THE $150 BILLION CALAMITY
David Maraniss; Rick Atkinson
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THE $150 BILLION CALAMITY

Fourth of Seven Articles

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

Edwin 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

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Construction in Austin during mid-1980s boom eliminated many views of the state Capitol. By late 1985, the city had become the Southwest's real estate gold mine.

At Highflying Austin Thrift, Rush of Deals Built Illusion of Success

SAVINGS, From A1

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.

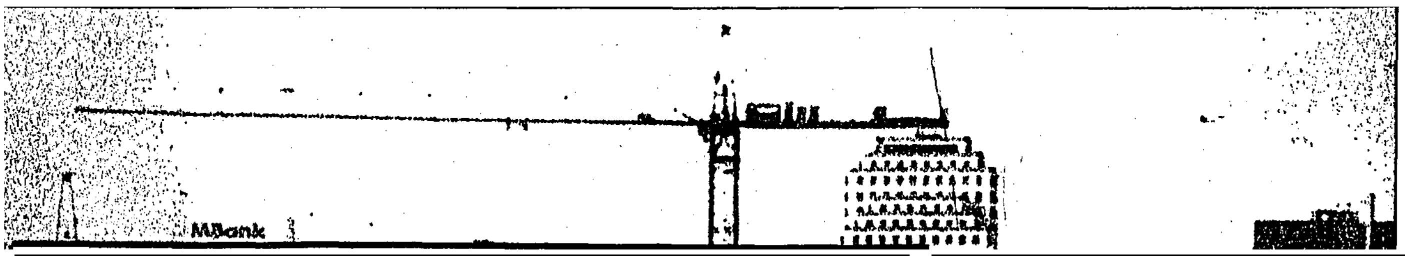
Ever since Gray had fired Joe Settle, the top regulator at the Federal Home Loan Bank of Dallas, many Texas thrift executives believed Gray had it in for them. His interference in the regional regulatory process, his efforts to restrict "brokered deposits," his move to impose growth restrictions—all 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."



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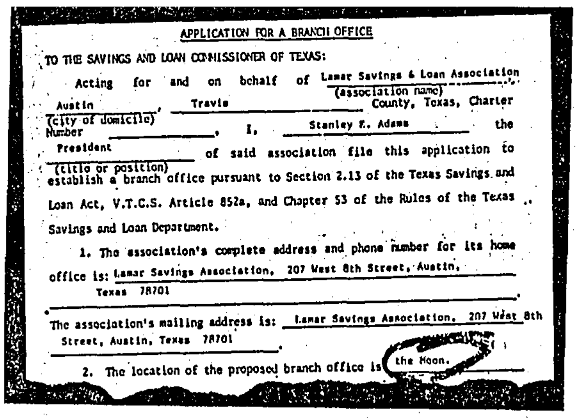
Stanley Adams, above, owner and chief executive of Lamar Savings Association, the fastest-growing thrift in Austin in the early 1980s, proposed the ultimate symbol for the state's highflying S&Ls when he filed for permission to open a branch office on the moon. His application, right, went on to note a site—Cayley Crater in the Sea of Tranquility.



APPLICATION FOR A BRANCH OFFICE

TO THE SAVINGS AND LOAN COMMISSIONER OF TEXAS:

Acting for and on behalf of Lamar Savings & Loan Association (association name) Austin (city of domicile), Travis County, Texas, Charter Number ______, I, Stanley E. Adams the President (title or position) of said association file this application to establish a branch office pursuant to Section 2.13 of the Texas Savings and Loan Act, V.T.C.S. Article 852a, and Chapter 53 of the Rules of the Texas Savings and Loan Department.

1. The association's complete address and phone number for its home office is: Lamar Savings Association, 207 West 8th Street, Austin, Texas 78701.

The association's mailing address is: Lamar Savings Association, 207 West 8th Street, Austin, Texas 78701.

2. The location of the proposed branch office is the Moon.

PHOTOS BY JAMES M. THRESHER—THE WASHINGTON POST

Views along Congress Avenue this year attest to the continuing impact of a real estate development boom that went bust with the plummeting of oil prices from $24.53 a barrel in December 1985 to $9.39 in May 1986. City officials in Houston and Austin feared that it would take at least 10 years to fill vacancies in surplus office and housing stock.

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 tooled 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 1988, 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 back yard. 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.

NEXT: Sending a message

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