Edwin Gray on the S&L Crisis: 'This Was a Self-Inflicted Disaster'

Edwin Gray was chairman of the Federal Home Loan Bank Board, which regulates the savings and loan industry, from 1983 until mid-1987. During his tenure, the deregulation seeds that had been planted earlier started to bear bitter fruit as S&Ls began failing and claims on the fund that insures depositors surged.

Suddenly, the little-known agency attracted the attention of outsiders—including politicians such as House Speaker Jim Wright (D-Tex.), who interceded with the bank board on behalf of S&Ls in Texas, where the industry's problems were centered.

Gray, who now is president of Chase Federal Bank in Miami, discussed these matters in an interview that appears in the October issue of Regardie's magazine. Following are edited excerpts of that interview, which was conducted by Michael Binstein, a Washington writer who has reported on banking issues for columnist Jack Anderson.

BY JAMES K W ATHERTON—THE WASHINGTON POST

Edwin Gray: "There were too many people who came into the business who didn't know . . . what fiduciary responsibility means."

Q Soon you'll be called to testify before the House Ethics Committee, which is investigating Jim Wright. One of the charges against Wright centers on the allegation that he strong-armed regulators to go easy on sick Texas thrifts. What will you tell the committee when you're asked about it?

A I received a call from Jim Wright in late September 1986. He was very unhappy with our handling of the Craig Hall situation. Hall, as you know, was a big-time Dallas real estate syndicator. Dozens of institutions were involved in his syndicated loans, many of which had gone bad.

Hall was up on the Hill lobbying hard. Wright called me and said that he was unhappy about Scott Schultz, a bank board supervisory agent in San Francisco, because he felt that Schultz wasn't being fair to Hall. We at the board didn't want to replace Schultz because we thought it might leave the impression that we were caving in to Hall. Wright said that he felt we were being too inflexible and that Schultz was the problem.

Because we were fighting for the passage of legislation to recapitalize the FSLIC [the Federal Savings and Loan Insurance Corp. which insures deposits at S&Ls], I felt strongly that we had to demonstrate some sense of accommodation if we had any chance for his support. So we replaced Scott Schultz with Angelo Vigna, one of our finest supervisory agents from New York.

[Wright responded to Regardie's, "I do not know anyone named Scott Schultz and do not recall that I have ever discussed any such person by name."]

Q In late 1986 and early 1987 the insurance fund was broke and the slightest spark of a problem could have caused an unstoppable run on one or more savings and loans. Images of the Great Depression must have been dancing around in your head.

A That's absolutely correct. My one goal was to pass the FSLIC recapitalization bill. It was so damn critical. We knew that Jim Wright had life and death power over this legislation. [Wright was majority leader until January 1987, when he became the speaker of the House.] He was, in a sense, strong-arming me. He seemed to be far more interested in protecting his friends, who we knew were running massively insolvent institutions, to prevent them from being closed down. He didn't seem to have any concern for protecting depositors, only savings and loan operators, whom he characterized as his "constituents."

We were experiencing $10 million in operating losses a day, and they were climbing. Every hour counted. I'd been warning for years that this would be paid for by taxpayers if we weren't careful, and the third most powerful man in the country was holding a bill hostage for some "constituents." What about all the other constituents in the country—taxpayers—who were being set up to pay these bills because of the delays?

Q Did Wright seem to be aware of the financial issues that were facing the FSLIC?

A "Well," he said, "I don't know that much about this." He himself said that. So I took 40 minutes to make sure that he understood the gravity of our situation at the FSLIC, what we were trying to do, the purpose of thrift regulation, and why it was important that we take vigorous action against those who were egregious in their mismanagement of federally insured institutions.

I told Wright that we were moving toward insolvency at the FSLIC, and that we had many difficult institutions to deal with. I said, "I want to emphasize, congressman, that our remaining dwindling reserves stand behind more than $800 billion in deposits."

He said, "Would you repeat that?"

I said, "There's $2 billion standing behind $800 billion in deposits."

He said, "Hmm," and he wrote it down.

Q Did you feel blackmailed by Wright, [that he] sought to hold the FSLIC recapitalization bill hostage to his own agenda in Texas?

A I don't know if I thought about it in those terms. I felt very strongly that since we were almost out of money and had so many hopelessly insolvent institutions to deal with, it was absolutely essential to recapitalize the insurance fund.

In another conversation Wright told me that he'd been talking to his friends, people he could rely on, and that they were telling him things that troubled him greatly. They were telling him that they were being treated very poorly by the bank board, particularly by Joe Selby in Dallas. I pointed out to him that Selby had come to the bank board from the Comptroller of the Currency's Office, where he'd served as a top deputy for many years, and that I'd personally wanted to hire him. Selby was considered to be an outstanding financial regulator. I also told Wright that I thought Selby was doing an outstanding job in Dallas.

But Wright, citing the people he relied on, said that this wasn't at all the story he was getting. And in the course of our conversation he asked, "Isn't there anything at all you can do to get him out of the job, to let him go?"

And I said no. I felt that Selby was doing a fine job. He was doing what I wanted him to do, which was to be a good regulator.

Q So Wright sought to persuade you to fire Selby?

A He didn't put it that way. He asked if there was anything I could do to get rid of him. He put it in the form of a question.

I was surprised that a man of Wright's stature would be trying to intervene with a man of Selby's stature, a man who reported to me on supervisory matters. At one point it occurred to me that maybe he didn't want to take me on personally. But he made it clear that his many friends were calling me and Selby the Gestapo.

[Wright responded to Regardie's: "I told Ed Gray of widespread criticism involving tactics by personnel in the Dallas Home Loan Bank Board. I told him of numerous reports throughout the state that accused the regulators of being overzealous, capricious, overbearing and autocratic. But I did not presume to tell him who to hire or fire."]

Q Tell me about your stormy relations with David Stockman and the OMB.

A David Stockman basically ignored the bank board. He didn't bother to answer my letters. Connie Horner, the associate director of the OMB, told me that she would convey his views if anything needed answering. It was the kind of recurring arrogance that Donald Regan was also so expert at.

Q What did you discuss with Horner?

A I basically said that we'd given up on the OMB. I said that we obviously weren't going to get any help, pointing out that Stockman wouldn't even respond to us out of courtesy. They'd apparently decided to play God with us.

Horner said that I didn't understand the administration's policy of deregulation and that we ought to be reducing, not seeking to increase, the size of our examination staff. She said that we ought to be trying to get the government out of the pockets of business. She clearly didn't seem to understand that thrift losses might have to be paid by the taxpayers down the road. She said that she would oppose my plan to transfer examiners to the federal home loan banks.

Q Why?

A Because this would remove the examiners from the control of the OMB. That was our idea: To get the examiners out from under the control of the people at the OMB, some of whom seemed to be ideological crazies who couldn't seem to understand the importance of regulating to protect the FSLIC, and ultimately the taxpayers. They didn't seem to be able to comprehend this fact of life. Nor did the crazies in the S&L business.

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I remember I almost fell out of my chair when Horner said that we didn't need more examiners, that I somehow didn't understand the purpose of deregulation. I responded that we would vigorously oppose the OMB and transfer the examiners anyway. A few weeks before the transfer she came over to my office and proposed a quid pro quo: If we would stop the transfer, she would give us 39 new examiner slots. We laughed. It was a joke. Within a year and a half we had added more than 750 new examiners in the federal home loan banks.

Q I understand that the Treasury secretary at the time, Don Regan, played an important role in the Financial Corp. of America rescue [in 1984].

A In September 1984, given the fact that FCA was threatened with a continuing liquidity crisis and had virtually run out of collateral with which to borrow either from the federal home loan bank or the Federal Reserve, we had gone to Dick Pratt, my predecessor at the bank board, who at the time was in a key position at Merrill Lynch. He was putting together a $1 billion brokered funds package at our request. This would provide liquidity for FCA, which was desperately needed to stay ahead of the crisis.

Then, one day, Pratt called to say that he couldn't go ahead with the deal. He said that he'd been overruled by his superiors. By the skin of our teeth, the next day we signed up another firm to put together the deal. Fortunately, Prudential-Bache came through.

More than a year later Pratt confided to me that Don Regan had been the reason that his superiors had overruled him. He said that Don Regan had intervened and caused his package at Merrill Lynch to be scuttled. I found this to be interesting indeed.

[Regan responded to Regardie's, "A careful search of my telephone logs and appointment schedules for August and September 1984 reveals that I made no calls to or received any calls from Merrill Lynch, nor did I see anyone from Merrill Lynch. There is a memo that shows that a lawyer for Merrill Lynch contacted the assistant secretary for domestic policy regarding FCA. The lawyer was told that there would be no governmental support for Merrill Lynch's undertaking of this transaction, as Treasury's role is not to ask anyone to do an underwriting. But he was told that Treasury had no objection to such an underwriting. The memo also states that Merrill Lynch people would be visiting with Preston Martin and others regarding FCA.

["I also contacted Richard Pratt. He has no recollection of my contacting anyone at Merrill Lynch regarding FCA, and he says that if Ed Gray somehow got this impression, he is sorry because he did not mean to convey it.

["Mr. Gray is mistaken in his statement, and no one can recall my calling Merrill Lynch regarding FCA."

[Pratt declined to comment on the matter.]

Q What was Regan's motive?

A I don't know. . . . Just a few weeks before Pratt was overruled, Regan was obviously very angry I'd made the suggestion that he check with me before he commented publicly about our very ticklish situation with FCA. The American Banker had run a front-page story in which it attributed to Regan the idea that the United States wouldn't stand behind the uninsured deposits at FCA. Given the extremely sensitive liquidity situation at the institution, all we needed was something like that in the financial press. In fact, that very day the institution suffered a $400 million outflow of deposits.

I wrote a courteous letter to Regan. He let me know what he thought of my letter and, basically, where he thought I could go. More than a year later, when Dick Pratt let me know how he had been overruled, I couldn't help but put two and two together. Was this Don Regan's way of trying to get me, to make me fail in trying to keep control of the situation at FCA? It sounded quite plausible to me, and it certainly was the first thing that came to my mind.

Q What did you know about the FSLIC crisis, and when did you know it?

A I was talking about the problem way back in 1983. I realized that I'd probably have the problem dumped on my doorstep down the road, and I wasn't about to countenance that. I felt very strongly that I had to make my concerns about the FSLIC known early on. But I felt that if I wasn't careful, I could start a run on federally insured institutions, so my statements were carefully crafted to try to prevent that.

But it became clear to me after a while that the industry didn't want to hear the message, particularly from its regulator. The more I raised my concerns, the more the industry became annoyed. Because they didn't like the message—this often occurs in Washington—they tried to make their criticism personal. In Washington, when opponents dislike your politics they typically call you a poor manager and criticize you personally in many other ways. Basically, many in the industry just wanted me to sweep the problem under the rug, as though it might then just disappear.

Q Why did the FSLIC run out of money?

A There are many reasons, but basically there were too many people who came into the business who didn't know and who really didn't want to know what fiduciary responsibility means. The fact that they were using other people's money made no difference to them. Safety and soundness and prudence were never part of their vocabulary or their thinking. Too many were driven simply by greed and self-aggrandizement. Too many resorted to practices that were nothing more than the deliberate abuse of the institutions they ran. Instead of treating their responsibilities as the equivalent of a public trust, they treated their institutions as though they were roulette tables. In the end, too many of them looted their institutions and left the litter for the FSLIC. Too often these thrift owners turned out to be outright crooks. And while not all of them will go to jail, it isn't because many of them shouldn't go.

Q Was the crisis avoidable?

A Yes. This was a self-inflicted disaster for the thrift system. The argument that the crisis is due to a depressed economy is baloney; the distressed economy isn't the reason that the FSLIC has been destroyed. Much of the reason is fraud, insider abuse, gross mismanagement, and the drive for a fast buck—that is to say, pure out-and-out greed. By early 1984 I'd concluded and, yes, warned publicly that thrift deregulation was on a collision course with the safety and soundness of the thrift industry.