

EDWIN J. GRAY

P.O. Box 6404 W
Miami, Florida 33156

May 30, 1989

TRANSMITTED BY FACSIMILE
ORIGINAL BY FEDERAL EXPRESSThe Honorable John McCain
United States Senator
Washington D. C. 20510

Dear Senator McCain:

I am in receipt of your letter of May 25, 1989 and I appreciate the opportunity you have provided to comment.

As you will recall, there were two meetings, the first was held in Senator DeConcini's office and began at 6PM. I believe the date of this first meeting was April 2, 1987. Attending the meeting were myself, you and Senators DeConcini, Cranston and Glenn. The second meeting was held, I believe, on April 9, 1987 in Senator DeConcini's office and was attended, I believe, by you, Senators DeConcini, Cranston, Glenn and Riegle, and by four representatives of the Eleventh District, Federal Home Loan Bank Board, including Principal Supervisory Agent James Cirona, Agency Functions Director Michael Patriarca, Supervisory Agent Sanchez and General Counsel William Black. I did not attend the second meeting, which was requested by Senator DeConcini.

I remember well the first meeting. Senator DeConcini, presumably acting for you and for Senators Glenn and Cranston, because Senator DeConcini, who was the host of the meeting, used the term "we" when he began the discussion, presented me with what I considered to be a quid pro quo at the outset of the meeting. He said first that "we" want to discuss with you (Chairman Gray) some concerns we have about Lincoln Savings. He said "we" wanted the meeting because "our friend" at Lincoln Savings had relayed these concerns to "us." Senator DeConcini said you (Chairman Gray) recently put a regulation into effect and that "we" are concerned the regulation may be unconstitutional. Senator DeConcini attributed to "our friend" knowledge of the constitutional issue. Senator DeConcini said "we" would be very concerned that a regulation might be unconstitutional (and therefore illegal). Senator DeConcini asked me if it wouldn't be possible to withdraw or at least put a moratorium on the regulation (the "Equity Risk Regulation" which had been adopted a few weeks earlier by the Bank Board). If I could do this, he said, "we" would help you (Chairman Gray) with a problem which Senator DeConcini said I had with Lincoln Savings: namely my (alleged) concern that Lincoln wasn't making enough home loans. I do not know the source of this alleged concern of mine, that Lincoln was not making enough home loans. I did not bring up this allegation. Perhaps the allegation emerged from discussions Senator DeConcini had with the "friend." At no time in my meeting with you and your three senatorial colleagues was Charles Keating's name mentioned by any of you. References were made to "Lincoln," and once, I recall, to American Continental.

EXHIBIT
SC-GY 14

GY 00105

Page Two
The Honorable John McCain

Senator DeConcini proposed the withdrawal or placement of a moratorium (which would have had the same practical effect) on the Equity Risk regulation while "we" determine whether it (the regulation) "is constitutional." He said "we" wouldn't want a regulation on the books which "isn't constitutional, of course."

Lincoln Savings had several weeks earlier sued the Federal Home Loan Bank Board in Federal District Court on the grounds that this same regulation was unconstitutional.

I replied to Senator DeConcini's quid pro quo that I was curious as to how we might possibly determine the constitutionality of the regulation if it were withdrawn, since constitutional questions require the adjudication of the courts.

Further, I went into a long discussion of the history of the Direct Investment Regulation (forerunner to the Equity Risk Regulation), how the Bank Board had proposed and then adopted the first such regulation in 1984-85, and how it had been adopted again in 1987, and how the subsequent stronger Equity Risk Regulation had been adopted only recently. I dwelled in my conversation on how the Bank Board had gone through the full regulatory process along the way, including the use of public comment periods, public hearings, and even lengthy congressional inquiry and oversight hearings for more than three years, all relating specifically to the Direct Investment and Equity Risk regulations.

I said to Senator DeConcini that I would not withdraw or place a moratorium on the regulation; that I couldn't do so even if I had wanted to do so -- which I didn't -- because the Bank Board, not just its Chairman, was solely empowered to do so; and that the proper place to determine questions of constitutionality was in the courts. Incidentally, after my term expired as a member of the Bank Board, the Federal District Court ruled that the Equity Risk Regulation was, and is, indeed constitutional. The regulation remains in effect

This approximately hour-long meeting, in Senator DeConcini's office, also took up concerns raised by the Senators in the meeting about the length of time the examination of Lincoln was taking (examination by regulators in the Eleventh Federal Home Loan Bank Board district); about appraisal standards which the Senators understood (presumably from the "friend") were allegedly harsh and unfairly applied on Lincoln by the Eleventh District regulators; about the financial condition of Lincoln (I was unable to provide information on this); and concerns that I did not know the financial condition of Lincoln or about why the examination was "taking so long" or about the application of appraisal standards on Lincoln.

I pointed out that I could not provide answers to the questions you and your colleagues were raising about the regulation of Lincoln because this was in what I described as the "very capable hands of the people at the San Francisco Bank (Federal Home Loan Bank of San Francisco-Eleventh District, Federal Home Loan Bank Board) and that these regulators were among the very best, if not the best, in the Federal Home Loan Bank System. I told you and your colleagues that I believed it would be unseemly for me to have a peculiar interest:

6Y 00106

Page Three
The Honorable John McCain

in Lincoln, and know the particulars of Lincoln (ie. its financial condition and regulatory characteristics) when I was the chief regulator of some 3,000 FSLIC-insured savings institutions. I was a policymaker and the head of a Federal Agency, I said, and with the very capable supervisory and examination staff in the Eleventh District (San Francisco) I had no need to know the particulars in question, particularly in regard to Lincoln. I went on to tell you and your colleagues that your "friend" had accused me personally many times of having a "vendetta" against Lincoln and that under the circumstances it would be particularly unseemly of me, I felt, to have an unusual interest in the supervision and examination of Lincoln. I told you and your colleagues that I was satisfied that the first-rate team from the San Francisco (FHLB) Bank was regulating Lincoln properly.

Senator Glenn, I recall, was particularly unhappy that I didn't know more about the regulation of Lincoln, given the fact that I was the "Chief Regulator," and that the people in San Francisco might be "running wild." I repeated that I was satisfied and pointed out that I had recruited Michael Patriarca to the first-level Agency Functions (regulatory) job in San Francisco, and noted that he had come from the Office of the Comptroller of the Currency in Washington as Deputy Comptroller of Multinational Banks.

In any event, I told you and your colleagues that "if my life depended on it, I could not tell you about the financial condition or regulation of Lincoln because I don't know and I don't believe I need to know these things." The regulation of Lincoln was in the most capable regulatory hands in the Federal Home Loan Bank System, I repeated to you and your colleagues in Senator DeConcini's office.

I told you and your colleagues you therefore would have to talk with the regulators in San Francisco. I said I would call them and arrange for them to meet with you and your colleagues, if you wished. (A few days later, I received a telephone call from Senator DeConcini, who I believe was calling from Arizona, requesting to meet with the regulators from the Eleventh District.)

I immediately returned to my office at the Bank Board and told my colleagues on the staff, including Chief of Staff Shannon Fairbank, Senior Special Assistant Mary Ellen Taylor and Acting Deputy Director of the FSLIC William Black what happened and what was said in my meeting with you and your three senatorial colleagues in Senator DeConcini's office, a few minutes before. You, Senator McCain, are free to call them to verify what I have related in this story, as I related it to them at the time.

I am aware of course, Senator, that your colleagues in the meeting in question, which I have related above, have denied that the quid pro quo made to me by Senator DeConcini occurred. Nevertheless, I have described Senator DeConcini's proposal precisely and accurately. Perhaps this is the reason why your colleagues have denied it so vehemently. In light of current events relating to Lincoln, as well as the so-called S&L crisis -- which will cost American taxpayers hundreds of billions of dollars -- it surely must be embarrassing that details of the discussion in this meeting have been disclosed publicly.

6Y 00107

Page Four
The Honorable John McCain

Frankly, Senator, I was taken aback by the brazenness of the proposal made by Senator DeConcini -- made on behalf of a "friend." I believe he also was referred to as a constituent once in the meeting.

I had never been asked until this meeting with you and your colleagues -- by any United States senator -- to withdraw a regulation for any reason, particularly on behalf of a friend, and especially in the privacy of a senatorial office. Senator Cranston had publicly expressed unhappiness with me at a hearing of the Senate Banking Committee in the Spring of 1984 for my vigorous espousal of a proposed Brokered Funds regulation, apparently on behalf of constituents, or perhaps even friends, but never had such a bold proposal been made to me directly, on behalf of a particular institution, by even one senator, not to mention four senators. I have to assume, because I have never been told otherwise, that Senator DeConcini was speaking on behalf of the other senators in his office attending this meeting with me, including yourself.

Senator McCain, I do believe that Senator DeConcini's proposal was certainly an abuse of senatorial authority, to answer your question specifically. If he truly was speaking on your behalf, which I don't know for sure was the case, then, yes, it was an abuse of senatorial authority, again, and certainly it was tantamount to an attempt to subvert the very regulatory process which previous Congresses had written into the law as appropriate public policy.

While it is, of course, possible that you somehow did not realize this at the time, or at least did not fully realize the implications of the discussion, I certainly did as regulator, and I could not help but be continually amazed during the meeting that all of you, as I recall, asked repeatedly whether there was anything improper in what was being discussed. I always responded, and I recall doing so deliberately, that as United States Senators it was not improper to ask questions. It was, of course, emanently improper to propose the withdrawal of a regulation -- for any reason -- and particularly because a "friend" apparently wanted it done, a "constituent" who operated a thrift institution under my jurisdiction as head of a U. S. Government agency.

Having seen you on television expressing regret that you were involved in these meetings is something I appreciate, particularly in retrospect, because the meetings were, and are, an embarrassment. Denying that any of this took place in the discussion, and suggesting that the only subject to come up was somehow a cursory expression of concern about the length of time the examination of Lincoln was consuming is simply an inaccurate, and untruthful, exposition of the meeting which, as you will surely recall, went on for an hour -- without any interruption.

You say in your letter, Senator, that you "respect the manner in which (I) have handled...this extremely difficult...issue." I'm not sure I quite understand what you mean by this, Senator. The fact is, I tried to be a good regulator. I tried to do everything I could during my tenure to avert the disastrous thrift crisis we all face today. I saw my efforts, which were as you will recall immensely unpopular with many I regulated (including the "friend") as necessary nonetheless. I will let history be the judge of my stewardship.

6Y 00108

Page Five
The Honorable John McCain

I saw my job as a regulator as that of safeguarding the health of our country's financial system and more particularly as that of protecting the federal deposit insurance system which, as we all now well know, is fully underwritten by every federal taxpayer in America. In short, my job, as I saw it, was to protect the FSLIC and the taxpayers -- which is the sole reason for our Federal Deposit Insurance System. I did not see my responsibility as protecting savings and loan operators and investors. This was not my role as overseer of the thrift deposit insurance fund, nor, frankly, should it be the role of any member of Congress since it is -- or ought to be -- Congress' responsibility to protect the very deposit insurance system it created in the first place, and without compromise.

I respect you for having written your letter and not merely resorted to namecalling as several of your senatorial colleagues have done. You seem to sincerely regret your involvement in the unfortunate event I have described. As you say in your letter, Senator McCain, "hopefully we will learn from the mistakes of the past and can prevent our nation from ever having to face this kind of (thrift) crisis again."

I would add, however, that the regulatory process for federally-insured financial institutions was established by the Congress and the President as a means of trying to safeguard the safety and strength of the nation's financial system. Exhibiting respect for the integrity of the regulatory process, and supporting it against those who would subvert it -- and subvert it for any reason whatsoever -- ought to be the proper response, especially in the now glaring light of this incident, which occurred in the darker privacy of a senatorial office.

Thank you again, Senator McCain, for writing. Don't hesitate to call me if I can be of further assistance.

Sincerely,



Edwin J. Gray

6Y 00109