolve the mess in Texas; one pundit has suggested it would be cheaper to give the state back to Mexico.

Attempts by Texans to understand what happened have been fitful, half-hearted. The governor appointed a special task force, which delivered a detailed study on the crisis in January 1988; yet task force members had to pay for their own stenographer, as well as the cost of printing the report.

Likewise, attempts by Texans to improve the state regulatory machinery have been fitful, half-hearted. A 1987 bill that would have doubled the number of state examiners and increased their paltry salaries died in committee. "I did not realize at the time," committee chairman Charles Evans explained in a recent interview, "that the industry was going under like it was." At the time, the industry was losing \$750,000 an hour.

## EPILOGUE/Four Lives

### DURWARD CURLEE

"Nobody did everything right. Everybody made mistakes. Horrible mistakes," said Durward Curlee, dragging on a cigarette in the shadows of a booth at the Night Hawk restaurant in Austin. His life is proof enough of that. Only four years earlier, he was the Washington lobbyist for 20 Texas thrifts; all of them have gone out of business or merged with other S&Ls.

In his heyday, Curlee earned half a million dollars a year. Now he is broke, his business ventures defunct and his personal holdings auctioned in a recent bankruptcy sale on the courthouse steps. High Flyers Inc. Gone. Side Deals Inc. Long gone. Many of his old clients are on trial or are under investigation by the federal government. The man who once likened Ed Gray to Adolf Hitler, who called the Dallas regulators the Gestapo, still feels that his good old boys in Texas have been wronged. But there is no hatred left in his voice, not even bitterness, only a sense of loss and regret and, as always in Texas, hyperbole.

If oil prices hadn't crashed, Curlee laments, "Donald Dixon would be Donald Trump. If the oil boom hadn't gone bust, these guys they're now trying to put in jail would be secretary of the Treasury."



### L. LINWOOD BOWMAN III

"It happened on my watch. I can't blame it on anyone else," said L. Linwood Bowman III, offering up each word in a slow drawl punctuated by deep sighs. For five crucial years, from 1982 to 1987, Bowman was the chief S&L regulator for the state of Texas. As he readily acknowledges, the calamity unfolded before his eyes, which in a figurative sense, sometimes seemed wide-open, sometimes half-closed.

Bowman watched a troop of his employees—close friends, business associates—leave his agency to work for the thrifts they regulated. Several now find themselves in trouble. Last month his former assistant, Pat Malone, pleaded guilty to funneling corporate money illegally to Texas politicians. Two weeks ago, Bowman's business partner and former deputy, Patrick King, was indicted on similar charges.



Since he left state service two years ago, Bowman has hovered around the edges of the S&L wreck, helping insolvent thrifts manage their bad assets. He works in the Millennium Building, originally built by a savings and loan association that later went bankrupt; now the Millennium belongs to the federal government. From his headquarters in the western hills above Austin, Bowman overlooks what may be the most overbuilt city in the nation. "We just turned out," he sighs, "to be the graveyard instead of the New Jerusalem."

## H. JOE SELBY

"I feel good about myself. I have nothing to be ashamed of," said H. Joe Selby on the morning of April 19, 1989. This is a pivotal day in his life, the day the House ethics committee makes public a 279-page report on Speaker Wright. The document includes a detailed account of the congressman's telephone call to Ed Gray in which he suggested that Selby was homosexual and, as the chief federal regulator in Dallas, gave preferential treatment to "a ring of homosexual lawyers."

Accounts of that phone call had been published before, but never with Selby's name attached. Now, Selby knew, his 89-year-old father and other relatives in Ganado, Tex., would read about the episode. That's unfortunate, Selby muses, but the story has taken on a life of its own, transcending his circumstances and his privacy.

After his firing last year, Selby sought to remove himself from the savings and loan scene. He began working as a financial consultant, living in Dallas but occasionally traveling to the Caribbean and Far East on jobs. Asked to run the Texas S&L department, he turned down the offer with a terse "never again." The damage had been done; the important battles fought. The entire experience still sickens him, he said, especially what he views as the ethical laxity, the incestuousness between regulators, Congress and the industry.

"My biggest surprise was that an entire industry could be raped and pillaged like it was," he added, voice rising in indignation. "Especially in my home state. It's still inconceivable to me that could have happened."



## EDWIN J. GRAY

"If I had tried to be the good guy, the good old boy, right now people would be trying to lynch me around the country," said Ed Gray.

His voice on this warm spring evening in Miami has the urgency of a man trying to convince himself as much as his listeners. Since leaving Washington two years ago, Gray has mellowed in many respects: He stopped smoking; his depression lifted; his finances improved; he found more time for his wife and daughters.

But when it comes to the S&L disaster, Ed Gray remains a man possessed, a man, as Joe Selby puts it, "on a holy mission." Voluble, fervent, tireless, he portrays himself as a man more sinned against than sinning, acknowledging past mistakes—such as living a royal lifestyle at industry expense—but brushes them aside as inconsequential in the larger catastrophe.

He devours newspaper articles about the bailout bill moving through Congress. Reading of the enduring influence of the savings and loan lobby, Gray said, takes him back to the days when he felt locked in a life and death struggle with his former friends at the U.S. League, a time when, in his words, "I made myself an ass to the industry."

"They're still doing what they did then," he observed. "They're still powerful. They're still going up there with 600 local executives, trying to make it look like righteousness is on their side. Only now everyone knows what they're doing. You read about it every day. When I was there no one knew. No one knew what I had to fight."

Gray is speeding down Biscayne Boulevard at midnight, heading toward his office at Chase Federal Bank F.S.B., the only one of the nation's 3,000 thrifts to offer him a job after he left the Bank Board. The others, he said, "hate my guts."

"You have to understand," he keeps saying, voice rising, body turning away from the steering wheel to look squarely at his listeners. "You have to understand." Again he plunges back in time, recollecting in half sentences, his mind jabbing and sparring with shadows of the past:

"I was saying to myself, I'll probably go down in flames, but somehow, some way, history will say . . . I knew I had tried, I had been warning, I had gone so many miles beyond anything expected of me . . . I took the position, what do I have to lose? So I went all the way . . . Now people in Congress are coming up to me. They say, 'Ed, you've been vindicated.'

"Thank God I did those things. Now I can look myself in the mirror."

*Staff writer Kathleen Day and staff researchers Melissa Mathis and Elizabeth Hudson contributed to this report.*

THE WHITE HOUSE  
WASHINGTON

Davis/Blymire  
June 20, 1990  
Title: Justice  
Draft: One

PRESIDENTIAL ADDRESS: U.S. ATTORNEYS, GREAT HALL, JUSTICE  
11:20 a.m., Friday, June 22

((Acknowledgements))

((I have to tell you, when <sup>I told my</sup> my grandkids ~~heard~~ <sup>heard</sup> that I'd be spending time with some of America's finest crime-fighters, one of them asked me if I would be sure and bring them back an autograph \\ . . . from Dick Tracy.)) \\ \\

Well, true villains are drawn from life, not from primary colors. And where financial fraud is concerned, it takes a discerning mind and an open heart to distinguish the incompetent from the fraudulent, the unlucky from the unlawful. This nation is very fortunate to be able to look to you -- the U.S. Attorneys of America -- to make these tough calls. We depend on you to read through piles upon voluminous piles of documents, and find in them, among the cold numbers of a ledger -- the heartache of a lost pension, the tragedy of a lost home -- and then act on that knowledge, in the spirit of justice.

This Administration, from our very first days in office, has had to work with Congress to try and contain the Savings and Loan crisis. We have also been challenged by pinstriped bankers who launder the smell of blood out of drug money. By white-collar thieves who cheat the elderly out of their life's work. By government contractors who steal by the numbers.

THE WHITE HOUSE

WASHINGTON

You know of the ((number)) of convictions from the ill-wind probe of federal defense contractors. You know that ((example of crackdown on drug financiers.)) You know that cases involving abuse of HUD contracts, the Department of Justice has already obtained ((number)) of convictions in Oklahoma alone, while courts have ordered almost two and one-half million dollars in restitution in that state -- more than half of which will come from a bank president who has a five-year reservation in prison.

When it comes to Savings and Loans swindles, one of my first acts as President was to direct Attorney-General Thornburgh to give these cases the highest judicial priority. And he did. Last year alone, the Department of Justice aggressively brought almost 800 convictions in financial fraud cases involving more than \$100,000. And there have been almost 200 indictments of major S&L cases since 1987.

More and more, our efforts are starting to pay off. An S&L Chairman gets 30 years in a celebrated case in Dallas, while the court deliberates restitution for \$17 million in losses. An S&L CEO in Santa Rosa is sentenced to prison, and the courts order almost \$7 million in fines and restitution. In Illinois, top officers of an S&L go to prison, and are ordered to repay \$17 million.

This is the result of a determined, aggressive approach, one that includes the boosting of our efforts with 153 FBI agents and 100 FBI accounting technicians and 118 Assistant U.S. Attorneys. The Dallas Task Force has been particularly successful, obtaining

THE WHITE HOUSE

WASHINGTON

52 convictions; so successful, in fact, that Attorney-General Thornburgh is expanding the task force concept to 37 other U.S. Attorney's offices around the country.

We are also bringing to bear<sup>?</sup> the resources of all federal agencies against financial fraud. It is often a local effort, like ~~the time~~<sup>when</sup> an alert passport clerk stopped a former savings and loan owner from skipping the country, a move which led to the recovery of almost \$3 million in cash, gold and jewelry. And it is a national effort, a constant quest for restitution through tens of thousands of civil cases leveled against S&L executives, owners and borrowers. These efforts can only benefit of the American taxpayer and depositor.

Yet, despite our progress, you know best that successful indictments and prosecutions don't happen overnight. Cases of financial fraud are torturously complex -- it has taken prosecutors three and a half years to bring an indictment in one legendary case in Dallas alone. Such cases require great patience and, I believe, an even greater commitment to support our regulators and law enforcers.

So today, I am here to announce my support of an amendment to the crime bill to enhance and enforce the civil and criminal penalties for fraud against financial institutions. This legislation, supported by Minority Leaders Bob Dole and Bob Michel, and Senators Heinz and Garn, will intensify the resources of the whole United States in the service of justice. Let me cite the prime measures of this amendment. It will:

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**First:** Put the very best legal minds of all agencies of our government at the service of the Department of Justice.

**Second:** Allow law enforcement agencies to request wiretaps to investigate bank fraud.

**Third:** Direct the courts to give priority to cases brought by the Federal Deposit Insurance Corporation and the Resolution Trust Corporation; and to establish procedures for expedited appeals.

**Fourth:** Protect taxpayers by authorizing the FDIC and RTC, and the Office of Thrift Supervision to seek court orders to freeze the corporate and personal assets of defendants in civil cases -- and to give the claims of the federal government priority in financial fraud cases.

**Fifth:** Protect the victims of financial fraud by authorizing the courts to order the payment of restitution. This would apply to even in cases where all victims were not identified in the count of conviction.

**Sixth:** Protect victims of fraud by prohibiting the use of bankruptcy as a strategy to avoid paying damages, penalties and forfeitures.

And **Seventh:** Authorize an additional \$25 million for the IRS and the Department of Justice to boost their already vigorous efforts in the investigation of financial institutions fraud.

These are the legislative steps we can and must take. We must leave no stone unturned. So we will, learning from our recent successes, take further administrative steps. The

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Attorney-General will establish, within the Department of Justice, a new unit to direct and sharpen the Department's actions even further, while helping to coordinate actions with other agencies. And Attorney-General Thornburgh and Secretary Brady are establishing "flying squads" from their departments and other regulatory agencies -- teams of crack prosecutors and auditors who will travel from city to city, breaking case after case.

The IRS is also preparing to aggressively pursue individuals suspected of tax fraud in connection with failed savings and loan institutions; while RTC is adding about 300 members to its investigative staff this year, to be part of a new national network of investigative teams. Treasury's Office of Thrift Supervision has also required 664 institutions to agree to terminate unsafe and unsound practices, removed more than 150 senior thrift officers and directors, and issued 111 cease and desist orders to stop unsafe and unsound practices.

In addition, Secretary Brady will announce ((Treasury paragraph to come.))

Let me say, I am deeply impressed by the cooperation between the men and women of the Departments of Justice and Treasury, and their determination to prosecute financial frauds. I commend Senators Dole and Heinz for leading this effort on Capitol Hill. And I hope all members of Congress work with us in this same spirit of cooperation.

((Ripped-off elderly anecdote to come.))

THE WHITE HOUSE

WASHINGTON

It is your duty, your sacred duty to right these wrongs, to stand up for the vulnerable against the unscrupulous, the guileless against the conniving.

You do a difficult job with a spirit of professionalism. I wish I could offer you a reward equal to the hard and necessary service you render to the nation. I can only thank you, on behalf of all Americans, for your dedication to justice.

Thank you for coming to Washington. May God bless each and every one of you, and may God bless America.

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nexis fraud/victims/elderly

Staffed 10AM

Davis/Blymire  
June 20, 1990  
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White-collar crime is not as dramatic as violent crime. But white-collar crime still ruins lives. It murders the fondest dreams of whole families. It takes a snake, a cold-blooded snake, to betray the trust and innocence of hard-working people. And so if we have to look under rocks to find white-collar criminals, then we will leave no stone unturned.\\ \\

Pres. Docs.

This Administration, from our first days in office, has worked with Congress to crack down on white-collar criminals. To crack down on pinstriped bankers who launder the smell of blood out of drug money, and white-collar crooks who cheat the elderly out of their life's hard work. To bring to justice government contractors who steal by the numbers.

defense contractors

You already know of the ((number)) of convictions from the Ill-Wind probe of federal defense contractors. You already know that ((example of crackdown on drug financiers)). You already know that among cases involving abuse of HUD contracts, the Department of Justice has already obtained ((number)) of convictions in Oklahoma alone, while courts have ordered almost two and one-half million dollars in restitution in that state -- more than half of which will come from a bank president who has a five-year reservation in prison. In all, the government has won 10,000 financial fraud convictions since 1985. And just last year alone, the Department of Justice aggressively won almost 800 convictions in major financial fraud cases -- cases involving more than \$100,000.

John Smietanka DOJ

Doug Tillett DOJ

25

real estate business

DT ?

When I took office, we also knew that something terribly wrong had happened in the Savings and Loan industry. And so, on the ((xxth)) day of my Administration, I directed Attorney-General Thornburgh to give these cases the highest priority. And he did. When it comes to civil action, we have sought restitution for depositors and taxpayers alike through tens of thousands of civil suits leveled against S&L executives, owners

USA Today 8/16/89 Money 1B (EXIS)

DT ?

and borrowers. And when it comes to criminal action, we aim for a simple, uncompromising position -- throw the crooks in jail.\\ \\ \\

This aggressive attitude is paying off. In three years, we've won 3,299 S&L convictions -- \$100 million ordered in restitution -- more than four centuries in prison terms meted out. And, I promise you this -- there will be more, much more.

Consider all that is happening: An S&L Chairman gets 30 years in a celebrated case in Dallas. An S&L CEO in Santa Rosa is sentenced to prison, and the courts order almost \$7 million in fines and restitution. In Illinois, top officers of an S&L go to prison, and are ordered to repay \$17 million. These cheats have cost us billions. They will pay us back in billions, and they will pay us back in years.

These are the results of a determined effort -- an effort which we are boosting with 153 FBI agents, 100 FBI accounting technicians and 118 Assistant U.S. Attorneys. The Dallas Task Force has been particularly successful, obtaining 52 convictions; so successful, in fact, that Attorney-General Thornburgh is expanding the task force concept to 37 other U.S. Attorney's offices around the country.

And because of Secretary Brady's leadership, the IRS is aggressively pursuing individuals suspected of tax fraud in connection with failed savings and loan institutions; while the Resolution Trust Corporation is adding about 300 members to its investigative staff this year, to become part of a new national investigative network. Treasury's Office of Thrift Supervision

Doug Tillet  
DOJ

John Smietanka  
DOJ

FFIF  
Fact Sheet

Audrey  
Woods  
Dallas  
Task Force  
514-0640

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has also required 664 institutions to agree to terminate unsafe and unsound practices, removed more than 150 senior thrift officers and directors, and issued 111 cease and desist orders to stop unsafe and unsound practices.

Throughout it all, our men and women in the federal agencies are doing a great job, from the halls of Justice and Treasury, to the passport clerk who recovered \$3 million in cash, jewelry and gold by keeping a former savings and loan owner from skipping the country.

We are learning a lot from our successes, including how much more there is to do. So I am here, today, to back new legislative and Administration action -- further ways we can crack down on white-collar crime.

First, let me declare my support of an amendment to the crime bill to enhance and enforce the civil and criminal penalties for fraud against financial institutions. This legislation, sponsored by Minority Leaders Bob Dole and Bob Michel, and Senators Heinz and Garn, will intensify the resources of the United States government in the service of justice.

These leaders of Congress and I want to authorize \$25 million increase for the IRS and Department of Justice so we can intensify their already vigorous investigations. We want to allow the use of wiretaps in investigating bank fraud. We also want Congress to authorize federal regulatory agencies to ask the courts to freeze the corporate and personal assets of defendants in civil cases -- so that they will not leave the

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USA Today  
8/16/89  
Money 1B  
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taxpayers high and dry. And we want to prohibit the use of bankruptcy as a strategy to avoid paying damages to the rightful recipients -- the depositors.

These are some of the legislative steps we can and must take. We can also build on our recent successes by taking further administrative action. The Attorney-General will establish, within the Department of Justice, a new unit to direct and sharpen the Department's actions even further, while helping to coordinate actions with other agencies. And where new problems emerge in S&Ls, we will need to get involved fast.

That's why Attorney-General Thornburgh and Secretary Brady have created a new approach -- a strike force against fraud -- teams of razor-sharp prosecutors and auditors recruited from their departments and other agencies -- striking city by city -- teams that will jump right into the paper chase, teams that will hit the trail while it's still hot.

I have seen for myself that the men and women of these two departments are working together because you share a tenacious spirit, born of a thirst for justice. Of course, we always quantify the importance of our work together in terms of billions of dollars lost. But, perhaps it is more appropriate to qualify it in terms of lives ruined -- in terms of savers whose hard work and honest trust has been treated like a joke; in terms of elderly people whose faith in the future has been repaid with bitter poverty at life's end.

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It is your duty, your sacred duty, to right these wrongs, to stand up for the vulnerable against the unscrupulous, the guileless against the conniving. We will not rest until the cheats, the chiselers and the charlatans spend a large chunk of their lives behind the bars of a federal compound.\\\

You do a difficult job in a spirit of professionalism. I can only thank you, on behalf of all Americans, for your dedication -- your dedication to justice.

Thank you for coming to Washington. May God bless each and every one of you, and may God bless America.

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Find out  
→ On what day did POTUS  
make S&L 1st priority

→ need total # of convictions →  
# of # fines ≈  
# of time in jail terms

DOJ. P.A. of ~~DOJ~~  
Doug Tillett  
Source Book, DOJ

← Clerk's  
7<sup>th</sup> or 14<sup>th</sup>?  
↓  
go to library  
↓  
all Pres. Docs.

~~DOJ~~

Source book DOJ  
- total convictions ~~190~~ 185 pres.  
2 figs.  
1. all cases fin. fraud  
failed S&L, bank tellers  
10,367  
- S&L more than \$100K  
3,299  
from '85 - pres.  
- amt. of restitution  
ordered 197-90  
\$100 million (slightly over)  
- jail time 187 - now ≈ 420  
as of today → over 400 years