

# CENTRUST BANK, STATE SAVINGS BANK

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## HEARING BEFORE THE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

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# CONTENTS

Hearing held on:	Page
March 26, 1990 .....	1
Appendix:	
March 26, 1990 .....	65

## WITNESSES

MONDAY, MARCH 26, 1990

Ryan, John E., district director, Atlanta Office of Thrift Supervision, accompanied by Maria I. Richmond, director of Supervision Operations, Atlanta Office of Thrift Supervision; Lawrence H. Fuchs, deputy comptroller, State of Florida; and Park T. Zimmerman, OTS Office, Atlanta .....	31
Seidman, William, Chairman, Federal Deposit Corporation .....	7
Wierschem, Kurt, managing agent, CenTrust Bank, ASSB .....	8
Williams, Ashbel C., Jr., assistant comptroller, State of Florida .....	39

## APPENDIX

Prepared statements:	
Annunzio, Hon. Frank .....	72
Gonzalez, Hon. Henry B. ....	66
Ryan, John E., and Maria I. Richmond with attachments .....	94
Schumer, Hon. Charles E. ....	75
Seidman, L. William .....	77
Wierschem, Kurt .....	80
Williams, Ashbel, Jr., and Lawrence Fuchs .....	119
Wylie, Hon. Chalmers P. ....	69

## ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

CenTrust political contributions .....	324
CenTrust Savings Bank, assets composition, 1983 v. 1989 .....	150
CenTrust Savings Bank, total assets .....	149
Documentation provided to the committee by State and Federal regulators and submitted for the record by Chairman Gonzalez .....	160
Financial statements of CenTrust Bank from form 10-K, prepared by Price Waterhouse Accountants .....	328
Index of documents provided to the committee by the Office of Thrift Supervision .....	370
Index to CenTrust photographs .....	381
Letter dated March 20, 1990, from counsel to David L. Paul to Chairman Henry B. Gonzalez; and response dated March 23, 1990 .....	138
Letters of invitation to witnesses .....	128
National Thrift and Mortgage News article dated January 29, 1990: "OTS Orders Halt in CenTrust Stock Trading" .....	158
Overview of CenTrust Bank, a State savings bank .....	141
Paul, David L.:	
Compensation 1984-1989 .....	151
Contacts with elected officials, submitted for the record by Mr. Wylie .....	318
Excessive lifestyle .....	153
Photograph and information on David Paul's yacht, <i>Grand Cru</i> .....	155
Supervisory history of CenTrust Bank .....	145
Thrift Liquidation Alert article: "Junk Heap Poses Liquidation Challenge" .....	159
Washington Post article dated February 18, 1990: "The S&L-Junk Bond Link" .....	156





# CENTRUST BANK, STATE SAVINGS BANK

Monday, March 26, 1990

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,  
*Washington, DC.*

The committee met, pursuant to call at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Henry B. Gonzalez [chairman of the committee] presiding.

Present: Chairman Gonzalez, Representatives Annunzio, Fauntroy, Vento, Schumer, Hoagland, Wylie, Leach, Hiler, and McCandless.

The CHAIRMAN. The committee will please come to order.

This morning, the committee resumes its autopsy of the savings and loan industry in an attempt to find out what went wrong and to develop a strategy to prevent more costly disasters from being visited on the American taxpayers.

The focus this morning is on the Miami-based thrift, CenTrust, a \$10 billion institution and the largest thrift in the Southeast.

With its mammoth yacht, I understand the staff put a picture up there—it doesn't look too big from here. Anyway, its towering office building, it's fabulous and expensive art, its Trump-style parties, CenTrust is an exciting story.

It is also a dreary story of one more savings and loan wreck, a wreck that might well have been prevented had the enforcement officials applied the safety restraints earlier and more forcefully.

In December 1988, with savings and loan deals falling on Washington like winter snow, most of us credited M. Danny Wall with copywriting a new regulatory game show, "Let's Make a Deal." As we examine CenTrust, we may have to conclude and concede that the original copyright should have gone to one of his predecessors, Richard Pratt, President Reagan's first appointee as Chairman of the Federal Home Loan Bank Board.

Dick Pratt's bank board worked out a deal with David Paul, a Connecticut real estate operator, to purchase an ailing \$1.9 billion institution, then known as Dade Savings and later to be renamed CenTrust. In the process Pratt shut out other bidders, sweetened the deal with forbearances on capital maintenance, growth, and liquidity and threw in half a billion dollars of good old supervisory goodwill.

In return, Mr. Paul promised to contribute real estate assets of \$32 million to the savings and loan. By the time he reached the table, \$16 million of the assets were headed for bankruptcy, but Chairman Pratt didn't blink an eye and let the deal fly.

Ultimately, \$7 million of capital was invested in a 95-ft. yacht, a floating capital that luckily didn't sink to the bottom of the Atlantic Ocean. Mr. Paul's half-line excesses have been documented in many places, but in his defense he made no secret of his plans to convert the savings and loan into a free-wheeling investment banking operation.

Before it was over, he was to place between \$1 and \$2 billion of the institution's assets in high-risk junk bonds, Drexel Burnham Lambert was right there standing along Paul promoting one junk bond deal after another, financed, of course, with federally insured funds.

From almost the moment the ink dried on the Pratt-Paul deal, the on-the-job examiners and supervisors operating out of the Atlanta Federal Home Loan Bank were concerned about the operations at Dade CenTrust.

As early as January 1986 the Atlanta team wanted a cease and desist order issued to curb some of the risky ventures. This is the same story on the State level that we know of in the cases of Maryland and Ohio. We had the same thing. In that case it was the State institution. You had the same thing, you had the regulators coming in, then because of some other things, including political involvement, nothing was really done.

The requests for the order were dropped on Rosemary Stewart's desk at the enforcement section of the Federal Home Loan Bank Board in Washington. The requests invariably were returned with demands for stronger evidence. The examiners dutifully went back into the field for more examinations only to be rebuffed again and again by the Washington office.

Along the line David Paul, borrowing a chapter from Charles Keating's book, complained about the examinations and demanded new teams of objective examiners. Keating had a habit of placing his examiners and auditors on the Lincoln payroll. Paul went him one or two better. He ultimately hired Pratt and former Home Loan Bank general counsel, Tom Vartanian, as consultants to CenTrust.

Neither Paul nor Keating were slouches when it came to revolving doors. CenTrust has the same sad bottom line. Washington could never get up the courage to act forcefully and support its profits in the field.

Finally, last year, after the stench of regulatory failures filled the air throughout the Nation, Danny Wall started action against CenTrust. Too late for the insurance funds, the institution or the taxpayers.

Our first witness this morning is Mr. William Seidman, again, Chairman of the Federal Deposit Insurance Corporation, who we understand is faced with the task of disposal of nearly a billion dollars of junk bonds from the portfolio of CenTrust.

He is accompanied by Kurt Wiershem, managing agent, CenTrust Bank, and Sandra A. Waldrop, Deputy Regional Director, Resolutions Operations of the RTC. With that I recognize Mr. Wylie.

Mr. WYLIE. Thank you very much, Mr. Chairman.

I am pleased that we are continuing the committee's investigation of the savings and loan debacle today. I applaud you for selecting CenTrust as the subject of our investigation.

Much like Lincoln, CenTrust is a comprehensive case study on what went wrong with thrift industry regulation. There are several items concerning CenTrust that are of interest to me, and I hope to explore them further today. Initially, I would like to know why David Paul ever was allowed to purchase CenTrust.

The Federal Home Loan Bank Board twice turned down Paul's change in control application under Chairman Richard Pratt. Why did newly appointed Chairman Edward Gray then approve the transaction? Next, what was CenTrust's relationship with Drexel, Burnham, Michael Miliken and other Drexel clients such as Lincoln.

CenTrust had extensive dealings with Miliken and Drexel. David Paul had virtually daily contact with Drexel representatives. Drexel Burnham seems to be a common thread that is showing up in the committee's investigation of the savings and loan crisis, and I look forward to exploring this link both today and in other hearings.

Third, why did the Washington Bank Board twice reject the Federal Home Loan Bank of Atlanta's recommendation for enforcement action against CenTrust, something which you referred to, Mr. Chairman.

This appears to be a repeat of the Lincoln situation where the regional office is taking a much tougher regulatory stance than Washington. We must assure ourselves that changes in law due to FIRREA ensure that this does not happen in the future.

Fourth, did David Paul have improper contacts with State and Federal regulators? Paul had several ex parte meetings with former Bank Board Chairman Wall. I am concerned that there is at least an appearance from these meetings that Paul may have been able to improperly influence the Washington regulators.

In addition, CenTrust Board of Directors' minutes indicate that the thrift far preferred the relaxed regulatory atmosphere of the State of Florida as opposed to tougher Atlanta Home Loan Bank personnel. Were the State regulators doing their job?

Fifth, I am stunned by the excessive misuse of federally insured Centrust funds by Mr. Paul in purchasing luxury boats, expensive art work, chauffeured limousines and countless other items for his own personal use.

David Paul lived a life of luxury on the backs of federally insured depositors. Moreover, I am interested in the purchase of these luxury items through funds that were transferred out of CenTrust to foreign institutions. Finally, I am concerned about David Paul's political ties.

Former Bank Board Chairman Ed Gray called David Paul the "most politically well-connected savings and loan executive I know of." We have already seen the political influence Charles Keating attempted to use regarding Lincoln.

I am concerned that David Paul could have far outreached Charlie Keating in exercising political ties. I have had my staff prepare a list of political contacts made by Paul compiled from his desk cal-

endars for 1987-1988, limousine records and other sources. This list runs several pages and is truly astounding.

[The list referred to can be found in the appendix.]

Mr. WYLIE. David Paul appears to have virtual unlimited access to former Presidents, Senators and Congressmen. Despite denials it appears clear at certain times this influence was exercised by Paul on behalf of CenTrust.

Additionally, it appears the fear of pressure from Paul's political friends clearly existed. I look forward to exploring all these issues today, Mr. Chairman, and I again commend you for holding these hearings.

Investigations like this should help ensure that savings and loans crises like the one we are going through will never happen again. Thank you, Mr. Chairman.

The CHAIRMAN. Well, thank you.

Again, let me say as chairman, and as I have said repeatedly, I am just one. Without your invaluable cooperation and leadership, too, we wouldn't be able to proceed as we have. Mr. Annunzio, as chairman of the largest subcommittee, on financial institutions, also has been implemental in bringing about some consistent oversight, Mr. Annunzio?

Mr. ANNUNZIO. Thank you very much, Mr. Chairman.

I, too, want to commend you for holding these hearings and for so dramatically bringing out the facts about an unhealthy setting of the savings and loan industry. Without your hearings, we might never have learned how negligent the Nation's top savings and loan regulators were in doing their job.

One thing has been brought home to me, after more than a year of close analysis of the savings and loan scandal. The blame for the problem lies totally and completely with the regulators and the administration that appointed these regulators, who knew what was going on in the savings and loan industry and looked the other way. Only the regulators.

Congress can't close a savings and loan or issue cease and desist orders. Congress can't remove savings and loans board of directors or assess fines when rules are broken. Only the regulators can do that. But now, because of regulators who couldn't or wouldn't do their jobs, the American taxpayers are going to pay, perhaps as much as hundreds of billions of dollars.

Today we will hear testimony, not only about regulators who would not step in to stop billions of dollars of loss to the taxpayers, but we will also hear about the regulator who allowed David Paul to get control of CenTrust, even though the regulator's staff was opposed.

Why did the regulators allow Mr. Paul to take over an insolvent institution by putting up some highly overrated real estate? That real estate turned out to have a value of only about one-tenth of its purported market price, and when some regulators tried to rein in the high-flying Mr. Paul, he required other former regulators to argue his case.

I hope, Mr. Chairman, we will have all of the former regulators who are involved in the CenTrust case before this committee.

It is my understanding that Mr. Gray's predecessor, Richard Pratt, was hired by Mr. Paul to defend CenTrust from audits by

state and Federal S&L examiners. I am not exactly certain what CenTrust was. Mr. Paul was paid \$16 million by CenTrust from 1984 to 1989.

He had a \$1.6 million mortgage from CenTrust to build a mansion which housed a \$29 million art collection, paid for by CenTrust. He had a \$7 million yacht paid for by CenTrust, a \$1.4 million leased jet paid for by CenTrust, a sail boat worth \$233,000.

Mr. Paul had expenses of \$122,000 for dinner parties plus \$170,000 for crystal and linens and \$104,000 for limousines. Everything was paid for by CenTrust. I don't think the institution should have been called CenTrust, C-E-N-T-R-U-S-T. It should have been called SinTrust, S-I-N-T-R-U-S-T.

In the face of it all, Mr. Chairman, I can only ask not where is the beef, but rather where is the regulators?

The CHAIRMAN. Thank you, Mr. Annunzio.

Mr. Leach, do you have an opening statement?

Mr. LEACH. No, I do not, Mr. Chairman.

The CHAIRMAN. Mr. Fauntroy?

Mr. FAUNTROY. Thank you, Mr. Chairman.

I am so pleased that you have called this hearing to review the supervision, operation, and subsequent closing of the CenTrust Bank. Once again we are examining an institution which embarked upon a fast growth, high-risk management strategy based upon substantial investments in junk bonds funded with brokered deposits.

The CenTrust situation stems largely from an inability to generate operating income from securities portfolio composed largely of less than investment grade corporate bonds.

A review of the supervisory record for this institution also cites substantial dissipation of assets and earnings, possibly in violations of law, including excessive investments and inappropriately at expenses such as you have heard repeated here already, the purchase of art work in excess of \$30 million, which resulted in a \$4.4 million loss; the purchase of excessive or expensive oriental and crystal and excessive and inappropriate levels of compensation to CenTrust officers and its chairmen.

Such activities resulted in the Federal regulators taking control of a failing CenTrust on the grounds that it had insufficient capital and was being operated in an unsafe and unsound manner. Like Lincoln Savings and other high-flying institutions, we can see from the case that CenTrust was looking more like an investment bank, relying on profits from the sale of investment securities rather than from traditional thrift operations, so, Mr. Chairman, these hearings will assist you and all of us in continuing to establish a record of the practices, which ultimately could cost taxpayers of this country \$200 billion.

It is my hope that these hearings will assist in minimizing taxpayer losses while preserving basic banking services to deposit and loan customers at this thrift. I look forward to hearing from the witnesses.

The CHAIRMAN. Thank you very much. Mr. McCandless, do you have a statement?

Mr. MCCANDLESS. Thank you, Mr. Chairman.

In the interest of time, I would ask that my opening statement be entered into the record.

The CHAIRMAN. Certainly, without objection it is so ordered.

Mr. Schumer.

[The prepared statement of Mr. McCandless can be found in the appendix.]

Mr. SCHUMER. Thank you, Mr. Chairman, and thank you once again for your leadership.

We are here today to look into another example of the collapse of the savings and loan industry. CenTrust is not a pretty sight.

CenTrust is a microcosm of the thrift crisis, put all the bad things that the thrift crisis allowed to happen and it is all distilled in one bank, CenTrust.

It abused the privilege of deposit insurance by consuming massive amounts of brokered deposits and then investing them in the riskiest possible way. It abused the trust of its shareholders by wasting hundreds of millions on art, some of it fake art, boats, and executive perks.

Finally, it took advantage of an incompetent regulatory system hiding its problems behind accounting gimmickry. Is this a thrift? Is this the type of industry we as taxpayers want to shelter at the cost of \$200 billion?

Mr. Chairman, the picture of the boat up there on the wall and the silverware, the limos, the hotels, those have become road signs in the thrift crisis. Just as there are international road signs, to the rest of the world and to us these excesses will symbolize the severe thrift crises. But actually there is an abstract idea behind it all, underlying the scandal—deregulation. Deregulation allowed a bevy of swindlers, frauds, and cheats to drink at the Federal trough.

David Paul is now added to this rogues gallery, headed, of course, by Charlie Keating. What I would like to know is how the accountants, how the regulators allowed these kind of expenses to be approved.

How is it that when you are dealing with federally insured dollars, not a private company but taxpayers' dollars, that these kinds of expenses which were listed on CenTrust's books were just blithely allowed to happen? How was it that the regulators allowed so many of the excesses in the thrift industry to occur in the days of deregulation? How was it that the accountants approved them? How was it that this crisis happened?

FIRREA was touted by the administration as a way to ensure that the deposit insurance crisis never occurs again. FIRREA accomplished a great deal and President Bush deserves credit for those accomplishments.

But it most certainly did not solve the problems in our financial institutions industry. There is lots of work to be done, and the CenTrust case highlights some of the things we must do.

In short, deposits must not, whether it be in a thrift or a bank, be allowed to fund risky new ventures. If banks and thrifts are to get new powers, they must get money from the markets, not from the taxpayers.

We must reduce, not expand, the scope of deposit insurance. For instance, brokered deposits, pass-through insurance, things like the

picks must be severely restricted. Third, even tougher capital standards must be imposed and more important, accurate accounting systems, such as market value accounting, must be adopted to ensure that real capital protects the taxpayers.

We must intervene in weak institutions sooner when the cost of resolution is lower, the opportunity for abuse smaller. Finally, Mr. Chairman, we must not shrink from closing banks and thrifts. As the Drexel failure demonstrated, even large official institutions with deep interrelationships can fail without causing chaos.

Mr. Chairman, I hope that this hearing continues as you intend it to, to show not only the excesses in the system, but paint a path to recover in the future so that we can assure the taxpayers, as they are asking us every day, that this will never happen again.

[The prepared statement of Mr. Schumer can be found in the appendix.]

The CHAIRMAN. Thank you, Mr. Schumer.

That is the intention. Our first witness, as I indicated, is our friend, Mr. Seidman, and without any further adieu, we recognize you, Mr. Seidman. You may proceed as you deem best. We want to thank you for giving us your prepared statement, which is short and to the point.

We will recognize you at this point.

**STATEMENT OF WILLIAM SEIDMAN, CHAIRMAN, FEDERAL DEPOSIT CORPORATION; ACCOMPANIED BY SANDRA A. WALDROP, DEPUTY REGIONAL DIRECTOR, REGIONAL OPERATIONS, RESOLUTION TRUST CORPORATION**

Mr. SEIDMAN. Thank you, Mr. Chairman, members of the committee. It is a pleasure to once again appear before you.

You have asked that the FDIC and RTC respond to several questions relating to what we have found since being appointed conservator of CenTrust Bank on February 2 of this year. Although we always try to be as responsive as possible to the committee, we have not yet been involved with the institution long enough to answer all your questions.

However, our preliminary analysis thus far indicates that the failure of CenTrust will result in a substantial loss to the RTC, probably in excess of \$2 billion. This loss was a result of prior mismanagement and poor operating procedures, risky investments.

This institution was operated like an investment bank, but even as investment bank it was operated very poorly. The management controls and other such things were simply not present.

With me today are Ms. Sandra Waldrop, and Mr. Kurt Wierschem. Ms. Waldrop is the Deputy Regional Director in the RTC Eastern Region Office and is in charge of regional operations relating to conservatorships, including CenTrust. Mr. Wierschem is both the RTC managing agent and the chief executive officer of CenTrust Bank.

They are here today to provide you with testimony and to answer questions about the activities at CenTrust based upon their own observations. It was my thought that it would be better to have the people actually on the job reporting to you what they were finding since we have not yet completed that investigation.

We are pursuing a complete investigation of CenTrust to determine its present status and whether any fraud or other misconduct occurred and to pursue those who may have acted in an inappropriate way. While we believe the potential for fraud exists, our investigation is not yet complete in that area.

There is no foolproof way of preventing losses to thrifts in the future. We can, however, offer three sound principles of supervision that have worked well in the past.

First, the industry must be well-capitalized. Second, proper accounting standards, which reveal true financial condition, must be followed. Third, and most importantly, there must be a supervisory staff and program in place that is tough, fair, responsive and free of political pressures.

Mr. Chairman, if it is acceptable to you, I would like to introduce my colleague, Mr. Wierschem so that he can give you testimony on what he has found at the CenTrust Bank.

The CHAIRMAN. Certainly, Mr. Seidman.

Did I hear you correctly say you estimated this to be in excess of \$2 billion?

Mr. SEIDMAN. Two billion dollars, yes sir.

The CHAIRMAN. Thank you.

#### STATEMENT OF KURT WIERSCHEM, MANAGING AGENT, CENTRUST BANK, ASSB

The CHAIRMAN. Mr. Wierschem.

Mr. WIERSCHEM. Good morning, Mr. Chairman, and members of the committee.

I am pleased today to provide information relating to CenTrust Bank. I am the managing agency of the institution for the RTC, and my comments are based on the information we have gathered since assuming that role.

CenTrust Bank was placed in conservatorship on February 2, 1990, by the Office of Thrift Supervision after a finding that it was operating in an unsafe and unsound manner. The RTC's goals in CenTrust, as in each conservatorship, are to establish control, maintain customer services, evaluate the institution's condition, identify and account for losses, and recommend viable alternatives for the least costly resolution of the institution.

The RTC has been conservator of CenTrust for less than 2 months. The RTC employees involved in the intervention are not trained examiners, but rather, are a mixture of asset managers and employees trained in the various operational areas of financial institutions.

Our focus has not been that of a regulator, rather, we have taken over the daily management of the institution and are proceeding to down-size and prepare the institution for resolution. We have not reviewed the institution's history, nor are we approaching the institution as examiners typically would. We do have our investigation unit reviewing the institution's records to determine if suits and claims for insider abuse or professional liability are warranted.

Our observations are preliminary at this time and are often based on interviews with employees at CenTrust. Upon entering CenTrust, we found that the operation of this institution was simi-



lar to that of a private investment banking or trading operation, rather than a traditional savings and loan. The primary focus of the firm apparently was trading. That is reflected in concentrations in financial instruments such as high yield bonds, high yield private placement issues, for currency futures, enumerated subordinated debt, interest rate swaps and swap options.

The business focus relied upon market gains from financial transactions to generate income versus generating traditional interest income on the spread between earning assets and the cost of funds.

CenTrust's major problems include rapid deposit growth, which was used to fund poor quality speculative assets., production of portfolio gains at the expense of asset value, investments in illiquid, high yield and privately placed bonds and equities with significant credit quality risks; and apparent liberal accounting practices.

CenTrust's growth had been accomplished via the wholesale marketplace. Brokered certificates of deposit, for 37 percent of total liabilities as of January 31, 1990. With high cost deposits and borrowings, CenTrust was unable to maintain a net interest margin sufficient to support expenses.

Earnings were further impacted by the practice of producing gains in the portfolio at the expense of asset value. Securities yielding above current market rates were commonly sold to produce profits and income, while those items with below market yields were kept in the portfolio, further depressing net interest income.

CenTrust classified many of their high yield private placement issues as commercial loans, which allowed them to maintain these items on the books at cost rather than at market value. In doing the propower markdown, writedowns of about \$400 million were reported. Presently, total writedowns on high yield bonds and equities are over \$500 million, of which about \$80 million is for securities with no ready market.

Accounting practices included enhancing income by deferring as many expenses as possible. As of the date of conservatorship, there were at least \$40 million of deferred costs relating to various electronic data processing installations, equipment purchases, legal fees on a number of major transactions including the pending sale of branches to Great Western, and broker commissions paid on certificates of deposit. These deferred costs have now been expensed.

I would like to comment briefly upon the major assets of the institution:

**High yield bonds.** Upon intervention, the vast majority of the nearly \$1 billion in junk bonds remaining in the portfolio appeared to be of very poor quality and were extremely illiquid. It appears that any higher quality issues had been sold prior to the RTC conservatorship.

Based on the volume of activity, holding periods, and timing between trades, the junk bond strategy appeared to have been one of trading versus investment. Gains were often recorded while issues containing losses were retained.

**Mortgage backed securities.** The remaining unsold issues have low rate coupons, and in this interest rate environment also have built in losses which will be realized when we sell the assets. It was

very difficult for us to ascertain which mortgage backed securities had or had not been pledged as collateral for various obligations.

We are only now fairly confident that we have determined which issues are available for sale.

**Single family residential loans.** CenTrust Mortgage Corporation, a subsidiary, originated a high quality loan that was sold in the secondary market. However, CenTrust Bank originated a much lower quality loan, both in terms of underwriting and of documentation, which remains in its portfolio. It will take us a great deal of due diligence to ascertain the real value of these loans and the ability of the secondary market to absorb them.

**Consumer loans.** As our review of the consumer loan portfolio progressed we found that the loans are over-advanced amounts to borrowers on automobiles. Since the loan paper was generated indirect in most cases, a dealer reserve had already been paid up front without a holdback, so that business could be generated. This leaves a substantial item on the books yet to be resolved.

In addition, approximately 12,000 titles and liens had not been recorded or perfected on these assets.

**Leasing.** In the leasing portfolio we again found questionable underwriting. To generate a high volume lease business, the bank offered inflated residual values on the collateral and a very favorable consumer interest rate. In about 18 months many contracts will come due, with high residual values compared to the anticipated market residual value of the collateral. We therefore believe substantial losses will be taken on this portfolio.

**CenTrust Tower.** This asset apparently contains a significant loss. The most recent contract for sale that CenTrust had was for \$88 million, and we believe there is \$170 million in costs in the building. We are presently obtaining new appraisals on the building.

**Business loans.** CenTrust appeared to be a lender of last resort on business related loans and commercial nonreal estate loans. Although this portfolio is rather modest in size, the pricing of the loans does not warrant the risks they contained. Overall loan underwriting appears weak, and the documentation and overall packaging of the assets are below market standards.

**Real estate loans and investments.** CenTrust does not have a large portfolio of commercial real estate loans in comparison to some other troubled savings and loans. However, there are some substantial real estate investments which will require workouts. CenTrust has an extensive network of subsidiaries. However, there are three primary operating subsidiaries—CenTrust Mortgage, Old American Insurance Company, and CenTrust Trust. We are currently reviewing CenTrust Trust to determine the true business nature of its affairs. CenTrust Trust is in Westport, CT, where Mr. Paul had a residence, and it appears to have been used for business operations that were not approved for CenTrust Bank.

The potential loss. We will start our formal asset valuation process next week to ascertain the potential loss in the institution. As of September 30, 1989, the assets size of the institution was approximately \$9 billion. At that time, prior management was downsizing the institution by selling quality assets and many of the better assets had been sold prior to our intervention. We believe we

face a loss of \$2 billion. However, a better documented and definitive loss figure will not be available until the asset valuation is completed.

Branch sales. Upon entering CenTrust, we found that a contract existed to sell 63 of the 71 branches of the institution to Great Western Bank. This proposed sale was designed to support CenTrust's recapitalization plan and may have been pursued to delay intervention by the Office of Thrift Supervision.

The management structure of the company and the way management functions did not interrelate with various activities within the firm resulted in most material decisions apparently being made by Chairman Paul.

Interviews indicate that functions within the corporation were very compartmentalized in that one department seldom talked to another department. Even the physical structure and security access within the CenTrust Tower Building was such that it was not easy for employees to gain access to other areas.

In evaluating the work of senior level managers, they appear to be capable people but their compensation was often in excess of market rate. Additionally, many officers of the bank were highly compensated without a commensurate level of responsibility.

The senior managers have consistently indicated to us that there was no device to measure the profitability of an area nor was there ever an attempt to measure the profitability of an activity or an area. They stated that any time this issue was brought up, the idea was rejected. This is supported since we found no real costing of an operation in any given area. Apparently there was little concern for deposit costs and/or on the other side of the ledger, what yield on assets would be, especially the yield on loans.

Asset/liability structure. To obtain funds, the institution consistently paid some of the highest rates in the market. That strategy was carried out on a retail level through the branch network by paying high rates for CDs as well as for large amounts of brokered moneys from Wall Street firms. There does not appear to have been any attempt to moderate the cost of retail deposits or to operate the branch network through traditional retail banking activities.

The Asset/Liability Committee's responsibility did not exist as normally executed at a bank or S&L. Rate risk management and hedging was really not possible in an environment where liquidity was so important. Hedges were often left on after the assets associated with them were sold.

Additionally, there was an unwillingness to cut losses short and get out of a position. Very seldom was there a stop loss instruction. Although the institution maintained a bond research group, their advice was often ignored. In buying the debt and equity kickers of the junk bonds, the institution often took large positions relative to its capital base.

CenTrust has very little free collateral or liquidity. The asset/liability structure appears to have been developed with little strategic planning. Assets were used for collateral to meet liquidity requirements as soon as they became available. This structure will be difficult to unwind.

Generally speaking, record keeping in the association is poor. Specifically, the accounting records lack accuracy. CenTrust management apparently never assigned responsibility for the accuracy of the records. Little emphasis was placed on the internal audit function, and it did not offer independent opinions to management on the quality of records.

In addition, there was a general disregard of accounting for items. The employees have advised us, for example, that if Mr. Paul made a trade, the broker called the bank and notified the bank of Mr. Paul's transaction. The bank appears to have accepted the broker's word without a confirmation process.

In summary, the RTC employees currently in the institution have not analyzed its supervisory history. Rather, our mandate is to control, down-size, and prepare the institution for resolution.

With respect to the question of improving future supervisory efforts, we would prefer to leave that question to those who are better qualified in that area.

Mr. Chairman, this completes my statement. I would be pleased to answer any questions.

The CHAIRMAN. Thank you very much, Mr. Wierschem.

[The prepared statement of Mr. Wierschem can be found in the appendix.]

The CHAIRMAN. Ms. Waldrop.

Ms. WALDROP. Mr. Chairman, I don't have a prepared statement. I will be glad to answer any questions you might have.

The CHAIRMAN. All right.

Mr. Wierschem, I noticed in your statement, you mentioned a list of activities at CenTrust. Among them was foreign currency futures. Was that very extensive, do you recall?

Mr. WIERSCHEM. Mr. Chairman, I am not fully versed in the total amount of their transactions in the past. All I can relate to right now is they still do have a certain amount of debt that they are carrying of foreign banks.

The CHAIRMAN. Do you have any evidence to show, did they do any what they call gold leasing?

Mr. WIERSCHEM. I am not familiar with that, sir.

The CHAIRMAN. It probably was Drexel-Burnham. They did. This is an item that is somewhat bothersome to me, and to the extent that they would have. But that would be mostly on that other level.

According to an article in the National Thrift News, dated January 29 of this year, 90 percent of CenTrust's security investments were done through Drexel. With Drexel in bankruptcy and CenTrust now under Federal control, how much of a loss from the \$15 million unsecured loan Drexel had with CenTrust and the \$1 billion in junk bonds are the American taxpayers expected to absorb?

Mr. WIERSCHEM. Mr. Chairman, we are still evaluating that market. The mount, the \$15 million to Drexel we are not quite sure as yet. We are having, as I understand, meetings on that bond issue right now or in the next few days on that specific \$15 million issue.

On the overall portfolio, we have attempted to mark that portfolio to market, and right now we have marked it down at least \$400 million.

The CHAIRMAN. But you couldn't at this time extrapolate——

Mr. WIERSCHEM. Not the final numbers, sir. I think as we go through our asset evaluation we will be able to put a better number on it.

The CHAIRMAN. Well, according to a Washington Post article of February 18 this year, Drexel had three conflicting roles with CenTrust. As an investment banker, Drexel raised \$150 million of CenTrust capital by selling junk bonds. As a bond broker, Drexel sold CenTrust \$1 billion in junk bonds. As a customer, Drexel borrowed \$15 million on an unsecured loan. Does that bear up on your examination?

Mr. WIERSCHEM. Mr. Chairman, I am not really sure that I understand the whole question in that we only have debt of Drexel \$15 million plus there is no doubt that there is extensive trading through Drexel. But I don't know if I really answered your question here.

The CHAIRMAN. You are not aware of the \$15 million unsecured loan?

Mr. WIERSCHEM. That would be the \$15 million, sir?

The CHAIRMAN. Unsecured loan.

Mr. WIERSCHEM. Yes sir, that? A bond issue of Drexel.

The CHAIRMAN. A bond issue?

Mr. WIERSCHEM. It is actually a bond, I believe, sir, a subordinated debt. I will be happy to check into that for sure and make sure that I am accurate on that.

The CHAIRMAN. All right, sir.

[The information referred to can be found in the appendix.]

The CHAIRMAN. Well, is any one of you three in any position to explain to the committee the influence of Drexel over CenTrust? Was it a foregone conclusion that CenTrust, like Lincoln and other large members of the Drexel daisy chain were always there to be counted on to purchase major chunks of Drexel's next offering as part of some informal arrangement?

Mr. SEIDMAN. I think the record shows that they were operating pretty much in the same way that Lincoln and others were, and that they were very large customers of Drexel's, that is correct.

The CHAIRMAN. It is stated that RTC has an estimated \$4.2 billion in junk bonds, surpassing Columbia S&L of Beverly Hills as the largest thrift industry holder of high yield securities. With two other large thrifts on the brink of insolvency, RTC could end up owning more than \$10 billion in junk bonds, making it then the largest holder in the country. It will be the king of the Junkies.

Mr. Seidman, you certainly have a monumental task in front of you, and we know that. Not only are you now the largest owner of real estate, but it looks like junk bonds as well. With junk bond values continuing to decline, could you tell the committee your plans for liquidating this vast holding of sub-investment grade bonds?

Mr. SEIDMAN. Mr. Chairman, we have a junk lady by the name of Spector, Ms. Spector, who has been operating in this field and will be operating as our person to handle these issues.

I want to emphasize they are not the same. Some are very bad and some are not so bad. Therefore, it takes careful analysis of the actual institution in order to try to come to a fair determination of

what the value is and each particular issue, so we will be doing that, and then we will be attempting to sell those issues as properly as we can where we think we can get reasonable value for them. But it is a monumental task. There are almost 4,000 junk bond issues out there, of which only about 40 or so have any real market at this time, so in order to determine real value, we have to analyze them individually, and we will be doing that and setting up an operation to sell them.

The CHAIRMAN. I think that is the most bothersome thing to me and has been all these years, since we had the oversight hearing, and that is what Uncle Sam is ending up with in attempting to resolve this, is pretty much what was happening in 1988, even before that, with management consignment. That is, Uncle Sam ended up with all the junk, all the crud, and even if assisting in a takeover, what we find, I think, is the worst possible world of a mixed economy.

If we went out, as some country's laws permit and just went on ahead and nationalized, you could say you had some uniformity, you had equal, uniform and fair, but the way it is now, those institutions that are still competing, that are not subsidized by the Government, are competing with institutions that have no bad loans.

Uncle Sam's got them all. How long can we continue that way without bringing down those that are unsubsidized and are still trying to compete? This, to me, is the number one issue now.

Mr. SEIDMAN. Mr. Chairman, I think there are two different kinds of institutions out there that we have to distinguish between when we say they are "subsidized." There are institutions that are out there operating with forbearances, with low capital, with income maintenance contracts and other kinds of subsidies, which will be a problem for sound institutions.

There are other institutions that have been recapitalized, and they are fully capitalized, so that they do not have any—they have no Government interest. They have been cleaned up by the Government, and private capital has been put back, put into them, so they are fully capitalized competitors, and they were bought on bid, and any institution could have bought them.

That is a somewhat different thing than an institution that is still in the marketplace with weak capital and with continuing Government subsidies, such as some of the institutions in the Southwest plan.

I think that our objective needs to be that the institutions that the Government sells back to the private sector should be sold without further Government involvement, and they have to be cleaned up institutions in order to be soundly capitalized to perform their job in the marketplace.

The CHAIRMAN. Well, one final thing here. I noticed a report we have here that the Garn institute shows up again. Apparently Cent-Trust donated over \$20,000. Do you find in your examination these contributions showing up? I thought during the time we had the original hearings that a lot of connections, and particularly at the time that the legislation was being considered, the first depository institutions—the Regulatory Act of 1980, and then the 1982 act, which was labeled the Garn-St Germain Act—there was a lot of

talk then about how—the idea was to get away from the company on the corner in the name of deregulation.

It isn't a question of whether one is for or against deregulation. It is a question of how a plan is formulated to deregulate and what follows thereafter. So the common line through all of this was the fact that somehow or other, you had these fund raising activities on behalf of the Garn Institute, and we have a record here indicating that there was a \$20,000 contribution from CenTrust. Did you find that, or do you recall?

Mr. WIERSCHEM. Mr. Chairman, I am not familiar with the details of that. I did supply the list of expenses in that area, but to the nature where or when, I have no knowledge.

The CHAIRMAN. I am going to ask unanimous consent to place in the record documents and evidentiary materials that the staff, as a result of its work, has found in connection with the CenTrust matter.

[The information referred to can be found in the appendix.]

Mr. WYLIE. Reserving the right to object, I was going to ask the same request and also, ask unanimous consent to put in David Paul's contact with other elected officials along the way, and I will pursue that a little more in my examination here, if it is OK with the chairman.

The CHAIRMAN. Certainly. Without objection, so ordered.

[The information referred to can be found in the appendix.]

The CHAIRMAN. Mr. Wylie.

Mr. WYLIE. Thank you, Mr. Chairman.

I did want to follow up on that because I think it is important to find out how we got here, and it might help. The chairman touched on it with reference to the Garn Institute there, but I have a memorandum from Marion Roach, Jordan Luke, and Darrell Dachau, dated November 19, 1987, and it refers in there—and this is a rather serious allegation—besides being used for business related trips, the corporate jet has been provided on several occasions to transport guests, politicians—Senator Kerry, Senator Breaux, Judge Peter Fay, and others—to various destinations.

As a matter of fact, these trips were in conjunction with business travel by CenTrust executives. The use of this mode of transportation and entertainment is not consistent with the image of a federally insured institution, I agree with that.

As I say, it is a rather serious allegation. The implication a little later on is there may be some insured depositors money used for those trips. Is this a part of our ongoing investigation to ascertain if, in fact—

Mr. SEIDMAN. That will be, Mr. Wylie. We will be looking for any improper uses of the funds to the institution which were obtained primarily by insured deposits. So we will be looking for that in connection with the officers and in connection with the professional groups that were involved, and we do have our special group in there looking for fraud or insider abuse. So we are conducting that investigation right now, but it really is too early for us to report on it.

Mr. WYLIE. I think you should. We need to know if there was a pattern of activity here which is really outside the scope of regula-

tion, if you please, which may have contributed to this problem, too.

There is also an allegation in one of these memorandums, that insured depositors' money was funneled into a political action committee, a PAC, and I am sure you are looking into that also?

Mr. SEIDMAN. We are looking into that.

Mr. WYLIE. Mr. Wierschem, are you aware that money to purchase art work by Mr. Paul was funneled through an offshore institution known as BCCI?

Mr. WIERSCHEM. No sir, I am not. I am not familiar with that.

Mr. WYLIE. That is also referred to in these series of memorandums which I have here, which I will be glad to supply to you. It seems to me as if that ought to be part of your ongoing investigation also.

Mr. SEIDMAN. We will follow up on all of those, Mr. Wylie.

Mr. WYLIE. OK. It also indicates in here—and the reason I am asking this is because BCCI was convicted last year of money laundering, and I think I know the answer to that, but if it was, in fact, convicted of money laundering, do you feel that David Paul's purchase of art work with funds transferred through BCCI was proper? I think the answer to that—

Mr. SEIDMAN. We will look into that as well, to the extent we can, and to the extent we can get the records.

Mr. WYLIE. OK.

Do you feel that the Federal Home Loan Bank Board was correct in determining that junk bonds were not per se an unsafe and unsound practice? There is a memorandum in there that says that they are not per se an unsafe and unsound practice.

Mr. SEIDMAN. We have never agreed with that at the FDIC.

Mr. WYLIE. Is it FDIC's position?

Mr. SEIDMAN. Well, we have not allowed banks to own junk bonds as such. They do participate in some highly leveraged transactions, but they are generally at the front of the list, not at the tail end where the junk bonds are.

Mr. WYLIE. During the course of the markup of FIRREA we got into a considerable and heated debate over the use of subordinated debt and good will as a part of capital. Both will be phased out over a period of time. Several amendments were filed during the course of FIRREA to allow forbearance on good will and on subordinated debt, as you know.

We are told now that if both of those—subordinated debt and good will—had been accounted as capital, CenTrust would still be a solvent institution. Do you know if that is or is not a fact—and I use the word solvent advisedly there.

Mr. SEIDMAN. I doubt it, because I think the loss is so large that even if you counted those it would still be insolvent, but I can't give you a definite answer. As soon as we can establish what the loss is, definitely we will be able to answer that for you.

Mr. WYLIE. OK. That is another answer which I think we need to know for the record as far as this institution is concerned.

Mr. SEIDMAN. Yes.

Mr. WYLIE. I will pursue some other questions a little later on, Mr. Chairman.

Thank you so much.



The CHAIRMAN. Thank you, Mr. Wylie.

Mr. ANNUNZIO.

Mr. ANNUNZIO. Thank you, Mr. Chairman.

Mr. Seidman, I join my colleagues in welcoming you to the panel today. As I said several months ago when we were discussing the FIRREA bill, it was going to be difficult to find a man to put all of these pieces together. In my observations, I have found that you have been able to put the pieces together. I wished you a lot of good luck then, and I continue to wish you good luck.

Mr. SEIDMAN. Thank you.

Mr. ANNUNZIO. I notice every day you continue to grow as the largest real estate priority in the United States. What is it now?

Mr. SEIDMAN. We have about \$220 billion in assets at the moment.

Mr. ANNUNZIO. You know, the thing I have emphasized is that we cannot let happen here what happened with FADA. The whole idea of creating RTC and FADA was to sell the assets so that we could start getting some of the money back into the Treasury and so the taxpayers would be getting their money back in Treasury.

I know how difficult that is. It is easily said, but it is hard to do. But that is the challenge and that is the task that you have, and that we have before us, to show the taxpayers that we knew what we were doing when we supported this legislation.

Now, Mr. Seidman, as a regulator, would you have allowed David Paul to acquire CenTrust by putting up only some highly questionable real estate?

Mr. SEIDMAN. I am not familiar with that transaction in detail, but obviously the amount of capital that he put in, and as we now know it, was insufficient, and I have not examined the record beyond that.

Mr. ANNUNZIO. As a regulator, you would not have allowed him to acquire CenTrust by—

Mr. SEIDMAN. From all that I have heard and clearly from what we have seen took place, it was a mistake.

Mr. ANNUNZIO. Do you feel that regulators, Mr. Seidman, such as Ed Gray and Dick Pratt, who allowed David Paul to gain control of CenTrust, and then run it into the ground, costing the taxpayers as much as \$2 billion, should be liable personally for some of the cost to the taxpayers? Don't you feel that the taxpayers should be able to sue these regulators for their malfeasance and misfeasance?

After all, the regulators' actions are the financial equivalent of the Alaskan oil spill. I bring that out, because in some of the institutions that we have closed, many of the directors of these banks—as an example, I know in the case of United in Chicago and other banks—members of the board have been sued. FDIC has made, I won't call it a deal, but an understanding with these directors where they paid a fine, they at least paid a fine.

One of the largest law offices in Chicago paid a tremendous fine to avoid court action. We do this, we have consent decrees, and so forth, with the directors. What do we do? How do we protect ourselves from some of these regulators?

Mr. SEIDMAN. That is very difficult to challenge, I think. I don't think that you can make regulators personally libel for anything except things that they do which are criminal and otherwise gross

negligence. I think you have to depend on the rules which govern regulators to deal with them, because if they were—if they had personal liability, I don't think you would have any regulators to begin with, and second, there would be so many suits against them that I don't think that is practical.

I think regulators have to be subject to the same rules as all other members of the Government are, and that is that they have to do their work honestly and with due care, and if they don't, then they are libel.

Mr. ANNUNZIO. Well, there appears to be gross negligence. That is why we got as far as we did. It just bothers me to the extent of how these people can sit in the chair and get away with this stuff. Who is responsible for turning over, now, this gross negligence that we see here displayed all over, who is responsible? Is the Justice Department doing anything about it? Is the Justice Department questioning Mr. Gray? Are they questioning Mr. Pratt? What has happened to Paul?

Mr. SEIDMAN. We, of course, are looking at the records in terms of everyone who was working for CenTrust, and we will come up with whatever recommendations that we can. I think you have to realize that the record shows that the regulators were under some terrific pressure from all kinds of people, including people in the Congress, legislature and others.

That doesn't excuse them.

Mr. ANNUNZIO. I don't question that at all. That is the penalty you pay when you take an appointed job. You know what you are doing before you go in. You know that the seat is a red hot seat before you get there. Is this guy Paul, I don't know much about it, is he in jail or out of jail?

Mr. SEIDMAN. He is not in jail, to my knowledge. We are doing a complete investigation on him. We have not completed our investigation for the record yet.

Mr. ANNUNZIO. The point I am getting at, when you investigation is completed, everything that you find will be turned over to the Justice Department, is that the understanding?

Mr. SEIDMAN. Yes.

Mr. ANNUNZIO. At that point when your information is turned over to the Justice Department, they will have enough material to work with, to determine whether these people have been guilty of malfeasance or an indictable offense or collusion? I don't care if they talked to the good Lord and if they talked to the good Lord and a certain savings and loan, that is collusion. That is the way it is.

I have been accused of many things myself, so I know. I don't want to say what everybody else says. If you can't take the heat, stay out of the kitchen. That is a lot of bunk. You know what you are doing at the time you are doing it, and what kind of recognition you are asking for. We all know that. If something should happen, we must be able to take the consequences.

Mr. SEIDMAN. We will do a complete investigation. If that investigation indicates that there has been criminal activity or other things—

Mr. ANNUNZIO. I have known you only for several months. You tell me there is going to be a complete investigation. I take you at your word.

Mr. SEIDMAN. Thank you, sir.

Mr. ANNUNZIO. My time is up. I am sorry.

Mr. LEACH. I just had several inquiries. One relates to junk bonds, one to nonjunk art. On the former, you have indicated that the FDIC has a standard rule against junk bonds. Do you have an estimate of how much money this particular thrift may have lost because of junk bond investments?

Mr. SEIDMAN. We have an estimate that the loss on what they have left is about \$400 million. I don't know how much they may have lost before that. They sold a lot of bonds before we got there, I understand.

Mr. LEACH. The only reason I raise this as definitively as I can is that there has been much opinion that has been broached in this committee that junk bonds are a good investment and one shouldn't be concerned.

But in this particular instance, you have a four-tenths of a \$1 billion loss to the U.S. Treasury. Secondly, I think we should be very careful about how we approach the art issue. There is a role for corporations to have modest art collections and that there is something uplifting about that.

Like some bonds, some art can be good investments, too. It is where you make them. In this case the taxpayer was allegedly funding spectacular investments in arts, Rubins, among other things, which were not only used as a bit of corporate property, but were used at the home of Mr. Paul. Is that correct?

Mr. SEIDMAN. I have read that in the papers.

Mr. LEACH. Strikes me as something regulators might pay attention to. And this raises a question that I think is relatively profound. FIRREA changed the law of the land. We all understand how it did that. But laws were in place before FIRREA.

Mr. Paul's extravagances were known long before FIRREA was passed, long before the past few months. How conceivably could this thrift have been allowed to continue under its current management for so long?

Mr. SEIDMAN. I cannot give you an answer to that. It seems inconceivable.

Mr. LEACH. Well, I again raise it, because this Congress moved in the regulatory process not only to enshrine a regulator unconstitutionally, as the court has now determined, but just as profoundly it maintained the former regulatory apparatus and only renamed it.

I stress this, because we enshrined a failed regulator and a failed process. It is still up to this committee to think very seriously about looking at whether we want to change that process.

Well, Mr. Chairman, I have no other questions other than to say that this issue is so gagging in its implications that we have almost lost sight of what \$2 billion is. I mean, this instance alone, with the possible competition of Keating, is possibly the largest bank robbery in history.

There is the old joke that was referenced a few months ago, the easiest way to rob a bank is to own it. But in this case, the easiest way to rob the Treasury, and this is literally Fort Knox being

robbed, is to run a bank improperly. I think we ought to bear that in mind as we look at what kind of regulatory approaches we want to take in the future.

Thank you, Mr. Chairman.

The CHAIRMAN. Did you have a question? Mr. Hoagland hasn't been recognized yet. Unless you have—

Mr. FAUNTROY. I do have a question, Mr. Chairman.

The CHAIRMAN. Mr. Fauntroy wishes to interject a question at this time.

Mr. FAUNTROY. No, I haven't questioned at all yet.

The CHAIRMAN. I beg your pardon.

Mr. FAUNTROY. I want the panel and Mr. Seidman to assist me with a special problem that I have with this CenTrust question. In 19 years on the Banking Committee, one of the things that has disturbed me as I have traveled to banking and financial institutions here and around the world, is the decadent opulence with which some banking officials carry out their lifestyles. I hope the American people never get to see the pictures of the lifestyle of this man, the CenTrust Towers, the gold-plated toilet bowls, the stretch limousines, the heliport, the private hangars.

How could our regulators allow people to use hundreds of millions of dollars of taxpayer guaranteed funds to fashion a lifestyle that is as disgusting as what I take from those reliable pictures? Mr. Annunzio pointed out the President does not have that lifestyle. The American people would not stand for it.

My question is, first of all, explain to me, what it is about heading financial systems and institutions that makes people vulnerable to this kind of—Lord help me, what shall I call it—this kind of sin, it is as you said "Sin Trust"? Please help me to understand just that.

Mr. SEIDMAN. I am afraid, Mr. Fauntroy, I am not too good at that. I have been quoting the Bible almost every time I have been up here, but I don't know the appropriate quote to handle that. All I can say is that these people found a machine in their basement, and they thought money was free and they could print it and use it any way they wanted, and there was nobody around to tell them that they couldn't. It was an outrage and the American people, I am sure, are very mad about it.

I think they should be. We simply let somebody have a credit card on the United States of America without any limits on it and let them spend it any way they wanted to. As a result of that, we got these tremendous excesses which we have seen here and in other cases.

Mr. FAUNTROY. Well, my concern is, you know, where were the auditors who reviewed this? I don't know if they got to see this. Have you seen this?

Mr. SEIDMAN. Yes, I have seen it.

Mr. FAUNTROY. Then you know what I am talking about. Where were the auditors?

Mr. SEIDMAN. We will be examining that to see whether they carried out their duties in accordance with the standards of their association. If they didn't, we will pursue them for the damage that they caused.

Mr. FAUNTROY. Mr. Chairman, will Mr. Paul come before us?

The CHAIRMAN. We have invited him. We expect him to probably show up. If not, we will proceed as best as we can.

Mr. FAUNTROY. I certainly don't want him to be treated as a whipping boy, but this is the living end in terms of what I have been concerned about for many years. I do want you to understand that.

You know, Mr. Seidman, excessive and inappropriate expenses on the part of management or financial institutions seems to be a recurring theme in these hearings. First, I am curious as to why such activities again are not detected by Federal, State and public auditors; and, second, I am curious as to why such expenditures are not disallowed and recouped on the part of the institution before they become a ward of the Federal taxpayer.

Again, where were the public and private auditors when all of this was occurring?

Mr. SEIDMAN. We will attempt to determine that with our investigation. We have everybody from the IRS to the thrift regulators to the private auditors involved, and we will be looking at all of those areas.

Mr. FAUNTROY. Do you think we need any new regulatory approaches on that?

Mr. SEIDMAN. We are not ready to recommend anything at this point, but we may well have some recommendations after we get through with our investigations. Again, this is very early in this particular investigation, and so we will be looking. We have made some recommendations to the committee all right with respect to changes that we think might help in FIRREA, and we will have more and much more fundamental things I think after we have completed our work.

Mr. FAUNTROY. Finally, Mr. Chairman, I would just hope that we could provide all three, Mr. Seidman, Ms. Waldrop and Mr. Wierschem, with a replica of this, in addition to looking at your Bible each day, you might want to look at this.

I think it will help us arrive at some way—

Mr. SEIDMAN. I think once was enough for me.

Mr. FAUNTROY. Thank you.

The CHAIRMAN. We had a duplication of that with Lincoln to begin with. We had the hanging gardens of Babylon in Phoenix, or outside of Phoenix. We had similar trappings of opulence, ownership of offshore island domains, and what-not. But this picture collection was a lot more accessible. In fact, if you watch Miami Vice, the opening shot shows the tower. So, if you want to be reminded, just look at Miami Vice, that aspect of Miami Vice.

Mr. Hoagland.

Mr. HOAGLAND. Thank you, Mr. Chairman.

Chairman Seidman, it is certainly a pleasure to have you back before the committee again today. By way of following up on the questions that my colleagues have asked, and reviewing the extraordinary excesses that are represented by these charts up on the wall, the compensation chart in the lower left-hand corner of the five charts does not give the actual figures.

We have another chart here that gives the figures of Mr. Paul's compensation as being over \$16 million from 1984 through 1989. I think those other charts speak for themselves. A photograph of

that speaks for itself. As someone who really has no peer in this, among the regulators and who is the most respected of all the individuals that appeared before us on this subject, what offerings do you have to the American people, what reassurances can you make that the changes in FIRREA are going to be adequate to prevent these things from happening again?

Maybe you could review for us and for the American people the major changes we have made?

Mr. SEIDMAN. I thank you for your kind comments, Mr. Hoagland, and I think FIRREA took several very important steps in terms of setting capital standards, of providing for back-up supervision by the FDIC as well as the Office of Thrift Supervision, and by requiring that real capital be put in the industry, and real accounting systems be used.

So I think that FIRREA took some important steps. I don't think that we have yet found a way to limit the way insured deposits can be used. I think there is important work to be done in looking at the kinds of assets that insured deposits can be invested in, then if other kinds of activities, junk bonds and so forth, if someone wants to invest in that they will have to raise their funding in the market without the U.S. taxpayer behind them.

So, I think that that is an important part of an additional study that has to be made to take another step in making sure that this won't happen again.

Mr. HOAGLAND. I think what so many of us are concerned about is where we are going to be 20 and 30 years from now, 40 years from now, when none of us are around and when everything that is happening now is in the history books and the attention of Congress and the administration is off on many other areas, what is going to prevent this from happening again?

It sounds to me like your sense is that we have some additional reforms ahead of us to be sure that the system is full term.

Mr. SEIDMAN. I believe that is correct. I think that FIRREA was a very good first step. It was a step that was needed to begin. But I think we still have to find ways to limit Government guarantees. We have far too many Government guarantees, not only in this area, but in a number of other areas.

They look like we can get there on the cheap, because they don't cost anything until they blow up and then they cost a huge amount. I think the whole economic system is operating far too much on Government guarantees and assurances and too big to fail on all the rest.

I think it is important that we move back from that.

Mr. HOAGLAND. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

I think that is absolutely correct. In fact, that is the most—as we work on this, and it is really back upward. I said a year ago that we had a monumental task before us, because we were caught up in a conjunction of events. Not only had we not faced up to the developments that have occurred in the real world, the Congress really hasn't, but we—what then has happened is that now we are trying to ex post hock, and the only thing we can derive from that

is the benefit of wisdom from hindsight, which is what we are trying to do.

I don't think you have to wait 20 years. In fact, I doubt seriously you will have to wait 20 months, maybe not even 12, because while we are on this. I bring up what I said a while ago, that I am more troubled now as an individual and speaking for myself, and hoping all the time I am dead wrong, than I was a year ago.

Because when we talk about safeguarding the deposit insurance, we are talking about the system of deposit insurance. This is what is on trial, at stake really. And with the fact that more banks, commercial banks have failed than S&Ls, and the fact is that as the oversight hearings brought out in January, the whole situation is tenuous. We cannot indulge in the luxury of thinking we can wait too long. We can't wait for a study from the Treasury in 1991.

We have asked and have received, thanks to Mr. Annunzio, a stipend of \$100,000 to conduct a study, not a study, but an examination and status report. Of course, that would be on the basis of obtaining expert help and the like. But even that—and the reason I keep saying this is because this is exactly the state of mind that some of us confronted all along.

In 1980, 1982, you couldn't tell anybody—you were immediately labeled as being anti-deregulation. You couldn't tell anybody that what we were doing was opening the gate for the high flyer, the speculator, the con artist, to move in.

Maybe some of us coming from a State where we had a very peculiar history, in the S&L history anyway, and also in the way of banking where 93 percent-plus of these institutions were State-chartered with stock, sensed that the changes being brought about to save the S&L would actually endanger the entire system.

At this point, with the overhang of debt in the public sector, in the private and corporate sectors, we can't indulge in the luxury of thinking that things are just going to be self-perpetuating and go on, and that the crises won't come up that will tend to compel us to lose control.

I brought up earlier that what bothers me the most is that with the exposure to some of these activities based on the use of insured deposits, now in the commercial bank system, the Federal Reserve Board has opened for participation some of the largest banking institutions in this equity-for-debt business, that we can see that this was the clear indication that we were in trouble.

I also want to bring out that part of the objective is to see what reform we can bring about or recommend in case we don't have absolute direct jurisdiction on the matter, on the accounting corporations systems and their lack of accountability. Other countries have strict regulation.

For instance, none of the accounting firms that have testified before us since a year ago in February, could have gotten away with what they reported to us or in England at all. But yet, in the United States they can. We have to, I am sure we are going to have to, legislate in that area. Because it is possible, Mr. Fauntroy asked, Mr. Annunzio asked, what is it, the auditors, the accountants didn't see this?

Well, they did. They saw it. Look, there was no connection between them seeing it and them doing something about it. Even reporting it to the proper level.

I would like to say, in addition, and maybe by—except I see Mr. Schumer, did you have any questions? We are about to complete with these witnesses. But I didn't know you were here until now. Do you have any questions?

Mr. SCHUMER. Yes. I don't want to interrupt you.

The CHAIRMAN. I would like to add into the record an exchange of correspondence I have had from one R.B.B. Harwell, Jr., in representation or ostensible representation of David L. Paul. He is listed as one of the witnesses here today. The staff received notice from Mr. Harwell that Mr. Paul was considering retaining him as an attorney.

The tone of his letter states that Mr. Paul is considering very seriously appearing before the committee. That he is not necessarily and doesn't think he would be necessarily interested in the Fifth Amendment. He is considering waiving it.

I, therefore, answered Mr. Harwell, even though the letter was directed to a member of the staff by way of attention. I put it this way: "I am in receipt of your letter dated March 20, which requested postponement of Mr. David L. Paul's appearance before the committee. As you know, the committee is reviewing the supervision, operation and subsequent closing of CenTrust Bank. As such, the appearance of Mr. Paul is essential to this committee's inquiry. We wish to accommodate your request that Mr. Paul be given adequate time to prepare and appear at a later date. A period of 2 weeks would seem to be adequate."

This seemed to be acceptable to the attorney. So that we would accept to have Mr. Paul appear before us. We will follow the procedures that we have before in other cases, and if issuance of a subpoena would resolve it, we would do so. If not, we will do the best we know how as we have up until now.

But the point is that this is a multifaceted hearing. We have not only in mind possible or mandatory action to banking laws, S&L laws, but to others, including, as I said and repeat, accounting. So I thought I would let my colleagues know about the letter. Mr. Leach, do you have a question?

Mr. LEACH. Are you suggesting that we are going to subpoena Mr. Paul?

The CHAIRMAN. Well, here is the point, Mr. Leach, let's be perfectly frank. We have tried to subpoena individuals that found it helpful to be subpoenaed. Do you know what I mean? That is—well, they found their way here easier, but also it enabled them to speak forth while under subpoena.

In Mr. Paul's case, we have to await to see exactly what he is going to tell us. We have given him a 2-week postponement. If it looks like that won't work, we will have to contemplate a subpoena and see if that will do it.

Mr. LEACH. Well, I appreciate the chairman's statement. I hope that the will of this committee, if he doesn't cooperate, would be to induce his cooperation.

The CHAIRMAN. That, of course, would be the best thing. Of course, we are respectful of basic rights, but I agree with you that



the best thing would be to have him here. I might add, if you would indulge me, that we have the same thing here as we have had with the Keating case. That is the counter-charge, that the ones to blame are the regulators and the Government.

They have nothing to do with their MDIs. They were pushed into bankruptcy. We have the same thing here. We have defenders on notice. In the Post article, a very great guy by the name of Richard Goodwin from Texas, who is a beneficiary of Mr. Paul, defended him, saying he was a good guy and meant well, and were it not for the nasty Government, he would have survived.

Well, all thieves will tell you they would succeed if only the cop hadn't caught them. So, all I can say is that we can expect that, and what we have done intentionally is to seek the information on condition, in order that every Member will have before him in this committee the knowledge to, in a knowledgeable way, bring about the changes that will be necessary in our fundamental statutory law.

We will have to have some. I think mostly in the areas where we have to have a tie-in with accountability.

Mr. Schumer.

Mr. ANNUNZIO. Would the gentleman from New York yield?

Mr. SCHUMER. I would be happy to yield.

Mr. ANNUNZIO. I am also asking unanimous consent that you have an additional minute. The Chair has indicated that when we get through with questioning this panel, we are going to complete for the day, and that is the reason I am asking you to yield.

I have one question—Mr. Wierschem, I note that CenTrust had a small real estate portfolio, that it markets its company at a high grade. If CenTrust had a mortgage portfolio of 70 percent of its assets, such as required in FIRREA, the QTL test, do you think CenTrust would have failed?

Mr. WIERSCHEM. Sir, I haven't sat down and computed what that yield might have been. I think that is the real key, to pay attention to the yield of the mortgage portfolio.

Mr. ANNUNZIO. The 70 percent, the 30 percent, the QTL test, that I have been struggling to maintain and hold?

Mr. WIERSCHEM. There are many that probably meet that test, but they don't have sufficient yield, even though their mortgage portfolios do make a profit. I think that is the real key.

Mr. ANNUNZIO. The real key is that they are not in bankruptcy.

Mr. SEIDMAN. I can certainly support that they would have had to work hard to get in as bad shape as they have in their present operation.

Mr. ANNUNZIO. Thank you, Mr. Schumer.

Mr. SCHUMER. Thank you, Mr. Chairman.

In my opening statement, at least I find that ultimately, deregulation is to blame for a lot of this. I read articles by others who say it is not deregulation to blame, some of the more conservative people. It is Federal insurance to blame. It is the same coin, just opposite sides. To say we should have deregulation while we still have Federal insurance is sort of like your home insurance agent coming up to you and saying, we will insure your house and you can keep oily rags in the attic and open barrels of kerosene in the basement, and we will still insure you.

If you didn't have the insurance, no one would be liable except the person who owned the home, but if you are going to keep the insurance, you can't deregulate.

My question is, following up on the questions that some of my colleagues asked. We have two types of excesses here. One is that type of excess and still, for the love of me, I can't see how a regulator seeing a \$7 million yacht on the balance sheet, and I assume an examiner would see that, would not disprove it.

But we also have something that created far more damage, and that is a thrift run as an investment bank, as a merchant bank, which is antithetical, in my judgment, to what Federal deposit insurance is all about. Because if it wasn't, we would have insured Drexel Burnham, and we would insure not only the big well established Wall Street investment banks, but anyone who has a little financial scheme, and wants it.

How was it, Mr. Seidman, you were a student of all of this back then and certainly not to blame, but how was it that people convinced themselves that anything a thrift did ought to be insured? How was it that regulators, when they saw the things that Cent-Trust was doing, whether it be that boat or running a swap operation, didn't disapprove them? Was it the tone that was set in the early eighties?

I don't know what it was. But I ask my question because I want to know if regulators today saw those same things, would they act any differently?

Mr. SEIDMAN. Well, how it came about, I think, is that the institutions got in real trouble because of inflation, and once that came up, everybody, including the Congress, the regulators and everybody else, tried to find some way out of it without having—some painless way out of it.

And so, the painless way out of it was to paper it over with phony accounting, to paper it over with phony capital standards, and to allow the institutions to use deposit insurance to try to gamble their way out of the hole they were in.

As usual, when you don't face the facts, and you don't act on the facts and you think there is a painless way out of something that is going to be very painful, you end up in the kind of a mess that we have now. It—Congress passed a law, the administration administered the law as though this were a deregulated industry.

No industry can possibly be deregulated if it is funded on charter of the United States. And we had the unfortunate thing that both the Congress and the administration and the regulators were gambling on the fact that they could get out of this whole and they were gambling with the taxpayers' money.

Mr. SCHUMER. But there were some of us who opposed all of this deregulation stuff all along, but I guess not enough. My question is, did deregulation mean, when it was passed or as it was interpreted, that someone could take insured deposits and do foreign exchange trading, debt equity swaps and other things that are regarded even by noninsured institutions as something that is very risky. Is that what it meant?

Mr. SEIDMAN. This is not a deregulated industry. I am a deregulator, but you cannot deregulate the asset side and not the liability side and have a deregulated industry. So I, with all due respect,

would say that you can't blame this on deregulation. You didn't deregulate the industry. The only way you could deregulate it was not to allow them to raise funds on the United States. You are gambling with the assets while you provided the funds from the U.S. Government. That is, if I may say so, not deregulation, that is insanity.

Mr. SCHUMER. That is what President Reagan and Secretary of the Treasury Don Regan called it when they came here. They called it deregulation. They just said it was another—they said, what was good for the phone company and for transportation, we ought to do the same thing here.

So I don't want to get into semantics as to what is deregulation and what isn't. What I want to get at is, calling it what you call it, deregulation of one side of the balance sheet, which is an accurate description, did that still mean even then to the people who were pushing it—I wasn't, so you know, did it mean that they could do anything they wanted with the money?

Mr. SEIDMAN. Well, in the sense that it was passed, I don't think I understood that, but under State laws, they were allowed to do almost anything they wanted with the money. That was a terrible mistake, and one that we are now paying for, and I think there was a tremendous misunderstanding on the part of those that called it deregulation, deregulation is based on the market being the monitor.

The market can't be a monitor if you use the U.S. Government's credit.

Mr. SCHUMER. Should we allow financial institutions to say use insured deposits for foreign exchange trading for their own account?

Mr. SEIDMAN. I think we have to make a determination of what they should use that funding for. That is what I said in answer to the chairman's question. I think that is a very important part of reform.

Mr. SCHUMER. What is your view? Why aren't all of us, whether we be regulator, Congressman, Democrat, Republican, say hey, if the institution wants to do it, that is one question, but to do it with insured funds, we have learned our legislation. Why isn't there unanimity that that ought to be happening?

Mr. SEIDMAN. I never know why there isn't unanimity, but that is a scarce commodity up here. I can't answer that. But I think it is quite clear that we need to concentrate and, in looking at further reform, on what insured deposits can be vested in, and some people have gone as far as to say only Government bonds, others have said mortgages, Government bonds and traditional banking business. Some have said it for small banks, you can have a different standard than big banks.

It is a very complex question, but I think it is one that all these hearings are bringing clearly to the forefront.

Mr. SCHUMER. Do we have some of the excesses that we have seen in CenTrust, not the totality, but each individual part occurring in insured institutions today?

Mr. SEIDMAN. They don't occur in any institutions that we regulate, to the best of my knowledge, because if they do and are using institutional money, we will stop it. There are a lot of people who

use their own money to live like that, so we can't set that kind of a standard. But if they are using institutional money for that, we do not allow them to do it.

Mr. SCHUMER. Aren't there some banks in banking institutions that have used insured deposits for merchant bank activities the way Mr. Paul did?

Mr. SEIDMAN. Most of those are being done in separate subsidiaries.

Mr. SCHUMER. It is still insured money?

Mr. SEIDMAN. Not necessarily. That is the key factor that I think needs to be studied. I think these institutions should have a perfect right to do whatever they want to do in the legal marketplace, but not with insured deposits.

Mr. SCHUMER. I agree with you there, although I guess I wouldn't—some of these subsidiaries, although they are separately capitalized, still—their funds are coming from the insured deposit marketplace, isn't that true?

Mr. SEIDMAN. It is true in some cases, but they are limited by how much they can get from their related company by law now, so that they cannot be totally funded as though they were part of the system.

Nevertheless, I would agree that there is clearly something to be looked at there.

Mr. SCHUMER. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Wylie for an additional question?

Mr. WYLIE. Thank you.

I would make the observation to follow up on what Mr. Schumer was saying, that most of the culprits were from States where there were liberal State charter laws. I think the State legislators have to come in for their share of the blame.

Most of these institutions are in Texas, California, Louisiana and Florida, and now we find another State-chartered institution, CenTrust, in this kind of a problem. So I think we do need, in the course of events, to preempt insofar as we can the State laws preserving—if it is necessary, I don't know if it is even necessary any more—the so-called dual banking system. That is just an observation.

I would make another observation. I find it fascinating that David Paul had several meetings with Charles Keating, and I am sure you have this information, if you don't, I can supply it.

In 1987 and 1988, we ought to know what was going on here and in what capacity was Lincoln dealing with CenTrust? What role did Drexel play in this relationship? Apparently, Drexel was a key player as far as CenTrust was concerned, and also with Lincoln. Do you have that information in your possession about those meetings?

Mr. WIERSCHEM. No, sir, I haven't.

Mr. WYLIE. It was apparently taken off of Mr. Paul's calendar. I don't know who got the calendar. But I have a list of meetings between the two here, which, as I say, I thought was rather fascinating. David Paul had several ex parte meetings with Danny Wall and other senior Federal Home Loan Bank Board officials while CenTrust was in an adverse posture toward the agency.

We ought to know the reason for those meetings, the timing of them. The timing doesn't look very good, and whether that was proper or not. Do you have any observations on that right now?

Mr. SEIDMAN. We will be looking into that. That is part of what our special group does that looks for improprieties.

Mr. WYLIE. I noted also in here that examiners from the Federal home loan bank from Atlanta and examiners from the State of Florida had dinner on David Paul's yacht the night before a scheduled examination meeting was to take place on August 6, 1988. Again, the timing seems coincidental perhaps, but what do you think about that?

Mr. SEIDMAN. We wouldn't allow our examiners to do that.

Mr. WYLIE. FDIC does not allow your examiners to do that?

Mr. SEIDMAN. No, we do not.

Mr. WYLIE. Thank you.

Just something else that you want to look into.

The CHAIRMAN. Mr. Leach.

Mr. LEACH. Mr. Chairman, I just had one question. In response to another member, very quietly, Mr. Chairman, you mentioned that we ought to move back away from the too-big-to-fail syndrome. You have been on record by saying that there are institutions too big to fail.

Does that represent a change in your thinking on this subject, or is this a new tenor coming out of the FDIC that we ought to be watching carefully?

Mr. SEIDMAN. I think, Mr. Leach, what we have always said is that we have never been able to find a way to handle a big institution without protecting all depositors, without taking undue risk of the system and potentially undue cost.

What I have said, and I think I am continuing to say, is that we need to study that and see if we can't find a way to limit that, because there are two different problems here. The S&L problem is a deposit insurance problem. That is where all the cost is. If you look at the bank, 75 percent of our cost come in taking care of big institutions where we have to take care of all depositors in order to stabilize the system.

As I said, I think that that is something that we would rather not do, and we certainly would like to find a way out of it. I don't know whether we can. It is the way the world treats the rest of their institutions. I don't think it would be wise for us to go after it without a real understanding of the rest of the institutions around the world, and we have to have a practical way of doing that.

All I have said is that I think we need to spend time seeing if we can find a way to do that.

Mr. LEACH. At least you are leaving open the possibility that managers of all institutions of any size have to be aware of the chance that you may back off. Is that a fair appraisal?

Mr. SEIDMAN. Yes.

The CHAIRMAN. Very good.

Ms. Waldrop, you have been sitting there very quietly. You are going to be the Assistant Director in charge of the conservatorship.

Ms. WALDROP. For the Eastern Region, yes.

The CHAIRMAN. Given the portfolio you have, how does CenTrust rank or how does it look to you?

Ms. WALDROP. With respect to potential loss?

The CHAIRMAN. Yes. And also as to the magnitude of the chore confronting you in view of—inside of your entire portfolio, you are not single-mindedly devoted just to CenTrust?

Ms. WALDROP. Absolutely not. I have responsibility for over 100 institutions. CenTrust is one of the largest, one of the top, one of the three largest of that portfolio, and in terms of loss, it will be very significant, but I don't know whether it will contain the most loss, but it will be, the loss will be very significant.

The CHAIRMAN. The argument is always advanced that some of the fears expressed be reduced somewhat with the disposition of assets. My point is when it comes to the Government disposing of assets, if all the Government has ended with is all the crud, how is it going to dispose of it. I mean, you are going to be in charge of handling some of the junk sale? You can't make a flea market out of junk?

Ms. WALDROP. As Chairman Seidman indicated, the junk bond portfolios will be handled by the Washington office, Lisa Spector, an expert in the industry who is now on payroll.

So, I gladly give to her the responsibility of dealing with the junk bonds from the Eastern Region. That is a very specialized field, as you know, and probably better dealt with that way.

The CHAIRMAN. Do you have any other statement or observation that you might wish to make to the committee?

Ms. WALDROP. No, sir, I don't think so. Thank you.

The CHAIRMAN. Thank you very much. Thank you very much again, Mr. Seidman and Mr. Wierschem.

The CHAIRMAN. The next panel consists of Mr. John E. Ryan, the District Director, Atlanta Office of Thrift Supervision; Ms. Maria I. Richmond, Deputy Director of Supervision Operations, Atlanta Office of Thrift Supervision; Mr. Ashbel C. Williams, Jr., assistant comptroller, State of Florida; and Mr. Lawrence H. Fuchs, deputy comptroller, State of Florida.

Mr. ANNUNZIO. Mr. Chairman, I understand that accompanying the witnesses today is Mr. Park T. Zimmerman, with the OTS Office in Atlanta. I also understand that it was Mr. Zimmerman who was most vocal in his opposition to Mr. Paul getting control of CenTrust and later in seeking aggressive examinations of CenTrust.

I would like to ask that he be allowed to sit at the witness table and answer any questions.

The CHAIRMAN. If it is agreed, and with the discretion of the panel, we would—we have invited this panel because they are from that particular office, and currently involved. If there is no objection, or there isn't any reason why an objection should be heard, if Mr. Zimmerman is present and he wishes to, you may just pull up one of those chairs, Mr. Zimmerman, over at the end there, or there.

We will proceed and recognize Mr. Ryan. Thank you and your colleagues for your patience and for your extreme cooperation with the committee and its staff.

Mr. Ryan.

**STATEMENT OF JOHN E. RYAN, DISTRICT DIRECTOR, ATLANTA OFFICE OF THRIFT SUPERVISION; ACCOMPANIED BY MARIA I. RICHMOND, DEPUTY DIRECTOR OF SUPERVISION OPERATIONS, ATLANTA OFFICE OF THRIFT SUPERVISION; LAWRENCE H. FUCHS, DEPUTY COMPTROLLER, STATE OF FLORIDA; AND PARK T. ZIMMERMAN, OTS OFFICE, ATLANTA**

Mr. RYAN. Thank you, Mr. Chairman.

We are pleased to have the opportunity to help this committee in its efforts to determine the facts and circumstances surrounding the failure of CenTrust Bank, a State savings bank, Miami, FL. CenTrust.

CenTrust, with assets of nearly \$9 billion, is the largest institution regulated by the Atlanta District of the Office of Thrift Supervision. On February 2, 1990, the OTS turned CenTrust over to the Resolution Trust Corporation, RTC, which was appointed conservator and on March 2, 1990, CenTrust was declared insolvent and placed into receivership.

The failure of CenTrust was the final chapter in what began in 1983 as an attempt to resolve, without cost, the troubled Dade Savings Bank by selling it to David Paul, a Westport, CT, real estate investor.

Let me state at the outset that neither Ms. Richmond nor I were present throughout the entire period of operation of CenTrust. I came to Atlanta in November 1989, and my personal involvement with CenTrust is limited to the 3 months before it was placed into conservatorship.

Ms. Richmond has a longer period of regulatory experience with CenTrust, having assumed the role of supervisory agent with responsibility for CenTrust in January 1988. In preparation for this testimony, both Ms. Richmond and I reviewed the extensive files on this institution and had numerous discussions with OTS staff that dealt with CenTrust at various times.

Our testimony and answers to the committee's questions will be based on information that we believe reliable, but not on first-hand knowledge in many instances. Our statement does not attempt to be a complete exposition of every issue, but covers the essential matters that we believe had a material effect on the institution.

The sale of Dade Savings Bank in 1983 occurred in an environment of high interest rates. When the purchase transaction was marked-to-market, CenTrust—later to be the new name of Dade Savings—had assets of \$1.8 billion and liabilities of \$2.3 billion. The difference, which amounted to \$525 million, was booked as "Goodwill." This \$525 million nonearning asset had to be supported with high-cost liabilities and had to be written off through charges to after-tax earnings over 25 years.

The "goodwill" created a substantial drain on earnings which, coupled with the other problems of Dade Savings, made it highly improbable that operations as a traditional thrift would produce the rate of return needed to maintain a viable institution.

CenTrust turned to high-risk investments and rapid growth to generate the needed income. While the final results are not yet in, the ultimate loss in disposing of the now \$9 billion CenTrust may well be substantially greater than the \$525 million loss present in

the old Dade Savings in 1983. With the advantages of hindsight, the unassisted sale should probably not have been permitted.

Mr. Chairman, my testimony attempts to discuss each of the relevant parts of the history of CenTrust. It deals with each issue in some detail and I will attempt to summarize where I can. Where it is important for a complete understanding of how matters developed, I will read from the testimony.

The CHAIRMAN. Mr. Ryan, let me say that your entire prepared text will be in the record as you gave it to us. And I take this opportunity to thank you. It was an excellent statement. It was given to us in time to study, so that you may do that, very well.

Mr. RYAN. Thank you.

Not unlike many S&Ls in the early 1980's, Dade Savings, a mutual savings bank, was caught in an interest rate squeeze with low-rate, long-term real estate loans being financed with high-cost deposits. Its continuing operating losses and other problems had all but eliminated its capital and it was obvious that a solution had to be found.

The firm of Warburg, Pairbas, Becker, which had been retained by Dade Savings to help find an acquirer, brought David Paul and his firm, The Westport Company, to the table. On October 1, 1982, a purchase contract for Dade Savings was signed by Mr. Paul and his company.

Before the transaction could be consummated, merger/conversation applications had to be approved by the Federal Home Loan Bank Board and the State of Florida. The purchase transaction was to be accomplished by the conversion of Dade Savings from mutual to stock form and the exchange of its stock for the stock of The Westport Company. At the time the transaction was consummated, David Paul, together with trusts for his children, owned 83.8 percent of the converted thrift.

The proposed acquisition by The Westport Company was pending at the FHLBB for nearly 1 year before it was finally approved. During this time, considerable discussions and negotiations with David Paul were held, primarily involving the true value of the real estate to be put into Dade Savings, the business plan proposed for the future operations of CenTrust and the need for additional capital. These negotiations were largely conducted in Washington by the FHLBB staff.

Early on, the Federal home loan bank of Atlanta was asked to review the proposal and, in January 1983, it advised the Board that the value of The Westport Company's real estate was overstated; that there was insufficient capital to ensure the viability of CenTrust; that The Westport Company was delinquent on major real estate loans at New England thrifts; and, that the proposed management lacked thrift experience. Subsequent to this advice, additional negotiations and discussions concerning these matters were conducted and, as we understand it, the FHLBB staff recommended denial of the proposal on at least two occasions.

As I mentioned before, there was a \$525 million shortfall of assets to meet liabilities and that shortfall was booked as goodwill setting the stage for the rapid growth and the high-risk operation that was to follow. CenTrust doubled in size in its first 2 years of



operation and it peaked with nearly \$10 billion in assets at fiscal yearend 1988.

Its growth occurred largely in mortgage-backed securities which had a book value of \$3 billion and in junk bonds which amounted to an excess of \$1 billion in 1988. On the positive side, CenTrust did generate a substantial amount of residential loans, some of which were sold and which amounted to about \$2.4 billion on the books of CenTrust at fiscal yearend 1989.

CenTrust was unable to generate sufficient core deposits to fund its growth targets; therefore, it turned to "wholesale" sources such as brokered deposits, reverse repos and Eurodollar financing. As a major player in both the mortgaged-backed and junk bond markets, CenTrust appeared more as an investment vehicle than as a traditional thrift.

Because the strategy was implemented in a period when interest rates were generally trending downward, substantial profits from the securities were realized and the strategy appeared to be working.

In fact, in its hey day, CenTrust was regarded in some quarters as a model success story. The 47-story \$100 million CenTrust Tower initiated by Dade Savings, but finished out in grand style by David Paul became a landmark in downtown Miami and served as a symbol of the company's apparent success.

Even though CenTrust reported substantial net income in every year, from 1983 to 1988, it was, in our opinion, skimming the profits off the top, leaving substantial risks and future losses embedded in the balance sheet.

Mr. Chairman, I will attempt to give you some examples of how this was done. First, the substantial gains reported in the earlier years resulted largely from the sale of loans that were marked-to-market as a result of the acquisition, and that subsequently increased in value with falling interest rates.

The profits from these sales were taken to bottom line net income rather than offset against the \$525 million goodwill that was created when they were marked-to-market. In other words, the assets were sold at a book profit with the loss carried as \$525 million goodwill to be written off over a 25-year period.

Second, there is considerable evidence of so-called "gains trading" by CenTrust. Gains trading is a device whereby CenTrust commits to take future delivery of securities at a price. If there is a gain on the transaction, CenTrust would take the profit by selling its position.

If there is a loss, CenTrust would take the delivery of the security and carry it at cost rather than at market value. The practical effect of this practice is the recognition of profit on the winners and deferral of losses on the losers.

Third, it seemed at every opportunity, junk bonds with market appreciation were sold at a profit while declines in market values were not recognized. Moreover, as we will later discuss, examiners were unable to determine with any degree of comfort, the true economic effect of many of the junk bond sales and purchases.

Fourth, CenTrust used every opportunity to front-end income and defer expenses. Examples include the deferral of approximately \$1.3 million in legal fees incurred in connection with an unsuc-

cessful sale and subsequent settlement of a lawsuit involving the CenTrust tower; capitalization of \$6 million of operating expense associated with the opening of branches; and the disparate accounting treatment given similar interest rate swap hedges where positive gains were immediately recognized while net costs were amortized over the life of the hedge.

Fifth, probably the most egregious practice of all, the income generated from these transactions was not all retained in the institution to offset the risk created by them, but instead used to pay excessive salaries, senior management perks, dividends, and to support additional leverage.

I will attempt to briefly describe what we know about CenTrust's connection with the firm of Drexel Burnham. As you may recall, the approval by the Federal Home Loan Bank Board of the acquisition of Dade Savings required the infusion of additional capital within 90 days of the transaction.

It was not until almost 2 years later that additional capital was raised, and even then it was in an amount less than what was required. The offering circular for these securities, dated May 8, 1985, revealed they were being underwritten by a syndicate of five investment bankers led by Drexel Burnham.

Although there is no clear-cut cause and effect relationship that we can show between the capital sale and the junk bond purchase, CenTrust began making significant purchases of junk bonds from Drexel around the time that Drexel was serving as lead underwriter for its new capital issue.

CenTrust purchased substantial amounts of junk bonds primarily from Drexel. These investments reached a high point of \$1.4 billion in 1989.

The bonds were typical 8 to 10-year term, many required only interest payments until maturity and, on some of the bonds, interest payments were made in the form of additional debt. Hence, the bonds performed well in early years.

A large portion of CenTrust bonds were for leveraged buyouts that were dependent on asset sales for repayment, and normal credit analysis of cash flows from business operation was insufficient to determine if the bonds could be serviced in an orderly manner.

Briefly in the rest of our discussion of this issue, we describe the purchase and sales of warrants and other sweeteners that were attached to some of these junk bonds and note how difficult it was to trace the value and the effect on the balance sheet of CenTrust.

In early 1989, we did hear from examiners who were examining Lincoln Savings that there had been transactions between Lincoln and CenTrust. CenTrust and Lincoln sold warranties and assets to each other through Drexel, with each recognizing substantial amount of income. CenTrust denied that Lincoln was the counterparty and stated that it had relied on Drexel's statement of fair value. CenTrust ultimately sold the securities purchased from Lincoln at a profit. Whether there were "corresponding" purchases that returned the profit to Lincoln, we were never able to determine.

With respect to luxury items and management fees, we tried to list in our attachment, attachment 4, some of the excesses that

were uncovered in our special examination of CenTrust relating to personal expenditures by Mr. Paul. It is only a partial listing, and these expenditures have been discussed at length.

The expenditures were discussed with Mr. Paul, who rationalized nearly every one of them as being necessary to conduct business with investment bankers and to promote the image of CenTrust. The outrageously expensive art work purchased by CenTrust was, according to Mr. Paul, considered to be an investment similar to a zero coupon bond.

He was advised by art experts, and although he once hoped to reap profits from the art purchases, he did readily admit that the purchases were a tactical blunder. The expensive appointments and furnishings for CenTrust Tower were rationalized as being expected and necessary to do business in downtown Miami.

I will try to explain where the regulators were while all this was going on. I know that this is paramount on everyone's mind. From the beginning, the Federal home loan bank of Atlanta regulators had a strained and contentious relationship with CenTrust and its CEO, David Paul. Examinations were conducted under extremely adversarial conditions, and examiners reported being frustrated by inordinate delays in getting information and financial data. When information was eventually supplied, it was often not on point or quite not what had been requested. CenTrust operated through a maze of subsidiaries, which maintained poor records, and it used an internal accounting system that was different from both its consolidated audited statements and the thrift financial reports that were submitted to us. All of this tended to obscure the true nature of transactions and made it extremely difficult to examine and analyze the institution's financial condition.

Mr. Paul exhibited disdain for both regulations and the regulators. He retained a number of noted thrift regulatory lawyers and consultants, was extremely litigious and challenged the regulators at every turn. Hardly anything of substance could be resolved by mutual agreement.

We have attached, as exhibit 5, a summary of the regulatory actions that were taken. It is by no means an all-inclusive list. As I say in my testimony, in the final analysis the principal question has to be why the regulators didn't stop CenTrust sooner—before it was too late. I think the short answer is that it is not for the lack of trying, and let me give you some examples of what was done.

The ability of the Federal home loan bank regulators to limit the junk bond purchase at CenTrust must be viewed in the context of the national policies and conventional wisdom of the time. The financial literature and empirical evidence in the mid 1990's seem to support the position that investments in junk bonds could be accomplished both prudently and safely.

I go on to cite numerous articles by academicians, two articles by research staff for the Federal Home Loan Bank Board, all of which came substantially to the same conclusion, that the higher yield on the junk bonds offset the added risk in their investment.

I think with the advantage of hindsight the conclusions in those studies will be shown to be substantially in error. But that was the environment in which these junk bond purchases were made. The regulations applicable to CenTrust, both at the State and Federal

levels, permitted junk bond purchases. Federal law permitted up to 11 percent of assets, Florida law, given the way it was exploited by CenTrust, arguably allowed CenTrust to increase its investments in junk bonds even above the 11 percent restriction applicable to Federal savings and loans.

Notwithstanding the empirical studies, the data on the defaults of junk bonds, the lack of a national policy prohibiting junk bonds, and the regulatory environment that permitted such investments, the Federal Home Loan Bank regulators became increasingly concerned about the level and quality of junk bonds being purchased by CenTrust.

Examination reports criticized the underwriting standards being used as well as the overall level of investments. On May 21, 1985, in a supervisory letter, CenTrust was directed to cease purchasing junk bonds, and again on August 6, 1985, CenTrust was directed to reduce its junk bond portfolio to no more than 10 percent of total assets.

CenTrust did not comply with these regulatory letters, and on January 6, 1986, the Federal Home Loan Bank of Atlanta regulators recommended to the Federal Home Loan Bank Board the issuance of a cease and desist order against CenTrust, which, among other provisions, would have limited CenTrust to holding no more than 10 percent of its assets in junk bonds and would require specific improvements in its underwriting practices.

The Atlanta regulatory staff was informed by the Office of Enforcement Lawyers that given national policy at the time, they felt they would be unable to persuade the Federal Home Loan Bank Board to issue an order limiting CenTrust's investments in junk bonds. However, the enforcement staff was willing to change the focus of the order to the unsafe and unsound manner in which CenTrust invested in junk bonds based on its underwriting standards, policies, and procedures.

They requested the examiners to gather further information and to engage experts to assist in the matter. The requested information was gathered during an ongoing exam and reports from two different experts were sent in January 1987.

Requests from enforcement for clarification and additional information continued for several months. I think it is fair to say that the Atlanta regulators concluded that a cease and desist order in the form that the Atlanta Bank was looking for was not going to be available and, therefore, were encouraged to attempt to negotiate a written agreement with CenTrust.

CenTrust declined to enter into such an agreement, at least in the form that was acceptable to the Federal home loan bank of Atlanta. In 1988, the examiners criticized in the exam report some \$400 million of junk bonds, citing the poor credit quality of the issuers.

Another principal problem that we believe left major losses embedded in the balance sheet was CenTrust's extensive trading activities in mortgage-backed securities. Generally accepted accounting principles permit thrifts to carry investment securities on their balance sheet at their historic cost on the theory that the securities were purchased with the intent that they would be held to maturity. Under these circumstances, changes in the market value of the

securities that occurred over the holding period would not result in any adjustment to the carrying value of the security because the holder is expected to receive par value at maturity.

Conversely, the accounting rules provide that securities purchased with the intent of buying and selling them in the market be treated as trading or, to put it differently, be treated as having been "held for sale," which would require them to be carried at the lower of cost or market. The dispute occurs when there is a disagreement about the intent of the holder.

Accounting literature and regulatory bulletins are far from clear on this issue even today. I will give you an example of why the Atlanta Bank determined in its review of CenTrust that it thought CenTrust was engaging in trading activity. In 1987, CenTrust entered into 427 purchase commitments for mortgage-backed securities totaling \$14.4 billion. Three-hundred forty-four of those commitments, totaling \$11.9 billion were "paired-off" at a profit to CenTrust of \$60 million. On the remaining 83 commitments of \$2.5 billion, CenTrust took delivery or funded the securities. In all but three instances, the securities which were funded were purchased at a higher cost than the current market. The net "unrealized" loss on the securities that they booked was \$81.6 million. In other words, when they had a gain, they took the profit, and the profit in this instance amounted to \$60 million. When they had a loss, they covered it up by booking it in the securities portfolio.

Despite repeated attempts by the regulators to force recognition of the market loss, CenTrust has never done so with respect to the market loss on its mortgage-backed securities portfolio.

CenTrust's outside auditors did not agree with the Atlanta regulations that CenTrust activities were such that would require marking securities to market under GAAP. Consequently, CenTrust received unqualified financial statements, as to that issue, from the outside auditors. OTS was reluctant to overrule the auditors in view of the controversy surrounding the issue and the lack of a clearly articulated national policy.

I might just turn now to the so-called personal abuses of David Paul. The regulatory response to the abuses of David Paul date back to the early days of his tenure at CenTrust. Examiners were critical of the level of salary and bonuses taken by Mr. Paul in view of the lack of profitability of the banking business at CenTrust. The 1986 proposed cease and desist order was an example of an early attempt to reduce his compensation.

The Federal Home Loan Bank Board had previously declined to pursue excessive compensation cases involving stock institutions which were reporting profits because it believed this was matter more properly decided by the shareholders. Supervisory pressures with respect to the personal use of the CenTrust jet resulted in the adoption of policies that required reimbursement for nonbusiness trips. However, as it turned out, most of the trips were allegedly "business-related."

The major abuses did not surface until early 1989, when Centrust moved from its rather Spartan headquarters in the old Dade Savings building to its new 47-story tower.

When the purchase of a \$13 million Rubens by CenTrust was reported in the press, a supervisory directive demanding an account-

ing of all purchases of art work cost in excess of \$25,000 was sent to CenTrust. As a result of this directive, it was learned that the art purchases totaled \$29 million. Subsequently, a supervisory letter dated March 15, 1989, requesting a meeting with CenTrust's board of directors was sent by Atlanta regulators. The board was severely criticized for permitting the purchase, was directed to cease such purchase and to develop a plan for the sale of the art. The controller for the State of Florida subsequently issued a directive which was later converted to a cease and desist order requiring the sale of the art within 6 months. The board agreed to the sale and produced a report, which showed that most of the art was sold in 1989, but at a loss of \$4 to \$5 million.

In May 1989, in light of these revelations, the Atlanta based regulators, together with the State of Florida, commenced an examination focusing almost exclusively on the expenditures and excesses by the bank's chairman, David Paul.

As I mentioned earlier, my first hand knowledge and involvement with this case began with my transfer from Boston to Atlanta on November 1, 1989. I am, therefore, able to speak with first-hand knowledge from that point on only.

In December 1989, I received a draft copy of the special examination on Mr. Paul's expenditures. I must report to the committee that I was appalled by its contents. In my 25 years of regulatory experience, I have not seen anything so egregious as the personal abuses set forth in that report. In view of the probable cost of CenTrust to the U.S. taxpayers, the use of CenTrust to pay for the lavish life style of David Paul can only be regarded as unconscionable. Mr. Paul, who had also received a copy of the special report, phoned me and requested an immediate meeting to explain these expenditures.

We met with Mr. Paul, listened to his rationalizations, and told him his actions were indefensible and that we intended to take immediate formal action to stop the abuses and to seek remedies for those abuses.

On the next day, December 6, I met with members of the Enforcement Review Committee in Washington, and the staff of the Office of Enforcement and recommended immediate corrective action in the form of a temporary cease and desist order and notice of charges for a permanent order to be issued against CenTrust.

A temporary order addressing those abuses and other problems was issued on December 8, 1989. I must mention that throughout this period we worked closely with the other regulatory authorities. On November 17, 1989, OTS Atlanta hosted a joint meeting with the Florida Controller's office, RTC, and the FDIC.

Our probable course of regulatory actions and the timing of those actions was discussed at that meeting. In the closing pages of my testimony I described the final attempts by Mr. Paul to sell branches and restructure the balance sheet in order to meet the new capital requirements of FIRREA.

We determined that those plans were not workable, that the bank was not viable in that it probably would not return to positive earnings, and concluded that the restructuring would not work.

Consequently, on February 2, we recommended that it be turned over to the RTC as conservator. That was done. Thank you.

[The prepared statement of Mr. Ryan can be found in the appendix.]

The CHAIRMAN. Thank you very much, Mr. Ryan.

Ms. Richmond, did you have a statement?

Ms. RICHMOND. No, I joined in Mr. Ryan's statement.

The CHAIRMAN. Oh, this is a joint statement.

Thank you very much.

Mr. Williams, did you have a statement.

**STATEMENT OF ASHBEL C. WILLIAMS, JR., ASSISTANT COMPTROLLER, STATE OF FLORIDA; ACCOMPANIED BY LAWRENCE H. FUCHS, DEPUTY COMPTROLLER, STATE OF FLORIDA**

Mr. WILLIAMS. Thank you, Mr. Chairman. We do have a statement.

It is a joint statement. My name is Ashbel Williams. I am assistant controller of the State of Florida. With me and a co-signer of our joint statement is Mr. Lawrence Fuchs, who is deputy controller of our State.

In the interest of your time and the committee's Mr. Chairman, we will not read our statement to you. You, of course, have copies in advance. If I could, I would like to hit a few high points.

I think, Mr. Ryan, did an excellent job of summarizing the partnership we have enjoyed with OTS Atlanta and the overall regulatory approach. I think two very appropriate questions have been raised here this morning in these proceedings. The first and most general of these is what instructions can we take from this unhappy experience with CenTrust and what actions may we embrace to avoid a recurrence of such a situation with CenTrust.

The CHAIRMAN. Pardon me, Mr. Williams. Could you speak a little bit closer to the mike?

Mr. WILLIAMS. Yes. Is that better?

The second of those things I think we have—the question that has been put before us this morning is where we are the regulators and how could this situation have been allowed to occur as history has proved that it did.

Responding in summary to the first of those questions, what action can we take to keep something like this from happening again?

I think the broadest answer is that we should always ensure that there is ample liquidity in the Federal insurance funds so that the ultimate regulatory step of closure and liquidation is always a very real threat to any management and shareholders institutions that have gone awry. Regulatory policy, absent that big stick, is not unlike foreign policy absent military to back it up.

In the case of CenTrust, as was established earlier in Mr. Seidman's testimony, and also in Mr. Ryan's, this was not a situation where a group of investors and managers started out with a new institution, with a clean sheet, and ran it down. This institution started in a hole with a depth in excess of \$500 million, and for at least its early years appeared to be making some progress in climbing out of that hole. And during the early years I think it is impor-

tant to note that the sorts of excesses that we have chronicled in our exhibits and have been often documented in our regulatory information, that we have provided for the committee's perusal, simply didn't exist. There was not a yacht in the early years, there is not a jet airplane in the early years, there was not a CenTrust tower in the early years.

What there were in the early years were a number of very, very high caliber private parties with some very extensive credentials, including a former national Chair of the Home Loan Bank Board, who was then a managing director of Merrill, Lynch Capital Markets; Dick Pratt, whose name came up earlier, Tom Vartanian, a former general counsel with Home Loan Bank Board here in Washington, who was special counsel to Mr. Paul and CenTrust.

We had as management consultant to CenTrust the senior information systems partner of Booz, Allen, Hamilton, who opined to the integrity of the management infrastructure that was being evolved at CenTrust. We had him testifying to the propriety of the trading activities that was to temporarily quote, unquote, "service as the profit engine to support the costs that would be incurred during the structuring of a management capability in CenTrust to conduct traditional thrift operations that were viewed to become profitable over some period of time."

You had the Wharton Econometric Forecasting Associates, acronym WEFA, one of the most prestigious econometric firms in the country, if not in the world. They were at all times opining to the propriety of this business plan.

We had at any given time probably at least a half dozen of the best and the brightest legal firms the United States has to offer. In addition, we were dealing with a board of directors, whose membership includes some very, very heavy hitting business people, well respected in their own right, such as the chairman of Calvin Klein Industries, the fashion house. We also had very high profile accounting firms, who were embracing and opining to the adequacy and appropriateness of accounting treatments that both OTSD and the state challenged early on.

You had people of the stature of Solomon Brothers, Lewis Ranieri, the father of Mortgage Bank Securities in the United States, personally embracing CenTrust, and the nature of the talent that Chairman Paul was able to bring into the institution no doubt is at least in some measure a consequence of the compensation packages that I think we all agree were excessive in comparison to the market at the time, resulted in some very high caliber talent being brought.

For example, the gentleman who was brought in to manage CenTrust's commercial lending activity had been the head credit analyst at no less than First Union Bank in Charlotte, NC. Now, institutions like Solomon Brothers and First Union that are the sources of management talent, brought into CenTrust, I think in anybody's book, are very successful institutions that have been very good at what they do and very appropriately conservative in their approach.

So I guess what I am painting for you is a picture wherein the early years the indicators that were visible were largely indicators that appeared to be headed in the right direction, and we did not



have the negative indicators of excesses, of losses, and so forth. You had an institution that was profitable.

I think it was Forbes Magazine that identified CenTrust as either the first or second most profitable company in the United States in the mid-eighties. You had all these very, very high caliber people at the elbows of the board of directors at CenTrust telling the regulators how wonderful everything was, and that we ought to relax and give them time, and it would all work out.

Again, because of the amount of legal talent that was available, it was a very contentious situation, and I think Mr. Ryan pointed out the litigious nature of Mr. Paul. I can certainly attest to the accuracy of that statement and cancel you that as early as I guess 1984 CenTrust, in fact, sued the State of Florida when the State of Florida challenged the propriety of some of their junk bond holdings.

Partially in response to that suit, our legislature changed our State law and tightened up what the allowable on investment ratings were for savings institutions to hold in their portfolios.

But cutting through it all on a question of how this whole thing happened, I guess the first thing is we started out with an institution that was in a hole.

The second thing is regulation is not synonymous with management. Regulation takes place after the fact, by definition. When the auditors, the Government auditors, came in and identified problems, the Government did act on those things, on those problems that were observed, and of course, the institution still has access to the American justice system, has the ability to challenge, to appeal, and so forth, and I think the record is that in most cases, the supervisory actions were there, and were timely within the constraints of what the regulatory system can deliver.

Beyond that, Mr. Chairman, I would be happy to answer questions.

[The prepared statement of Mr. Williams can be found in the appendix.]

The CHAIRMAN. Thank you very much, Mr. Williams.

I think you did remarkably well in summarizing your statement, and succinctly stating the most important points. There is no question about it, even in the case of Lincoln and Mr. Keating, they were able to retain top experts in every line, even our present Chairman of the Federal Reserve Board. Unfortunately, his predictions in every one of the cases didn't turn out so right.

However, at that time, the aura, the atmosphere, something we can't recall today, you are right in stating that. But I think the basic thing here is the truth that—there is an old, old Spanish saying, going back to Guerrero in the 16th century.

[Speaking Spanish]

Roughly translated, "Mr. money bags, a mighty powerful gentleman indeed."

And, of course, with money there is a lot of things you can do. I think you have stated it very well, though, in the record, and the record reveals that in every one of the instances, with no exception, the local regulatory, the sub-level, was on the job, did their job, performed well, only to be suborned and betrayed on the top highest levels, and that you could duplicate in the private sector, in

the governmental sector. It was just an unhappy combination at this juncture.

Mr. Ryan, I think on page 3 of your statement—I think it is about the third paragraph—and I am going to quote:

"The firm of Warberg, Paribus, Berger, which has been retained by Dade Savings to help find an acquirer, brought David Paul and his firm, the Westport Company, to the table. On October 1, 1982, a purchase contract for Dade Savings was signed by Mr. Paul and his company. That was the very same date that I made a very lonely appearance before the Rules Committee against what is now known as the Garn-St Germain.

You stated later on about the accounting practices. One of the first things that aroused first my curiosity, then my anger—and I so reported to the Rules Committee—and it wasn't easy. You know, you are never too sure when you are alone whether you are right or not, but I followed my chairman, and it was a tough thing to do to go in and contradict what he had just told the Rules Committee. And it did create some confusion in the minds of a couple of the Rules Committee members.

But the next day—and I noted Mr. Schumer isn't here—that bill was brought up. It was the closing hours of the Congress that October 1982, so the very next day on the 2d, it was brought up late, sometime around 7:30 p.m. Ironically, the one vociferous voice against it was the then Majority Leader, Jim Wright. That is ironic.

I had done what I could the day before. Mr. Wright came to me and said, Henry aren't you going to speak? I said well, I don't know what we can do now. The bill was passed at about 10 p.m., on a voice vote as a conference report, which is what we appeared before the Rules Committee on.

One of the things that stuck out like a sore thumb was the phrase "Regulatory Accounting Practices." I raised that issue and asked a question, and when there was an answer, that is when I persisted and insisted on going to the Rules Committee.

Of course, there is a difference, as you well know, between regulatory accounting principles and GAAP accounting. The thing I want my colleagues to know is that it was the Congress that did that. It was not the regulators, it wasn't the lawyers or anybody else. It was the Congress, and at that time, given the atmosphere, the idea was to save the S&L industry. That was the battle cry. This was the way this bill was pushed, even though, as I brought out in the Rules Committee, 90 percent of what was contained in that conference report had never had 1 minute's hearing in the House of Representatives, and it went way beyond "saving the S&Ls."

So that is so much history, but we are going through pretty much the same type of complacent atmosphere today. The scene hasn't changed that much.

When you, Mr. Williams, point out, and very aptly, that it is the knowledge that you have a true integral deposit insurance fund and that it is there to do what it is supposed to do, which is to close down and pay out, that you have different things happening. But how in the world—as I have been saying—can we say we have that? I can't go out and tell my constituents that I have a pledge

that they are absolutely insured up to \$100,000 when the spread is as it is.

In commercial banking, you have the total covered insured deposit of \$2.9 trillion, and you have much less than \$15 billion in the insurance fund to cover this. How can we say we have an insurance fund as we understand the word insurance? When I raised the issue when we had the first regulatory oversight as we mandated in the FIRREA, Mr. Seidman, a very honest man, very straightforward, said, well, the main thing is, yes, that is true, the ratio isn't there that we would like to have. However, it is the big ones.

In other words, at that point I don't believe the Bank of New England had gone under, so how many of those can that fund really take?

What is the condition of the equivalent of the old FSLIC? Ratio-wise it is not much different.

Obviously, if you had in that fund what we ought to have, we wouldn't be conducting and continuing the draining to the taxpayers as it is today. We were prodded and we prodded our colleagues last year, because we said that every day we delayed the enactment of FIRREA we lost \$20 million.

Well, today Mr. Seidman said it was around \$14 million. Actually that is among those in conservatorship, but those insolvent institutions there on the sidelines added to that, I would say it is over \$20 million a day. We can't be complacent about it. Neither do I want to be an alarmist, but I do think we have a continuing unsolved problem.

Yes, passing the law was essential, but it wasn't necessarily going to be the cure in itself. Just passing a bill doesn't do much until you enforce it and implement it. The other thing, and in conjunction with that which I wanted to bring out, I believe that was on page 13 of your statement, Mr. Ryan, I say this in order to emphasize to my colleagues some of whom have been prone to believe that we ought to recall the act, you point out one good thing that has come out of this.

In other words, if FIRREA had not been in place, the temporary order, which in your words, the most comprehensive one ever issued by the FHLBB or OTS and included any number of provisions made possible by Congress' enactment of FIRREA several months earlier, this was the result of a FIRREA.

You could move even as late as it was still appropriately and with this batch, because the law enabled you to, which it didn't before. So I think that what we have before us is the need to remind us by hearing these past histories that as far as our present environment is concerned, the situation is highly risky. It is still very dangerous, and it has nothing to do with addressing anything that we didn't address last year. That is the entire system of deposit insurance funds systems.

Now I have some questions, but I think I have exceeded my time in this first round. I will recognize Mr. Wylie.

Mr. WYLIE. Thank you, Mr. Chairman.

I appreciate the appearances of the witnesses here this morning. And I think you have added information to our ongoing investigation of what happened as far as CenTrust and other State chartered institutions are concerned.

Mr. Williams, you mentioned the State laws were lax, in effect, and regulators were lax. Maybe I am misinterpreting what you said there, but I think at the time this was all going on that might have been the case.

I would add on to the objection of our chairman that it is hard to pass laws to regulate greed, even if we tighten them up some more, but there will be an ongoing question as to where the regulators were in this while process.

In the beginning of your testimony you seem to absolve the regulators from the failure of these banking institutions. Granted, thrifts and banks are brought down in large part by incompetent or negligent management or greed, but isn't it the role of the regulators to detect these abuses before an institution fails. And I would suppose then the follow-up question is, if it is not, why do we have regulators on the job?

Mr. WILLIAMS. Thank you, I will try and give you an either or answer.

First of all, if I created the impression that I sought to provide absolution for regulators, I apologize. Clearly, regulators have a responsibility in this whole experience, just as managers could, directors do, Congress did, State legislatures do, and so forth.

As to the question of your first question about State laws in Florida, rather than characterizing our laws as lax, I don't think that is necessarily the case, and the evidence that they were not lax is that there had never in the history of the State been a problem with them before.

I think you hit it right on the head when you said that laws can never adequately deal with greed in CenTrust. You had an institution that was willing and committed, with singleness of mind, to bring to bear extraordinary levels of talent and creativity, interpreting both statutes and acting standards. They recognized and pursued an opportunity to exploit an existing law in a manner that had never previously been attempted. It was the regulatory effort to stop that exploitation that in turn led to a suit brought by CenTrust that subsequently led to a revision of State law to make it more difficult to exploit the situation.

Mr. WYLIE. The reason I said that the Florida law was lax was because the State of Florida issued an order to CenTrust to divest all its junk bonds according to a newly enacted Florida law, which you mentioned in 1985, and CenTrust was able to avoid complying with this order.

Now, they may have been given—they may have been given a road to follow, or a path to follow or some indication that this was OK from what some of the Federal regulators did. Now, in the Garn-St Germain Act which has been referred to many times, we never specifically mentioned junk bonds.

But the Federal regulators interpreted the commercial loan investment, I think they were allowed 11 percent of their portfolio to be invested in commercial loans and they said that a junk bond, in effect, is a commercial loan. I think that is the way that CenTrust got out of complying with the Federal law, is that correct?

I see Mr. Ryan, you are shaking your head affirmatively.

Mr. RYAN. That is correct.

Mr. WYLIE. Why didn't the State of Florida then take action to enforce the law?

Mr. RYAN. That is correct as pertains to a Federal savings and loan. A State chartered savings and loan derives its investment powers from the State, and CenTrust was a State-chartered savings bank.

Mr. WYLIE. Mr. Williams, did you have anything to do with advising the State legislature as to the change in the law in 1985, were you around at that time?

Mr. WILLIAMS. No, sir, I did not. The State legislature in Florida meets in April and May.

I came to work for the controller of Florida in September 1985. I was not involved in that.

However, I have, in preparation for today's hearing, gone back and had our staff review the situation and get back with the gentleman who was then director of our division of banking, and prior to being our director of division of banking had been a staff director of the Commerce Committee of the Florida House of Representatives, and he basically outlined the series of events that I went over a moment ago.

I think, coming back to your question, though, about what did the State of Florida do about the CenTrust position in junk bonds, I think answer is they were given, they CenTrust, was given a directive to reduce its exposure in that area.

There was subsequently a tremendous amount of discussion of an adversarial nature between CenTrust, Deloitte and its accounting firm, the State and OTS over what exactly constituted their portfolio.

They liked to think of junk bonds as, quote, "commercial loans with bond characteristics," unquote.

It is a very creative kind of a thing. And during the period of this wrangling going on with the institution and the regulators, the level of adversarial relationships escalated, things became more and more strained.

Ultimately we saw the State move to remove Paul as chairman of the institution altogether. That happened immediately after the Federal regulators operating on our joint examination, for example, entered a cease and desist order on the various excesses that have been chronicled earlier today, so I think the answer is actions were taken and escalated over time.

Mr. WYLIE. In a report here that we have, David Paul once remarked that at this time is easier to deal with the Florida supervision office than it is the Federal regulators in the Atlanta office of the OTS.

Do you think you were easy on CenTrust?

Mr. WILLIAMS. Well, I don't know if he thought we were being easy on CenTrust when we—

Mr. WYLIE. Well, why would he make this statement?

Mr. WILLIAMS. I don't know. This is the same man who is quoted in a Washington Post article that appeared last week as saying his number one persecutor was the comptroller of Florida, so maybe he had a change of heart.

Mr. WYLIE. Thank you.

I have been given a slip that my time is up. I will come back.

The CHAIRMAN. Mr. Vento.

Mr. VENTO. Thank you, Mr. Chairman.

Your comments are appropriate concerning the RTC losses. Today the OTS just came out with a statement which indicated that the 40 percent of the institutions and savings and loan's are still losing money, \$20 billion last year collectively, Mr. Chairman, so it is important that we get on with that task, and obviously CenTrust is now one more problem on the plate, and that I have got some new ideas last week.

We will be looking at those in more detail, Mr. Chairman, and your wisdom in 1982 with regards to regulatory accounting standards is something I wish that we all would have taken lead from.

The fact is when the regulators themselves first proposed we were at best getting involved with what they had, the path they had led us down, which was the wrong path, I think we recognize, everyone today, but I don't think anyone then thought they were going to do what they did with it.

I mean, this reads like a—this is ridiculous as you read the description of events that have taken place with regards to CenTrust. It looks like the Government is absolutely powerless to stop any of the actions that took place as I read it.

It is just like they have a license to go out and to steal is what it reads like, Mr. Chairman, I must say.

I have—Mr. Annunzio had to leave, but he had a number of questions for Mr. Zimmerman.

Mr. Zimmerman, I don't know, you were not able to testify, I guess, or didn't have as prepared statement. Can you tell us something about your background so that all of us can get a little better benefit from the responses that I am going—or questions I am going to place to you.

Mr. ZIMMERMAN. Well, I joined the Federal home loan bank of Atlanta in July 1979—I am a lawyer by training—as a supervisory agent at the staff level, continued through 1989, ending up as the director of agency functions under the president of the bank, and since FIRREA I am the senior deputy director at the Atlanta OTS.

Mr. VENTO. Very good. I understand you are opposed to Mr. Paul's acquisition of CenTrust from the beginning in 1983, I guess.

Could you please tell why you felt that way.

Mr. ZIMMERMAN. Well, it might be a bit strong to say I was personally against it. The gentleman who wrote our memorandum making a recommendation in the case, it was not made with some other people there, although I agreed in substance with their comments.

Essentially our analysis of the business plan that we were asked to comment on was that given the large loss embedded in Dade Savings, the predecessor to CenTrust, that \$500 million hole which we filled with goodwill subsequently, although when you value it makes a difference as to how big it is because if you value it at the peak of the interest rate cycle, the discount is larger and the loss would be more.

We felt the nature of the capital proposed to be infused was not sufficient to make that institution viable over time.

Mr. VENTO. This was, of course, when it was much smaller in size and you were still recommending against it. That was your recommendation was that it was not adequate, it would not be sound.

The purpose here was to try and inject some assets. Mr. Paul apparently didn't put real money in, he put assets in, is that correct?

Mr. ZIMMERMAN. That is correct.

Mr. VENTO. Were you personally pressured by, for instance, superiors or others? Who was pushing to, in other words, to approve this, to actually accept the representation and the offer of Mr. Paul?

Mr. ZIMMERMAN. Well, initially I might say that this transaction was largely handled in Washington, DC, at that time the Atlanta office did not have—

Mr. VENTO. Who was the chairman of the Federal Home Loan Board at that time?

Mr. ZIMMERMAN. Richard Pratt. The application was filed—

Mr. VENTO. In 1983 he was chairman?

Mr. ZIMMERMAN. 1982 when the application was filed, he was chairman.

Mr. VENTO. Who was chairman in 1983?

Mr. ZIMMERMAN. 1983 when the board approved it, it was Mr. Ed Gray.

Mr. VENTO. Edwin Gray, thank you.

In other words, the activity went on in Washington, were you aware of any unusual pressure—who was pushing this issue at you in Atlanta?

Was there anyone present there urging you to approve this or advocating for Mr. Paul?

Mr. ZIMMERMAN. I believe most of the advocacy occurred in Washington. No one came to our offices at least to discuss it with me.

The approval—I might point out the Washington staff also recommended denial on a couple of occasions, not just the Atlanta staff, on our combined review of this. There were a number of prominent people involved in the institution early on.

One was a Dr. Maurice Mann, formerly president of the Federal home loan bank of San Francisco, then with Warburg, Pairbas, who I think was very persuasive in his advocacy of the proposition.

There were some changes in the staff that occurred over the summer. The new Bank Board Chairman came in. I believe subsequently a new director of the Office of Examination and Supervision—

Mr. VENTO. Let me ask you this, Mr. Zimmerman. Obviously, your memory—you were there working, it is hard to ask the other witness, Mr. Ryan, questions about this, because he has only been there for less than a year. Mr. Seidman indicated that it was difficult to take action against CenTrust because of interference from legislators.

I don't know if that is from his testimony, I am reading Mr. Annunzio's questions, so I assume that there was a reference to this.

I would like to know if you know of any involvement by legislators, whether they interfered with the duties or asked for consideration of what was going on in CenTrust. Do you have any knowledge of that, Mr. Zimmerman?

Mr. ZIMMERMAN. Not directly. At the time I had responsibility for CenTrust, no legislator ever approached me personally. Now, whether they approached my superiors at the bank or in Washington, I can't say.

Mr. VENTO. You weren't personally approached and you have no knowledge of their involvement in this process; is that correct?

Mr. ZIMMERMAN. That is correct.

Mr. VENTO. Of course, you were aware that after Mr. Pratt left the chairmanship of the Federal Home Loan Bank Board, that Mr. Richard Pratt was involved, was hired and was in fact representing Mr. Paul; is that correct?

Mr. ZIMMERMAN. I believe he was a consultant for Mr. Paul, beginning as far as I can tell at least in 1987.

Mr. VENTO. What did they do?

Mr. ZIMMERMAN. He appeared in our office, explaining the nature of the trading program, investment program at CenTrust, and providing justification for the particular methodology they used there.

Mr. VENTO. Well, Mr. Chairman, I just want to follow up with one question because Mr. Zimmerman has brought up this issue of, is it a common practice for people to have representatives in top offices of the Federal Home Loan Bank Board or at the regional offices to actually be in the employ of people like Mr. Paul and work and represent them in a regular business practice before the regulatory agency itself?

This was almost instantaneous. Mr. Pratt left and he is there working, representing or working for, as a consultant to Mr. Paul. It sounds as through a series of other people in the Federal Home Loan Bank Board, you know, now are almost instantly turning around and working, representing people in the industry. These were not—I mean, Mr. Pratt was outside the industry, a teacher and educator, I guess, and executive for—business executive.

But many others sound as if they were professionals that had actually gone out. Is that a common practice in this particular—is this a common practice in our regulatory scheme?

Mr. ZIMMERMAN. It is, I believe, a common practice. Now, in fairness to Mr. Pratt, his term ended in 1983. The earliest that I was aware he was consulting for CenTrust was not until 1987.

Mr. VENTO. I don't know that.

Mr. ZIMMERMAN. It was not immediate, but he did find his way there. It is not unusual at all for lawyers who have served—in fact, not only is Mr. Vartanian formerly with the Bank Board, but Mr. Arthur Leibold, who represents him from time to time also was a former general counsel at the Bank Board; they both have active savings and loans practices, and have almost from the time they left the agency.

Mr. VENTO. A good training ground.

The CHAIRMAN. I was persuasive until FIRREA took good care of them.

Mr. ZIMMERMAN. I think there was a cooling-off period, a period of a year required where they are not allowed to appear before their agency.

The CHAIRMAN. Well, actually we had the hearings in San Antonio where we had a former chairman of the FSLIC intervening in



his own behalf, incidentally, with the successor in writing. We brought that out last year. And you had other ex-officials of FSLIC and lawyers and what-not coming in, writing in.

I think you wouldn't be apt to find that happening under the law. Just as in the case of the ability to issue your cease and desist order. You could do it under FIRREA this time, but you couldn't do it before. I think, though, that that practice, Mr. Vento, was fairly common.

Mr. VENTO. Mr. Chairman, I realize that we have tried to limit it, and I hope that it is effective, but I think it shows the persuasive nature of what was going on during the past decade with regard to these problems.

The CHAIRMAN. No question. At best, it was a most incestuous relationship, although—Mr. Leach.

Mr. LEACH. Mr. Wylie noted earlier in the testimony of the chairman of the FDIC that there were several regulators that had supper on the yacht of Mr. Paul and may have on his corporate jets. Does that apply to anyone at this panel?

Ms. RICHMOND. The supper on the yacht applies to me.

Mr. LEACH. Is that a normal circumstance for a regulator?

Ms. RICHMOND. No, sir, it is not. Would you like me to explain the circumstances of it?

Mr. LEACH. Yes. I think that would be appropriate.

Ms. RICHMOND. The supper on the yacht involved probably some five or six regulators. It was basically an unfortunate, embarrassing situation that we got into that we just couldn't figure out how to get out of quickly enough.

The context was a series of meetings that we were having with CenTrust basically to discuss the first round of responses to an examination report. There were a number of people who had come from the Federal home loan bank in Atlanta, State regulators, examiners, consultants, attorneys, a huge room full of people that basically sat closeted in for what ultimately amounted to 8 or 9 days.

But during the process of those meetings, fairly early one morning, Mr. Paul suggests that, in view of the length of the meetings and the fact that we were all trying to get to understand each other a little bit better there, he thought it would be nice if we would all continue through a working dinner.

He understood that our rules were that we would all go Dutch treat. It seemed like a reasonable thing to do.

Later that afternoon, and I think at least my perception at that point was that, you know, we would just leave from there and all go out to dinner somewhere. Later that afternoon, I think about 4, Mr. Paul said that he had made arrangements for the dinner, and that the yacht would pick us up at the dock, which was right in front of the hotel we were staying in.

Quite frankly, I think we were all just snuckered. A number of eyes went around the table saying, my God, what have we gotten ourselves into? But at least I and nobody else seemed to have the presence of mind to deal with it that quickly. We did go to the dinner, were on the yacht approximately 2, 2½ hours.

Came back the next day, immediately reimbursed Mr. Paul and at least with respect to myself, that was the only occasion. It was

poor judgment. It was a situation we didn't react to quickly enough, and it is certainly embarrassing.

Mr. LEACH. I appreciate that, and I appreciate that explanation. Was there anybody here that wants to amplify that?

Mr. WILLIAMS. I was also there that evening and share the same perspective. I don't think that we had any of our actual exam personnel there that evening.

Mr. LEACH. What are you?

Mr. WILLIAMS. I am an administrator.

Mr. LEACH. Who do you work for?

Mr. WILLIAMS. For the Comptroller of Florida.

Mr. LEACH. I see.

Ms. RICHMOND. He means the field examiners.

Mr. WILLIAMS. You have to understand the way the process works. I personally do not write an examination report. There is a separation there to provide additional independence. Don't mistake me, sir. I am not apologizing.

Mr. LEACH. Let me ask you, might you ever have ridden on a plane?

Mr. WILLIAMS. Yes, I was, and let me explain the circumstance there. I was in New York in 1986 together with the Comptroller of Florida. We ran into Mr. Paul while we were there. This was not a State business trip, this was a campaign trip paid for by the comptroller's reelection campaign. The Comptroller of Florida is a state-wide elected official.

We ran into Mr. Paul while we were there. He inquired as to when we were returning to the State capitol. We told him we had to go at some particular point that was frankly a rather awkward time. He said, "I have my airplane here if you would like to use it, I will make it available to your campaign. That way you can complete the schedule you would like to adhere to and return to the capitol."

We did so, and we also paid for the airplane, for the use of the airplane in full out of campaign funds, not public funds. Mr. Paul was not on the airplane.

Mr. LEACH. Let me ask, we have a mix of Federal and State thrift examiners and policymakers here. In either Federal or State statute is there either the authorization or the encouragement of thrifts which have as a purpose to aid home buyers, to speculate in art? Is that in the Federal statute, Mr. Ryan.

Mr. RYAN. No, sir, it is not.

Mr. LEACH. Is that in the Florida State?

Mr. FUCHS. There is a prohibition against making an investment which is not enumerated within the statute or pre-approved by the State of Florida. When those investments were made, the State of Florida took action to cause divestiture.

Mr. LEACH. Is it not true that in Federal statute, and in most States—and I am not sure it is true in Florida—that short of closing an institution, there is the power to remove the head of an institution?

Is that not true in Federal statute, Mr. Ryan?

Mr. RYAN. Yes, sir, it is.

Mr. FUCHS. Yes, it is, and we took action to remove Mr. Paul.

Mr. LEACH. My own inquiry to you is that the FDIC reported to us this morning that there may be a \$2 billion loss subsequent to when Mr. Paul took over the thrift with a \$500 million hole. I just want to ask each of you why was not Mr. Paul removed many, many, many, many months ago?

Mr. Ryan.

Mr. RYAN. Mr. Chairman, first of all, let me point out that I—

Mr. LEACH. You are part of the solution, not the problem. I agree with that.

Mr. RYAN. I arrived in Atlanta in November. But to put it in perspective, it is fair to say that if you look at the operation of CenTrust over the time span that Mr. Paul had it, CenTrust was profitable every year. CenTrust reported substantial profits.

Mr. LEACH. Let me just object for a second to this. You made a statement in your opening statement that was a serious misuse of the English language. You phrased in your opening statement that the only way that this \$500 million hole could be dealt with was to buy high-priced certificates of deposit, and then let the income stream cover the difficulties.

The word "income" is not true. It is a cash flow. I would be very, very doubtful if there has ever been any income in CenTrust over any of the years Mr. Paul was there. If there were income, it would have been a miracle given a \$500 million negative worth when the individual took it over, the gold-plated toilets, and the extraordinary expenses that all of you witnessed when you rode on his boat—and I accept your explanation that you recognized the difficulty and rectified it—or his airplane—but I don't as easily accept your explanation, Mr. Williams.

These were extraordinary expenses. It doesn't take any brains, if you look around any industry in America that is competitive, to know that the only chance an institution has to compete is to be exceedingly careful on expenses, exceedingly careful.

And there is never evidence of that with Mr. Paul, never, at any stage of Mr. Paul's stewardship. I will be darned if I can believe that there was ever a moment that that institution ever turned in income, never in any honest reporting system.

Now, I can believe that with ease it reported cash flow. It just took in more deposits. But income is another matter.

Mr. RYAN. I happen to agree with you; however, under generally accepted accounting principles, which is the standard by which most institutions are judged, CenTrust did report income—positive net income in every year from 1983 through 1988. Only in 1989 did it report a loss.

As a matter of fact the financial statement dated September 30, 1989, prepared under generally accepted accounting principles and submitted to us in December or January, shows the institution to have a positive net worth of \$234 million.

Now, I find that somewhat incredible in view of the fact that the Chairman of the FDIC has just informed us that he thinks there is going to be a \$2 billion loss in this institution. I therefore agree with you. The economics of CenTrust's transactions were such that there wasn't any real income.

But we are told to judge these institutions under generally accepted accounting principles, to calculate their net worth and cap-

ital requirements using generally accepted accounting principles. Using those standards this institution was not only profitable, but it met its capital requirements until FIRREA took the regulatory "goodwill" away from them.

Those are the facts.

Mr. LEACH. Well, let me ask, is it not true that CenTrust during these years never reported any income on an operating basis?

Mr. RYAN. That is true.

Mr. LEACH. The only profits it reported were based upon a technique of reporting junk bond appreciations. Is that valid?

Mr. RYAN. That is very true.

Mr. LEACH. This didn't raise any alarm bells with anybody?

Mr. RYAN. It did. We were concerned about that practice from the outset. The examination reports are replete with criticisms of the trading activity; of the pairing off of securities to generate a profit; of the splitting off stocks from the bond piece of junk bonds and subsequently selling some of the warrants and stocks at a profit while continuing to hold the junk bonds on the books at their historic cost.

Mr. LEACH. Was there any evidence that any of the officers or directors kept any of the warrants?

Mr. RYAN. I am not aware of any evidence to that effect.

Mr. LEACH. Well—

Mr. RYAN. I think in fairness that if one has to explain why nothing was done, most regulatory actions stem from some egregious violation of law, or perceived unsafe practices. CenTrust was an institution that was arguably permitted under Federal and State law to purchase junk bonds.

It was permitted under generally accepted accounting principles to report income the way it did. Until FIRREA was allowed to count the \$525 million worth of goodwill resulting from the purchase of Dade Savings. All of this created an aura of a profitable, compliant institution.

Mr. LEACH. I appreciate that, and I think you have a good feel of the circumstances. I am glad you are in the job you are. I am only sorry you weren't in that job a few years ago.

Mr. WILLIAMS, as I understand it, the airplane flight from New York to Tallahassee was paid for out of political campaign funds. Whose, yours? Were you running for something?

Mr. WILLIAMS. I was not personally running for something. The Comptroller of Florida was running for reelection.

Mr. LEACH. So, it is not a conflict of interest for the Comptroller of Florida, who, among other things, has responsibility for regulating financial institutions and, if he is like many other comptrollers, the placement of State funds in financial institutions, to ride in a corporate jet?

Mr. WILLIAMS. First of all, the Comptroller of Florida does not place public funds in the State institutions. The Treasurer of Florida has that duty. Florida has very strong and very clear campaign finance laws requiring clear delineation who contributes to campaigns, what their employment is, and so on. And the comptroller complies with those laws just as a member of this committee would.

Mr. LEACH. I appreciate that. Did Mr. Paul ever give the Comptroller of Florida campaign contributions?

Mr. WILLIAMS. In 1986, he supported the campaign.

Mr. LEACH. Did he give any contributions the day before the flight, for instance?

Mr. WILLIAMS. Not to my knowledge.

Mr. LEACH. We have modest information to the contrary, not substantial, less than several thousand dollars, but more than one contribution might have occurred. Let me again, in a very real ethical way, question the idea that a regulator not only flies in a corporate jet of someone that he is regulating, particularly someone in such a dicey circumstance, but that the answer to the problem is the political process.

I think both are dubious. As we look at the statistics of all the campaign funds given by Mr. Paul, again, my question is: If you give so much money in politics, how can you prudently be running an institution and managing its resources, let alone the obvious question of what you expect in return?

I think we got another case study in what has gone amok in American public life. Would you agree with that, Mr. Williams?

Mr. WILLIAMS. No, sir, not necessarily, for two reasons: Obviously, I think the really central question that the public has a right to an answer to is what was expected in return here? Was there some political pro quo. Was there some compromising of the regulatory process? I would suggest that the fact that the Comptroller of Florida signed an order seeking permanent removal of one David L. Paul from the Florida thrift industry, from this institution specifically, and from the entire industry permanently, should put the public mind to rest on that question.

Further—

Mr. LEACH. You may be right about that. As a matter of fact, I don't know the Comptroller of Florida, and I suspect he may be a very decent individual. I do think this is a problem. But go ahead.

Mr. WILLIAMS. The other point I wanted to make is that this took place in 1986. In 1986, there was nowhere near the perspective on CenTrust that exists today. Nowhere near. I realize I may be getting into shades of gray here, but I can assure you that if there were highly contentious situations that we would not put ourselves in that position.

It was a very isolated experience, anyway, not unlike this business of the hamburger on the boat.

Mr. LEACH. I appreciate that. Let me say, I think the two instances I raised are very small, and I don't think one should draw deep conclusions from these two minor episodes. But certainly, the end result does look very large from the public's perspective.

I would only conclude by observing something that Mr. Wylie did earlier, that when you have Federal deposit insurance and lack State regulation, the States have really put a burden on the U.S. Government and in this case, it appears that Florida had more lax regulations than maybe it should have.

I would hope that this model will be reassessed in the State of Florida. I realize FIRREA has preempted some of the jurisdictional rights of States. But there was reason to do that.

Mr. WILLIAMS. May I respond? Respectfully, sir, I would like to challenge you on that, challenge not you, sir, but the contention that the State was lax. I don't think the State was lax and in fact, shortly after, I came to work for the Comptroller's Office in Florida. I attended a meeting together with some of our senior staff in Atlanta with Tom Zimmerman, who was then on deck in the Atlanta office of the Home Loan Bank Board.

It was made clear to us when we went over a series of problem institutions that we had, just how difficult the situation was with the FSLIC fund and the lack of liquidity in it. Mr. Zimmerman was doing a stellar job dealing with the resources he had at his disposal.

We had sought to go ahead and schedule closures on four or five small institutions that we felt were imminently insolvent. It was made abundantly clear to us, and if I am incorrect here, chime in, that in fact the resources of the Atlanta district were being—the system generally, maybe not the district specifically were being concentrated in the oil patch, California, and so forth, where there were far, far more problem institutions than there were in Florida.

I came across my notes from this meeting the other day in preparation for coming up and testifying before you today and read comments such our staff is tied up for every weekend for the balance of the calendar year handling closures in the West Coast and Southwest.

We can't get to the problems in Florida, because you have comparatively few problems to these other areas. We have to take our priorities in order.

I was new to the regulatory business at the time. I listened to that conversation. I went back to Tallahassee and reported to Gerald Lewis what the instruction was we had been given. He was not satisfied with that response, and we arranged a meeting here in Washington with then-Acting Director of the FSLIC, Thurmond Connell, Sam Connell. He had formerly been in Atlanta. We had an excellent working relationship with him.

We met at the FSLIC headquarters and said that every day we were delaying action on these failing thrifts in Florida. The ultimate cost was going up in many cases by thousands of dollars a day and we felt we had a legal responsibility as Comptroller of Florida, as a sworn constitutional official, to exercise our job and did not like being put in the position by the Federal Government of being held back from doing so.

It was again made clear that there were much less problems in other parts of the country that were perceived to be higher priorities, and that while he would make every effort he could to help us out, there would not be a clear guarantee of when to act. We subsequently went back to Tallahassee, gave the matter further thought, and subsequently came to Washington a second time, this time meeting with then-Chairman of the Home Loan Bank Board, Danny Wall, and we even put on the table the notion of trying to assist in the direct recapitalization of the FSLIC Fund.

This was before President Bush proposed FIRREA. You may remember at the time, during Congressional debate, there had been, and we had been actively lobbying in that process. There had been some concern about providing too large a capital infusion to the

FSLIC fund for fear that the regulators might go on a spree of closures and be irresponsible if they were given too much money.

We put on the table to Mr. Wall the notion of getting together several State pension funds and depending on our ability to negotiate adequate security with the U.S. Treasury, possibly providing some direct cash infusion to the FSLIC fund.

Mr. LEACH. If you had done that, Mr. Williams, there would be tens of thousands of State employees around this country that would be burning your house today. I am glad you were unable to persuade Washington.

Mr. WILLIAMS. Actually, it was the other way around, sir. What happened was Mr. Wall didn't feel he could give us the level of security that we wanted. So, we were the ones that walked on that transaction.

Mr. ZIMMERMAN. Mr. Leach, I wonder if I could amplify. I am afraid you might be left with the impression that while Rome was burning, we weren't doing anything about it. I would just like to point out, particularly on the area of the junk bonds, that as early as 1985, 5 years ago, we began by directing them to stop purchasing the bonds. We followed up with a directive to them to reduce the amount in their portfolio.

Mr. LEACH. Did they violate the directives?

Mr. ZIMMERMAN. Yes, they did.

Mr. LEACH. Then why in heaven's name didn't you replace Mr. Paul? When you have the authority to get rid of them when they violate your orders.

The CHAIRMAN. Mr. Leach, would you yield to me? I think the answer is they did try. In January 1986 and again in October 1986, this office recommended that Washington bring a temporary cease and desist order. Of course, they didn't have FIRREA then, they had it now. Such an order was not issued. It really didn't come into being until March 1989.

So, from that level, they did. The came up to the District of Columbia which, after all, is still the scene of the crime, and it went to Rosemary Stewart's desk, and that is where it stayed. So, in all fairness to them, they did try.

Mr. LEACH. I appreciate that. Does the State of Florida have the power to replace a head? Your answer was affirmative?

Mr. WILLIAMS. Yes, and we did a removal order on David L. Paul.

Mr. LEACH. What date?

Mr. FUCHS. In the last months of this year.

Mr. Leach—

Mr. LEACH. Does the Southeast Regional Office have that authority?

Mr. ZIMMERMAN. We did, but the standards were much more stringent at that time, requiring proof of dishonesty and substantial loss to the institution.

Mr. LEACH. What about the violation of agreements?

Mr. ZIMMERMAN. This was a directive. In order for them to have due process once they violate a directive, it is incumbent upon us to proceed against them at a cease and desist hearing which we were never able to persuade Washington to begin.

Mr. LEACH. Did you need Washington's authority?

Mr. ZIMMERMAN. Yes, sir, we did. Keep in mind this junk bond issue was not as clear-cut as it would appear today. Everyone was trying to find the correct solution to this. I don't think, I must say to you that I don't think their failure to act was based on corruption of any sort. I believe it was a question of what is the appropriate national policy?

Mr. LEACH. I appreciate that.

Mr. WYLIE. Would the gentleman yield?

According to my information here, on September 5, David Paul said at a staff meeting, that problems with the Federal regulators could be handled in a face-to-face meeting with the Washington Bank Board officials. Was the Washington office of the Bank Board more favorably disposed to the wishes of Mr. Paul, do you think, than you were?

Mr. ZIMMERMAN. I was not disposed to accept his arguments perhaps quite as readily. It may be my provincial outlook speaking there. But the two views that he was successful with in Washington had to do with the acceptable level of junk bonds in the portfolio and the type of underwriting that he was doing and the accounting for the securities trading, which we felt should have been—should have required them to mark their portfolio to market.

He took a squad of experts to Washington, and I think in both cases, they were trying to look at the issue not just in the CenTrust context, but in the context of other institutions that were open and operating and following in some cases similar procedures on how to fairly attack the problem on a national level rather than to pick on one institution in that context.

I believe that is where the issues began to ferment at the Washington level. In 1988, after we raised the issue for the second time, shortly after that, the Office of Regulatory Affairs issued a regulatory bulletin relating to trade versus investment. So, prospectively, we began to approach that issue across the country on the same basis.

Prior to that, we were relying on GAP announcements.

Mr. WYLIE. Did David Paul ever allude to his contacts with Federal officials to you? Did he ever make any threats that he would take the issue to the Federal Home Loan Bank Board officials in Washington?

Mr. ZIMMERMAN. Frequently. He threatened that frequently.

Mr. WYLIE. Did it have any effect on you?

Mr. ZIMMERMAN. No, not particularly. And I must say that other than the fact that the bank board didn't always do it right when we wanted them to do it, nobody ever suggested to us that we back off of CenTrust.

Quite the contrary, Mr. Dochow sent me a memo at one point saying please don't misunderstand our position. We don't want you to stop looking closely at CenTrust. So I never felt that they were calling off their field forces in this case.

The CHAIRMAN. Would you yield on this point? On November 1987 Paul did meet with Danny Wall and on the first month, January 1988 you had a new clean examination. So it did work. He didn't have to threaten. He did come to Washington.

He did meet with Mr. Wall and he got results.



Mr. VENTO. Would the gentleman yield? I just wanted to inquire a little bit about the accounting procedure. You mentioned that it was GAP accounting, but who was doing the auditing? Who was the auditing firm for CenTrust?

Mr. ZIMMERMAN. DeLoitte, Haskins and Sells.

Mr. VENTO. They vouched for the appraisals and values? There was an argument over marked to market. So there were two issues. It is almost, Mr. Chairman, I realize that we—I guess that is one of the reasons we had to write a lot of regulations there because they needed the guidance.

I think it is important to note that again it is a failure of auditing that has gone on and appraisals and a variety of other things, although we all recognize that junk bond portfolios in the last 6 months have behaved differently than what we were before then.

I think a \$2-billion loss is not entirely attributed to that difference in performance today. I thank the gentleman for yielding.

Mr. LEACH. Mr. Chairman, I just have two quick questions. One, did he ever threaten a lawsuit against any of you?

Mr. ZIMMERMAN. Yes, he did.

Mr. LEACH. So it is another example of an individual in a regulated industry threatening a lawsuit and possibly hamstringing the Government by threat of suit. Finally, as I look at this chart of compensation, do you have to prove this compensation?

Mr. ZIMMERMAN. Not specifically, although we asked that it be included in a cease and desist order. We did recommend that it be reduced, as well slowing growth, as well as stopping their excessive forward commitments.

Mr. LEACH. Slowing growth, not stopping it?

Mr. ZIMMERMAN. Not stopping it. The regulatory scheme allowed them to grow at a rate not to exceed 25 percent on an annual basis over any 2 quarters. We asked that it be reduced to 15 percent maximum growth rate.

Mr. LEACH. So in other words, your estimate is that it would grow at about two times the inflation rate even though we had a negative net worth excluding good will?

Mr. ZIMMERMAN. Yes. If the inflation rate at that time was 5 percent, I am not sure that it was, but I will defer.

Mr. LEACH. It is less than that. I am giving you the benefit of doubt.

Mr. ZIMMERMAN. We weren't doing a stop cold. We were trying to slow them down and get things under control.

Mr. LEACH. I appreciate that there is a lot at fault here and we haven't turned on ourselves as much as we should. Several of you have reasonable positions over time. I recognize this. Maybe this is something we can all learn something from. Thank you.

The CHAIRMAN. Thank you. I would like to put into the record a copy of the report addressed to Rosemary Stewart, Director Enforcement Division, FHLBB from Mr. Zimmerman, dated January 6, 1986, in which he recites violations and the like in a very thorough fashion.

[The information referred to can be found in the appendix.]

The CHAIRMAN. I have one question for Ms. Richmond right now. That is, I understand in January 1986, I beg your pardon, we have a memorandum that indicates that CenTrust may have destroyed

or removed documents from the institution's headquarters in January of this year, 1990. Have you any information to support this?

Ms. RICHMOND. I don't have any specific information to support it. There were allegations to that effect that there were documents leaving the institutions. That, of course, was in the month before it was taken over when CenTrust probably had every reason to believe that that action was forthcoming. The way the information came to our attention was through some anonymous calls which we tried very hard to track down and get more on.

But eventually what we did was to try to base our examiners in as many places as we possibly could to inspect documents going out. In one case a shipment of boxes was going out, the examiners stopped, and asked what it was. They said it is copies of documents going to law firms because there was a great deal of litigation going on both with us and the State.

The examiners did open those boxes and inspected them and determined that they were in fact copies. A couple of other things that we did on that, too. Mr. Ryan called David Paul. We also wrote to the institution. Their explanation and the explanation of counsel was that they were in fact shipping out only copies to go to one of their many law firms that were defending them.

He certified to that. We got the chairman of the Audit Committee at CenTrust involved at that point, but were not specifically aware of original documents that left the institution. The RTC may know the answer to that.

The CHAIRMAN. You may not be aware, but is there any possibility that such could have happened?

Ms. RICHMOND. I certainly think there is every possibility.

The CHAIRMAN. This question I address to either Mr. Williams or Mr. Fuchs or both. According to the administrative complaint filed by the State of Florida, CenTrust savings lost \$29 million between July 1, 1988, and September 30, 1989.

During the same period of time David Paul, without approval from CenTrust Board of Directors, purchased over \$29.3 million worth of paintings and sculptors, most of which were carried on the book as office property and equipment, yet ended up in Mr. Paul's personal residence.

These purchases included a single painting that brought with us a \$1.2 million commission. Would you please tell the committee, is it fair to assume that had CenTrust not spent over \$29 million on art work during that period of time, the institution would have shown a profit rather than a \$29 million loss.

Mr. WILLIAMS. I think the correlation between the losses and the volume of the art purchase certainly begs that question. Clearly that was the question that occurred to both the State and the Federal regulators at the time.

I think it is nothing short of outrageous that a purchase of that nature was made at that point in the life cycle of this institution. It just would be outrageous if a family upon encountering some kind of losses went out and purchased some luxury item.

It is just not done. It defies common sense. That is why the institution was immediately directed to divest itself of the art works. CenTrust at first made a series of arguments and challenges. They

challenged the authority of the State to intervene in the matter at all.

They claimed they were holding the art as an investment. In fact it was on their books as furniture and fixtures. We said if it is furniture and fixtures where are your depreciation schedules. They said they didn't have one and told us: "You ought to be smart enough to know that old master paintings are an investment."

We said if they are, they are not an approved investment. You did not seek or attempt our approval. Therefore, it is unauthorized and we are telling you right now, get rid of them. The response to that was, well, surely there is some portion of our portfolio that is legitimate for us to have art.

They cited a number of other institutions such as Chase Manhattan, Southeast Bank of Florida that have art collections as examples and comparables and said tell us what you think is a reasonable percentage of assets to have in art and we will do it and comply with whatever you tell us as long as it is reasonable.

We said the percentage is zero, get rid of the art. That led to a protracted battle that ended with an order from us for the art to be turned over to a third party. There were actually several sequential orders. One was to sell the art within 6 months was the initial order.

Six months came and went. They did not sell the art. They said that in fact the nature of the art market was such that it took a long time and if we tried to rush out the process we would be mandating losses for the institution.

I personally took the responsibility to learn something about the art market. Met with some third party experts who had no involvement in this matter at all and concluded that while there was some merit in the statement, that surely that these things should not be just sold at public auction on the steps the following morning; that it certainly made no sense to have the art works physically in the possession of the institution, just as if we were trying to sell the tables and chairs that we are now using in this room.

Arguably our motivation to sell them would be much stronger if we were not sitting in them at the time. So we sought to have the paintings moved out of the institutions into the hands of a competent third party, to sell them.

Instead, the reputation was made to us by the institution that they were forced to go out and sell these things at a loss. I am sure when Mr. Paul is before you, he will tell you that the State of Florida forced CenTrust to incur a multiplied loss on their art collection. That is simply not true. But that is—and by the way, to this date we have not seen any solid, tangible evidence that any sale of that art work ever closed.

It was represented to us on more than one occasion that the works were either sold or were being sold. As you all know, there is a difference between a contract for sale and evidence of a closing actually taking place and a transaction being funded.

The CHAIRMAN. Well, I am not interested so much in art, rather I think that is a commodity that is also susceptible to a lot of speculation. But the fact is that Mr. Paul did this despite not obtaining the consent of his board. Is that a violation of Florida law or not?

Mr. Keating did the same thing. he bought a flock of art. It is the same pattern, as a matter of fact. It just seemed to—as I stated in my question, he listed that as office equipment, so if he did it in defiance of or not having the support of the board, once it was discovered that he had circumvented the board, is that a violation of Florida law?

Mr. WILLIAMS. Yes, it is a violation. He made the argument that in fact board consent was there, submitted reams of information theoretically supporting that.

There has been some question as to what level of confidence could be put in those board minutes as to whether they were in fact contemporaneous. From our perspective the key was the effect on the institution and there you come down to the monetary cost of the paintings and the way you deal with that is to sell the paintings.

The CHAIRMAN. I say there is a responsibility I believe on the part of the State Enforcement Branch to enforce that. If there is criminal culpability attached to that violation, is there any record of the State of Florida attempting to prosecute the man?

Mr. FUCHS. I think you are opening a whole new area here. The State of Florida began an investigation, not an examination, but an investigation of Mr. Paul's activities in January 1989. That investigation continued on and off, at one point suspended waiting for the examiners to allow us back into the institution, and continues to this date.

The State of Florida has assigned three personnel full time to the U.S. Attorney's Office, detached from our agency, to continue the investigation of CenTrust. This is not a situation that is unique to CenTrust. We did the same thing with Commonwealth Savings and Loan, had personnel detached to the U.S. Attorney's Office, and also did it in the case of Sunrise Savings and Loan where we were successful in obtaining criminal indictments. So the State of Florida's commitment to pursuing these matters even when they go beyond our jurisdiction is a matter of record.

The CHAIRMAN. OK.

Mr. LEACH. Mr. Williams, you have raised a point that surprises me a good deal. The chairman has properly raised the question of how approval to buy the art was initiated. But also I think the State of Florida has an extraordinary interest in how the sale was made.

If one assumes we have a terrifically insolvent institution which is about to be closed, then the seller has an obvious vested interest, when there is a conflict of interest, to sell assets cheap because the public will pick up the difference.

So the question is not whether or not there is a contract of sale, but whether or not it was handled by a neutral third party, in a competitive manner and using standard techniques of selling art. I would simply like to ask, is the State of Florida following that?

Mr. WILLIAMS. That is exactly the question we asked. You are exactly correct. We had an order that sought to have the State prove who the buyer of the art was because we had exactly the same concerns. The institution in fact challenged the order. They filed suit in Federal court and perhaps at the State level as well on that

matter, and it was still in litigation when the institution was ceased.

But your points are very well taken.

Mr. LEACH. Your point is that they have not been sold?

Mr. WILLIAMS. The representation made by the institution is that it was sold.

Mr. LEACH. How could it be sold if you have a court order against it?

Mr. WILLIAMS. I didn't say there was a court order against it.

Mr. LEACH. You said you were seeking intervention of one type or another?

Mr. WILLIAMS. The intervention that the State of Florida sought was to insure that the art works were placed physically in the hands of a third party, competent seller of fine arts, approved by the State government for independence, competence and integrity. That is what our order was.

The institution challenged that order in court and pending that challenge we had no evidence they complied with it. Subsequently the institution has claimed publicly they have in fact sold the art works and that was what I was alluding to earlier when I said—

Mr. LEACH. I hope you are in close contact with Mr. Fuchs' office.

Mr. WILLIAMS. Our offices are physically very close together and we worked very closely on this whole matter.

Mr. LEACH. Thank you very much.

The CHAIRMAN. I have one more question. According to the Bank Board's 1989 examiners report, CenTrust made about \$30 million on three securities transactions from or with Papa Keating, Charles Keating, Jr.

Lincoln Savings or its affiliates. These were the Memorex, Playtex and Grand Union deals. During the hearings we had on Lincoln we exposed these illegitimate transactions. Could you detail those transactions for the committee, the \$30 million, and what your concerns were?

Mr. FUCHS. The concerns we had were the same that Mr. Leach brought up about the arm's length nature of the transaction, whether they were part of the daisy chain where the issues went back and forth between CenTrust and Lincoln and inflated in value at each turn.

We were only capable of looking at one end or one corner of the triangle. That was the CenTrust corner. To facilitate the process we requested assistance from the Securities and Exchange Commission. They were already involved in the litigation with Drexel, Burnham, Lambert and were looking at the Keating case in California.

They agreed to reopen their view of CenTrust as it pertained to that potential daisy chain and my presumption is or my best information is that that review continues.

The CHAIRMAN. SEC is continuing its review, is it?

Mr. FUCHS. To my knowledge, yes, sir.

The CHAIRMAN. Mr. Wylie.

Mr. WYLIE. Yes, sir, Mr. Chairman.

Mrs. Richmond, I mentioned a little earlier that there was a memorandum from Mr. Paul where it was alluded to as having come from Mr. Paul that said that the staff problems could be re-

solved by going to Federal regulators and you had indicated and maybe Mr. Zimmerman answered that. I don't know, one of you, that the reason I am asking you is that there is a memorandum here from Mr. Fred Wolf and I will get into that in just a minute, along these lines, but Mr. Keating's name has come up here frequently, threatened to go to politicians or to elected officials.

Did you ever run into any of that with reference to Mr. Paul?

Mr. ZIMMERMAN. Well—

Mr. WYLIE. Do you have any information along those lines, Mr. Zimmerman?

Mr. ZIMMERMAN. I think he made it known that he was active in political circles and we read newspaper articles to that effect. As I said, he didn't say to me at one time he reputed to have said to one of my colleagues that they were going to go up and try to get similar treatment that Lincoln got, having jurisdiction removed.

Now, to my knowledge he never attempted that.

Mr. WYLIE. There was at least a veiled threat at one time that he was going to try to follow the pattern of Lincoln and go to elected officials in Washington.

Mr. ZIMMERMAN. Frankly, by that time we were hoping that he would do that. But he disappointed us.

Mr. WYLIE. Do you have a comment on that Ms. Richmond?

Ms. RICHMOND. I would just reiterate that he threatened that kind of thing constantly and quite frankly I don't really think we believed it. I remember him telling us at no time he had been asked to be the new head of FSLIC. He told us on another occasion, as a matter of fact, it was the occasion of our first call to him regarding the art work and he said that you know, we just didn't understand what the situation was and he was going to report us to the Senate Banking Committee.

Mr. WYLIE. Not the House, but the Senate Banking Committee.

Ms. RICHMOND. But I mean he tended to be a name dropper, so I don't think it was anything that was taken too seriously, at least from my standpoint.

Mr. WYLIE. Did he mention any names other than the Senate Banking Committee?

Ms. RICHMOND. I can't remember any specific names that he ever raised. I never got any calls from anybody.

Mr. WYLIE. You didn't get any calls from any Senate Banking Committee members?

Ms. RICHMOND. No.

Mr. ZIMMERMAN. No, sir.

Mr. WYLIE. Did he mention any names to you?

Mr. ZIMMERMAN. No. I don't recall him using a particular name.

Mr. WYLIE. Just in a generic sense?

Mr. ZIMMERMAN. Yes, "I have friends in high places."

Mr. WYLIE. OK. I have a memo here, an interoffice memo, which says the second bit of information I received is that Fred Wolf was a high muckedy muck at GAO and is liked here for his connections. And it was a memo which was sent to you, Ms. Richmond. Do you know the memo I am talking about?

Ms. RICHMOND. Not off hand, no.

Mr. WYLIE. Do you know Fred Wolf?

Ms. RICHMOND. I know who he is. I do not know him personally.

Mr. WYLIE. He was mentioned for awhile in some newspaper article, as possible head of OTS. What did he do for CenTrust?

Ms. RICHMOND. My only recollection of his involvement with CenTrust is that in probably October or November 1989, I guess, to draw back a little bit, CenTrust's former accountants resigned in June 1989 and they engaged——

Mr. WYLIE. Who are they?

Ms. RICHMOND. Deloitte Haskins and Sells. They engaged Price Waterhouse later in July or August.

The OTS staff met with Price Waterhouse probably, and don't hold me to a date, probably around August to express concerns. They met with them for about 2 or 3 hours. At some point subsequent to that the, I believe the State of Florida requested—State Comptrollers Office requested Price Waterhouse to come and meet with them also and it was in the context of that meeting that I heard Mr. Wolf's name, that he had heard of the State's meeting and perhaps thought he should attend or we should meet in Washington or something.

But it was really just a third party discussion. I didn't know Mr. Wolf at all at that point.

Mr. WYLIE. That is the context of this interoffice memorandum from James C. Winning, which indicates that if they are going to do business with Price Waterhouse that they may need some professional help and maybe Fred Wolf could give it to them. All right.

Earlier, I mentioned Mr. Chairman, to Mr. Seidman that there was a memorandum here that indicated that perhaps some of the insured deposits went into political action contributions and Mr. Seidman said that they were following up on that. He had a list of political contributions which were made by CenTrust which were made a part of his testimony.

I don't see it. I have a copy of it now. With your approval or by unanimous consent, I should ask approval to put it into the record at this time.

The CHAIRMAN. That was part of the unanimous consent for documents and other evidentiary material so that would be included within that. We had intended it. We did have a copy of that we intended to place it into the record.

Mr. WYLIE. I note there is one on here of particular interest to me since we have had a lot of discussion on it today. It says alliance for capital access, junk bond lobby group, \$50,000. Thank you, Mr. Chairman.

The CHAIRMAN. Well, that—it has been a pretty active group up until lately around these quarters. In connection with the possibility of documents having been destroyed, I would recommend that in the area where we had these arm's length transactions, Paul, with Keating and others, that if there is an absence or dearth of documentation that perhaps that would be the area where any destruction would have happened.

Up until now in your review of the documents, this particular transaction with Keating, do you have that fairly well substantiated?

Ms. RICHMOND. Yes, sir, we do.

The CHAIRMAN. You do.

Ms. RICHMOND. I might add that had we not had thrift examiners in Lincoln at the time, we would not have been able to find that transaction. That came to them from some information at Lincoln.

The records at Centrust showed that the trades were done through Drexel as were many, many other trades. It was merely because there was an examiner in Lincoln and an examiner in Centrust that you could look and say, hey, these happened the same day and went both ways.

The CHAIRMAN. Very good. Well, gentleman and lady, thank you very much. You have been most patient. We have run right through the lunch hour and we are very grateful to you. You will get a transcript of the proceedings here today. Some of the Members will submit some questions in writing to you so that you may address them by the time you look over the transcript, modify it, correct it.

Does anyone of you have any additional statements to make or observations, Mr. Ryan.

Mr. RYAN. No, sir.

The CHAIRMAN. Well, thank you very much. You have been a great help.

[Whereupon, at 2:05 p.m., the hearing adjourned, subject to the call of the Chair.]



## APPENDIX

March 26, 1990

OPENING STATEMENT OF HENRY B. GONZALES, CHAIRMAN  
HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

HEARING ON CENTRUST SAVINGS AND LOAN ASSOCIATION  
March 26, 1990

This morning the Committee resumes its autopsy of the savings and loan industry in an attempt to find out what went wrong and to develop a strategy to prevent more costly disasters from being visited on the American taxpayers.

The focus this morning is on a Miami-based thrift, Centrust, a 10 billion dollar institution and the largest thrift in the Southeast.

With its mammoth yacht, its towering office building, its fabulous and expensive art, its Trump-style parties, Centrust is an exciting story. It is also a dreary story of one more savings and loan wreck -- a wreck that might well have been prevented had the enforcement officials applied the safety restraints earlier and more forcefully.

In December of 1988 -- with savings and loan deals falling on Washington like the winter snow -- most of us credited M. Danny Wall with copyrighting a new regulatory game show -- "Let's Make a Bad Deal." As we examine Centrust, we may have to concede that the original copyright should have gone to one of his predecessors -- Richard Pratt, President Reagan's first appointee as Chairman of the Federal Home Loan Bank Board.

Dick Pratt's Bank Board worked out a deal with David Paul, a Connecticut real estate operator, to purchase an ailing 1.9 billion dollar institution then known as Dade Savings and later to be renamed Centrust. In the process, Pratt shut out other bidders, sweetened the deal with forbearances on capital maintenance, growth and liquidity and threw in a half-billion dollars of "supervisory goodwill."

In return, Mr. Paul promised to contribute real estate assets of 32 million dollars to the savings and loan. By the time he reached the table,

16 million dollars of the assets were headed for bankruptcy. But, an anxious Chairman Pratt didn't blink an eye and let the deal fly. Ultimately, 7 million dollars of capital was invested in a 95-foot yacht -- "floating capital" that luckily didn't sink to the bottom of the Atlantic Ocean.

Mr. Paul's high-flying excesses have been documented many places, but in his defense he made no secret of his plans to convert the savings and loan into a free-wheeling investment banking operation. Before it was over, he was to place between one and two billion dollars of the institution's assets in high-risk junk bonds. Drexel Burnham Lambert was right there standing alongside Paul, promoting one junk bond deal after another -- financed with Federally-insured funds.

From almost the moment the ink dried on the Pratt-Paul deal, the on-the-job examiners and supervisors operating out of the Atlanta Federal Home Loan Bank were concerned about the operations at Dade-Centrust. As early as January 1986, the Atlanta team wanted a cease and desist order issued to curb some of the riskier ventures. The requests for the order were dropped on Rosemary Stewart's desk at the Enforcement Section of the Federal Home Loan Bank Board in Washington.

The requests invariably were returned with demands for stronger evidence. The examiners dutifully went back into the field for more examinations only to be rebuffed again and again by Washington. Along the line, David Paul -- borrowing a chapter from Charles Keating's book -- complained about the examinations and demanded new teams of "objective" examiners. Keating had a habit of placing his examiners and auditors on the Lincoln payroll. Paul went him one or two better -- he ultimately hired Pratt and former Home Loan Bank Board General Counsel Tom Vartanian as consultants to Centrust. Neither Paul nor Keating were slouches when it came to revolving doors.

Centrust has the same sad bottom-line -- Washington could never get up

the courage to act forcefully and support its troops in the field. Finally last year -- after the stench of regulatory failures filled the air throughout the nation -- Danny Wall started action against Centrust -- too late for the insurance funds, the institution or the taxpayers.

Our first witness this morning is William Seidman, Chairman of the Federal Deposit Insurance Corporation who, we understand, is now faced with the task of disposing of nearly a billion dollars of junk bonds from the portfolio of Centrust. He is accompanied by Kurt Wiershem, Managing Agent, Centrust Bank, and Sandra A. Waldrop, Deputy Regional Director, Resolutions/Operations, Resolution Trust Corporation.

STATEMENT OF HONORABLE CHALMERS P. WYLIE  
CENTRUST HEARING  
MARCH 26, 1990

Thank you Mr. Chairman.

I am pleased that we are continuing the Committee's investigation of the savings and loan debacle today. I applaud you for selecting CenTrust as the subject of our investigation. Much like Lincoln, CenTrust is a comprehensive case study in what went wrong with thrift industry regulation. There are several items concerning CenTrust that are of interest to me and that I hope to explore today.

Initially, I would like to know why was David Paul ever allowed to purchase CenTrust? The Federal Home Loan Bank Board twice turned down Paul's change in control application under Chairman Richard Pratt. Why did newly appointed Chairman Edwin Gray approve the transaction?

Next, what was CenTrust's relationship with Drexel Burnham, Michael Milken and other Drexel clients such as Lincoln. CenTrust had extensive dealings with Milken and Drexel. David Paul had virtually daily contact with Drexel representatives. Drexel Burnham seems to be a common thread that is showing up in the Committee's investigation of the savings and loan crises and I look forward to exploring this link both today and at other hearings.

Third, why did the Washington Bank Board twice reject the Federal Home Loan Bank of Atlanta's recommendation for enforcement actions again CenTrust. This appears to be a repeat of the Lincoln situation where the regional office is taking a much tougher regulatory stance than Washington. We must assure ourselves that changes in law due to FIRREA ensure that this does not happen in the future.

Fourth, did David Paul have improper contacts with state and Federal regulators? Paul had several ex parte meetings with former Bank Board Chairman Wall. I am concerned that there is at least an appearance from these meetings that Paul may have been able to improperly influence the Washington regulators. In addition, Centrust's Board of Director minutes indicate that the thrift far preferred the relaxed regulatory style of the State of Florida as opposed to tougher Atlanta Home Loan Bank personnel. Were the State regulators doing their jobs?

Fifth, I am stunned by the excessive misuse of Federally insured CenTrust funds by Mr. Paul in purchasing luxury boats, expensive artwork, chauffeured limousines and countless other items for his personal use. David Paul lived a life of luxury on the backs of Federally insured depositors. Moreover, I am interested in the purchase of these luxury items through funds that were transferred out of Centrust to foreign institutions.

Finally, I am concerned about David Paul's political ties. Former Bank Board Chairman Ed Gray called David Paul "the most politically well connected savings and loan executive I know of." We have already seen the political influence Charles Keating attempted to use regarding Lincoln. I am concerned that David Paul could have far outreached Charlie Keating in exercising political ties. I have had my staff prepare a list of political contacts made by Paul compiled from his desk calendars for 1987 and 1988, limousine records and other sources. This list runs several pages and is truly astounding. David Paul appears to have had virtually unlimited access to former Presidents, Senators and Congressmen. Despite denials, it appears clear that at certain times this influence was exercised by Paul on behalf of CenTrust. Additionally, it appears certain from internal Bank Board memoranda that the fear of pressure from Paul's political friends clearly existed.

I look forward to exploring all of the issues today, Mr. Chairman, and I again commend you for holding these hearings. Investigations like this will insure that the savings and loan crisis will truly never happen again.

Thank you.

OPENING STATEMENT OF HONORABLE FRANK ANNUNZIO  
CENTRUST SAVINGS BANK HEARINGS  
MONDAY, MARCH 26, 1990

I want to commend you, Mr. Chairman, for holding these hearings and for so dramatically bringing out the facts about an unhealthy segment of the savings and loan industry. Without your hearings, we might never have learned how negligent the Nation's top savings and loan regulators were in doing their jobs.

One thing has been brought home to me after more than a year of close analysis of the savings and loan scandals. The blame for the problem lies totally and completely with the regulators and the Administration that appointed those regulators.

Who knew what was going on in the savings and loan industry and looked the other way? Only the regulators. Congress can't close a savings and loan or issue cease and desist orders. Congress can't remove savings and loan boards of directors or assess fines when rules are broken. Only the regulators can do that.

But now, because of regulators who couldn't, or wouldn't, do their jobs, the American taxpayers are going to have to pay perhaps as much as \$200 billion.



Today we will hear testimony, not only about regulators who would not step in to stop a \$1 billion loss to the taxpayers, but we will also hear about the regulator who allowed David Paul to get control of Centrust, even though the regulator's staff was opposed. Why did the regulators allow Mr. Paul to take over an insolvent institution by putting up some highly overrated real estate? That real estate turned out to have a value of only about one-tenth of its purported market price.

And when some regulators tried to reign in the high flying Mr. Paul, he hired other former regulators to argue his case. I hope, Mr. Chairman, we will have all of the former regulators who were involved in the Centrust case before this Committee. It is my understanding that Mr. Gray's predecessor, Richard Pratt, was hired by Mr. Paul to defend Centrust from audits by State and Federal S&L examiners.

I am not exactly certain what Centrust was. Mr. Paul was paid \$16 million by Centrust from 1984 to 1989. He had a \$1.6 million mortgage from Centrust to build a mansion which housed a \$29 million art collection paid for by Centrust. He had a \$7 million yacht paid for by Centrust; a \$1.4 million leased jet paid for by Centrust; and a sail boat worth \$233,000. Mr. Paul had expenses of \$122,000 for dinner parties, plus \$107,000 for crystal and linens, and \$104,000 in limousine expenses. Everything was paid for by Centrust. I don't think the institution should have been called C E N T R U S T. It should have been called SinTrust-- S I N T R U S T.

In the face of it all, Mr. Chairman, I can only ask, not "Where's the Beef?," but rather "Where's the Regulators?"

Statement of  
The Honorable Charles E. Schumer (D-N.Y.)  
Hearing on Centrust Savings and Loan Association  
March 26, 1990

We are here today to look into another example of the collapse of the savings and loan system. Centrust is not a pretty sight.

Centrust is a microcosm of the thrift crisis. It abused the privilege of deposit insurance by consuming massive amounts of brokered deposits and investing them in the riskiest possible way. It abused the trust of its shareholders by wasting hundreds of millions on art (some of it fake), boats and executive perks. Finally, it took advantage of an incompetent regulatory system, hiding its problems behind accounting gimmickry.

Is this a thrift? Is this the type of industry we as taxpayers want to shelter at a cost of more than \$200 billion?

The symbols on the charts on the wall are like roadsigns, internationally recognized as indicators of the thrift crisis. The fine china, limos, pleasure yacht and unbelievably excessive salaries are tangible evidence of this debacle.

But there is an abstract idea behind this scandal, a concept underlying these abuses. Deregulation. Deregulation allowed a bevy of swindlers, frauds, and cheats to drink at the federal trough. Today, we add David Paul's name to deregulation's Rogue's Gallery, a group headed by Charlie Keating. But we must not ignore what truly went wrong.

How could the regulators have let this happen, not just in Centrust but in the industry as a whole? How could they have possibly missed the roadsigns, the yacht and the salary? Where were the Reagan Administration's regulators?

FIRREA was touted by the Administration as the way to ensure that a deposit insurance crisis never occurs again. While FIRREA accomplished a great deal -- and President Bush deserves credit for those accomplishments -- it most certainly did not "solve" the problems in our financial institutions industry.

The Centrust case highlights some of what still must be done:

- o Insured deposits must not be allowed to fund risky, new ventures. If banks and thrifts are to get new powers they must get money from the markets not the taxpayers.
- o We must reduce not expand the scope of deposit insurance. For instance, brokered deposits and pass-through insurance must be severely restricted.

- o Even tougher capital standards must be imposed and, more important, accurate accounting systems such as market value accounting must be adopted to ensure that real capital protects the taxpayer
- o We must intervene in weak institutions much sooner when the cost of resolution is lower and the opportunity for abuse smaller.
- o Finally, we must not shrink from closing banks. As the Drexel failure demonstrated, even large financial institutions with deep interrelationships can fail without causing chaos.

TESTIMONY OF

L. WILLIAM SEIDMAN

CHAIRMAN

RESOLUTION TRUST CORPORATION

WASHINGTON, D.C.

ON

CENTRUST BANK, A STATE SAVINGS BANK

BEFORE THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

UNITED STATES HOUSE OF REPRESENTATIVES

10:00 A.M.

MARCH 26, 1990

ROOM 2128, RAYBURN HOUSE OFFICE BUILDING

Good morning, Mr. Chairman and members of the Committee. It is a pleasure to once again appear before you.

You have asked that the FDIC and RTC respond to several questions relating to what we have found since being appointed conservator of CenTrust Bank on February 2nd of this year. Although we always try to be as responsive as possible to the Committee, we have not been involved with the institution long enough to answer all your questions.

Our preliminary analysis thus far indicates that the failure of CenTrust will result in a substantial loss to the RTC, probably in excess of \$2 billion. This loss was a result of prior mismanagement and poor operating procedures within the institution, including the use of risky investments.

With me today are Ms. Sandra Waldrop, and Mr. Kurt Wierschem. Ms. Waldrop is the Deputy Regional Director in the RTC Eastern Region office and is in charge of regional operations relating to conservatorships. Mr. Wierschem is both the RTC Managing Agent and the Chief Executive Officer of CenTrust Bank. They are here today to provide you with testimony and to answer questions about the activities at CenTrust based upon their own observations.

We are pursuing a complete investigation of CenTrust to determine its present status and whether any fraud or other misconduct

occurred. While we believe the potential for fraud exists, our investigation is not complete.

There is no foolproof way of preventing losses to thrifts in the future. We can, however, offer three sound principles of supervision that have worked well in the past. First, the industry must be well capitalized. Second, proper accounting standards, which reveal true financial condition, must be followed. Third, there must be a supervisory staff and program in place that is tough, fair, responsive and free of political pressures.

Mr. Chairman, this completes my written statement. My colleagues and I would be pleased to answer any questions we can.

TESTIMONY OF

KURT W. WIERSCHEM  
RTC MANAGING AGENT  
AND  
CHIEF EXECUTIVE OFFICER  
CENTRUST BANK

ON

CENTRUST BANK, A STATE SAVINGS BANK

BEFORE THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS  
UNITED STATES HOUSE OF REPRESENTATIVES

10:00 A.M.  
MARCH 26, 1990  
ROOM 2128, RAYBURN HOUSE OFFICE BUILDING



Good morning, Mr. Chairman and members of the Committee. I am pleased to be here today to provide information relating to CentTrust Bank. I am the managing agent of the institution for the RTC and my comments are based on the information we have gathered since assuming that role. CentTrust Bank was placed in conservatorship on February 2nd, 1990 by the Office of Thrift Supervision after a finding that it was operating in an unsafe and unsound manner.

The RTC's goals in CentTrust, as in each conservatorship, are to: establish control; maintain customer services; evaluate the institution's condition; identify and account for losses; and recommend viable alternatives for the least costly resolution of the institution.

The RTC has been conservator of CentTrust for less than two months. The RTC employees involved in the intervention are not trained examiners but rather are a mixture of asset managers and employees trained in the various operational areas of financial institutions. Our focus has not been that of a regulator. Rather, we have taken over the daily management of the institution and are proceeding to downsize and prepare the institution for resolution. We have not reviewed the institution's history nor are we approaching the institution as examiners typically would. We do have our investigation unit reviewing the institution's records to determine if suits and claims for insider abuse or professional liability are warranted.

Our observations presented below are preliminary at this time and are often based on interviews with employees of CenTrust.

1. THE FINANCIAL CONDITION OF THE INSTITUTION AT THE TIME THE RTC WAS APPOINTED CONSERVATOR

Upon entering CenTrust, we found that the operation of this institution was similar to that of a private investment banking or trading operation, rather than a traditional savings and loan. The primary focus of the firm apparently was trading. That is reflected in concentrations in financial instruments such as high-yield bonds, high-yield private placement issues, foreign currency futures, collateralized mortgage obligations, non-rated subordinated debentures, interest rate swaps, and swap options. The business focus relied upon market gains from financial transactions to generate income versus generating traditional interest income on the spread between earning assets and the cost of funds.

In accordance with our normal practice, upon being appointed conservator, we reviewed CenTrust's financial statements to adjust them as required by generally accepted accounting principles and to provide appropriate valuation reserves on a going-concern basis. After making the appropriate adjustments, the institution was insolvent.

CentTrust's major problems included: (1) rapid deposit growth which was used to fund poor quality speculative assets; (2) production of portfolio gains at the expense of asset value; (3) investments in illiquid high-yield and privately-placed bonds and equities with significant credit quality risks; and (4) apparent liberal accounting practices.

CentTrust's growth had been accomplished via the wholesale marketplace. Brokered certificates of deposit accounted for 37 percent of total liabilities as of January 31, 1990. With high-cost deposits and borrowings, CentTrust was unable to maintain a net interest margin sufficient to support expenses.

Earnings were further impacted by the practice of producing gains in the portfolio at the expense of asset value. Securities yielding above current market rates were commonly sold to produce profits and income, while those items with below-market yields were kept in the portfolio, further depressing net interest income.

CentTrust classified many of their high-yield private placement issues as commercial loans, which allowed them to maintain these items on the books at cost rather than at market value. Under regulatory policy these securities are to be classified as investments rather than loans and thus have to be marked to market. In doing the proper markdown, as of February 28, 1990,

writedowns of about \$400 million were recorded. Presently, total writedowns on high-yield bonds and equities are over \$500 million, of which about \$80 million is for securities with no ready market.

Accounting practices included enhancing income by deferring as many expenses as possible. As of the date of conservatorship, there were at least \$40 million of deferred costs relating to various electronic data processing installations, equipment purchases, legal fees on a number of major transactions including the pending sale of branches to Great Western and broker commissions paid on certificates of deposit. These deferred costs now have been expensed.

As of January 31, 1990 total equity capital was about \$27 million. Writedowns and reserves summarized above total about \$551 million for a total capital deficit of about \$525 million, before writing off goodwill of \$372 million.

High-Yield Bonds. Upon intervention, the vast majority of the nearly \$1 billion in junk bonds remaining in the portfolio appeared to be of very poor credit quality and were extremely illiquid. It appears that any higher quality issues had been sold prior to the RTC conservatorship.

Based on the volume of activity, holding periods, and timing between trades, the junk bond strategy appeared to have been one of "trading" versus "investment". Gains were often recorded, while issues containing loss were retained.

Mortgage-Backed Securities. Remaining unsold issues have low rate coupons and in this interest rate environment also have built-in losses which will be realized when sold. It was very difficult for us to ascertain which mortgage-backed securities had or had not been pledged as collateral for various obligations. We are only now fairly confident that we have determined which issues are available for sale.

Single-Family Residential Loans. The rather small portfolio (\$2.1 billion) of single-family loans consists of two categories. The first category is those loans originated by CenTrust Mortgage Corporation, a subsidiary, and sold into the secondary market. The mortgage company originated a high quality loan which was easily sold.

However, CenTrust Bank originated a much lower quality loan, both in terms of underwriting and of documentation, which remains in its portfolio. It will take us a great deal of due diligence to ascertain the real value of these loans and the ability of the secondary market to absorb them.

Consumer Loans. As our review of the consumer loan portfolio progressed we found that the loans are over-advanced amounts to borrowers on automobiles. Since the loan paper was generated "indirect" in most cases, a dealer reserve had already been paid up front without a hold-back, so that business could be generated. This leaves a substantial item on the books yet to be resolved. In addition, approximately 12,000 titles and liens had not been recorded or perfected on these assets. The real delinquency on these loans is yet to be determined although we anticipate some delinquency problems. CentTrust was continuing to generate a high dollar volume which has the effect of covering up any real delinquency problems. Additionally, since the loan advance rates on the collateral were high, the impact has yet to be felt.

Leasing. In the auto leasing portfolio, we again found questionable underwriting. To generate a high volume lease business, the bank offered inflated residual values on the collateral and a very favorable consumer interest rate. In about 18 months, approximately 200 contracts per month will come due, with high residual values compared to the anticipated market residual value of the collateral. We therefore believe substantial losses will be taken on this portfolio.

CentTrust Tower. This asset apparently contains significant loss. The most recent contract for sale that CentTrust had was for \$88

million, and we believe there is \$170 million in costs in the building. We are presently obtaining new appraisals on the building.

Business Loans. CentTrust appeared to be a lender of last resort on business-related loans and commercial non-real estate loans. Although this portfolio is rather modest in size, the pricing of the loans does not warrant the risks they contained. Overall loan underwriting appears weak and the documentation and overall packaging of the assets are below market standards.

Real Estate Loans and Investment Loans. CentTrust does not have a large portfolio of commercial real estate loans in comparison to some other troubled S&L's. However, there are some substantial real estate investments, which will require workouts.

Subsidiaries. CentTrust has an extensive network of subsidiaries. However, there are three primary operating subsidiaries: CentTrust Mortgage, Old American Insurance Company, and CentTrust Trust.

CentTrust Mortgage Corporation is a large national mortgage company with over 900 employees. It has a good net worth and reputation, and originates an excellent quality residential product. We are presently trying to market this subsidiary.

The Old American Insurance Company appears to be a properly managed company. We suspect, however, that some of the profits were taken out of the insurance company and funneled upstream to the parent, CenTrust Bank. Also, some of the junk bonds of CenTrust Bank were apparently forced down to the insurance subsidiary, which will have to record the loss.

We are reviewing CenTrust Trust to determine the true business nature of its affairs. CenTrust Trust is in Westport, Connecticut, where Mr. Paul had a residence, and it appears to have been used for business operations that were not approved for CenTrust Bank.

Potential Loss. We will start our formal asset valuation process next week to ascertain the potential loss in the institution. As of September 30, 1989 the asset size of the institution was approximately \$9 billion. At that time prior management was downsizing the institution by selling quality assets and many of the better assets had been sold prior to our intervention. If we take the percent of loss that has been our experience in the Eastern Region conservatorships, we come up with an approximate loss of \$2.0 billion. However, a better documented and definitive loss figure will not be available until the asset valuation is completed.



Branch Sale. Upon entering CenTrust we found that a contract existed to sell 63 of the 71 branches of the institution to Great Western Bank. This proposed sale, was designed to support CenTrust's recapitalization plan and may have been pursued to delay intervention by the Office of Thrift Supervision.

2. FDIC'S ASSESSMENT OF THE PRIOR MANAGEMENT OF THE INSTITUTION

The management structure of the company, and the way management functions did not inter-relate with various activities within the firm, resulted in most material decision apparently being made by Chairman Paul. Interviews indicate that functions within the corporation were very compartmentalized in that one department seldom talked to another department. Even the physical structure and security access within the CenTrust Tower building was compartmentalized so that it was not easy for employees to gain access to other areas. It has been reported that if employees were seen visiting another department, they were often subjected to questioning on their actions.

In evaluating the work of the senior level managers, they appear to be capable people, but their compensation was often in excess of market rate. Additionally, many officers of the bank were highly compensated without a commensurate level of responsibility.

3. DISCUSSION OF ANY PRACTICES BY PRIOR MANAGEMENT THAT CONTRIBUTED TO THE INSTITUTION'S FAILURE

The senior managers have consistently indicated to us that there was no device to measure the profitability of an area, nor was there ever an attempt to measure the profitability of an activity or an area. They stated that any time this issue was brought up, the idea was rejected. This is supported since we found no real costing of an operation in a given area. Apparently, there was little concern for deposit costs and/or, on the other side of the ledger, what the yield on assets would be, especially the yield on loans.

Asset/Liability Structure. To obtain funds, the institution consistently paid some of the highest rates in the market. That strategy was carried out on a retail level through the branch network by paying high rates for CD's as well as for large amounts of brokered monies from Wall Street firms. There does not appear to have been any attempt to moderate the cost of retail deposits or to operate the branch network through traditional activities such as cross-selling checking accounts, fee income products, low rate money markets, passbooks, and products of this nature.

The Asset/Liability Committee's responsibility did not exist as normally constituted at a bank or S&L. Rate risk management and

hedging was really not possible in an environment where liquidity was so important. Hedges were left on after the assets associated with them were sold.

There was an unwillingness to cut losses short and get out of a position. Very seldom was there a stop loss instruction. Although the institution maintained a bond research group, their advice was often ignored. In buying the debt and equity kickers of the junk bonds, the institution often took large positions relative to its capital.

CentTrust has very little free collateral or liquidity. The asset/liability structure appears to have developed with little strategic planning. Assets were used for collateral to meet liquidity requirements as soon as they became available. This structure will be difficult to unwind.

The deposit accounting system does not meet the institution's basic needs. For example, the maturing Certificate of Deposit records are not available by week or by day, making the planning for liquidity funding extremely difficult.

Records. Generally speaking, record-keeping in the association is poor. Specifically, the accounting records lack accuracy. CentTrust management apparently never assigned responsibility for the accuracy of records. Little emphasis was placed on the

internal audit function and it did not offer independent opinions to management on the quality of records.

In summary, there was a general disregard of accounting for items. The employees have advised us, for example, that if Mr. Paul made a trade, the broker called the bank and notified it of Mr. Paul's transaction. The bank appears to have accepted the broker's word without a confirmation process.

Other Issues. There are many expense categories that we believe have been abused. We have identified seven that are the most likely targets and from which we are seeking to extract information: a) Board of Directors; b) security; c) entertainment; d) corporate transfers; e) Tower construction; f) political contributions; and g) communications. This will take some time as we sift through the records and identify questionable issues.

It appears that all expenses associated with any activity were to be capitalized to the greatest extent possible. For example, a previous attempt to sell the CenTrust Tower building resulted in \$1.5 million of expenses. These expenses were capitalized and deferred when the sale did not go through. Likewise, when new branches were built, all costs associated with the branch, including the first three months operating expenses, were

capitalized. This means we have unrealized losses that will need to be taken when we sell assets.

4. FDIC's ANALYSIS OF THE SUPERVISORY HISTORY OF CENTRUST BANK  
WITH AN EMPHASIS ON HOW FUTURE SUPERVISORY EFFORTS CAN BE  
IMPROVED

As indicated previously, the RTC employees currently in the institution have not analyzed its supervisory history. Rather, our mandate is to control, downsize, and prepare the institution for resolution. With respect to the question of improving future supervisory efforts, we would prefer to leave that question to those who are better qualified in that area.

STATEMENT BY

JOHN E. RYAN, DISTRICT DIRECTOR  
and  
MARIA I. RICHMOND, DEPUTY DISTRICT DIRECTOR

OFFICE OF THRIFT SUPERVISION  
ATLANTA DISTRICT

BEFORE THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS  
U. S. HOUSE OF REPRESENTATIVES  
WASHINGTON, D. C.

March 26, 1990

OVERVIEW

We are pleased to have the opportunity to help this Committee in its efforts to determine the facts and circumstances surrounding the failure of CentTrust Bank, a State Savings Bank, Miami, Florida ("CentTrust"). CentTrust, with assets of nearly \$9 billion is the largest institution regulated by the Atlanta District of the Office of Thrift Supervision ("OTS"). On February 2, 1990, the OTS turned CentTrust over to the Resolution Trust Corporation ("RTC") which was appointed conservator and on March 2, 1990, CentTrust was declared insolvent and placed into receivership.

The failure of CentTrust was the final chapter in what began in 1983 as an attempt to resolve, without cost, the troubled Dade Savings Bank by selling it to David Paul, a Westport, Connecticut real estate investor.

Let me state at the outset that neither Ms. Richmond nor I were present throughout the entire period of operation of CentTrust. I came to Atlanta in November 1989, and my personal involvement with CentTrust is limited to the three months before it was placed into conservatorship. Ms. Richmond has a longer period of regulatory experience with CentTrust having assumed the role of supervisory agent with responsibility for CentTrust in January 1988. In preparation for this testimony, both Ms. Richmond and I reviewed the extensive files on this institution and had numerous discussions with OTS staff that dealt with CentTrust at various times. Our testimony and answers to the Committee's questions will be based on information that we believe reliable, but not on our first hand knowledge in many instances. Our statement does not attempt to be a complete exposition of every issue, but covers the essential matters that we believe had a material effect on the institution.

The sale of Dade Savings Bank in 1983 occurred in an environment of high interest rates. When the purchase transaction was marked-to-market, CentTrust -- later to be the new name of Dade Savings -- had assets of \$2.3 billion and liabilities of \$2.8 billion. The difference, which amounted to \$525 million, was booked as "Goodwill". This \$525 million non-earning asset had to be supported with high cost liabilities and eventually had to be written off through charges to after-tax earnings over 25 years.

The "goodwill" created a substantial drain on earnings which, coupled with the other problems of Dade Savings, made it highly improbable that operations as a traditional thrift would produce the rate of return needed to maintain a viable institution. CentTrust turned to high risk investments and rapid growth to generate the needed income. While the final results are not yet in, the ultimate loss in disposing of the

now \$9 billion CentTrust may well be substantially greater than the \$525 million loss present in the old Dade Savings in 1983. With the advantages of hindsight, the unassisted sale should probably not have been permitted.

#### ACQUISITION OF DADE SAVINGS

Not unlike many S&L's in the early 1980's, Dade Savings (a mutual savings bank) was caught in an interest rate squeeze with low-rate, long-term real estate loans being financed with high cost deposits. Its continuing operating losses and other problems had all but eliminated its capital and it was obvious that a solution had to be found.

The firm of Warburg, Pairbas, Becker, which had been retained by Dade Savings to help find an acquirer, brought David Paul and his firm, The Westport Company, to the table. On October 1, 1982, a purchase contract for Dade Savings was signed by Mr. Paul and his company. The Westport Company, headquartered in Westport, Connecticut, was a real estate investment trust organized in 1971 as HNC Mortgage and Realty Investors, that engaged in the development and management of residential and commercial properties in the Eastern United States and Chicago, Illinois. Westport converted from a REIT to an unincorporated business trust in 1976 and was acquired by Mr. Paul and his associates in 1981.

Before the transaction could be consummated, merger/conversion applications had to be approved by the Federal Home Loan Bank Board ("FHLBB") and the State of Florida. The purchase transaction was to be accomplished by the conversion of Dade Savings from mutual to stock form and the exchange of its stock for the stock of The Westport Company. The practical effect of the transaction was the injection of the approximate \$26 million in real estate assets owned by The Westport Company into Dade Savings and the transfer of ownership of Dade Savings to the shareholders of The Westport Company. At the time the transaction was consummated, David Paul, together with trusts for his children, owned 83.8% of the converted thrift.

The proposed acquisition by The Westport Company was pending at the FHLBB for nearly one year before it was finally approved. During this time, considerable discussions and negotiations with David Paul were held, primarily involving the true value of the real estate to be put into Dade Savings, the business plan proposed for the future operations of CentTrust and the need for additional capital. These negotiations were largely conducted in Washington by the FHLBB staff.

In early negotiations, the Federal Home Loan Bank of Atlanta, ("FHLB of Atlanta"), was asked to review the



proposal and, in January 1983, it advised the Board that the value of The Westport Company's real estate was overstated; that there was insufficient capital to ensure the viability of CentTrust; that The Westport Company was delinquent on major real estate loans at New England thrifts; and, that the proposed management lacked thrift experience. Subsequent to this advice, additional negotiations and discussions concerning these matters were conducted and, as we understand it, the FHLBB staff recommended denial of the proposal on at least two occasions.

The final outcome of the negotiations came in September 1983, when the FHLBB approved the transaction with the understanding that additional common equity capital of \$35 to \$40 million would be raised within 90 days of consummation of the acquisition and that the value of the real estate being put into Dade Savings would be guaranteed by Paul Associates, another David Paul company.

As illustrated in Exhibit I, recognition of the value of Dade Savings' assets and liabilities, even after the injection of The Westport Company, left a \$525 million shortfall of assets to meet liabilities. This shortfall set the stage for the rapid growth and high risk operations that were to follow.

#### IMPLEMENTATION OF THE STRATEGY

As illustrated in Exhibit II, CentTrust doubled in size from \$2.3 billion to \$4.7 billion in the first two years after the Paul acquisition and peaked with nearly \$10 billion in assets at fiscal year-end 1988. CentTrust's growth occurred largely in mortgage-backed securities which had a book value of \$3 billion at fiscal year-end 1988 and in junk bonds which amounted to in excess of \$1 billion in 1988. On the positive side, CentTrust did generate a substantial amount of residential loans some of which were sold and which amounted to \$2.4 billion on the books of CentTrust as of fiscal year-end 1989.

CentTrust was unable to generate sufficient core deposit business to fund its growth targets; therefore, it turned to "wholesale" sources such as brokered deposits, reverse repurchase agreements and Eurodollar financing. As a major player in both the mortgage-backed and junk bond markets, CentTrust appeared more as an investment vehicle than as a traditional thrift. Because the strategy was implemented in a period when interest rates were generally tending downward, substantial profits from sales of securities were realized and the strategy appeared to be working. In fact, in its heyday, CentTrust was regarded in some quarters as a model success story. The 47-story, \$100 million CentTrust Tower, initiated by Dade Savings, but finished out in grand style by

David Paul, became a landmark in downtown Miami and served as a symbol of the Company's apparent success.

#### THE RESULTS DISSECTED

Even though CenTrust reported substantial net income in every year from 1983 through 1988 (see Exhibit III), it was, in our opinion, skimming the profits off the top, leaving substantial risk and future losses embedded in the balance sheet. The following are some examples of how this was done.

First, the substantial gains reported in the early years resulted largely from the sale of the loans that were marked-to-market as a result of the acquisition and that subsequently increased in value with falling interest rates. The profits from these sales were taken to bottom line net income rather than offset against the \$525 million goodwill that was created when they were marked-to-market. In other words, the assets were sold at a book profit with the loss carried as a \$525 million asset to be written off over a 25-year period.

Second, there is considerable evidence of so-called "gains trading" by CenTrust. Gains trading is the device whereby CenTrust commits to take future delivery of securities at a price. If there was a gain on the transaction, CenTrust would take the profit by selling its position. If there was a loss, CenTrust would take delivery of the security and carry it at cost rather than at market value. The practical effect of this practice is the recognition of profit on the winners and deferral of losses on the losers by putting them in portfolio.

Third, it seemed that at every opportunity, junk bonds with market appreciation were sold at a profit while declines in market value were not recognized. Moreover, as later discussed, examiners were unable to determine, with any degree of comfort, the true economic effect of junk bond sales and purchases.

Fourth, CenTrust used every opportunity to front-end income and defer expenses. Examples include the deferral of approximately \$1.3 million in legal fees incurred in connection with an unsuccessful sale and subsequent settlement of a lawsuit involving the CenTrust Tower; capitalization of \$6 million of operating expenses associated with the opening of branches; and the disparate accounting treatment given similar interest rate swap hedges, where positive spreads were immediately recognized while net costs were amortized over the life of the hedge.

Fifth, the income generated from these transactions was not all retained in the institution to offset the risks

created by them, but used to pay excessive salaries, senior management perks and dividends.

#### THE DREXEL CONNECTION

The approval of the acquisition of Dade Savings by the FHLBB required the infusion of additional capital within 90 days of consummation of the transaction. It was not until almost two years after the acquisition that additional capital was raised and even then it amounted to only \$17 million as opposed to the \$35 to \$40 million required. An additional \$12 million in high cost subordinated debt was also raised at the time. The offering circular for these securities dated May 8, 1985, revealed they were being underwritten by a syndicate of five investment bankers led by Drexel Burnham Lambert. Although there is no clear cause and effect relationship between the capital sale and the junk bond purchases, CentTrust began making significant purchases of junk bonds from Drexel around the time that Drexel was serving as lead underwriter for the securities.

CentTrust purchased substantial amounts of junk bonds and equity securities, primarily from Drexel. These investments reached a high point of \$1.4 billion in 1989. The bonds were typically 8 to 10 year term and many required only interest payments until maturity and, on some of the bonds, interest payments were made in the form of additional debt. Hence, the bonds performed well in the early years. A large portion of CentTrust's bonds were for leveraged buyouts, that were dependent on asset sales for repayment, and normal credit analysis of future cash flows from the business operation was insufficient to determine if the bonds could be serviced in an orderly manner.

CentTrust would frequently sell junk bonds or stocks and warrants back to Drexel at a profit and purchase other securities. The value of the stocks and warrants was difficult to establish because they were often obtained as "sweeteners" to the bond purchases; they were not publicly traded and were typically booked at a nominal amount. Drexel was in the middle of these transactions while at the same time Drexel was establishing market value. Thus, the true economic value of the transactions could not be determined.

In early 1989, information from the examination of Lincoln Savings indicated that Lincoln and CentTrust had sold warrants and other assets to each other, through Drexel, with each recognizing substantial income. CentTrust denied knowledge that Lincoln was the counterparty and stated that it had relied on Drexel's statements of fair value. CentTrust ultimately sold the securities purchased from Lincoln at a profit. Whether there were "corresponding" purchases that returned the profit to Lincoln could not be determined.

LUXURY ITEMS AND MANAGEMENT PERKS

Attached as Exhibit IV is a partial listing of the perks and benefits enjoyed by Mr. Paul during his tenure as Chief Executive Officer. These expenditures have been discussed at length with Mr. Paul who rationalizes nearly every one of them as being necessary to conduct business with investment bankers and to promote the image of CenTrust. He has stated that thrift regulators are offended by these perks, because they are not accustomed to dealing with Wall Street investment bankers with whom he identifies.

The outrageously expensive artwork purchased by CenTrust was, according to Mr. Paul, considered to be an investment similar to a zero coupon bond. He was advised by art experts and, although he once hoped to reap profits from the art purchases, he did readily admit that the purchases were a major tactical blunder. The expensive appointments and furnishings for the CenTrust Tower were rationalized as being expected and necessary in downtown Miami.

Perhaps one of the most publicized events attributed to Paul was the so-called "chefs charity dinner". In 1988, at a charity auction, Mr. Paul was the winning bidder of a prize consisting of a gourmet dinner to be prepared by famous international chefs. The chefs were flown to Miami from Paris where they prepared a dinner for approximately sixty guests at Mr. Paul's home. Although the chefs' services were covered in the prize, their transportation and the cost of the food and beverages at the dinner were not. In the end, the additional cost of the dinner was in excess of \$122,000 and was initially paid for by CenTrust. As I will describe later, this money was ultimately paid back.

REGULATORY RESPONSE

From the beginning, the FHLB of Atlanta regulators had a strained and contentious relationship with CenTrust and its CEO, David Paul. Examinations were conducted under extremely adversarial conditions and the examiners reported being frustrated by inordinate delays in getting information and financial data. When information was eventually supplied, it was often not on point or quite what had been requested. CenTrust operated through a maze of subsidiaries which maintained poor records and it used an internal accounting system that was different from both its consolidated audited statements and the thrift financial reports. All of this tended to obscure the true nature of transactions and made it extremely difficult to examine and analyze the institution's financial condition.

Mr. Paul exhibited disdain for both regulations and the

regulators. He retained a number of noted thrift regulatory lawyers and consultants, was extremely litigious, and challenged the regulators at every turn. Hardly anything of substance could be resolved through mutual agreement.

Exhibit V provides a brief summary of the principal supervisory actions that were taken or recommended. It by no means tells the entire story. Supervisory agents and examiners were in constant communication with the institution. The records on this case, which include massive responses from CenTrust, fill several file cabinets. However, in the final analysis, the principal question has to be why the regulators didn't stop CenTrust sooner. The short answer is that it was not for the lack of trying.

The ability of the FHLB regulators to limit the junk bond purchases at CenTrust must be viewed in the context of the national policies and conventional wisdom at the time. The financial literature and empirical evidence in the mid-1980's seemed to support the position that investments in junk bonds could be accomplished both prudently and safely. Numerous articles and studies were being published similar to one by John J. Curran that appeared in the April 29, 1985 issue of Fortune Magazine which said "...the risks of default on the low-rated securities, new evidence suggests, are slim in relation to the fat yields...".

A study dated April 19, 1985, by the Congressional Research Service of the Library of Congress titled "The Role of High Yield Bonds (Junk Bonds) in Capital Markets and Corporate Takeovers: Public Policy Implications" came to no firm conclusion and did not recommend additional further regulation.

Internal studies at the FHLBB explored alternative regulatory approaches to junk bond investments. One study concluded in part: "...the empirical evidence generally supports the hypothesis that the return on high yield bonds more than offsets the additional risk...". Moreover, the study cautions "...that precluding the holding of junk bonds on the grounds of safety and soundness could be deemed arbitrary in the absence of data to substantiate the assertion of excessive risk...". In fairness, many of these papers on junk bonds contained disclaimers about the lack of historical data on the market given the rapid expansion of the use of low-rated securities.

Regulations applicable to federally-chartered S&L's -- until the passage of FIRREA -- essentially permitted investment in junk bonds up to an amount equal to 11% of total assets. Because CenTrust was a state-chartered institution, Florida law governed CenTrust's investment authority. Early in the implementation of the junk bond

strategy, the Florida Comptroller's office took the position that state-chartered institutions were limited to the purchase of investment grade securities. Undeterred, CentTrust continued to buy junk bonds by exploiting a provision in Florida law that allowed the purchase of unrated securities provided a credit file as to the quality of the investment was maintained and by citing a Florida law that allowed the purchase of corporate securities up to 25% of assets. In any event, CentTrust purchased junk bonds in amounts well in excess of the 11% of assets limit permitted for a federally chartered thrift.

Notwithstanding the foregoing, the FHLB regulators became increasingly concerned about the level and quality of junk bonds being purchased by CentTrust. Examination reports criticized the underwriting standards being used as well as the overall level of investment. On May 21, 1985, in a supervisory letter, CentTrust was directed to cease purchasing junk bonds and again on August 6, 1985, CentTrust was directed to reduce its junk bond portfolio to no more than 10% of total assets. CentTrust did not comply with these supervisory letters and on January 6, 1986, the FHLB of Atlanta regulators recommended to the FHLBB the issuance of a cease and desist order against CentTrust which, among other provisions, would have limited CentTrust to holding no more than 10% of its assets in junk bonds and would require specific improvements in its underwriting practices.

The Atlanta regulatory staff was informed by Office of Enforcement lawyers that given national policy at the time, they felt they would be unable to get the FHLBB to issue an order limiting CentTrust's investment in junk bonds. However, the Enforcement staff was willing to change the focus of the order to the unsafe and unsound manner in which CentTrust invested in junk bonds based upon CentTrust's underwriting standards, policies and procedures. They requested the examiners to gather further information and engage experts to assist in the matter. The requested information was gathered during the on-going exam and reports from two different experts were sent in January, 1987. Requests from Enforcement for clarification and additional information continued for numerous months.

Inasmuch as a cease and desist order was apparently not available in the desired form, the FHLB of Atlanta regulators were encouraged to attempt to negotiate a written agreement with CentTrust. CentTrust declined to enter into an acceptable agreement, and a decision was made to update the information through further examination efforts in late 1987.

In 1988, the examiners criticized, in an exam report, some \$400 million of junk bonds, citing the poor credit quality of individual issues. This analysis supported a

directive to CenTrust in 1989 to cease purchasing junk bonds and establish substantial reserves. CenTrust substantially complied with this directive.

Another principal problem that we believe left major losses embedded in CenTrust's balance sheet was the extensive trading activities in mortgage-back securities and other investments. Generally accepted accounting principles normally permit thrifts to carry investment securities on their balance sheet at their historical cost (adjusted with amortization and accretion requirements) on the theory that the securities were purchased with the intent that they would be held to maturity. Under these circumstances, changes in the market value of the securities that occur over the holding period would not result in any adjustment to the carrying value of the security because the holder is expected to receive par value at maturity. Conversely, the accounting rules provide that securities purchased with the intent of buying and selling them in the market be treated as a trading account which would require that the securities be marked-to-market. The dispute occurs when there is a disagreement about the intent of the holder. Accounting literature and regulatory bulletins are far from clear on this issue even today.

As previously mentioned, examiners were of the opinion that CenTrust was trading securities and as such should have recognized the market loss on the securities held in its portfolio. We believe that the pattern of activity over time sustains this finding. For example, in fiscal 1987, CenTrust entered into 427 purchase commitments for mortgage-backed securities, totaling \$14.4 billion. 344 of those commitments totaling, \$11.9 billion, were "paired-off" at a profit to CenTrust of \$60.6 million. On the remaining 83 commitments of \$2.5 billion, CenTrust took delivery or funded the securities. In all but three instances, the securities which were funded were purchased at a higher cost than current market. The net "unrealized" loss on those securities was \$81.6 million. (Two of three securities which were funded with gains were sold within 10 days.)

Despite repeated attempts by the regulators to force recognition of the market loss in its securities, CenTrust has never done so. On several occasions, the examiners referred the facts to Atlanta District accountants who, in turn, had discussions with FHLBB staff accountants in Washington and at various times they all agreed that the weight of evidence would support a finding that CenTrust was actively trading its securities portfolio. CenTrust's outside auditors, however, did not agree that CenTrust's activities were such that would require marking securities to market under GAAP. Consequently, CenTrust received unqualified financial statements (as to this issue) from the

outside auditors. OTS was reluctant to overrule the auditors in view of the controversy surrounding the issue and the lack of a clearly articulated national policy.

In 1988, the firm of Deloitte, Haskins and Sells terminated its engagement with CentTrust and Price Waterhouse conducted the 1989 audit. Neither firm, however, required CentTrust to mark securities to market although a statement as to the effect of such a markdown was contained in the Price Waterhouse opinion letter on the fiscal year-end 1989 results.

In addition to trading versus investment issues, the examiners learned from OTS examiners in Lincoln Savings that some of CentTrust's trades involved transactions with Lincoln. Since there were examiners reviewing records of both institutions simultaneously, it could be determined that Lincoln and CentTrust were selling assets back and forth with each registering profits. Absent the "tip", this would not have been found since the records at CentTrust reflected the trades were made through Drexel. CentTrust's records did not indicate the party or the circumstances of the party on the other side of the transaction. It was obvious that any comprehensive review of these transactions would have to be undertaken on a coordinated basis which required access to the records of Drexel in addition to Lincoln and CentTrust. OTS-Atlanta was aware that a 407(m)(2) investigation of the Drexel connection at another thrift was being recommended by the Office of Enforcement and requested the investigation be expanded to include CentTrust. That request was granted. OTS-Atlanta has been informed that the Office of Enforcement turned the results of that investigation over to the Securities and Exchange Commission.

The regulatory response to the abuses of David Paul date back to the early days of his tenure at CentTrust. Examiners were critical of the level of salary and bonuses taken by Mr. Paul in view of the lack of profitability of the banking business at CentTrust. The 1986 proposed cease and desist order was an early attempt to reduce his compensation. The FHLBB had previously declined to pursue excessive compensation cases involving stock institutions which were then reporting profits because it believed this was a matter more properly decided by shareholders. Supervisory pressure with respect to the personal use of CentTrust's jet resulted in the adoption of policies that required reimbursement for non-business trips. Most trips turned out to be "business-related", however.

The major abuses did not surface until early 1989 when CentTrust moved from its rather spartan headquarters in the old Dade Savings building to its new 47-story tower. The purchase of a \$13 million Rubens at Sotheby's in New York was



reported in the press. A supervisory directive for an accounting of all purchase of artwork costing in excess of \$25,000 was made. As a result of this directive, it was learned that the art purchase totaled \$29,050,484.

In a supervisory letter dated March 15, 1989, requesting a meeting with CentTrust's Board of Directors, the Board was severely criticized for permitting the purchase of the art, directed to cease such purchases, and to develop a plan for sale of the art. The Comptroller for the State of Florida subsequently issued a directive -- which later was converted to a cease and desist order -- requiring sale of the art within six months. The Board agreed to the sale and produced a report which showed most of the art was sold in 1989, but at a loss of \$4 - \$5 million.

The supervisory letter also inquired about the payment for the chef's dinner. Coincidentally, Mr. Paul's personal check reimbursing CentTrust for the dinner was dated simultaneously with receipt of the supervisory letter inquiry some three months after the dinner.

In light of these revelations and past regulatory experience with CentTrust, there was believed to be a strong probability that even more abuses were occurring. Working closely with the Florida Comptroller's Office, a joint comprehensive examination into such expenditures was begun. This turned out to be an arduous task with the examiners receiving no cooperation from management and sifting through reams of expense reports and other documents.

As mentioned earlier, my first-hand knowledge and involvement with this case began with my transfer from Boston to Atlanta, effective November 1, 1989. I, therefore, am only able to speak from first-hand knowledge from that point on. In early December, 1989, I received a draft copy of the special examination on Mr. Paul's expenditures. I must report to the Committee that I was appalled by its contents. In my twenty-five years of regulatory experience, I have not seen anything so egregious as the personal abuses set forth in that report. In view of the probable cost of CentTrust to the U.S. taxpayers, the use of CentTrust to pay for the lavish life style of David Paul can only be regarded as unconscionable.

Mr. Paul, who had also received a draft copy of the special report, phoned me and requested an immediate meeting to explain the expenditures. We met with Mr. Paul, listened to his rationalizations, and told him his actions were indefensible and that we intended to take immediate formal action to stop the abuses and to seek remedies for those abuses. On the next day, December 6, I met with the members of the Enforcement Review Committee and the staff of the

Office of Enforcement, and recommended immediate corrective action in the form of a Temporary Order to Cease and Desist and Notice of Charges for a permanent order to be issued against CentTrust. A temporary cease and desist order addressing those abuses and other problems was issued on December 8, 1989. (See Exhibit VI). The Temporary Order was the most comprehensive one ever issued by the FHLBB or OTS and included a number of provisions made possible by Congress' enactment of FIRREA several months earlier. The Comptroller's Office for the State of Florida, in response to these abuses, instituted action to remove David Paul from CentTrust.

Throughout this period, we worked closely with the other regulatory authorities. On November 17, 1989, OTS-Atlanta arranged a joint meeting with the Florida Comptroller's Office, RTC, and FDIC in attendance. The probable course of regulatory actions and the timing of those actions were discussed at that meeting.

#### THE FINAL CHAPTER

In 1989, as interest rates rose and the defaults on junk bonds escalated, CentTrust's true financial condition began to become apparent. The lack of operating income could no longer be offset by gains on the sale of loans and securities and losses were mounting. At fiscal year-end 1989, CentTrust reported net losses of \$119 million wiping out 41% of the total net income booked over the past five years of operations. Moreover, those losses were likely to continue given the prohibition contained in FIRREA on investment in junk bonds and the need to shrink in size in order to meet the new capital requirements.

The passage of FIRREA prohibited the purchase of additional junk bonds, required the divestiture by 1995 of the junk bonds held in portfolio, and wiped out \$379 million of goodwill which could not be counted as part of CentTrust's tangible capital base. As of September 30, 1989, CentTrust was \$402 million short of meeting its 1.5% tangible capital requirement and it was losing money. CentTrust's back was against the wall.

In an effort to improve its tangible capital position and as a first step in a three-part restructuring plan, CentTrust entered into an agreement to sell 63 branches representing \$2.4 billion of deposits -- the majority of its core business -- to Great Western Savings Bank, a large thrift located in California. The branch sale would have produced a premium of 4% or about \$100 million. The premium would be used to partially offset a \$180 million write-off of goodwill left over from the Dade Savings acquisition. This transaction would have improved the tangible capital position

of CentTrust but, even after the sale, CentTrust would have been far short of the capital requirements and it was doubtful it could become a profitable and viable institution.

Exhibit VII reflects the basic elements of the restructuring plan. Essentially, CentTrust proposed to continue to shrink in size after the branch sale by liquidating much of its mortgage-backed securities portfolio and other assets and by repaying or placing with others brokered deposits, borrowings, and other non-core liabilities. CentTrust estimated that this shrinkage strategy would take about a year to implement if losses from the liquidation of assets were to be minimized.

The final step contemplated the merger of the "good assets" and deposit liabilities into a newly chartered thrift leaving the junk bonds and goodwill in existing CentTrust. Existing CentTrust would then give up its deposit insurance and become a non-insured holding company. David Paul would resign his official position at the thrift and would bring in management acceptable to the regulators. The end result was a "clean thrift" without David Paul, an appealing prospect. At one point, a merger with Ensign Bank which included the possibility of fresh capital was proposed; however, the proposal fell through on January 11, 1990.

The restructuring proposals were closely and thoroughly analyzed but, in the end, they were determined to be unworkable. Moreover, CentTrust was considered to be in an unsafe and unsound condition and to have substantially inadequate capital, a determination that was made possible only with the passage of FIRREA (See Exhibit VIII). OTS, therefore, turned CentTrust over to the RTC on February 2, 1990.

SUPERVISORY CONVERSIONEFFECT OF PURCHASE ACCOUNTING AND CAPITAL INJECTION \*

	<u>DADE</u> (pre-conversion)		<u>CENTRUST</u> (post-conversion)
Cash	37		37
Investments	144		144
Loans	1,933	<-525>	1,408
Real Estate Holdings	128	26	154
Fixed Assets	31		31
Other Assets	18		18
Goodwill	_____	<+525>	<u>525</u>
TOTAL ASSETS	<u>2,291</u> =====		<u>2,317</u> =====
Deposits	1,969		1,969
Borrowings	307		307
Other Liabilities	<u>15</u>		<u>15</u>
TOTAL LIABILITIES	<u>2,291</u> =====		<u>2,291</u>
CAPITAL	(0)	<+26>	<u>26</u> <u>2,317</u> =====
TOTAL LIABILITIES AND CAPITAL			

- \* These simplified financial statements are designed to show the effect of the \$26 million capital injection of the Westport Company and the write down of assets to reflect current values, and the resulting establishment of "goodwill". In reality these events took place a year apart, additional losses were sustained in the interim, and thus the statements do not represent CentTrust's actual financial statements at any time. Assets and liabilities are similar to those held in October 1983.

Exhibit I

## FINANCIAL GROWTH

(in millions)

	1983	1984	1985	1986	1987	1988	1989
<b>Assets</b>							
1-4 mtgs.	1,263	298	715	1,471	1,424	1,977	2,350
MBS	311	847	1,120	1,057	2,443	3,097	1,442
Corporate Bonds	-0-	-0-	610*	629*	882	1,173	922
All Others	228	1,631	1,802	2,543	2,589	3,101	3,866
Goodwill	505	484	464	442	434	417	395
<b>TOTAL ASSETS</b>	<b>2,307</b>	<b>3,260</b>	<b>4,711</b>	<b>6,142</b>	<b>7,772</b>	<b>9,765</b>	<b>8,975</b>
	=====	=====	=====	=====	=====	=====	=====
<b>Liabilities</b>							
Core Deposits	1,969	2,125	2,677	2,881	3,144	3,364	3,225
Brokered Deposits	*	-0-	45	519	1,533	2,821	3,051
Borrowings	247	818	1,613	2,088	2,203	2,645	1,983
Other Liabilities	75	212	219	357	493	557	481
<b>TOTAL LIABILITIES</b>	<b>2,291</b>	<b>3,155</b>	<b>4,554</b>	<b>5,845</b>	<b>7,373</b>	<b>9,387</b>	<b>8,740</b>
	=====	=====	=====	=====	=====	=====	=====
<b>CAPITAL</b>	<b>16</b>	<b>105</b>	<b>117</b>	<b>297</b>	<b>399</b>	<b>378</b>	<b>235</b>
	=====	=====	=====	=====	=====	=====	=====
<b>TOTAL LIABILITIES AND CAPITAL</b>	<b>2,307</b>	<b>3,260</b>	<b>4,711</b>	<b>6,142</b>	<b>7,772</b>	<b>9,765</b>	<b>8,975</b>
	=====	=====	=====	=====	=====	=====	=====

\* Corporate debt total did not include all junk bonds at these dates

Exhibit II

GAINS ON SALES AS A PERCENT OF NET INCOME  
(Figures are in thousands)

	1983	1984	1985	1986	1987	1988	1989
REPORT NET INCOME (LOSS)	<u>19,532</u>	<u>23,250</u>	<u>36,636</u>	<u>55,906</u>	<u>61,506</u>	<u>50,052</u>	<u>119,484</u>
LESS							
Gains on Loans and Loan servicing	-0-	127,499	91,387	134,506	103,791	44,255	25,864
Gains on Sale of Investments	<u>3,326</u>	<u>14,162</u>	<u>36,475</u>	<u>27,432</u>	<u>27,746</u>	<u>43,047</u>	<u>14,568</u>
INCOME (LOSS) BEFORE GAINS ON SALES OF ASSETS	(12,858)	(48,408)	(91,226)	(106,032)	(70,031)	(37,243)	(159,916)

Exhibit III

## MANAGEMENT PERKS AND LUXURY ITEMS

Attached is a sample of the excessive expenditures made by CenTrust, which were determined during the examination which began in May 1989. Many of these expenditures accrued to the direct benefit of David Paul.

I. Salary and partial list of benefits to David Paul in 1989

o Salary	\$700,000
o Bonus	310,000
o Life Insurance on Paul, payable to wife	257,783
o Car allowance - cash	6,000
o Chauffeured Mercedes Limousine - lease	26,000
o Guard Service at residence (annualized)	142,947
o Security system at residence (annualized)	78,289
o Phone Service in residence and autos (annualized)	33,082
o Corporate jet - Cost of lease, hangar pilot salary (Does not include fuel, insurance, pilot's expenses, catering) Jet was primarily used by David Paul	1,364,616
o Out of town Limousine Service (annualized)	<u>16,992</u>
	\$2,935,709

II. CenTrust Property housed at David Paul's Residence

o 2 Dehumidifiers	275
o 1 Deep fryer	419
o 1 Refrigerator	468
o 4 12 button phones	1,268
o 4 smoke alarms	759
o Various office equipment	10,943
o Intercom system	3,238
o Security Equipment	<u>132,718</u>

Depreciated book value \$150,088

Exhibit IV

### III. CenTrust Loans to David Paul

o Mortgage loan on adjoining residences in Miami - Initial amount was \$800,000 in 1984.	6,100,000
o Loan on Bentley (Rolls Royce) granted 12-13-88	<u>109,050</u>
Outstanding 6-30-89	<u>\$6,209,050</u>

### IV. Examples of Other Luxury Expenditures by CenTrust

o Collection of "Old Master" and other art.	\$29,050,484
o Four Persian rugs, two of which were delivered to Paul's residence and later moved.	208,000
o Table linens for Corporate Dining room	22,427
o Baccarat crystal for Corporate Dining room	84,240
o Bills from Tiffany's for gifts, stationary, etc. over 2 year period. Some items ordered by Mrs. Paul	35,662
o Sailboat - 40 ft. sloop	232,500

### V. Miscellaneous Expenditures

o Supplemental Retirement plan - Plan was in addition to regular pension. Prior to 9/89 there were only 4 participants, including Paul. On 9/89, 6 participants, were added Contribution 1983 - 1990	\$4,894,000
o Billings from Stanhope hotel in 1988 35 nights	47,000
o 1988 Annual Board Retreat	147,000



SUMMARY OF SIGNIFICANT SUPERVISORY ACTIONS CONCERNING  
DADE/CENTRUST

OCTOBER 19, 1982	DAVID PAUL FILES APPLICATION FOR THE SUPERVISORY CONVERSION AND ACQUISITION OF DADE SAVINGS.
JANUARY 11, 1983	BANK BOARD STAFF RECOMMENDS DENIAL OF THE SUPERVISORY CONVERSION.
JANUARY 26, 1983	ATLANTA RECOMMENDS DENIAL OF THE APPLICATION.
MARCH 10, 1983	BANK BOARD STAFF RECOMMENDS DENIAL OF THE SUPERVISORY CONVERSION.
JULY 1, 1983	BANK BOARD STAFF RECOMMENDS DENIAL OF THE SUPERVISORY CONVERSION.
SEPTEMBER 28, 1983	BANK BOARD APPROVES DAVID PAUL'S APPLICATION CONDITIONED ON SALE OF ADDITIONAL STOCK.
AUGUST 13, 1984	ATLANTA ADVISES CENTRUST THAT IT IS SUBSTANTIALLY DEVIATING FROM ITS APPROVED BUSINESS PLAN AND REQUESTS NEW PLAN.
JANUARY 22, 1985	ATLANTA DIRECTS DAVID PAUL TO CEASE PURCHASING MASSMUTUAL STOCK IN VIOLATION OF BANK BOARD CONDITIONS.
MID 1985	CENTRUST ENTERS INTO CONSENT ORDERS WITH SEC RELATING TO INADEQUATE DISCLOSURE CONCERNING ITS PURCHASE OF MASSMUTUAL STOCK.
MAY 9, 1985	CENTRUST SELLS APPROXIMATELY \$30 MILLION OF COMMON STOCK AND SUBORDINATED DEBT. DREXEL, BURNHAM, LAMBERT IS THE PRINCIPAL UNDERWRITER.
MAY 21, 1985	ATLANTA DIRECTS CENTRUST TO CEASE PURCHASING JUNK BONDS.
AUGUST 6, 1985	ATLANTA DIRECTS CENTRUST TO REDUCE JUNK BOND PORTFOLIO TO NO MORE THAN 10% OF TOTAL ASSETS BY OCTOBER 31, 1985.

Exhibit V

PAGE TWO

JANUARY 6, 1986

ATLANTA RECOMMENDS CEASE AND DESIST ORDER AGAINST CENTRUST TO CONTROL JUNK BONDS.

MARCH 17, 1986

ATLANTA DIRECTS CENTRUST TO MARK JUNK BONDS AND SECURITIES TO MARKET BECAUSE OF TRADING ACTIVITY.

JULY 2, 1987

ATLANTA REQUESTS CENTRUST, IN LIEU OF A CEASE AND DESIST ORDER, TO EXECUTE A SUPERVISORY AGREEMENT RELATING TO JUNK BONDS, UNDERWRITING INVESTMENTS AND LIMITING GROWTH. CENTRUST DECLINES.

FEBRUARY 17, 1989

ATLANTA RECOMMENDS THAT CENTRUST AND CERTAIN OTHER THRIFTS BE ADDED TO AN EXISTING 407 (M) (2) INVESTIGATION REGARDING THE DREXEL LAMBERT THRIFT CONNECTION.

MARCH 15, 1989

ATLANTA DIRECTS CENTRUST TO LIMIT GROWTH, CEASE PURCHASING JUNK BONDS, CEASE PAYING COMMON STOCK DIVIDENDS, INCREASE GENERAL LOSS RESERVES AND SELL ART WORK.

MAY 5, 1989

ATLANTA REQUESTS 407 (M) (2) INVESTIGATION INTO USE OF CENTRUST ASSETS FOR DAVID PAUL'S PERSONAL BENEFIT.

SEPTEMBER 6, 1989

ATLANTA DIRECTS CENTRUST TO CEASE PURCHASING ITS OWN PREFERRED STOCK AND SUBORDINATED DEBT.

OCTOBER 5, 1989

ATLANTA DIRECTS CENTRUST TO CEASE PAYING PREFERRED STOCK DIVIDENDS.

DECEMBER 8, 1989

OTS ISSUES TEMPORARY CEASE AND DESIST ORDER TO STOP DISSIPATION OF ASSETS AND SET UP A RESERVE FOR MARKET LOSS ON DEFAULTED SECURITIES.

FEBRUARY 2, 1990

OTS APPOINTS RTC CONSERVATOR FOR CENTRUST.

## CEASE AND DESIST ORDER FACT SHEET

DECEMBER 8, 1989

The temporary cease and desist order immediately requires  
CentTrust:

- 1) not to issue or sell any subordinated debt without prior OTS approval;
- 2) to make all of its books and records available for immediate inspection by OTS examiners;
- 3) to cease funding its Supplemental Executive Retirement Plan or any similar benefit plans without prior approval of OTS;
- 4) to halt any increases in executive compensation until CentTrust has three consecutive fiscal quarters of operating profit and receives prior approval of OTS, roll back executive compensation to no more than that in effect as of September 1, 1989, and require the return of any bonuses paid to any executive officer after September 30, 1989;
- 5) to cease payments of dividends on any of its outstanding stock until it complies with its fully phased in capital requirements pursuant to OTS regulations and receives prior OTS approval;
- 6) to make loans and investments only as permitted by the Home Owners Loan Act, and cease making investments in non-interest earning speculative assets, such as artwork, oriental rugs and crystal stemware or other luxury decorative items;
- 7) to cease purchasing any additional fixed assets or furniture, fixtures and equipment in excess of \$5,000 without prior OTS approval, submit a policy acceptable to OTS for such future purchases, and adhere to this policy;
- 8) to submit a plan acceptable to OTS for the disposition of all property, including artwork, oriental rugs, crystal stemware, and other property designated by OTS as excessive and unnecessary;
- 9) to cease payment or reimbursement, and order and

Exhibit VI

require repayment of personal, non-business related expenses of any officer, director or employee, and require the return of all CentTrust property kept by any officer, director or employee at their residences or away from CentTrust's premises which is non-essential for CentTrust's business;

10) to establish and adhere to appropriate guidelines and internal controls acceptable to OTS regarding proper documentation and approval for repayment of only prudent, appropriate, reasonable and necessary travel and entertainment expenses;

11) to cease payment for any expenses relating to the operation of any yachts or other boats not owned by CentTrust, or any security services for the residences of any officer, director or employee;

12) to submit a plan within 15 days which is acceptable to OTS to terminate, rescind or otherwise dispose of property, contracts, leases or other agreements relating to corporate jet aircraft and hanger facilities, limousines located in the New York - Connecticut area, limousine services, sailboats, and vendor or art services relating to design or consultant contracts, and to carry out such plan within 90 days;

13) to submit for prior approval to OTS a budget for its annual meeting if in excess of \$20,000 and not exceed such budget; and

14) to establish specific reserves in an amount equal to the market losses on all defaulted securities held in its portfolio, and report such reserves on its September 30, 1989 financial statements.

RESTRUCTURING PROPOSAL

	9/30/89	Post Branch Sale	Post 12 Months Shrinkage	Holding Company	Bank
<u>Assets</u>					
Junk Bonds	755	593	513	388	125
Goodwill	380	197	197	177	20
All Other Assets	<u>7,851</u>	<u>5,592</u>	<u>2,232</u>	<u>445</u>	<u>1,794</u>
Total Assets	8,986	6,382	2,949	1,010	1,939
<u>Liabilities</u>					
Core Deposits	2,535	627	627	0	627
Brokered Deposits	3,051	2,606	827	0	827
Other Deposits	663	217	155	0	155
Other Liabilities	2,386	2,667	942	670	272
Shareholders Equity	<u>351</u>	<u>265</u>	<u>398*</u>	<u>340</u>	<u>58</u>
	8,986	6,382	2,949	1,010	1,939

\* Assumes earnings in the bank and the holding company and a gain on the sale of an asset.

Exhibit VII

Data From CentTrust's Thrift Financial Reports Showing Capital Compliance  
Before and After FIRREA

	9/84	9/85	9/86	9/87	9/88	9/89	9/89 Post- FIRREA
Total Assets	3,121,775	4,722,077	6,084,448	7,670,436	9,680,923	8,875,904	8,875,904
Goodwill	484,167	463,161	442,092	421,040	400,701	379,487	379,487
Regulatory Capital							
Sub Debt	-0-	-0-	-0-	-0-	150,000	2,341	*
General Reserves	-0-	-0-	-0-	7,396	40,543	55,242	*
Preferred Stock	-0-	-0-	-0-	60	146,694	123,996	*
Common Stock	25,713	44,186	137,343	208,385	66,446	66,446	66,446
Retained Earnings	87,392	112,273	159,428	191,047	123,105	43,676	43,676
TOTAL	113,112	156,459	296,771	406,898	596,788	291,701	110,122
						-379,487	Less Goodwill
						(269,365)	
Reg. Capital Requirement	N/A	133,492	197,650	212,246	277,625	255,108	133,132 (Tangible requirement)
Amount over (short)		22,967	99,121	194,642	319,163	36,593	(402,504)

\*The accounts no longer qualified for the tangible capital test.

TESTIMONY OF

ASH WILLIAMS, JR.  
ASSISTANT COMPTROLLER  
STATE OF FLORIDA

AND

LAWRENCE FUCHS  
DEPUTY COMPTROLLER  
STATE OF FLORIDA

ON

CENTRUST BANK OF MIAMI, FLORIDA

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS  
UNITED STATES HOUSE OF REPRESENTATIVES

March 26, 1990  
Room 2128, Rayburn House Office Building

Thank you for providing us the opportunity to discuss our experience with CenTrust Bank.

But before going forward, it may be useful to briefly summarize the regulatory environment that existed in the early 1980s. The Federal Home Loan Bank Board (FHLBB), the federal government's primary thrift regulator, was woefully understaffed in terms of both administrators and examiners. As a result, an agreement was reached between the agency and the State of Florida to provide examination personnel to assist in examinations of state-chartered savings and loans.

In short, our office agreed to provide examiners to assist the federal regulatory agency in fulfilling its responsibility - a procedure which remains essentially intact 10 years later. To this day, all such exams are joint examinations conducted according to schedules prepared by the federal supervisory staff in Atlanta.

The arrangement is in marked contrast from the system employed by both us and our federal banking counterparts in examining commercial banks. In examining state banks, this office conducts independent examinations. So does the Federal Deposit Insurance Corporation (FDIC). The two agencies stagger their exams, and each accepts the finding of the other.

And by way of explanation, an examination, by definition, is an after-the-fact review. The system functions in arrears. Regulators check activities of a financial institution, typically 18 months after the fact, to review compliance with applicable laws and regulations.

Regulators are neither designed nor equipped to manage banks or thrifts. Profits are made, or losses suffered, on the basis of the skills of bank management and market conditions. The role of regulators is limited to determining whether the rules and guidelines governing the institution are being followed.

With that in mind, let us begin.

By 1983, Dade Savings and Loan, CenTrust's predecessor, was imminently insolvent. It got there the old-fashioned way - poor management, no mechanism to compensate for interest-rate swings and an inadequate infrastructure to



achieve profitability. The institution was the epitome of a floundering, hopeless S&L wrought by the vagaries and uncertainties of deregulation.

Arguably, the federal government should have closed the institution. Unfortunately, the insurance fund was inadequate to the task. This was due, at least in part, to the Garn-St. Germain Act of 1982, which raised insurance on deposits from \$40,000 to \$100,000 without a commensurate increase in premiums to cover the added exposure. Consequently, the ailing thrift lingered, continuing its burden on the regulatory system and increasing the probability of eventual taxpayer burden.

Faced with the dilemma, the federal government and our office were forced to seek an external source of capital. Given the long odds of rehabilitating the institution, we probably need not add that few Rockefellers or Morgans came forward. Indeed, the situation itself had created an adverse selection pool.

Enter David L. Paul, an entrepreneur and real estate developer from New York who approached both us and our federal counterparts with a plan to inject new capital into the S&L. It was to come by means of a transfer of the assets of a business (the Westport Company) he controlled to the association. And it was done without any taxpayer assistance.

Mr. Paul's business plan was predicated on sound banking principles: a conventional operation relying on home mortgages, consumer loans, some commercial loans and student loans - primarily funded with low-cost core deposits. The plan was reasonable and with the benefit of additional capital, there appeared to be a reasonable prospect of success. And in the absence of an adequate insurance fund, there was really no viable alternative.

Based on Mr. Paul's projections that it would take time before operating profits would be generated, he proposed to supplement earnings with sales of loans and certain mortgage-backed securities.

And on Nov. 3, 1983, he assumed control of Dade Savings. In 1984, he changed its name to CenTrust.

Mr. Paul's plan seemed to work. The initial years of his ownership were actually profitable. In fact, "Forbes Magazine" highlighted the institution as among the most profitable companies in America. In truth, many of these

profits were the result of liberal accounting principles. Moreover, when Mr. Paul took over the thrift, he marked the institution's loans and mortgage-backed securities down to reflect their actual value. And the difference became the "goodwill", which he amortized at \$21 million a year.

In the mid 1980s, interest rates were generally falling. And as they fell, the actual value of the loans and securities in CenTrust's portfolio increased. The thrift carefully sold off these loans and securities, netting a profit on the transactions. This activity provided the primary source of income during the early years.

At the same time, Mr. Paul brought in the best and brightest talent money could buy. He brought in top managers and administrators from around the country. CenTrust's board of directors read like a Who's Who of business and government. Among its members: Sir Edward D.G. Davies, a leading authority on investments; Barry Schwartz, chairman of Calvin Klein Industries; Author Richard Goodwin, an architect of President Lyndon Johnson's Great Society programs; and Lewis Ranieri, a man known as the father of the mortgage-backed security.

By late 1987, interest rates had ceased their decline. CenTrust, still unable to achieve operating profits on its core banking business, turned to what is known as "gains trading in forward commitments" in mortgage-backed securities. This is an activity in which an institution commits to purchase a security in the future and often can earn a profit by selling the option before the funding date.

Despite its profitability, it was clear that there was an over reliance on non-operating income. Our concerns were expressed in a March 26, 1984 examination letter.

"... on a net operating income basis, the association is still operating at a deficit. The directorate should continue to explore further opportunities which would insure Dade Savings long-term viability."

That same year, we became aware of CenTrust's holdings of what are now known as "junk bonds." While Mr. Paul, then as now, referred to them as

commercial loans with bond characteristics, we felt they were prohibited by our investment statute.

As a result of the junk bond issue, previous concerns over deviations from its initial business plan and the employment of liberal accounting principles, we concluded in 1984 that CenTrust would have to be scrutinized exceedingly closely.

During a meeting that summer with Mr. Paul, we took the position that investments in below investment-grade bonds by a thrift were prohibited by statute. Mr. Paul disagreed and sued our agency over our interpretation of the statute. While the suit was pending, the Florida Legislature enacted a law expressly prohibiting a thrift from acquiring junk bonds - an action which rendered the challenge moot.

As a result, our office instructed CenTrust to divest itself of its junk without suffering any financial losses.

In the latter part of 1986, senior members of our staff went to Atlanta to meet with FHLBB officials to discuss some of our supervisory concerns about Florida thrifts generally. We requested that efforts be initiated to relieve our regulatory agency of the burden of insolvent and impaired savings institutions. We offered to recommend receiverships/conservatorships and any other assistance that we could provide. We were advised, in essence, that the resources of the insurance fund were too constrained to consider resolving any Florida thrifts. We were told that the problems facing the savings and loan industry in the oil patch greatly exceeded those in Florida and that the insurance fund was stretched as far as possible.

To say the least, we found the situation alarming. It prompted Florida Comptroller Gerald Lewis to come to Washington to meet with officials here. As you recall, in 1986 and 1987, Congress recognized the dilemma facing the insurance fund. While in Washington, Comptroller Lewis met with Florida's representatives in the House and Senate, as well as the chairmen of both FDIC and FSLIC. In these meetings, Mr. Lewis expressed his strong support for the adequate recapitalization of the insurance fund.

In our meeting with the acting director of the FSLIC, Thurmond Connell, we requested federal assistance and an explanation for the absence of federal

involvement in several situations that showed little promise of being resolved. Mr. Connell reiterated what we had been told previously - that funds to accomplish what needed to be done in Florida were not available.

In an effort to find a solution, Mr. Lewis, who is a trustee of Florida's pension fund and a member of the Council of Institutional Investors, traveled to Washington again in 1988 to meet with then-FHLEBB Chairman Danny Wall. At that meeting, Mr. Lewis offered to try to organize a consortium of state pension funds to assist in the recapitalization of the insurance fund provided assurances were made that the proposed investment was adequately secured by the federal government.

When the savings and loan bill that was enacted last summer was first proposed, Comptroller Lewis was among its most ardent supporters as it represented a means of addressing the lingering problems of both failed and troubled thrifts.

But to get back to CenTrust, our examiners and those of our federal counterparts concluded another examination in the summer of 1986 which uncovered continuing problems at the institution. While we might point out that CenTrust remained profitable at this point, the exam showed that the thrift continued to maintain an unacceptably large number of junk bonds, high operating expenses and still relied almost exclusively on non-operating income.

We wrote a letter to CenTrust outlining our concerns and objections, and, as was generally the case, the institution took exception to nearly every conclusion we reached. The exam was criticized as being overly subjective. Mr. Paul criticized our examiners as inexperienced and incapable of meeting the task. While we obviously disagreed, we determined that the next examination would be conducted by the best state and federal examiners.

In 1988, the next examination went forward and identified more problems than ever before. The nature of the problems was much as before: junk bonds, lack of tangible capital and an over reliance on trading income.

At about the time we concluded our report the following January, we became aware that CenTrust had purchased a \$13 million painting through Sotheby's in New York. We quickly found out that the painting in question was part of an approximately \$30 million collection assembled by Mr. Paul to adorn

the institution's new building in Miami. At the risk of understatement, this information exacerbated our concerns regarding the conduct of the institution's management and its Board of Directors. The art purchases represented the beginning of the end for CenTrust. In fact, Mr. Paul, himself, characterized the ill-advised transactions as the biggest mistake of his life.

Occurring as they did in the third-quarter of 1988 - a period in which interest rates were rising, thus effectively wiping out "gains trading" which had enabled CenTrust to turn a profit - the art purchases were made during a period in which CenTrust lost money. Such a purchase by a thrift under any circumstances would have been alarming. To do so while it was operating in the red was simply unacceptable.

In April of 1989, we directed Mr. Paul to liquidate the institution's art collection within six months. Although sensitive to the implications of a fire sale, we felt that we had to act to protect the institution's depositors. To no one's surprise, the directive was largely ignored. So in November of last year, we issued a formal cease-and-desist order requiring the institution to turn the art over to an independent third party for its ultimate sale. Instead, Mr. Paul chose to liquidate a large portion of the art himself, sustaining a multi-million dollar loss in the process.

At about this time, CenTrust began experiencing upheavals in its management. The chief operating officer resigned in May of 1989. Six weeks later, its president quit. In addition to all of this, we began in May of last year what was to be our final examination of CenTrust.

The critical first phase of the joint exam focused on the operations and expenses of the association. It identified abuses that were previously unknown. Mr. Paul, who knew better than anyone what we would find, continued his concerted effort to impede the examination's progress. Examiners were forced to make written requests for even nominal data; they had to make appointments to see certain CenTrust employees; and they were denied access to certain areas of the CenTrust building and Mr. Paul's lavish home, where some assets of the thrift were kept.

The examiners dealt with these obstacles on a daily basis. During this period, the certified public accounting firm employed by CenTrust to prepare

its quarterly reports - Deloitte, Haskins and Sells - notified regulators of its intention to resign. Although Mr. Paul claimed that there was no substantive dispute, the accounting firm indicated otherwise. Apparently there were several disagreements over the proper accounting of transactions. The dispute was serious enough to prompt the accountants to terminate their profitable relationship with a large client.

Last summer, several CenTrust shareholders sued Mr. Paul and the Board of Directors, alleging breach of fiduciary duty and waste of corporate assets.

Last fall, we received a preliminary copy of the examination. Along with the deficiencies previously documented, it found that Mr. Paul had inappropriately spent about \$40 million of the institution's funds on such extravagances as the artwork, a corporate jet, yachts, limousines and lavish entertaining.

Around Thanksgiving of last year, senior members of our staff met with Office of Thrift Supervision officials and FDIC personnel in Atlanta to map out our strategy for dealing with the problems we uncovered. Following the meeting, Comptroller Lewis wrote to both FDIC Chairman William Seidman and then-Director of the OTS, Danny Wall, suggesting that each take a personal interest in the case.

Our examination report, plus the support provided by the freshly-enacted Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), allowed us to move forward. By early December, OTS issued a cease-and-desist order which ordered a halt to the inappropriate expenditures on the part of CenTrust. Twelve days later, our office filed an enforcement action seeking the removal of Mr. Paul from the institution.

We might add that despite the headlines generated by the disclosure that CenTrust had allegedly squandered up to \$40 million in depositors' funds, the fundamental flaw with CenTrust was its inability to generate profits from its core banking operations and its fatal reliance on gains trading and poor quality junk bonds. Let us put it another way: Under FIRREA, with its new capital requirements and its insistence that generally accepted accounting principles - and not the gimmicky method used in the past by S&L's - be employed, CenTrust was doomed.

And so on February 2 of this year, Comptroller Lewis authorized OTS to place CenTrust into conservatorship after examiners confirmed that under the standards imposed by FIRREA, CenTrust was unsalvageable.

Thank you for the opportunity to present this summary, and we look forward to answering any questions you may have when the committee meets next week.

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## COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

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March 12, 1990

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CD72 128-4347

Honorable L. William Seidman, Chairman  
 Federal Deposit Insurance Corporation  
 550 17th Street, N.W.  
 Washington, D.C. 20429

Dear Chairman Seidman:

As part of the Committee on Banking, Finance and Urban Affairs' continuing oversight of insured depository institutions and the implementation of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the Committee will hold hearings on March 26, 1990, to explore the operation, supervision, regulation and subsequent closing of CentTrust Bank, a state savings bank of Florida.

The Committee will need to identify the problems which led to the institution's failure, when the problems were discovered by the regulatory agents, the timing and nature of any subsequent responses or actions by federal and state regulatory authorities, and the estimate of the ultimate loss to the deposit insurance fund and related issues. So that the Congress and the public will have a full and accurate picture of the CentTrust case, the Committee will need your complete and timely cooperation.

Your appearance before the Banking, Finance and Urban Affairs Committee is requested for 10 a.m. Monday, March 26, 1990, in Room 2128 of the Rayburn House Office Building, Washington, D.C. At that time, the Committee will expect you to be prepared to discuss in detail all issues involved in CentTrust Bank, including: (1) the financial condition of the institution at the time FDIC was appointed conservator, (2) FDIC's assessment of the prior management of the institution, (3) a discussion of any practices by prior management that contributed to the institution's failure, and (4) FDIC's analysis of the supervisory history of CentTrust Bank with an emphasis on how future supervisory efforts can be improved. The Committee will need a response to this request for your appearance by no later than March 19, 1990.

In accordance with the Committee rules, please deliver 200 copies of your prepared statement to B-303 Rayburn House Office Building. In order to ensure that members of the Committee have

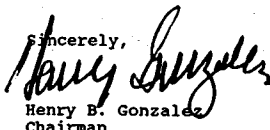


sufficient time to review your statement, the Committee requires that such testimony be provided by Thursday, March 22, 1990. Your entire statement will be included in the hearing record and, if delivered when requested, the statement will be made available to all Committee members in advance of your appearance.

In the interim, the Committee will need to review the documents necessary to reconstruct the history of CenTrust Bank. Committee staff will be in contact with your office to identify specific documents, now in the possession of the Federal Deposit Insurance Corporation, that the Committee has identified at this time as essential to the inquiry. This letter is also intended to cover additional documents which are subsequently identified and requested by the Committee as essential to the inquiry.

I can not over emphasize the need for full and timely compliance with this request. Any questions regarding your testimony or the production of documents should be immediately directed to Gary Bowser of my staff at (202) 225-2924.

Sincerely,



Henry B. Gonzalez  
Chairman

HBG:dbv

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March 12, 1990

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(202) 225-4147

Ms. Sandra A. Waldrop  
 Deputy Regional Director, Resolutions/Operations  
 Resolution Trust Corporation  
 245 Peachtree Center Avenue  
 Suite 1100  
 Atlanta, GA 30303

Dear Ms. Waldrop:

As part of the Committee on Banking, Finance and Urban Affairs' continuing oversight of insured depository institutions and the implementation of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the Committee will hold hearings on March 26, 1990, to explore the operation, supervision, regulation and subsequent closing of CentTrust Bank, a state savings bank of Florida.

Your presence is requested at 10:00 a.m., Monday, March 26, 1990, in Room 2128 Rayburn House Office Building, Washington, D.C.

In accordance with the Committee rules, please deliver 200 copies of your prepared statement to B-303 Rayburn House Office Building. In order to ensure that members of the Committee have sufficient time to review your statement, the Committee requires that such testimony be provided by Thursday, March 22, 1990. Your entire statement will be included in the hearing record and, if delivered when requested, the statement will be made available to all Committee members in advance of your appearance.

If you have further questions regarding your testimony, please contact Gary Bowser of my staff at 202-225-2924.

Sincerely,

*Henry Gonzalez*  
 Henry B. Gonzalez  
 Chairman

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 BILL PASCO, NEW YORK

(202) 225-4247

Mr. Kurt Wiershem  
 Managing Agent - CentTrust Bank, ASSB  
 c/o Resolution Trust Corporation  
 100 SE 2nd Street  
 Miami, Florida 33102

Dear Mr. Wiershem:

As part of the Committee on Banking, Finance and Urban Affairs' continuing oversight of insured depository institutions and the implementation of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the Committee will hold hearings on March 26, 1990, to explore the operation, supervision, regulation and subsequent closing of CentTrust Bank, a state savings bank of Florida.

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If you have further questions regarding your testimony, please contact Gary Bowser of my staff at 202-225-2924.

Sincerely,

*Henry B. Gonzalez*  
 Henry B. Gonzalez  
 Chairman

HENRY B. GONZALEZ, TEXAS, CHAIRMAN  
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 EDWARD H. BAKER, LOUISIANA  
 CLIFF STANLEY, FLORIDA  
 PAUL GILLMORE, OHIO  
 BILL FAYON, NEW YORK

(202) 225-4347

Mr. John E. Ryan  
 Director,  
 Office of Thrift Supervision, Atlanta  
 P.O. Box 105217  
 Atlanta, Georgia 30348-5217

Dear Mr. Ryan:

As part of the Committee on Banking, Finance and Urban Affairs' continuing oversight of insured depository institutions and the implementation of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the Committee will hold hearings on March 26, 1990, to explore the operation, supervision, regulation and subsequent closing of Centrust Bank, a state savings bank of Florida.

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If you have further questions regarding your testimony, please contact Gary Bowser of my staff at 202-225-2924.

Sincerely,

*Henry B. Gonzalez*

Henry B. Gonzalez  
 Chairman

HENRY B. GONZALEZ, TEXAS, CHAIRMAN  
FRANK ANNUNZIO, ILLINOIS  
WALTER E. FAUNTROY, DISTRICT OF COLUMBIA  
STEPHEN L. REAL, NORTH CAROLINA  
CHARLES W. STENBERG, N. HARTFORD  
JOHN J. LAFALCE, NEW YORK  
BARRY ROSE GALT, OHIO  
BRUCE F. VENTO, MINNESOTA  
DAVID BARNARD, JR., GEORGIA  
ROBERT SANDA, NEW YORK  
CHARLES E. SCHUMER, NEW YORK  
BARNETT FRANK, MASSACHUSETTS  
RICHARD H. LEHRMAN, CALIFORNIA  
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MARTY KAPLAN, OHIO  
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THOMAS R. CAMPER, DELAWARE  
ESTERAN EDWARD TORRES, CALIFORNIA  
GERALD D. ELECZAK, WISCONSIN  
BILL NELSON, FLORIDA  
PAUL E. CARLISLE, PENNSYLVANIA  
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JOSEPH P. EDWARDS, MASSACHUSETTS  
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# U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ONE HUNDRED FIRST CONGRESS

2129 RAYBURN HOUSE OFFICE BUILDING  
WASHINGTON, DC 20515

March 12, 1990

CHALMERS F. WYLLIE, OHIO  
JIM LEACH, IOWA  
ROBERTA L. BARNHART, CALIFORNIA  
STAN PATRICK, VIRGINIA  
BILL MCCOLLUM, FLORIDA  
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JIM BARNES, CONNECTICUT  
RICHARD H. BAKER, LOUISIANA  
CLIFF TETLIE, FLORIDA  
PAUL DILLON, OHIO  
BILL PASIK, NEW YORK

(202) 225-4247

Ms. Maria I. Richmond  
Deputy Director Supervision Operations  
Office of Thrift Supervision, Atlanta  
P.O. Box 105217  
Atlanta, Georgia 30348-5217

Dear Ms. Richmond:

As part of the Committee on Banking, Finance and Urban Affairs' continuing oversight of insured depository institutions and the implementation of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the Committee will hold hearings on March 26, 1990, to explore the operation, supervision, regulation and subsequent closing of CentTrust Bank, a state savings bank of Florida.

Your presence is requested at 10:00 a.m., Monday, March 26, 1990, in Room 2128 Rayburn House Office Building, Washington, D.C.

In accordance with the Committee rules, please deliver 200 copies of your prepared statement to B-303 Rayburn House Office Building. In order to ensure that members of the Committee have sufficient time to review your statement, the Committee requires that such testimony be provided by Thursday, March 22, 1990. Your entire statement will be included in the hearing record and, if delivered when requested, the statement will be made available to all Committee members in advance of your appearance.

If you have further questions regarding your testimony, please contact Gary Bowser of my staff at 202-225-2924.

Sincerely,

*Henry B. Gonzalez*

Henry B. Gonzalez  
Chairman

HENRY B. GONZALEZ, TEXAS, CHAIRMAN  
 FRANK ANNUNZIO, ILLINOIS  
 WALTER S. FAUNTROY, DISTRICT OF COLUMBIA  
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 DWYER WILSON, MARYLAND  
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# U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ONE HUNDRED FIRST CONGRESS  
 2128 RAYBURN HOUSE OFFICE BUILDING  
 WASHINGTON, DC 20518

March 12, 1990

CHALLENGER F. WYLLIE, OHIO  
 JIM LATCH, IOWA  
 STEPHEN S. BILIRAKIS, CALIFORNIA  
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 BILL MACCELLANO, FLORIDA  
 ROBERT ELLERCA, NEW JERSEY  
 DOUG KESSELTER, IOWA  
 JAMES BAKER, CALIFORNIA  
 JOHN HILL, GEORGIA  
 THOMAS J. NEASE, PENNSYLVANIA  
 STEVE BRADLEY, TEXAS  
 TONY ROTH, WISCONSIN  
 AL INGRAM, CALIFORNIA  
 JAMES SUTTON, NEW JERSEY  
 PATRICIA BARR, MARYLAND  
 JIM BLUMBERG, KENTUCKY  
 RICHARD H. BAKER, LOUISIANA  
 CLIFF STANLEY, FLORIDA  
 PAUL GILMORE, OHIO  
 BILL PATON, NEW YORK

202-225-4347

Mr. Ashbel C. Williams, Jr.  
 Assistant Comptroller, State of Florida  
 Plaza Level, The Capital  
 Tallahassee, Florida 32399-0350

Dear Mr. Williams:

As part of the Committee on Banking, Finance and Urban Affairs' continuing oversight of insured depository institutions and the implementation of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the Committee will hold hearings on March 26, 1990, to explore the operation, supervision, regulation and subsequent closing of CenTrust Bank, a state savings bank of Florida.

Your presence is requested at 10:00 a.m., Monday, March 26, 1990, in Room 2128 Rayburn House Office Building, Washington, D.C.

In accordance with the Committee rules, please deliver 200 copies of your prepared statement to B-303 Rayburn House Office Building. In order to ensure that members of the Committee have sufficient time to review your statement, the Committee requires that such testimony be provided by Thursday, March 22, 1990. Your entire statement will be included in the hearing record and, if delivered when requested, the statement will be made available to all Committee members in advance of your appearance.

If you have further questions regarding your testimony, please contact Gary Bowser of my staff at 202-225-2924.

Sincerely,

*Henry B. Gonzalez*  
 Henry B. Gonzalez  
 Chairman

HENRY B. GONZALEZ, TEXAS, CHAIRMAN  
 FRANK ANNUNCIO, ILLINOIS  
 WALTER E. FAHRSTEDT, DISTRICT OF COLUMBIA  
 STEPHEN L. REAL, NORTH CAROLINA  
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 MARY ROSE DALLAN, OHIO  
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 EDUAR BARBARO, JR., MICHIGAN  
 ROBERT GARCIA, NEW YORK  
 CHARLES E. SCHWENK, NEW YORK  
 BARREY FRANK, MASSACHUSETTS  
 RICHARD H. LUBMAN, CALIFORNIA  
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 MARY LUTHER, OHIO  
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 THOMAS R. CAVIER, DELAWARE  
 ESTHER EDWARDS TORRES, CALIFORNIA  
 GERALD D. KAPLAN, WISCONSIN  
 BILL NELSON, FLORIDA  
 PAUL E. CARLTONSKI, PENNSYLVANIA  
 ELIZABETH A. PATTERSON, SOUTH CAROLINA  
 THOMAS MESSLER, MARYLAND  
 JOSEPH P. KENNEDY, MASSACHUSETTS  
 FLOYD H. PLAKE, NEW YORK  
 EDWIN BOWSER, MARYLAND  
 DAVID S. PRICE, NORTH CAROLINA  
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 JIM MCCORMACK, WASHINGTON  
 PETER HOAGLAND, NEBRASKA  
 RICHARD S. REAL, MASSACHUSETTS

**U.S. HOUSE OF REPRESENTATIVES**  
**COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS**  
 ONE HUNDRED FIRST CONGRESS  
 2128 RAYBURN HOUSE OFFICE BUILDING  
 WASHINGTON, DC 20515

March 12, 1990

CHARLES F. WYLLIE, OHIO  
 JIM LEACH, IOWA  
 ROBERTA S. SPANNEY, CALIFORNIA  
 STAN FARRIS, VIRGINIA  
 BILL BRIDGEMAN, FLORIDA  
 DAVID BOULDER, NEW JERSEY  
 DAVID BOENHUTTE, NEBRASKA  
 DAVID DUNN, CALIFORNIA  
 JOHN HELJA, NEVADA  
 THOMAS J. BODIA, PENNSYLVANIA  
 STEVE BARTLETT, TEXAS  
 TONY ROTH, WISCONSIN  
 JAMES SARTON, NEW JERSEY  
 AL MACANDRESE, CALIFORNIA  
 PATRICIA BARK, HAWAII  
 JIM BURNING, KENTUCKY  
 RICHARD H. BAKER, LOUISIANA  
 CLYD STARRS, FLORIDA  
 PAUL OLLMAN, OHIO  
 BILL PATTON, NEW YORK  
 (202) 225-4247

Mr. Lawrence H. Fuchs  
 Deputy Comptroller, State of Florida  
 Plaza Level, The Capital  
 Tallahassee, Florida 32399-0350

Dear Mr. Fuchs:

As part of the Committee on Banking, Finance and Urban Affairs' continuing oversight of insured depository institutions and the implementation of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the Committee will hold hearings on March 26, 1990, to explore the operation, supervision, regulation and subsequent closing of CentTrust Bank, a state savings bank of Florida.

Your presence is requested at 10:00 a.m., Monday, March 26, 1990, in Room 2128 Rayburn House Office Building, Washington, D.C.

In accordance with the Committee rules, please deliver 200 copies of your prepared statement to B-303 Rayburn House Office Building. In order to ensure that members of the Committee have sufficient time to review your statement, the Committee requires that such testimony be provided by Thursday, March 22, 1990. Your entire statement will be included in the hearing record and, if delivered when requested, the statement will be made available to all Committee members in advance of your appearance.

If you have further questions regarding your testimony, please contact Gary Bowser of my staff at 202-225-2924.

Sincerely,



Henry B. Gonzalez  
 Chairman

HENRY B. GONZALEZ, TEXAS, CHAIRMAN  
 FRANK ARMBRISTER, ILLINOIS  
 WALTER E. FAUNTROY, DISTRICT OF COLUMBIA  
 STEPHEN L. NEAL, NORTH CAROLINA  
 CARROLL RUSSELL, JR., KENTUCKY  
 JOHN J. LAFALCE, NEW YORK  
 MARY ROSE DAKIN, OHIO  
 BRUCE F. VENTO, MINNESOTA  
 DOUG BARNARD, JR., GEORGIA  
 ROBERT GARCIA, NEW YORK  
 CHARLES E. SCHUMER, NEW YORK  
 BARRY FRANK, MASSACHUSETTS  
 RICHARD H. LEHRMAN, CALIFORNIA  
 BRUCE J. MCKENSON, CONNECTICUT  
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 FLOYD H. PLAGE, NEW YORK  
 EUGENE WILSON, MARYLAND  
 DAVID E. PRICE, NORTH CAROLINA  
 NANCY PELOSI, CALIFORNIA  
 JIM McDERMOTT, WASHINGTON  
 PETER HOAGLAND, NEBRASKA  
 RICHARD E. NEAL, MASSACHUSETTS

**U.S. HOUSE OF REPRESENTATIVES**  
 COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ONE HUNDRED FIRST CONGRESS  
 2129 RAYBURN HOUSE OFFICE BUILDING  
 WASHINGTON, DC 20515

March 15, 1990

CHALLENGER P. WYLLIE, OHIO  
 JIM LEACH, IOWA  
 NORMAN D. BISHOPWAY, CALIFORNIA  
 STAN PARRIS, VIRGINIA  
 BILL BRIDGEMAN, FLORIDA  
 MARCO RUBENSON, NEW JERSEY  
 DOUG SCHULTZ, NEBRASKA  
 DAVID EISEN, CALIFORNIA  
 JOHN HELA, IDAHO  
 STEVE BARTLETT, TEXAS  
 TONY ROTH, WISCONSIN  
 AL NICARDOLES, CALIFORNIA  
 JAMES BAYTON, NEW JERSEY  
 PATRICIA SARKIS, HAWAII  
 JIM BLUMM, KENTUCKY  
 THOMAS J. ROSE, PENNSYLVANIA  
 CLIFF STEARNS, FLORIDA  
 PAUL SALAMON, OHIO  
 BILL FAXON, NEW YORK

DD2 225-247

Mr. David L. Paul  
 42 La Gorce Circle  
 La Gorce Island  
 Miami Beach, Florida 33141

Dear Mr. Paul:

As part of the Committee on Banking, Finance and Urban Affairs' continuing oversight of insured depository institutions and the implementation of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the Committee will hold hearings on March 26, 1990, to explore the operation, supervision, regulation and subsequent closing of CentTrust Bank, a state savings bank of Florida.

The Committee will need to identify the problems which led to the institution's failure, when the problems were discovered by the regulatory agents, the timing and nature of any subsequent responses or actions by federal and state regulatory authorities, and the estimate of the ultimate loss to the deposit insurance fund and related issues. So that the Congress and the public will have a full and accurate picture of the CentTrust case, the Committee will need your complete and timely cooperation.

Your appearance before the Banking, Finance and Urban Affairs Committee is requested for 10 a.m. Monday, March 26, 1990, in Room 2128 of the Rayburn House Office Building, Washington, D.C. At that time, the Committee will expect you to be prepared to discuss in detail the issues involved in the management, operation and regulation of CentTrust Bank from September 1982 to February 2, 1990. The Committee will need a response to this request for your appearance by no later than March 19, 1990.

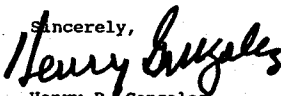
In accordance with the Committee rules, please deliver 200 copies of your prepared statement to B-303 Rayburn House Office Building. In order to ensure that members of the Committee have sufficient time to review your statement, the Committee requires that such testimony be provided by Thursday, March 22, 1990. Your entire statement will be included in the hearing record and, if delivered when requested, the statement will be made available to all Committee members in advance of your appearance.



In the interim, the Committee will need to review the documents necessary to reconstruct the history of CenTrust Bank. The Committee requests that you provide a copy of all communications and correspondence related to CenTrust Bank and its affiliated entities, either internal in nature or with third parties, regarding the purchase, operation, management, regulation and attempted sale of CenTrust. It is specifically intended that communications and correspondence be interpreted as including, but not limited to, letters, memoranda, notes of telephonic meetings, electronic mail or other computer-related communication, and any minutes taken at meetings where CenTrust Bank was discussed. We also ask that you review the documents in your possession for the purpose of compiling a list of any meetings between employees of any federal and state regulatory agency and officials, employees or representatives of CenTrust Bank or any of their subsidiaries. Please provide the date and purpose of any such meetings.

I can not over emphasize the need for full and timely compliance with this request. Any questions regarding your testimony or the production of documents should be immediately directed to Gary Bowser of my staff at (202) 225-2924.

Sincerely,

A handwritten signature in black ink, appearing to read "Henry B. Gonzalez", written over the typed name.

Henry B. Gonzalez  
Chairman

## NEAL &amp; HARWELL

LAW OFFICES  
2000 ONE NASHVILLE PLACE  
150 FOURTH AVENUE, NORTH  
NASHVILLE, TENNESSEE 37210-2417

TELEPHONE TELECOPIER  
(615) 244-1713 (615) 726-0573

ANSEL L. DAVIS  
OF COUNSEL

JAMES F. NEAL  
AUBREY B. HARWELL, JR.  
JOHN D. ROSS  
JAMES F. SANDERS  
THOMAS M. DUNDON  
ROBERT L. SULLIVAN  
RONALD G. HARRIS  
ALBERT F. MOORE  
PHILIP N. ELBERT  
JAMES G. THOMAS  
WILLIAM T. RAMSEY  
DELTA ANNE DAVIS  
PHILIP D. IRWIN  
SUSAN McDONALD  
GEORGE M. CATE III  
EDMUND L. CARET JR.  
SUSAN DUVIER BASS

March 20, 1990

VIA TELECOPIER AND FEDERAL EXPRESS

The Honorable Henry B. Gonzalez  
Chairman  
Committee on Banking, Finance  
and Urban Affairs  
U. S. House of Representatives  
2129 Rayburn House Office Building  
Washington, D. C. 20515

RECEIVED

MAR 21 1990

COMMITTEE ON BANKING  
FINANCE, AND URBAN AFFAIRS

Re: David L. Paul

Dear Chairman Gonzalez:

I had a telephone conversation yesterday with Gary Bowser of your staff regarding the March 15, 1990 letter from you to David L. Paul, wherein Mr. Paul's appearance was requested before your Committee on March 26, 1990. Mr. Bowser suggested that I communicate directly to you my thoughts regarding your request.

I am currently out of the State and do not anticipate being back in my office until March 26, 1990; it appears that it will be at least then, if not later, before I will be able to see Mr. Paul. While I have talked to Mr. Paul on several occasions, there has been no ultimate decision made concerning my representing him, although, it appears likely at this time that I will become his counsel. However, until that decision is made, I am concerned about making commitments at this time for Mr. Paul.

Notwithstanding the fact that I do not currently represent Mr. Paul, there are, nonetheless, some observations I wish to convey to you. Certainly, it would be easy for Mr. Paul to exercise his constitutional rights to decline respectfully to testify before your Committee. However, I do see some significant benefit regarding Mr. Paul's possibly waiving his Fifth Amendment privilege and providing testimony before your Committee. However, a decision of this magnitude cannot be made without some indepth analysis and significant face-to-face

The Honorable Henry B. Gonzalez  
March 20, 1990  
Page 2

conversations between Mr. Paul and his attorney. Therefore, as I told Mr. Bowser, it would be my hope that the Committee would postpone the scheduled time for the appearance of Mr. Paul so as to allow him an opportunity to retain counsel, confer with that counsel, analyze the situation, and make a meaningful judgment regarding your request. If this proves to be impossible, Mr. Paul would have no alternative at this time but to decline respectfully your request that he appear on March 26, 1990.

Sincerely,

*Aubrey B. Harwell, Jr.*

Aubrey B. Harwell, Jr.

ABHJr/jl

c: Mr. Gary Bowser

HENRY B. GONZALEZ, TEXAS, CHAIRMAN  
 PHILIP H. ANDERSON, ILLINOIS  
 WALTER E. FAUNTROY, DISTRICT OF COLUMBIA  
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**U.S. HOUSE OF REPRESENTATIVES**  
 COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ONE HUNDRED FIRST CONGRESS  
 2129 RAYBURN HOUSE OFFICE BUILDING  
 WASHINGTON, DC 20515

March 23, 1990

CHALLENGER P. WYLLIE, OHIO  
 JIM LEACH, OHIO  
 NORMAN D. SHUMWAY, CALIFORNIA  
 STEVE PARR, VIRGINIA  
 BILL MCCOLLUM, FLORIDA  
 MARK ROSENBERG, NEW JERSEY  
 DOUG BERENSON, NEBRASKA  
 DAVID DREHER, CALIFORNIA  
 JOHN WELLS, NEVADA  
 STEVE BARTLETT, TEXAS  
 THOMAS J. WEDGE, PENNSYLVANIA  
 TOBY ROTH, WISCONSIN  
 AL MCCARDLES, CALIFORNIA  
 JAMES SEXTON, NEW JERSEY  
 PATRICIA SHER, HAWAII  
 JIM BURNING, KENTUCKY  
 RICHARD H. BAKER, LOUISIANA  
 CLIFF STEARNS, FLORIDA  
 PAUL SULLIVAN, OHIO  
 BILL FAXON, NEW YORK

(202) 225-1217

Aubrey B. Harwell, Jr.  
 Neal and Harwell  
 2000 One Nashville Place  
 150 Fourth Avenue, North  
 Nashville, Tenn. 37219-2417

Dear Mr. Harwell:

I am in receipt of your letter dated March 20, 1990 which requests a postponement for the appearance of Mr. David L. Paul before the Committee on Banking, Finance and Urban Affairs. As you know, the Committee is reviewing the supervision, operation, and subsequent closing of CentTrust Bank. As such, the appearance of Mr. Paul is essential to the Committee's inquiry.

Therefore, the Committee wishes to accommodate your request that Mr. Paul be given adequate time to prepare and appear at a later date. A period of two weeks would seem to be adequate. I will await your reply before fixing a specific date for Mr. Paul's appearance.

If you have any questions you may contact Gary Bowser of my staff at (202) 225-2924.

Sincerely,

*Henry B. Gonzalez*  
 Henry B. Gonzalez  
 Chairman

**OVERVIEW OF CENTRUST BANK, A STATE SAVINGS BANK**

CentTrust Bank, headquartered in Miami, was owned and controlled by David L. Paul. In 1983 David Paul in a supervisory conversion approved by the Federal Home Loan Bank Board and the Florida Department of Banking and Finance acquired the failing Dade Federal Savings and Loan Association (Dade). Dade was organized in 1934 as a Federal mutual savings and loan association and was converted to a Florida mutual savings and loan association in 1979. On November 3, 1983, with the acquisition by David Paul, Dade was converted from a Florida mutual to a Florida stock savings and loan association. In 1984 David Paul changed the name of Dade to CentTrust

**BACKGROUND ON DAVID L. PAUL**

As reported, David L. Paul, 50, former Chairman of CentTrust Bank, was brought up in the affluent neighborhoods of Miami and Manhattan. In 1961, Mr. Paul earned a degree in economics at the University of Pennsylvania's Wharton School. Subsequently, he enrolled in Columbia University's law school. Although he attended Columbia's law school from 1961 to 1965, he did not receive his J.D. degree until April 7, 1969. In 1970, Mr. Paul began a career as a real estate contractor\developer by taking over several failing apartment projects in New Jersey. He later moved on to other apartment projects, shopping centers and high-rise office buildings. In 1981, David Paul acquired the Westport Corp., a Connecticut-based real estate investment trust. Westport barely survived the real estate crash of the late 1970's, salvaging only \$32 million of its \$140 million in real estate assets, consisting of properties located primarily in Chicago and the Northeast.

Mr. Paul has stated that in 1982 he shifted his emphasis from real estate development for the "intellectual stimulation" of banking. Through Peter Moser, a friend on the Board of Directors of Dade Federal Savings and Loan Association, Mr. Paul

learned that Dade was having financial problems and was looking for a buyer. In 1982, David Paul enters into a contract to acquire all of Dade's outstanding stock in a government supervised merger by contributing Westport's assets as capital. In 1984, Mr. Paul renamed Dade Federal CenTrust Bank, A State Savings Bank, and in April 1985 took CenTrust public. By 1988, through brokered deposits and substantial investments in junk bonds, Mr. Paul turned the failing thrift with \$1.9 billion in assets into the largest thrift in Florida and the Southeast, eventually amassing \$10 billion in assets.

#### EXCESSIVE LIFESTYLE

According to regulators, Mr. Paul lived a lavish and flamboyant lifestyle, using CenTrust as his personal expense account. From 1984 to 1989, Mr. Paul's compensation, including salary, bonuses and dividends, totaled over \$16 million. In fiscal year 1989, Mr. Paul received \$1.75 million in total compensation (about \$2 million less than the \$3.7 million received in Fiscal Year 1988). This decrease in compensation was a direct result of a supervisory directive that mandated CenTrust discontinue dividend payments because it was accruing substantial losses.

In addition to receiving millions in compensation from CenTrust, David Paul received \$6.1 million in mortgages to purchase, improve and renovate three adjoining properties located on La Gorce Island. It should be noted that from November 1988 to March 1989 when CenTrust was realizing substantial losses, it extended Mr. Paul an additional \$3.1 million in mortgages, bringing the grand total to \$6.1 million. Another \$400,000 was paid by CenTrust for various security services maintained at Mr. Paul's residence. Other extravagances enjoyed by Mr. Paul at CenTrust's expense, include: (1) \$29 million for a collection of Old Masters paintings, including a \$13.2 million Rubens which Mr.

Paul placed on display at his personal residence, (2) \$7 million for a 95 foot custom made yacht christened the "Grand Cru," (3) \$1.4 million a year to lease a corporate jet, (4) \$260,000 for 2 board meetings\retreats in 1988 and 1989, (5) \$232,500 for the "Bodacious" corporate sailboat, (6) \$122,000 for Mr. Paul's famous "French Chefs" party, (7) \$107,000 for Baccarat crystal and French linens for the executive dining room, and (8) \$104,000 in limousine expenses.

#### SUPERVISORY CONCERNS

Regulators report that, once in control of CentTrust, Mr. Paul embarked upon a fast-growth high-risk management strategy based on substantial investments in junk bonds funded with brokered deposits. Immediately after taking CentTrust public in 1985, Mr. Paul established a Capital Markets Group to handle investments in junk bonds and other corporate securities, and raise funding through brokered deposits. In fact, a staggering 80% of deposits taken by CentTrust from 1986 to 1988 were brokered deposits. By June 30, 1988, \$2.5 billion or 43% of CentTrust's total deposits were brokered CD's. This increase in brokered deposits was paralleled by a corresponding increase in investment securities transactions. At one point CentTrust held about \$1.4 billion in junk bonds. CentTrust was looking more like an investment bank, relying on profits from the sale of investment securities rather than from traditional thrift operations.

Florida State regulators became concerned about CentTrust's investment activities as early as 1985, ordering Mr. Paul to reduce CentTrust's holdings of the below-investment-grade "junk" bonds. In a separate episode, regulators ordered CentTrust to sell a large block of stock it had accumulated in MassMutual, a Massachusetts real estate investment trust. And in 1987, Paul was questioned by SEC investigators in New York over CentTrust's purchase and quick sale, in November 1986, of 457,300 shares of

stock in Staley Continental Inc., a Chicago food processor. In 1986, the Federal Home Loan Bank of Atlanta advised CenTrust it had "significant supervisory concerns about aspects of CenTrust's operations," and rejected CenTrust's application to take over Freedom Savings and Broward Federal, both troubled institutions.

Since David Paul's acquisition in 1983 to fiscal year end 1988, CenTrust was reporting profits. All income generated by CenTrust during this time period came as a direct result of the thrift's investment banking activities. CenTrust was never able to generate income solely from operations. However, by the third quarter of 1988 this situation change and CenTrust began to realize significant losses also in its investment banking activities and other non-lending activities. In March 1989, CenTrust's Supervisory Agent at the Federal Home Loan Bank of Atlanta designated CenTrust a "troubled institution" and issues numerous supervisory directives.

In addition, FIRREA imposes further restrictions on thrifts' investment activities and participation in brokered deposits. CenTrust was required to mark to market its portfolio of junk bonds maturing after July 1, 1994. Moreover, CenTrust could no longer rely on brokered deposits, its primary source of deposits, unless it met certain minimal capital requirements mandated by FIRREA. By the end of its fiscal year 1989, CenTrust was reporting total losses of \$120 million and had tangible capital of negative \$245,470,000, failing to meet capital requirements by \$374,185,000.

On February 2, 1990, CenTrust was placed into conservatorship, regulators declaring CenTrust was in unsafe and unsound condition and had insufficient capital. Finally, on March 9, 1990, CenTrust was placed into receivership by the Office of Thrift Supervision which appointed the Resolution Trust Corporation receiver.



SUPERVISORY HISTORY OF CENTRUST BANK, A STATE SAVINGS BANK

CentTrust Bank, headquartered in Miami, was owned and controlled by David L. Paul. In 1983 David Paul, in a supervisory conversion approved by the Federal Home Loan Bank Board and the Florida Department of Banking and Finance, acquired the failing Dade Federal Savings and Loan Association (Dade). Dade was organized in 1934 as a Federal mutual savings and loan association and was converted to a Florida mutual savings and loan association in 1979. On November 3, 1983, with the acquisition by David Paul, Dade was converted from a Florida mutual to a Florida stock savings and loan association. In 1984 David Paul changed the name of Dade to CentTrust

- 
- Oct. 1, 1982 David L. Paul, then Chairman of the Westport Corporation, a Connecticut-based real estate company, submits a contract to purchase Dade Federal. Paul agrees to contribute (in a Trust) Westport's assets valued at \$32 million as a non-cash infusion of capital to Dade Federal.
- January, 1983 Federal Home Loan Bank of Atlanta (Atlanta) sends a memorandum to the Federal Home Loan Bank Board (now the Office of Thrift Supervision -- OTS) expressing a negative view of Mr. Paul's business plan. Atlanta concludes that the business plan was unrealistically optimistic, the value of Westport's assets were overstated, and the proposed new management lacked sufficient financial institution experience. The staff of the Office of Examination and Supervision (OES) at the Bank Board recommend denial of David Paul's application.
- February, 1983 Before the Bank Board renders a formal decision on the acquisition, David Paul becomes involved in the day-to-day affairs of Dade Federal.
- Mar. 10, 1983 OES staff again recommend denial of David Paul's application, indicating a need for a greater infusion of capital.
- Sept. 28, 1983 After a year of consideration, where only Westport's offer was reviewed, the Bank Board approves the sale of Dade to David Paul. Dade's assets of \$1.9 billion are marked down resulting in the creation of \$526 million in goodwill.

- June 26, 1984 Examination commenced. Examiners identify that CentTrust has \$100 million in high risk poorly underwritten junk bonds.
- March 1985 CentTrust's investments in junk bonds is now \$700 million or 16 percent of assets. The Supervisory Agent directs CentTrust to cease purchasing such securities in a letter dated May 21, 1985.
- July 26, 1985 Special limited examination commenced. The purpose of the examination was to review CentTrust's junk bond portfolio. Nine of 21 bonds reviewed were considered substandard.
- Aug. 2, 1985 Special limited examination commenced. The purpose of the examination was to review the Paul Properties Guaranty and CentTrust Trust. The examination report indicates that as of June 30, 1985 the value of David Paul's contributed assets had declined to \$6.7 million.
- Aug. 6, 1985 Supervisory Agent directs CentTrust to reduce its level of junk bonds to no more than 10 percent of assets by October 31, 1985.
- Sept. 27, 1985 Special limited examination commenced. This examination was performed due to the extraordinary amounts of securities transactions. Sales totaling \$972.1 million occurred during the eleven month review period, resulting in profits of \$25.7 million.
- Jan. 6, 1986 CentTrust fails to comply with the August 6, 1985 Supervisory Agent directive. This prompts Atlanta to recommend that Washington issue a cease and desist order.
- July 11, 1986 Examination commenced. CentTrust was rated a "4" on a scale of 1 to 5, the best rating being a 1. Numerous deficiencies were noted concerning the operation and condition of CentTrust. The examiner noted continued operating losses, increasing levels of non-earning assets, increasing levels of general and administrative expenses, and negative effects of interest rate swaps entered into by the institution. Examiners were most concerned with the institution's high level of junk bonds.
- Sept. 24, 1986 Atlanta follows up its January 6, 1986 recommendation by again requesting that Washington issue a C&D. The Office of Enforcement determines

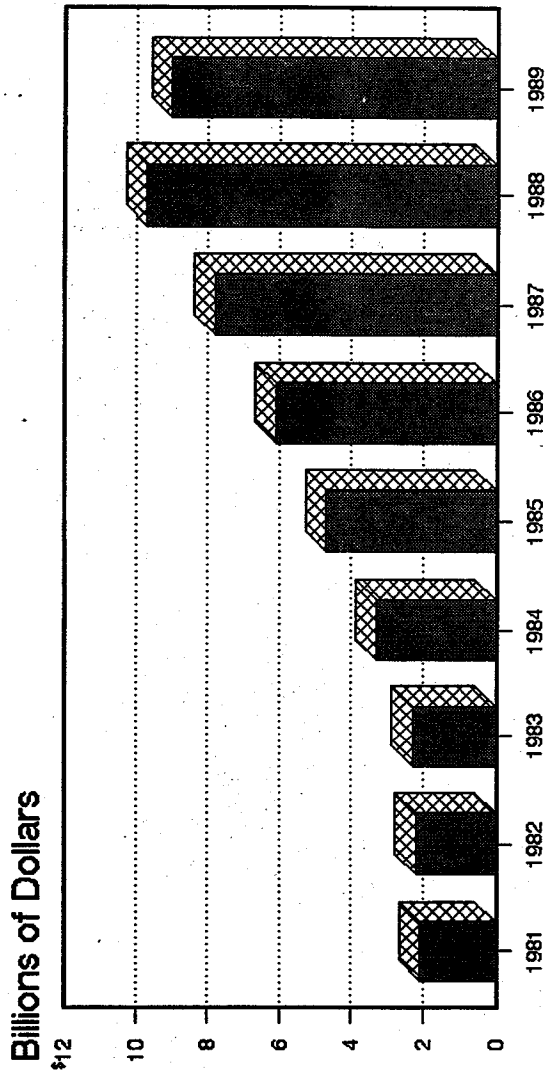
there is not sufficient legal grounds.

- July 1987      The Federal Home Loan Bank of Atlanta initiates a voluntary supervisory agreement with CentTrust. However, unsuccessful efforts to negotiate voluntary agreement were dropped in favor of a new examination, commenced January 11, 1988.
- Jan 11, 1988      Examination commenced. Mr. Paul claims undue bias on the part of the previous 1986 examination and supervisory staff. A new team of examiners is organized to begin an unbiased review of CentTrust's operations. The examination focused on asset quality, operations, risk management and legal compliance. Examiners gave CentTrust an overall rating of "4." The report disclosed that CentTrust's asset quality, operations and risk management exhibited areas of material weaknesses which exposed the institution to potential future losses. The examination also revealed that, despite certain improvements in CentTrust's operating results, its sale of its most marketable securities leaves the institution with a portfolio of low quality hard to sell assets, effectively weakening the institution due to a shortage of performing assets.
- Mar. 15, 1989      The Report of Examination and a Supervisory Letter is transmitted to CentTrust. The letter addresses the problems noted in the examination and directs CentTrust, among other things to: cease growing, suspend payment of common stock dividends, discontinue purchasing high yield bonds, stop purchasing expensive works of art and develop a plan to dispose of the \$30 million art collection (Florida State directed CentTrust to sell the art collection by October 1989).
- May 31, 1989      Examination commenced. Numerous and significant items of supervisory concern, many of which indicate that the institution has not complied with the supervisory directives issued in the March 15, 1989 Supervisory Letter, are uncovered. A number of inappropriate expense items relating to Mr. Paul are also revealed.
- July 17, 1989      In a meeting held in Atlanta, David Paul presented the OTS with a proposal to sell 63 of CentTrust's 71 branches to Great Western Savings. According to the agreement, if the regulators do not approve the transaction by March 31, 1990 either party may terminate the agreement.

- Nov. 17, 1989 A meeting is held in Atlanta with representatives from the FDIC, the RTC, the State of Florida, Washington OTS, and the Atlanta OTS. Everyone in attendance agree that CentTrust can not be viewed as a "going concern" and that action should be taken to bring the institution under supervisory control as soon as possible.
- Dec. 8, 1989 A temporary cease and desist order is issued by the OTS. The order requires the institution to: lower its exorbitant and unnecessary expenditures, to recognize losses on defaulted securities, prepare and maintain accurate financial statements and records, and provide OTS personnel with access to pertinent documents and financial records.
- Dec. 20, 1989 State of Florida issues an order to remove David Paul as Chairman and Chief Executive Officer of CentTrust. The complaint discusses many of the excessive expenditures by Paul and his misuse of institution funds.
- Feb. 2, 1990 CentTrust is placed into Conservatorship by the Office of Thrift Supervision for being in unsafe and unsound condition and for having insufficient capital.
- Mar. 9, 1990 CentTrust is placed into Receivership by the Office of Thrift Supervision. The RTC is appointed receiver.

# **CENTRUST SAVINGS BANK**

## **Total Assets**

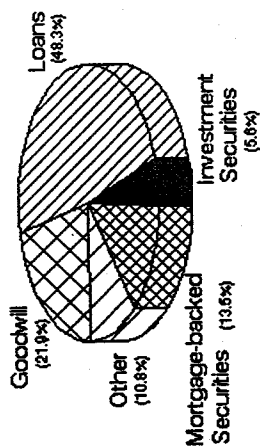


Mr. Paul Took Over CenTrust in 1983  
Source: CenTrust 10ks

# CENTRUST'S ASSETS

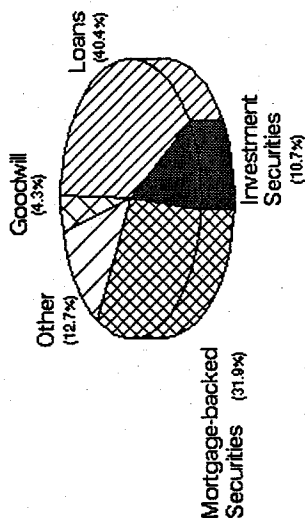
1983

\$2.3 Billion



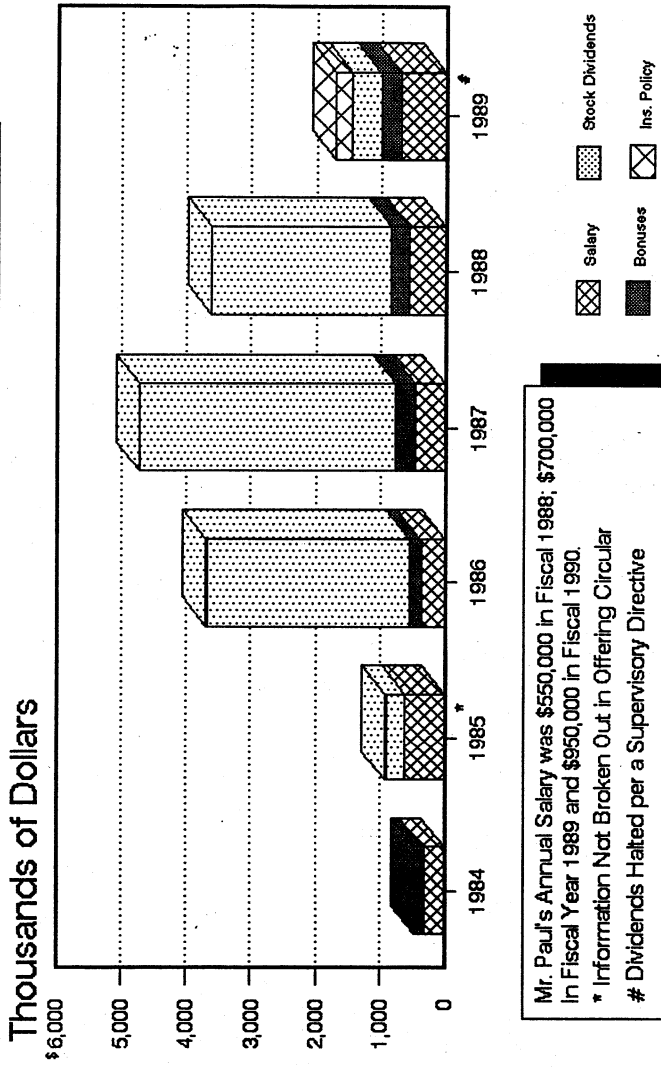
1988

\$9.7 Billion



Mr. Paul Took Over Centrust in 1983  
Source: Centrust Annual Reports

# DAVID L. PAUL'S COMPENSATION



Mr. Paul's Annual Salary was \$550,000 in Fiscal 1988; \$700,000 in Fiscal Year 1989 and \$950,000 in Fiscal 1990.

\* Information Not Broken Out in Offering Circular

† Dividends Halted per a Supervisory Directive

Source: Office of Thrift Supervision

## CENTRUST

David L. Paul  
Total Compensation  
(9\30\84 - (9\30\89)

DATE	SALARY*	BONUSES	DIVIDENDS	TOTAL
Sept. 30, 1984	\$320,860	\$140,000	\$ 0	\$460,860
Sept. 30, 1985	605,667 **	0	299,960	905,627
Sept. 30, 1986	371,600	176,000	3,138,059	3,685,659
Sept. 30, 1987	471,000	290,625	3,969,981	4,731,606
Sept. 30, 1988	552,073	300,000	3,920,632	4,772,705
Sept. 30, 1989	700,000	310,000 #	445,212	1,455,212
TOTAL				\$16,011,669

\* David Paul's salary in Fiscal Year 1990 was increased to \$950,000.

\*\* Information on salary and bonuses was not broken out separately in the Offering Circular.

# Paid in October 1989.

Source: Office of Thrift Supervision



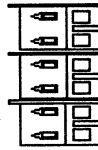
## DAVID PAUL'S EXCESSIVE LIFESTYLE



\$29 Million Old Masters Art Collection



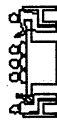
\$7 Million Custom Made "Grand Cru" Yacht  
\$232,500 for the "Bodacious" Corporate Sailboat



\$6.1 Million Mortgage for 3 Adjoining Properties



\$1.4 Million\Year to Lease a Corporate Jet



\$260,000 1988\1989 Board Meeting\Retreat

## DAVID PAUL'S EXCESSIVE LIFESTYLE



\$257,784\Year for \$6 Million in Life Insurance



\$122,000 Dinner Party Catered by 6 Famous French Chefs



\$107,000 for Baccarat Crystal and French Linens  
for the Executive Dining Room



\$104,000 in Limousine Expenses



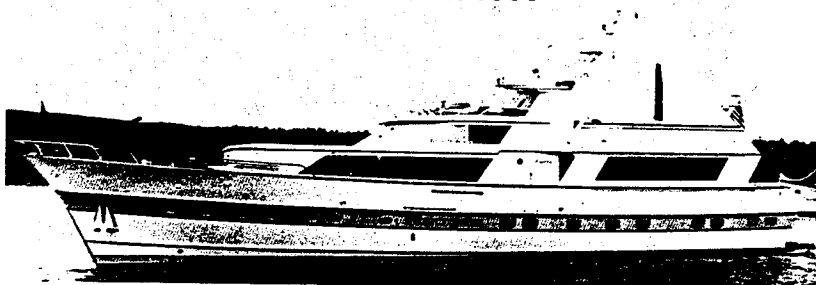
\$47,000 for 35 Nights at the Stanhope Hotel

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Accommodations for 6 plus 1. Full Master suite all with king size bed, ensuite bath and Jacuzzi. Spectacular interior enhanced with combinations of fabrics, metals, exotic woods (Seswood), marbles and finishes that give each separate living area its own identity, but congruous with the total theme of the yacht. Leather counter and table tops. Gold leaf ceilings with indirect lighting. Working fireplace between Main Salon and After Deck. A most unusual bar done in Zebra wood that can be enclosed. All on the boat deck is a second waist-high full galley with dining table. The use of cubic space in this yacht makes you feel you are on a much larger vessel. Decor is elegantly conservative. Powered by twin GM16V-92TAM's. United Engine Conversion.

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The Washington Post

# The S&L-Junk Bond Link

Investigators Uncover Elaborate Network Connecting Drexel With Raiders, High-Flying Thrifts

By Jerry Knight  
Washington Post Staff Writer

Government investigators have discovered an elaborate web that connected bank, insurance and investment firms, including the investment bank of Drexel Burnham Lambert, many of Wall Street's best-known corporate raiders and some of the highest flying savings and loans.

Working closely together, those organizations bought each other's bonds, gave each other loans, traded securities back and forth, financed corporate takeovers, participated in real estate deals together and sometimes allegedly helped each other create phantom profits and evade regulatory requirements, investigators said.

The network of companies that used Drexel to finance corporate takeovers is not yet known, but the investigators said the associations in reality have been understood as a result of investigations by the Securities and Exchange Commission, the Resolution Trust Corp. and the House Banking Committee.

The three federal investigations, the failure of some big thrifts, Drexel's bankruptcy filing last week and other legal proceedings are revealing new connections among the organizations.

"The whole Milken-takeover-junk bond thing was intertwined with the collapse of the thrift industry," said John Stoad, a California attorney representing bondholders who are suing Lincoln Savings and Loan, the thrift that has become a symbol of the S&L debacle. Lincoln is also a symbol of how the junk bond and savings and loan crises interweave.

When Phoenix real estate developer Charles Keating decided to buy a savings and loan bank in 1983, he had no trouble finding the money. Keating went to Drexel Burnham Lambert, the investment bank, and secured the sale of junk bonds that funded his \$50 million purchase of Lincoln. (The securities are called junk bonds because they carry a relatively high risk of default, as well as a high investment return.)

Soon after buying Lincoln, Keating virtually stopped making loans to families to buy homes and began using the money to buy junk bonds from Drexel. By the time Lincoln went broke six years later, Keating had leveraged the original \$50 million from Drexel into \$454 million worth of junk bonds—\$374 million of them bought from Drexel and clients.

Lincoln's collapse and Drexel's bankruptcy have uncovered Robert Campeau's ill-fated purchase of Allied Stores and Federated Department Stores and the buyout of Eastern Air Lines, all of which are now in bankruptcy court. Records of Lincoln's holdings obtained by The Washington Post also show that Lincoln bought \$50 million worth of bonds from Washington Redskins owner Jack Kent Cooke for a successful cable television deal. (Details on Page H9.)

Drexel secretly acquired 10 percent of Lincoln's parent company, American Continental Corp., without disclosing the investment to the SEC as required by law, according to documents made public when ACC

filed for bankruptcy. Nor did Drexel ever obtain permission from federal thrift regulators, who must approve purchasers of large stakes in S&L companies. Auditors stated the investment was illegal. Drexel officials said they could offer no explanation.

Using junk bond money from Drexel to finance a savings and loan and then using the savings and loan to buy junk bonds from Drexel was a sequence that was repeated two dozen times, records of Drexel's underwriting activities show.

Drexel raised more than \$1.2 billion in junk bond capital for S&L clients and thus was able to create buyouts worth more than \$10 billion worth of bonds issued in the last five years. At least one case, an S&L financed by Drexel junk bonds bought junk bonds issued by another Drexel S&L client, which in turn used the money to invest in more Drexel junk bonds.

Of the 10 thrifts that are the biggest investors in junk bonds, eight also raised money by selling junk bonds through Drexel. Three of the eight were thrifts owned by prominent corporate raiders who were long-time Milken associates: Revlon chief Ronald O. Perleman owns First Gibraltar

Bank of Houston with \$457 million invested in junk bonds; the Beilberg family controls Far West S&L of Newport Beach, Calif., with \$487 million; and the BancAmerica Texas Bank, which is owned by the BancAmerica Savings Bank of Stockton, Calif., with \$493 million.

The primary focus of the federal investigations, however, is a group of S&Ls and other companies that had extensive business dealings with Drexel and each other. They include Lincoln; CentTrust Bank, a Miami thrift that failed earlier this month; San Jacinto S&L, which is owned by Summit Corp., a bankrupt Texas real estate company; and Texas Thrift, which is owned by Texas Thrift through Drexel; and Silverado Bank, a failed Denver thrift best known for saving President Bush's son Neil on its board of directors.

Silverado is affiliated with MDC Holdings, a Colorado real estate company that issued junk bonds through Drexel. MDC has already settled an SEC complaint charging it falsely inflated its earnings through bond transactions with Lincoln.

The House Banking Committee has issued subpoenas asking to force Milken to testify about his transactions with savings and loans. Committee members plan to ask about such

(Continued)

Why did ACC pay Lincoln five times as much as Lincoln paid for the stock only four months earlier? Was ACC trying to create a quick profit to bolster its S&L subsidiary? Or did ACC take advantage of Lincoln by paying only \$1 a share for stock it sold for \$6.94 a few months later? Why did ACC sell the stock and then buy it back six months later at a huge loss?

Similar questions are asked by regulators about a series of trades in restricted stock of Memorex NV, the recording tape and computer company that was another client of Drexel. With Drexel's approval, ACC and Lincoln arranged a series of transactions in which the value of the Memorex stock went from \$2.8 million to \$1 million to \$2 million to \$13.3 million in less than two years.

When the transactions were sorted out, Lincoln made \$1 million, a Phoenix businessman whose land dealings with Lincoln are the subject of a federal indictment, and made \$1 million and ACC made \$11.3 million.

Government regulators say the net result was to enrich ACC at the expense of Lincoln.

Keating's lawyers have argued in court papers and hearings that there was nothing improper about either the Memorex or Playtex deals. Keating himself has launched a public relations offensive, maintaining he is a victim of a vendetta by federal regulators who don't appreciate his sophisticated business practices.

February 18, 1990

CentTrust also is closely tied to Lincoln. Two transactions between the thrifts at issue are closely linked involving Drexel and a peculiar kind of stock that was sometimes used to sweeten Drexel's junk bond deals. When private companies sold junk bonds, they sometimes also gave buyers "restricted stock" that was not publicly traded. The stock was valued at pennies a share, but it potentially could be worth much more if the company later decided to sell shares to the public.

In December 1986, Drexel sold Lincoln 2.1 million shares of this kind of stock in Playtex Corp. for 20 cents a share. Four months later Lincoln sold the shares to its parent company, American Continental Corp., for \$1 a share, a total of \$2.1 million. In December 1987, ACC sold the stock to CentTrust for \$6.94 a share, or \$10.4 million. The following June, ACC bought the stock back for \$10.60 a share, or \$15.9 million, giving CentTrust a profit of \$5.5 million—more than 50 percent in six months.

Since there was no public market for the stock, its value was set each time by Drexel, which had a legal obligation to set a fair price. Because Drexel secretly owned part of ACC, it was not a disinterested party in the transaction. The series of transactions raises several questions with securities and banking regulators:

# National Thrift & Mortgage News

## OTS Orders Halt in CenTrust Stock Trading

WASHINGTON.—The Office of Thrift Supervision has ordered a halt to trading in all publicly-held securities of the ailing CenTrust Bank, SSB, Miami.

OTS officials last week declined to comment on the move while analysts who follow the company predicted that the action could be a prelude to placing the \$8.9 billion CenTrust under a conservatorship.

CenTrust shares trade on the American Stock Exchange.

The thrift, one of the largest in the Southeast, is embroiled in court battles with the OTS concerning its financial condition.

It also is fighting a Federal cease and desist order and a state removal action filed against its chairman, David Paul.

Mr. Paul could not be reached for comment. Last week CenTrust issued a statement saying the trading suspension "represents a continuation of abusive and highly prejudicial tactics by the OTS apparently aimed at forcing CenTrust out of business."

The state-chartered thrift said it has been made a target because of its refusal to knuckle under to OTS' improper demands by an agency desperately anxious to show itself as a tough regulator in view of its failure to act effectively in the thrift crisis.

In its cease and desist order, OTS has charged the thrift with a "serious dissipation of assets," noting that its books and records are incomplete and that the thrift impeded an ongoing OTS examination of the institution.

In a counter motion against the agency, CenTrust denied these allegations.

In one of its filings, CenTrust says its auditors, first Deloitte Haskins & Sells, and then later Price Waterhouse declared they were not aware of any material weakness in its books and records.

CenTrust also has launched a legal

challenge to the goodwill provisions of the Financial Institutions Reform, Recovery and Enforcement Act.

CenTrust recently posted a \$119 million loss for the year, plunging its tangible capital to negative \$160 million.

The thrift has been one of the largest investors in high-yield securities issued by Drexel Burnham Lambert with junk bond holdings as of September totalling \$923 million.

Along with others, it is the subject of a congressional investigation into an alleged 'daisy chain' involving Drexel; Lincoln Savings and Loan Association, Irvine, Calif.; and Imperial Savings Association, San Diego.

Ken Thomas, a high yield analyst for K.H. Thomas & Associates, Miami, noted last week that CenTrust "has one of the worst junk bond portfolios in terms of defaults and quality."

He expects CenTrust to post an addition \$100 million loss for the quarter ending December.

He attributes many of its problems to junk bond and securities investments.

Analysts in general have a hard time discerning the quality of CenTrust's portfolio saying the thrift has commercial loans that have bond characteristics.

CenTrust's high yield holdings include Braniff Airlines, Integrated Resources, MCI Communications, Sunshine Mining, Hudson Funding, and many other companies.

CenTrust has experienced large losses on both its Braniff and Integrated Resources holdings. Both companies are in bankruptcy.

According to Mr. Thomas, about 90% of CenTrust's securities investments were done through Drexel.

The thrift also holds \$44 million in the stock of Carnival Cruise Lines.

—Paul Muolo

# THRIFT LIQUIDATION ALERT

A Weekly Update on the Federal Sale of S&L Assets

## Junk Heap Poses Liquidation Challenge

RTC, with an estimated \$4.2 billion in junk bonds, has just surpassed Columbia S&L of Beverly Hills as the largest thrift-industry holder of high-yield securities — and Wall Street is awaiting the agency's call for help. The bailout agency earned the dubious distinction when it seized Imperial SA of San Diego, which held \$1.3 billion in junk bonds at the end of last year's third quarter, according to K.H. Thomas Associates, a Miami-based thrift consulting firm.

Plans for liquidating holdings of sub-investment grade bonds have become a top priority at the agency, whose portfolio is expanding while junk bond values continue their long decline.

It's a safe bet that later this year RTC will become the biggest player in the \$200 billion junk market, mainly because of two large thrifts on the brink of insolvency: Columbia S&L, with \$4.1 billion of junk bonds, and Far West S&LA

of Newport Beach, Calif., with a \$697 million portfolio. "The government will end up owning more than \$10 billion in junk bonds, making it the largest holder in the country," predicted Kenneth H. Thomas, president of K.H. Thomas Associates.

RTC officials have not yet disclosed their plans, but it's likely that they will soon ask Wall Street firms to bid on some sort of junk-bond disposal assignment.

Elizabeth N. Spector, RTC's director of finance and administration, has recently been seeking the advice of Wall Street's junk bond specialists and is expected to consult with help shortly. Spector, former director of Merrill Lynch, Capital Markets, notes that the division that is now reviewing bids from securities firms that want to serve as RTC's securitization adviser.

Michael Hyland, a portfolio manager with Solomon Brothers Asset Management, warns that disposition will be difficult because "the bid and ask spreads are so wide and there is such a disparity of opinion about the market and its recovery," he said. RTC must hire Wall Street advisers familiar with recent trading histories for a wide range of issues.

One of RTC's first challenges will be to determine the quality of its junk holdings, which range from "good junk" that is unlikely to default to "toxic waste," which offers virtually no hope of paying interest or principal.

As such a large holder of corporate debt, RTC is likely to be among the major creditors of a number of firms, including some that have already filed for bankruptcy. That means the agency must assign in-house attorneys or hire outside counsel to serve on creditor committees — a time-consuming affair.

As for disposing of junk bonds, Spector is said to have heard numerous proposals, including a recommendation that RTC set up its own centralized trading desk.

Another possibility is securitizing the junk bonds, which a few Wall Street firms have already done for private issuers, according to Marvin Markus, a managing director at Ridder, Peabody & Co. He said RTC should consider separating the higher-quality securities from shaker debt and packaging them into senior and subordinated junk-backed bonds. It could then sell the senior portion, with steady cash flows, to investors, and hold the riskier subordinated piece to avoid having to mark its value.

## RTC's Junk Bond Woes

RTC-controlled thrifts with more than \$5 million in sub-investment grade securities. Data as of Sept. 30, 1989, provided by K.H. Thomas Associates, Miami.

	Book Value (C. Mill.)	% of Assets
Imperial SA, San Diego	\$1,316.8	11.98
Centrust Bank (S&L), Miami	896.5	10.29
City Savings Bank, FSB, Redminister, N.J.	714.6	7.28
United S&LA FA, Irvine, Calif.	339.4	9.19
Franklin SA, Ottawa, Kan.	246.9	2.60
Western Empire FS&LA, Irvine, Calif.	191.8	33.78
ABO Bank FSB, Albuquerque, N.M.	160.0	7.26
Commonwealth FS&LA, Fort Lauderdale	124.1	8.05
Gibraltar Savings FA, Simi Valley, Calif.	61.4	0.75
Benjamin Franklin FSA, Houston	43.0	2.13
Sooner FSA, Tulsa, Okla.	39.0	2.55
Empire of America FSB, Buffalo	28.7	0.28
Western S&LA FSA, Phoenix	23.2	0.54
Sun State S&LA FSA, Phoenix	9.8	1.10
Atlantic Financial Savings, Bala Cynwyd, Pa.	8.8	0.15
Benjamin Franklin FS&LA, Portland	5.2	0.10
<b>Total for group</b>	<b>\$4,240.1</b>	

Federal Home Loan Bank of Atlanta  
Atlanta, Georgia

# MEMORANDUM

0000024

To: Rosemary Stewart, Director, Enforcement Division, OGC

From: Park T. Zimmerman, Supervisory Agent

Date: January 6, 1986

Subject: CenTrust Savings Bank  
Miami, Florida **FHLBB No. 2745**  
Recommendation for Cease and Desist Order

Asset Size	\$4.6 Billion as of October 31, 1985
Control	David L. Paul
Type of Institution	State Stock
Other Remarks	Subject of a Supervisory Conversion/ Acquisition 1983

Violations: The primary reason for requesting a cease and desist order is the institution's unsafe and unsound asset deployment. CenTrust had \$692 million or 15 percent of its total assets at December 20, 1985, invested in "junk bonds", that is bonds rated below the top four grades or not rated. Junk bond investments were cited in a recent examination report as representing unsafe and unsound investments due to CenTrust's unusually large investment in them, because a substantial amount of the bonds were substandard and because of concentrations within the portfolio which violated the loans to one borrower limitations contained in Section 563.9-3(b)(2) of the Insurance Regulations. Also, in certain instances the institution failed to adequately underwrite the investment, its investment policy was inadequate in certain respects, and its investment in junk bonds had many speculative aspects. Certain bond issuers were also companies which engaged in corporate raiding, which is not an appropriate purpose for bonds held by an insured institution.

The large investment exceeded 10 percent of assets, which was the level that CenTrust was not supposed to exceed after October 31, 1985. This limit was mandated in a supervisory directive contained in a letter dated August 6, 1985, with which CenTrust had promised to comply. CenTrust's holding of junk bonds has instead steadily increased from 13 percent of assets at October 31, 1985 to 15 percent of assets at December 20, 1985.

The junk bond investments are not part of an approved business plan. The business plan requirement, dated December 27, 1984, arose from CenTrust's supervisory conversion and subsequent stock offering. Although CenTrust submitted a "business plan" on October 22, 1985, the plan has been deemed unacceptable by the Supervisory Agent because: (1) it is not totally self-contained; (2) it does not, in CenTrust's words, "...supercede the approved business plan...negotiated (with)... the Federal Home Loan Bank Board,..." and (3) years two and three of the plan were not approved by the board of directors. Thus, the business plan requirement remains unsatisfied.



Page Two

In addition, the institution has been chronically late in filing regulatory reports in violation of Section 563.18(a). A meeting was held on this subject with President Paul and his reporting staff and the violations continued. A letter has been sent to the institution stating that the failure to file reports in a timely manner might result in a recommendation for regulatory enforcement action.

The institution's liabilities grew at a rate of 25.36 percent during the period between March 31 and September 30, 1985. This is a violation of Section 563.13-1(a) (1) of the Insurance Regulations.

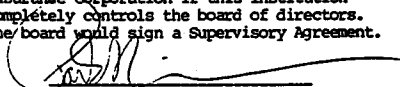
Actions to be stopped or actions to be required by issuance of the cease and desist order: The institution should be required to divest junk bonds that exceed 10 percent of assets. The divestiture should be required to occur within one month of the date of the cease and desist order. Also, CenTrust should be required to submit a business plan acceptable to the Supervisory Agent within one month of the date of the cease and desist order. The business plan is to contain a limitation on junk bonds of 10 percent of assets. CenTrust will be required to cease investing in bonds that are substandard, and to submit an investment policy for junk bonds that provides for minimum underwriting standards and which meets the approval of the Supervisory Agent. The policy is to include language indicating that all investments will comply with regulatory limitations and requirements for investment in bonds, and to specify that investment in bonds of companies that engage in corporate raiding are not permitted.

CenTrust will be required to submit all regulatory reports to the appropriate parties within the time limits specified by the report form instructions; e.g. by the 10th of the following month for monthly reports, by the 20th of the following month for quarterly reports.

Lastly, the order will contain language mandating compliance with the growth limitations of Section 563.13-1(a) (1) of the Insurance Regulations.

Attached you will find copies of documents that support our request for issuance of the cease and desist order.

A cease and desist order, rather than a Supervisory Agreement, has been requested because of CenTrust's failure to comply with supervisory directives in the past and because of the large potential cost to the Federal Savings and Loan Insurance Corporation if this institution fails. Also, David Paul completely controls the board of directors. It is very doubtful that the board would sign a Supervisory Agreement.



Attachments

0000124

## INTEROFFICE MEMORANDUM

Date: 30-Jan-1990 06:05pm EST  
From: Maria I. Richmond  
RICHMOND M AT A1 AT ATLANT  
Dept: OTS - Atlanta District  
Tel No: (404)888-8073

TO: See Below

Subject: Centrust-records

Over the past several days there have been several unconfirmed reports that CentTrust is shipping records out of the bank or shredding documents. We have responded to these concerns in the following ways.

1. District Director Jack Ryan called DLP on January 30, 1989. He advised Paul of what we had heard and told Paul the activity must cease if it is occurring. Per Ryan, Paul responded that only copies were leaving the institution and that these were being sent to various law firms. He said the only originals leaving were documents being sent out to be copied and would be returned. he said no shredding was taking place.

2. Maria Richmond called Jesse McCrary, Chairman of the audit committee, to relate the same concerns. She advised that we had no independent confirmation that originals were leaving the premises or that shredding was taking place, but felt he should be aware that we had received this information and expected it to stop, if true. McCrary said he would convene the audit committee 1-31 to investigate and address if appropriate. McCrary appeared anxious to cooperate and said that such a practice, if any, would not continue while he sat on the board.

3. A letter to Paul, previously discussed with enforcement, was faxed to the institution. the letter said that originals should not leave the institution without our prior approval and that staff counsel should maintain a record of all copies leaving. Return confirmation was requested.

0000138

David L. Paul  
Chairman of the Board  
Centrust Savings Bank  
Miami, Fl

Dear Mr. Paul:

Yesterday it came to our attention that under your direction, documents were being sent out of the Centrust headquarters. In response to Examiner-in-Charge Bailey's request to review any and all documents prior to such documents being sent out of the building, you denied his request taking the position that these documents were being sent to legal counsel and were, therefore, protected by attorney/client privilege.

12 CFR § 563.17-1 requires that institutions maintain accurate and complete records and that such records be made available at all times for examination wherever said records, documents, files material, or property may be located. Without the prior approval of the OTS, no original documents are to leave the building and in-house legal counsel shall maintain a log of all documents which have already been, or will be, sent to outside parties. We also require that, within 10 days of the date of this letter, you provide the examiners with a certification from all applicable parties that none of the documents they received were original documents.

Finally, please provide your written assurances that no documents subject to the confidentiality provisions of 12 CFR Part 505 were provided to any party not directly representing Centrust Savings Bank. This response should also be submitted within 10 days of the date of this letter.

Sincerely,

MIR

bcc  
Marc Levy, OE  
James Winning, OTS Washington  
Ed Jackson  
FCT  
Ken Klein  
General File

## I N T E R O F F I C E   M E M O R A N D U M

Date: 06-Nov-1989 02:24pm EST  
From: JAMES C. WINNING  
WINNINGJC  
Dept: ORA  
Tel No: (202) 331-4544

TO: KEVIN O'CONNELL

( OCONNELLK )

Subject: Centust

Talked with Maria. She said that Jack Ryan wanted to have a meeting around next Wednesday to discuss Centrust's branch sale, its general outlook and regulatory posture toward Centrust from this point on. This meeting would include us, D. Dochow, OE, OGC, OGC-CASD, accounting fellows and anyone else with something to say or interested in listening. She asked if this call concerning the incorrect TFR's could be addressed at that meeting. I explained that you had reached an irritation level with the issue and might want to discuss it sooner. She will be available on Wednesday if so. Do you want me to go ahead or wait until the meeting next week. J. Ryan will be up for the ERC meeting and will presumably set up the Centrust meeting at that time.

0000003A

## INTEROFFICE MEMORANDUM

**Date:** 07-Nov-1989 08:27am EST  
**From:** JAMES C. WINNING  
 WINNINGJC  
**Dept:** ORA  
**Tel No:** (202)331-4544

TO: Remote Addressee

( RICHMOND\_ME@ATLANT )

CC: KEVIN O'CONNELL

( OCONNELLK )

CC: Remote Addressee

( GEER\_J@ATLANT )

CC: Dan Sawyers

( SAWYERSDA )

CC: Remote Addressee

( INGRAM\_K@ATLANT )

**Subject:** Centrust

I spoke with the respective accounting fellows, staff, etc. about the proposed meeting with Fred Wolf in Washington prior to the meeting with the state on the 15th. The general consensus was that this is just too much form over function. Everyone seem to agree, however, that someone from Washington should be at the meeting on the 15th to show unanimity. Would it suit your purpose to have Dan Sawyers at the meeting on the 15th? Let me know.

The second bit of information I received is that Fred Wolf was a high muckety-muck at GAO and is likely here for his connections, a la Henry Forer (sp? sorry Henry). Its just too much to hope for that Centrust would cause Price Waterhouse some professional trepidation.

Jim

*was he  
 what do  
 for Centrust*

Federal  
Home Loan  
Bank  
Board



# Memo

Dade SAV.  
Miami, Fla

OFFICE OF EXAMINATIONS AND SUPERVISION

INTER-OFFICE COMMUNICATION

FROM:

John Luban, OES

TO:

Sam Conell  
FHB Bank of Atlanta

DATE:

7/1/82

SUBJECT:

Sam -

OES will be briefing Board member Hovde next week on the functions of our office. One item to be covered is "major upcoming issues". We have determined that the Baker Case should be included under this item, and we have therefore prepared the attached write-up for the briefing.

John

Pending Approval of the Board of Directors of the State of Florida, Miami, FL

Dade S&LA is a state-chartered mutual association which at May 31, 1983 had assets of \$2.3 billion and net worth of \$2.3 million (equal to 0.1% of assets). The application for the supervisory conversion will be processed for the Board's consideration within two to three weeks after receipt of essential information from the applicant regarding the proposed accounting, tax consequences, and an appraisal supporting the value for the capital infusion into the association.

The proposal involves the exchange of the association's conversion shares for the shares of stock held by the stockholders of The Westport Company ("Westport"), a publicly held real estate trust, whose principal stockholder is a Mr. David L. Paul. The reported book equity in Westport to be infused into the association is approximately \$32 million, however, independent appraisals and estimates for three major assets of Westport, used by the Board staff, and agreed upon by the applicant to test the value of the proposed equity, indicate an approximate \$8 million overvaluation. An appraisal of another major asset of Westport has not yet been completed.

A viability analysis by OES of the applicant's proposed business plan for the association following the conversion indicates that at least \$76 million would need to be infused into Dade at the acquisition date by the Westport stockholders. To bolster the proposed capital infusion, Mr. Paul has agreed to pledge approximately \$7 million in other assets (primarily end loans on property sales by Westport), and intends to enter into an agreement for A. G. Becker Paribas Incorporated ("Becker") to underwrite a secondary issuance of Dade's stock to the public. Becker advises that its commitment under any such underwriting agreement would only be effective the night before the actual stock solicitation, and that at this time, approximately \$30 million of stock could likely be sold. The applicant also indicates that Dade's capital could possibly be enhanced further at some later date by realizing approximately \$13 million in profits on the sale of certain of Dade's assets, and by approximately \$20 million via a further sale of Dade's equity securities to the public. No firm commitments have been presented for this \$33 million additional capital proposal.

At this time, OES considers the proposal inadequate to sustain the viability of the association because only the net value of the Westport equity (@ \$32 million which may be even less depending upon the value determined by independent appraisals), and perhaps the \$30 million from a secondary stock issue for which a commitment from Becker may be available, for a total of @ \$62 million, are reasonably assured of being infused into the association. This falls short of the required \$76 million which is only sufficient to cover Dade's projected net losses before positive earnings would be realized at the end of a five-year period when net worth would be close to zero. Because of the short-fall in the proposal for the minimum amount of needed capital to assure viability for the association, OES will likely recommend that the Board deny the application. If the Board concurs in this recommendation, OES will begin shopping the association and may refer the case to the FSLIC. An unassisted solution is a good possibility in view of the attractive Florida market and branch system of the association. In this regard, an unsolicited offer by another group of investors has been received by the staff for the supervisory conversion and exchange of Dade's stock in return for real estate with a stated value of \$50 million, which could also be enhanced with a public stock issue. OGC has advised that we should not consider this latter offer until the Board has first acted on the pending voluntary proposal.

SA Chalker

DADE S&LA  
MIAMI, FLA.file  
1010  
✓ FTJohn R. LaRocca  
Financial Analyst

January 7, 1983

Mark Rundle  
Regional DirectorAppraisal Review -  
The Westport Co. Properties

Today I spoke to Frank Mongello, District Appraiser for District 1 regarding his review of certain appraisals for properties owned by The Westport Co. I advised Frank of OES' plan to use available appraisals on Westport properties to test the book values of those properties in evaluating the proposed exchange of Westport stock by David Paul (and use of push-down accounting) for Dade S&LA's stock following the proposed supervisory conversion of Dade.

Frank stated that he was reviewing 10 (of 26) Westport properties originally proposed in the Dade supervisory conversion for contribution by Paul to Dade. Two of these properties (which apparently are still on Westport's books) have recent updated appraisals which have been provided to Mongello. These appraisals were obtained in conjunction with the on-going examination of County PS&LA of Westport, Conn., an association which has loans outstanding to David Paul secured by Westport properties. While the appraisal reports for these properties are in the process of being finalized, the appraisals will show the following values for the two Westport properties:

Fox Hill Condominiums	:	@ \$3,780,000
Casagne Condominiums	:	@ \$5,588,000
		<u>\$9,368,000</u>

While the values will not result in any appraised loss to County PS&LA in its loans secured by these properties (totalling @ \$9,554,000), it is noted that they are substantially lower than the book values and stated fair market values for the properties on Westport's books (as of 10-12-82, shown in the Dade supervisory conversion application):

Fox Hill Condominiums B/V+F/V	:	\$ 6,048,000
Casagne Condominiums B/V+F/V	:	\$ 7,596,000
		<u>\$13,644,000</u>

Accordingly, the appraisals show \$4.3 million, or 13.4% reduced book equity in the Westport Co. (stated as \$32 million for purposes of the Dade supervisory conversion).



-2-

On 1/7/83, I spoke to Dick Hewitt about what the status was with respect to the District Appraisers' review of Westport properties. He stated that he, Mongello and Lovell were reviewing appraisals or providing estimates of values for all the Westport properties and would be preparing a summary of their findings. His informal findings are that many of the properties were "dogs". I told him to attempt to provide us with conclusions (if possible by the end of 1/10/83 week) so that final decisions can be made on the Dade supervisory conversion by 1/31/83. He said he'd try but he's still awaiting final word on the reviews by Mongello & Lovell. In this regard, Lovell is awaiting an appraisal on the Commons property in Nutley, N.J. I told Dick we had received a copy of an appraisal report for the Commons as one of the exhibits to an amendment to the conversion application and that I would immediately forward it to Lovell with instructions for expeditious review. (I called DD Giancola - Lovell is on leave - and so advised, and mailed a copy of appraisal on 1/7/83.)

My conclusions are that there may be major problems with the value of the equity of The Westport Co. as a satisfactory capital infusion into Dade because:

- 1) assets of Westport may be substantially overvalued - indicating overvalued equity in the company;
- 2) The Westport Co. has produced historical net operating losses (positive net income has resulted from the sale of assets only - given the review by the Board's appraisers of Westport properties, any such extraordinary gains if any available following the conversion will be minimal);
- 3) the projected (positive) cash flow for the Westport properties provided in the conversion application appear highly optimistic and are based on Westport's unsupported guestimates of property sales to produce such results.

---

Financial Analyst

JRL:sld  
cc: SA Chalker

Federal  
Home Loan  
Bank  
Board



# Memo

OFFICE OF EXAMINATIONS AND SUPERVISION

INTER-OFFICE COMMUNICATION

FROM: F. M. Dorer  
TO: D. James Croft, Director

DATE: January 11, 1983  
SUBJECT: Dade S&LA  
Miami, FL  
FHLBB No. 2745

WEC  
bill  
✓ OTD  
FT

Following are my recommendations for actions involving this \$2+ billion, state-chartered mutual association, which is projected to become insolvent this month.

1. Recommend denial of the application for a supervisory conversion because it involves the sale of a mutual institution, as represented by the proposed five-year, \$1 million employment contract to Mr. Lipton.
2. Assign the case to OFSLIC and commence the bidding process.
3. Prepare and issue to the State of Florida a 90-day notice of intent to appoint a receiver or conservator.
4. If a bid acceptable to the Board is received, appoint a receiver and merge or otherwise dispose of the institution. If an acceptable bid is not received, appoint a conservator and operate the institution essentially in a Phoenix-Open Door Liquidation mode.
5. Do not proceed with the proposal to remove Mr. Lipton.

As you know, The Westport Corporation has proposed to acquire Dade via a supervisory conversion. Such conversion involves a five-year, \$1 million employment contract to Ronald Lipton, the president and a director of Dade and the holder of a majority of the members' proxies. OES has recommended that the application be processed to the Board with a recommendation for denial due to the employment contract.

OGC appears to prefer approving the application with a condition that the employment contract be voided. According to Mr. Zimmerman, Westport will attempt to bend the Dade directors to approve voiding the contract. If this is done, Mr. Lipton will have to wait 15 days before holding a special members' meeting to elect new directors. During this 15-day "window of opportunity," the conversion can be effected.

I have serious reservations about the Westport/OGC scheme. First, I don't like it because it is so patently a scheme. Second, experience shows that Dade's directors cannot be relied upon to either take an action or to stand their ground once they have made a decision. Third, the scheme assumes that Mr. Lipton will not act during the 15-day period. If the Dade directors void the contract, Mr. Lipton probably will set up a bank account for legal defense, seek a court

Page 2

order restraining the conversion, and take other legal steps to gain necessary time. It appears to me that there is a high probability that Dade, Westport and the Board will be bound up in some interminable litigation while the institution goes down the tubes.


My final reason for opposing the Westport/OGC scheme is that I do not believe Westport is a suitable acquirer for Dade. From all I can find out, it appears that Westport needs Dade far more than Dade needs Westport. Although I do not yet have enough facts to conclusively prove my point, I am convinced that we will be making a serious mistake if we permit Westport to gain entry into any insured institution.

If, as I firmly believe, we recommend denial and the Board so acts, we would then be in a position to treat Dade in the same manner as any other large institution which is fast approaching insolvency. A merger or acquisition by a responsible entity which can and will solve Dade's problems should be our objective. This will not occur if we continue to deal with The Westport Corporation.

I can see no benefit to the proposal to commence an action to remove Mr. Lipton. At this stage, such an action will only further muddy the waters and produce more delays and litigation.

Incidentally, you will be interested to know that OGC has taken the position that FSLIC and not OES is the proper office to make a recommendation for the appointment of a conservator or receiver for Dade. As a result, nothing has been done on that recommendation. That unique position seems to cavalierly dispose of your "sick bed" note to me!

Mr. Rundle has just informed me that Westport's attorneys will be meeting with Dade's directors this Friday (1-14) in an effort to have Dade's board remove the objectionable management contract. If successful (or even if the directors evidence a cooperative attitude); we will be subjected to considerable pressure to approve the Westport acquisition. In such an event, I propose to use all available information to support a recommendation for denial based on Westport's financial condition and history of operations.

  
Deputy Director

Federal  
Home Loan  
Bank  
Board



# Memo

*Draft*

OFFICE OF EXAMINATIONS AND SUPERVISION

INTER-OFFICE COMMUNICATION

FROM: Richard Hewitt, III

DATE: January 13, 1983

TO: John LaRocca  
Office of Examinations and Supervision

SUBJECT: Dade SGLA, Miami, FL  
Westport Company Equity Exchange  
Security Property Analysis

Per your request, a review was made of the 26 asset groupings reflected in Attachment I. As noted therein, the asset categories were grouped as mortgage loans, operating properties and development properties. Of the 26 groupings, 21 of the projects were inspected by a FHLBB District Appraiser.

As reflected in Tables I, II and III, various differences exist between the Westport Company and Bank Board estimates of values resulting in an overall reduction of "equity" of \$6,942,868. In 20 instances Bank Board value estimates were lower while only in 6 were they higher.

The largest category discrepancies were, as expected, reflected in the operating and development type categories (resulting in \$3,452,058 and \$3,458,814 equity reductions, respectively). The mortgage loan category consisting of only two projects reflected only a minor negative Westport to Bank Board equity charge (\$31,996). Overall, the equity discrepancy amounts to some 15% of the Westport Company stated book value of \$45,087,600. (As delineated herein relative to the Rutley Apts., these differentials could well result in a 23% equity estimate reduction).

It should be noted that actual appraisals were not prepared by the Bank Board and indeed in some cases the derived estimates were based largely on judgment, the developing of cash equivalency of reported sales prices, and/or review of typically limited supplied appraisal data. In most cases reappraisals were recommended for proper evaluation.

Included as Attachment II are review summaries tabbed to the specific projects and reflecting:

- (1) summary of supplied material as they related to market value of the asset
- (2) summarization of the District Appraiser site inspection comments (if applicable)
- (3) a conclusion section reflecting suggested courses of action and a "best estimate" of market value

John LaRocca  
January 13, 1983  
Page -2-

*Draft*

It should also be noted that the above analysis relative to the Mutley Apts. (3C) utilizes a net book value of \$15,000,000, which is the amount noted in both the Asset Summary page and Valuation Analysis Exhibits page of the Westport provided materials. Confusion appears to exist, however, since on Schedule 1 of the same Asset Summary a net book value of \$21,984,000 is reflected. If the \$21,984,000 figure is utilized (after adjusting for underlying mortgages) the equity differential increases for this project from \$500,000 to \$7,484,000, which would increase the overall equity discrepancy from 15% to 23% based on a revised total net book value of \$59,555,600 (net of underlying mortgages). As reflected in the Attachment II summary sheet for this project, the subsequently submitted appraisal (Nov. 1982) is totally unacceptable and appears to be grossly inflated relative to value.

Given the magnitude and risk of certain of the reviewed projects, it is recommended that prior to a final acceptance of the Westport proposal that, at a minimum, the Furniture Mart in Chicago and the Mutley Apartments in New Jersey be reappraised by an appraiser of the Bank Board's selection.

In conclusion, based on the reviews and analyses made from a collateral standpoint, it appears that the Westport Company holds a portfolio consisting of largely illiquid properties. Many of these require enormous current and future capital infusions in order to just break-even.

In view of Dade's own immense major project funding dilemmas it would not appear that the proposed "marriage" is much of a match.

Richard Hewitt, III  
Chief District Appraiser

Attachments

RH:sdm

1/14/83

NOTE: VP also has with Westport Co. gives that Mutley property is in the process of being acquired by the company (check with J. V. 17162) and will be booked as a \$21,984,000 asset (and \$6,984,000 mortgage payable)

*JL*

*According to  
mutley's  
Dade will  
have from  
\$6,984,000 to  
\$13,924,000*

John LaRocca  
January 13, 1983

TABLE I

		<u>Mortgage Loans</u>		<u>FHLBB</u>	
<u>Tab #</u>	<u>Project</u>	<u>Underlying Security Value</u>	<u>Stated Net Book Value</u>	<u>Mortgage Value</u>	<u>Equity</u>
2a	IPA	\$2,191,000	\$419,000	\$415,597	\$ (3,403)
2b	South Hampton MHP	230,000	250,000	221,407	(28,593)
<b>Totals</b>		<u>\$2,421,000</u>	<u>\$669,000</u>	<u>\$637,004</u>	<u>\$ (31,996)</u>

TABLE IIOperating Properties

<u>Tab #</u>	<u>Project</u>	<u>Security</u>	<u>Stated Book Value</u>	<u>FHLBB Est. Value</u>	<u>Equity A</u>
3a	Countryside MHP	229 Pads	\$ 835,000	\$ 610,988	\$ (224,012)
3b	Foxhill Condos	104 Units	2,686,000*	149,010*	(2,536,990)*
3c	Butley Apts	432 Units	8,016,000*	7,516,000	(500,000)*
3d	Plaza 20 Offices	Rent Space	2,169,000	1,510,000	(659,000)
3e	Rodevay Inn	160 Rooms	1,703,000	2,170,000	467,000
3f	Rolling Meadows MHP	122 Pads	227,000	329,944	102,944
3g	Terrace Hills MHP	136 Pads	264,000	250,000	(14,000)
3h	Woolworth Bldg.	39,000 sq ft	178,000	90,000	(88,000)
<b>Totals</b>			<u>\$16,078,000</u>	<u>\$12,625,942</u>	<u>\$ (3,452,058)</u>

\* Net of specific underlying mortgages

John LaRocca  
January 13, 1983

*Wright*

TABLE III  
Development Property

<u>Tab #</u>	<u>Project</u>	<u>Security</u>	<u>Stated Book Value</u>	<u>FHLB Est. Value</u>	<u>Equity/</u>
4a	Bartlett Land	95 Acres	\$ 1,242,000	\$ 1,000,000	\$ (242,000)
4b	Brookhaven Land	103.3 Acres	1,665,000	1,130,000	(735,000)
4c	Casagmo Condos	126 Units	2,847,000*	1,167,706*	(1,679,294)*
4d	Columbia Land	17.4 Acres	104,000	175,000	71,000
4e	Commons of Menand	7 Condo Sites	66,000	60,000	(6,000)
4f	Danbury Exec. Tower II	2.143 Acres	554,600	350,000	(204,600)
4g	Deerfield Land	112 Acres	704,000**	750,000	46,000**
4h	Fairfax Land	359 Acres	1,832,000	2,000,000	168,000
4i	Furniture Mart	2M //	16,397,000**	16,250,000**	(147,000)**
4j	Longview Land	77 Acres	172,000	53,900	(118,100)
4k	Milford Land	75 Acres	523,000	442,500	(80,500)
4l	Natlick Land	192 Acres	822,000	420,000	(402,000)
4m	Plaza 20 Condos	2 Units	84,000	62,680	(21,320)
4n	Rolling Meadows Land	54.2 Acres	115,000	60,000	(55,000)
4o	Tanglewood Condos	8 Acres	303,000	460,000	157,000
4p	Westwood Condos	784 Sites/ Comm. Land	710,000	500,000	(210,000)
<b>Totals</b>			<u>\$28,340,600</u>	<u>\$24,881,786</u>	<u>\$(3,458,814)</u>

\* Net of specific underlying mortgages

\*\*50% participation

028-074 0111

Federal  
Home Loan  
Bank  
Board



# Memo

OFFICE OF EXAMINATIONS AND SUPERVISION

INTER-OFFICE COMMUNICATION

FROM: John R. LaRocca  
Financial Analyst

TO: Mark Rundle  
Regional Director

DATE: January 17, 1983

SUBJECT: Westport Co.

I have reviewed District Appraiser Hewitt's January 13, 1983 draft memorandum which summarizes the findings of the review of the Westport properties made by the various FHLBB district appraisers. Hewitt indicates that the district appraisers believe that the properties are overvalued on Westport's books by \$6,942,868. However, the amount may be increased based upon the correct Westport book value for the Nutley Apts. in Nutley, New Jersey.


Hewitt's \$6,942,868 overvaluation amount includes \$500,000 for the Nutley property based on a \$8,016,000 net book value for the asset (book value of \$15,000,000 less a \$6,984,000 mortgage liability). The \$15,000,000 book value for the asset was indicated on the supplemental exhibits reviewed by Hewitt which made up the assets (and liabilities) for the Westport Co. However, the summary page for all the Westport assets and liabilities which indicated a total \$32 million book equity for the company shows the book value asset for the Nutley property at \$21,984,000, with a mortgage payable of \$6,984,000.

I spoke to Mr. Allen Murker, Vice President of Westport about the Nutley property. He stated that the property is not presently on the books of Westport but is closing next week when it will be booked for a \$21,984,000 sales price (book value for the asset of \$21,984,000 and book value for the mortgage assumption of @ \$6,984,000). I asked Murker about the present owner of the Nutley property being sold to Westport, and was told the seller is David Paul. Murker indicated that the payment terms for the transaction had not yet been finalized but would probably involve cash and a note payable (together with a mortgage assumption) by Westport. (The descriptive material presented in the supervisory conversion application indicated that the payment terms would be \$3 million in cash and the balance in Westport Co. stock.)



I have some serious concerns about the Nutley property.

- 1) The list of Westport assets and liabilities comprising the \$32 million equity shows the Nutley property on the books as a \$21,984,000 asset, with a \$6,984,000 liability (for the mortgage payable). This list comprises essentially all the assets of Westport which is expected to be on the books for the acquisition of Dade. (The list does not reflect cash, fixed assets, or other assets which the company obviously has. However, the unaudited financial statements of Westport as of October 31, 1982 included in Amendment 3 to the application for the supervisory conversion indicates that on that date Westport had assets of \$57 million and book equity of \$38.1 million. Of this total, \$6 million of assets is proposed as a spin-off prior to the acquisition. This spin-off will reduce book equity to \$32 million.) Based on the balance sheet of Westport at October 31, and considering the proposed \$6 million spin-off of assets, it appears that Westport does not have the necessary resources to effect the proposed \$21,984,000 Nutley Apts. acquisition and still maintain the \$32 million in book equity for the Dade acquisition.
- 2) The Nutley Apts. acquisition is a less than arms length transaction by David Paul, owner of the property and majority stockholder of Westport. Given this fact and the review of a current appraisal for the property by Board appraisers (who indicate that the asset will be overvalued by \$7,484,000 if booked by Westport as a \$21,984,000 asset and \$6,984,000 mortgage payable) there are serious questions whether the acquisition of the property is in the best interests of Westport (and Dade), and whether \$32 million in book equity will exist for the proposed acquisition of Dade.

  
Financial Analyst

JRL:ald

Federal  
Home Loan  
Bank  
Board



# Memo

OFFICE OF EXAMINATIONS AND SUPERVISION

INTER-OFFICE COMMUNICATION

FROM: Mark Rundle  
Regional Director

TO: D. James Croft  
Director

DATE: March 10, 1983

SUBJECT: Dade S&LA  
Miami, Florida  
FHLBB No. 2745  
Proposed Supervisory  
Conversion

## Proposal

Supervisory conversion of Dade S&LA, Miami, Florida ("Dade") from a state-chartered mutual to a state-chartered stock association, with the converted S&L stock to be exchanged for the stock of The Westport Company ("Westport"), a real estate company with a proposed book equity of \$32 million at the time of closing. Mr. David L. Paul, controlling stockholder of Westport, will acquire control of Dade in the stock exchange, and pursuant to a business plan provided in the supervisory conversion application, intends for the association to engage actively in mortgage banking in addition to the institution's traditional S&L functions.

In conjunction with the applications for supervisory conversion and acquisition of control, Mr. Paul has requested various waivers of regulatory requirements for Dade, including a 10-year waiver of the association's compliance with the net worth requirements.

## Recommendation

We recommend that the supervisory conversion application for Dade submitted by Mr. David L. Paul be denied. It is our view that the proposed amount of capital infusion and the business plan for the association following the conversion do not provide a viable solution for this financially troubled institution. Our analysis also considered a recent guaranty by NEWCO, a company to be formed from the spin-off of certain assets of Westport prior to the acquisition of Dade. This guaranty provides approximately \$7 million in NEWCO assets against any valuation problems with the Westport assets.

Aside from the above, we believe that some of the requested forbearances by the applicant to various Board regulations, including Mr. Paul's steadfast request for a 10-year forbearance against supervisory action against the association for failure to comply with the net worth requirements, are unacceptable.

## Comments

Our analysis indicates that the proposed supervisory conversion under various scenarios will result in extremely marginal net worth at best, and negative net worth with the continued operation of Dade as a traditional savings and

The results shown for Scenario #1 incorporate the full value for the stated \$32 million book equity of Westport, and the applicant's projections for future earnings for the company. Credit has been given to the Westport equity and earnings only to show the effects under Scenario #1. It is noted that major concerns relating to these items still exist based on the review by the Bank Board's District appraisers of appraisal reports provided by Mr. Paul in the supervisory conversion application. Despite meetings of Westport representatives with the District Appraisers, the Bank Board appraisers continue to believe that the appraisals for the four major assets of Westport (representing approximately 64% of total assets) are materially deficient. Although the Bank Board appraisers have not reappraised these major assets, based on their review of information provided in the appraisals, inspection of the properties, and knowledge regarding the market for each property, they estimate that these assets alone are overstated on the books of Westport by approximately \$11.8 million. If the estimates of value for these Westport assets are substantiated, the proposed initial capital of Dade of \$32.0 million would be reduced to \$20.2 million. The District Appraisers continue to be particularly critical of the appraisal and value for the Nutley Apartments property of Westport (with a book value of \$22 million) which was recently acquired by the company from a partnership in which Mr. David Paul holds a substantial interest. In addition, the Bank Board appraisers were very critical of the short discount periods in the appraisal reports. These periods, which are viewed as extremely optimistic, were also used by the applicant to produce the favorable results in the cash flow and net income projections for Westport.

Because of the unresolved issues relating to the Westport equity and future earnings, we also considered the possibility of the proposed supervisory conversion with a \$32 million cash infusion, yielding a 10% annual return to Dade. This type of infusion program (Scenario #2) produces net worth even more marginal than that achieved under Scenario #1.

The results which we show under Scenarios #1 and #2 (Dade with a mortgage banking operation and with a capital infusion of \$32 million) substantially differ from those projected by Kaplan, Smith and Associates, Inc. ("K&S") for the applicant. This difference is due primarily to the following assumptions:

1. K&S shows additional net worth of \$25 million from the applicant's proposed issuance of subordinated debt (@ 10% interest rate) by Dade during 1983 following the conversion and change in control. Our analysis does not include this amount in the net worth of Dade because a) it assumes that the total amount will be purchased by investors, without a commitment to date by any investor to do so, b) it utilizes, in our view, an optimistic 10% interest rate for the debt of this financially marginal association, and c) it automatically assumes Bank Board approval of the debt as net worth despite the fact that no application, nor details regarding the terms of the debt, have been submitted, and various waivers of regulatory eligibility requirements, due to Dade's poor financial condition, would have to be granted.

2. OES reduced K&S' projected volume of originations and sales for Dade's proposed mortgage banking operation by one-half. The K&S projections are unsupported and represent an extremely optimistic assumption of the association's ability to increase its market share of mortgage loan-activity. This view is based on Dade's historical performance and the fact that the institution is currently competing against several larger out-of-state S&Ls which now operate in Florida following recent interstate mergers. Although the loan originations/sales volumes we used are lower than those projected by K&S, we believe the lower volume still represents an optimistic level when comparing the volumes against Dade's historical performance.
3. The FSLIC viability run utilizes annual operating expenses for Dade equal to 2% of the association's average assets, whereas K&S' results are based on operating expenses increasing from the current 1.5% level to 1.75% over a 5-year period. Our basis for utilizing the 2% operating expense ratio is based on Dade's current level of operating expenses, the increased expenses anticipated for the mortgage banking operation and other new services to be provided by the association, and probable costs related to resolving the institution's problem real estate venture projects. Moreover, the 2% operating expense ratio is in line with other S&Ls with mortgage banking operations.
4. We have projected other loan originations to increase 15% annually, in line with the 15% annual growth rate projected by K&S for savings growth. K&S projects other loans to increase from 7.2% of deposits at 9/30/82 to 16.7% of deposits at 9/30/87, which because of the 15% growth rate in deposits, results in a significantly larger volume of originations than we project.
5. We have increased K&S' projected fees on mortgage loan originations of 1-2% for various loans to 2.75% for all mortgages we project to be originated. Our fees are in line with those charged by major lenders in Dade's market, and effectively "unnets" the K&S projected operating expenses which Mr. Harris Friedman of K&S indicated reflected the results for more normal fees.

We believe that even the marginal results produced under Scenarios #1 and #2 may be optimistic since neither Dade nor Westport currently has experienced personnel to implement the expanded mortgage banking activity. To implement this operation (especially in view of the magnitude of the loan volume anticipated) will likely require the hiring of outside experienced individuals and a massive retraining program for current association employees, events to our knowledge which have not yet been initiated.

-5-

Because of the uncertainty we foresee regarding the success (at least in the initial years) of Dade implementing its mortgage banking operation, we also considered the supervisory conversion in light of the association's continued traditional savings and loan operation with a \$32 million cash infusion. The results-produced are those previously shown under Scenario #3. Under this scenario, Dade would have only marginal net worth after the first year of operation and would become insolvent early in the second year. The results shown under this scenario, which include substantial purchase accounting benefits to the bottom line in the early years following Dade's acquisition, indicate that even with the inclusion of the \$25 million in subordinated debt in net worth as projected by K&S, the association's net worth would be completely exhausted in the second year of operation.

Our analysis also considered other aspects of the proposal by Mr. Paul. Amendment No. 7, dated February 14, 1983, to the application included the applicant's latest position on requested supervisory forbearances and draft letters regarding a guaranty of NEWCO assets in support of the proposal. The applicant requests 11 separate forbearances to be granted by the Board to Dade with respect to various regulations. Several of the forbearances relate to supervisory actions which we believe would be inappropriate for the Board to grant. Without detailing all the requested forbearances, we find particularly unacceptable Mr. Paul's uncompromising position (as indicated by letters to, and discussions with, the OES staff by counsel for the applicant) that the Board agree to forbear for 10 years from exercising its supervisory authority under Section 563.13 of the Insurance Regulations for Dade's failure to comply with net worth requirements. With respect to this forbearance, we note that projected net worth for Dade under our most optimistic scenario (#1) would result in substantial deficiencies during just the first 5 years following the conversion:

	(Millions)				
	1983	1984	1985	1986	1987
Projected Net Worth	\$10.7	\$ 1.0	\$12.3	\$11.2	\$12.7
Estimated Net Worth Requirement (3% of average assets)	\$62.7	\$68.2	\$75.9	\$85.6	\$98.0
Estimated deficiency	\$52.0	\$67.2	\$63.6	\$74.4	\$85.3

The draft letters in Amendment No. 7 indicate the assets of NEWCO will be available to guaranty the stated \$32 million equity of Westport. Applicant has provided the staff a listing of the proposed assets of NEWCO, which consist primarily of end loans made by Westport to purchasers of the company's properties. The NEWCO assets have an approximate book value of \$7 million. No specific details with respect to the terms or performance of the end loans were presented.

The NEWCO guaranty offers nothing to alter our position on the supervisory conversion proposal, as our analysis was based on the \$32 million equity of

-6-

Westport at full value. Moreover, our view of the proposal would remain unchanged even if the NEWCO assets were added to the proposed capital infusion. Our review of the personal financial statement included in the change of control notice by Mr. Paul indicates he has few other assets to bolster the capital infusion for Dade. In addition, Mr. Paul has not provided any information about other sources of capital for Dade other than that proposed in the application.

A final issue in our decision for the proposed conversion is the unresolved tax consequences arising from the association's conversion and the subsequent acquisition of control. Applicant is still in the process of obtaining a tax ruling from IRS on the proposal. The purchase agreement between Dade and Mr. Paul is conditioned upon the receipt of a tax-free ruling. Applicant has, under one of the forbearances, requested the Board to aid tax counsel for the applicant in obtain a ruling that the supervisory conversion will not have a tax consequence for the association. In a December 2, 1982 letter included in Amendment No. 2 to the supervisory conversion application, Peat, Marwick, Mitchell & Co. estimated that tax-consequences, if the acquisition is deemed a taxable transaction, would exceed \$100 million, resulting primarily from discounts arising from revalued assets and liabilities of Dade. The public accountants noted that the potential adverse tax effects could be reduced if an argument that a portion of the excess purchase price should be allocated to an amortizable asset such as a deposit base could be sustained.

*Mark Russell*

---

Regional Director

JRL:ald

cc: Deputy Director Dorer  
Supervisory Agent Connell  
District Director Heath

May 16, 1983

0000057A

To the Board of Directors of  
Dade Savings and Loan Association  
101 East Flagler Street  
Miami, Florida 33131

As you are probably aware the undersigned have submitted a proposal for the unassisted supervisory conversion and acquisition of Dade Savings and Loan Association (Dade) which provides for at least an aggregate capital contribution to Dade of approximately \$53 million dollars in cash, income producing properties and free and clear assets.

We are cognizant that there presently exists another supervisory conversion plan for Dade which precludes the Dade Board from discussing or considering alternative plans until May 31, 1983. We believe that after May 31, when the Dade Board is free to consider our proposal, you will find it clearly in the best interest of the Institution, its depositors, the public, the FSLIC and the Dade Board.

In our judgement our proposal provides a viable solution to the problems of Dade because:

1. The amount of capital to be infused will be substantial, not the minimum required for viability. Dade will thereby have an opportunity to effect a business plan and revitalize its operations.
2. The proposed infusion is of a form which is readily available, including cash and properties with realistically appraised values. Infusion is not contingent on any underwriting or secondary financing. If additional capital is required subsequently we are prepared to increase it.
3. The properties to be infused are all located within the normal operating and lending area of Dade, so that their development or disposition can be easily overseen by Dade.
4. The expertise of the individual Acquirers in the Florida market will provide operational and business benefits to Dade.

5. We are not shifting substantial liabilities which would place additional liabilities on the Institution.

In addition, one of the participants in our group is Mr. Albert Sakolsky who presently has a contractual relationship with Dade in a project entitled The Missions. If the Dade Board concludes because of Mr. Sakolsky's participation in this proposal that there exists a conflict of interest, Mr. Sakolsky is prepared as a condition of our proposal, if our proposal is in fact accepted, approved and subsequently closed, to abrogate that particular contractual relationship.

We are desirous of presenting our proposal to you as soon as possible within the confines of the Dade Board's legal ability. It is not our intention to interfere with any present restrictions or contractual relations.

Yours truly,  
American Capital Corporation  
Jack Burstein  
Robert Marlin  
Edward McBride  
Albert Sakolsky



AMERICAN CAPITAL CORPORATION

0000056 *A*

ROBERT M. MARLIN  
CHAIRMAN OF THE BOARD

May 31, 1983

Mr. George L. Christopher  
Kirkpatrick, Lockhart, Hill,  
Christopher & Phillips  
1900 M Street, N.W.  
Washington, D.C. 20036

Dear George:

Enclosed please find copy of a letter from Dade Savings received  
by me this morning.

Very truly yours,



Robert Marlin

prr

Enclosure



May 25, 1983

Mr. Robert Marlin  
Chairman of the Board  
AMERICAN CAPITAL CORPORATION  
5555 Biscayne Boulevard  
Miami, Florida 33137

Dear Mr. Martin, et al:

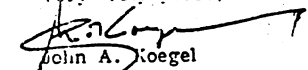
The Board of Directors of Dade Savings and Loan Association has considered your letter directed to the Board dated May 16, 1983, and has authorized me, as Secretary of the Association, to submit this response.

At the present time, Dade Savings and Loan Association is contractually committed to affiliate with the shareholders of The Westport Company by contract dated as of October, 1, 1982, as amended and extended from time to time. That contract was recently extended until such time as the FHLBB shall have approved or denied the affiliation between Dade and Westport. As a result, although we thank you for your interest in discussing a proposed affiliation with Dade, the Dade Board is not in a position at this time to commence negotiation with you and your group regarding any potential proposal.

If for some reason the Dade/Westport affiliation proposal is not approved by the FHLBB, at that time, the Board of Directors of Dade Savings and Loan Association would be willing to commence negotiation regarding the proposal contained in your May 16, 1983 letter.

Once again, thank you for your interest in this matter.

Very truly yours,

  
John A. Koegel  
Secretary  
On behalf of the Board-

JAK/uc

cc: Mr. Joel D. Ware  
Mr. David L. Paul

## KIRKPATRICK, LOCKHART, HILL, CHRISTOPHER &amp; PHILLIPS

A PARTNERSHIP INCLUDING A PROFESSIONAL CORPORATION

1900 M STREET, N. W.

WASHINGTON, D. C. 20036

0000055A

TELEPHONE (800) 488-7000

CABLE NIPRI

TELEX 440808 NIPRI

WRITER'S DIRECT DIA. JR  
(202) 452-2

BY HAND

IN PITTSBURGH  
KIRKPATRICK, LOCKHART, JORDON & STECKMAN  
1800 OLIVER STREET  
PITTSBURGH, PENNSYLVANIA 15222  
(412) 845-6500DOCKETS  
RECORDED

June 7, 1983

172745

Frances M. Dorer, Deputy Director  
Office of Examinations and Supervision  
Federal Home Loan Bank Board  
1700 G Street, N.W.  
Washington, D.C. 20552

Marc J. Rundle, Regional Director  
Office of Examinations and Supervision  
Federal Home Loan Bank Board  
1700 G Street, N.W.  
Washington, D.C. 20552

Re: Proposal for Supervisory Conversion and Acquisition  
of Gade Savings and Loan Association, Miami, Florida  
(FHLBB No. 2745)

Dear Frank and Marc:

At George Christopher's request, I am enclosing copies of a letter relating to the above which was hand delivered late yesterday. We had intended to provide copies to you at the same time for your information, but neglected to do so.

Very truly yours,



Thomas M. Leahey

TML:jb

Enclosure

028-074 0123

## KIRKPATRICK, LOCKHART, HILL, CHRISTOPHER &amp; PHILLIPS

A PARTNERSHIP INCLUDING A PROFESSIONAL CORPORATION

1900 M STREET, N. W.

WASHINGTON, D. C. 20036

TELEPHONE (800) 452-7030  
 CABLE: KIPPH  
 TELEX 460808 KIPPH U  
 WRITER'S DIRECT DIAL 877888

June 6, 1983

IN PITTSBURGH  
 KIRKPATRICK, LOCKHART, JOHNSON & HUTCHINGS  
 1600 OLIVER BUILDING  
 PITTSBURGH, PENNSYLVANIA 15222  
 (412) 584-0000

202/452-7030

Dr. D. James Croft, Director  
 Office of Examinations and Supervision  
 Federal Home Loan Bank Board  
 1700 G Street, N.W.  
 Washington, D.C. 20552

Thomas P. Vartanian, Esq.  
 General Counsel  
 Federal Home Loan Bank Board  
 1700 G Street, N.W.  
 Washington, D.C. 20552

Re: Proposal for Supervisory Conversion and Acquisition of  
 Dade Savings and Loan Association, Miami, Florida  
 (FHLEB No. 2745)

Gentlemen:

Reference is made to my letter to Dr. Croft of April 27, 1983, enclosing the proposal of our clients, American Capital Corporation, Jack Burstein, Robert Marlin, Albert Sakolsky and Edward McBride, for the unassisted supervisory conversion and acquisition of Dade Savings and Loan Association ("Dade").

In late April we were informed that the Bank Board's consideration of the proposal for the conversion of Dade involving the Westport Company ("Westport") was in "the eleventh hour" (i.e., in the final stages), and that, therefore, the proposal of our clients would not be reviewed by the Bank Board staff. We understand that Westport had originally submitted a proposal relating to Dade last fall, although the proposal presently under consideration by Bank Board staff differs very significantly from that originally submitted and now is based in part upon an offering of stock in the institution through an investment banker. We further understand that that proposal is no further advanced than it was on April 27, when we submitted the proposal on behalf of our clients.

In the first week of May we had a meeting with Bank Board staff to urge the staff to review our clients' proposal. The staff reaffirmed that such review would not be undertaken. The suggestion, however, was made that we review our proposal with the board of directors of Dade and attempt to obtain support for our proposal from the Dade board.

KIRKPATRICK, LOCKHART, HILL, CHRISTOPHER &amp; PHILLIPS

June 6, 1983

Page Two

Thereafter, we sent to the Dade board of directors a letter dated May 16, 1983, a copy of which is enclosed. The response, dated May 20, 1983, from the Dade board is attached hereto. Apparently the Dade board is precluded by its contract with Westport from entertaining any alternative proposal, no matter how much more favorable such alternative proposal may be or for how long the Westport proposal may be pending. In this regard, the agreement between Westport and Dade includes the following provision:

"(a) Dade agrees that prior to the Closing Date (unless this Agreement is terminated prior thereto pursuant to Section 9.2) it will not negotiate or execute any contract or agreement or enter into any understanding with any third party or take any other action which would adversely affect the ability of Dade and Westport to consummate the transactions contemplated by this Agreement."

Our clients remain interested in acquisition of Dade and remain convinced that their proposal will produce a substantially stronger institution than will the Westport proposal. In fact, as indicated in their letter to the Dade board, our clients are prepared to increase the amount of capital they will infuse if that is necessary. Moreover, our clients are anxious to discuss their proposal with, and if necessary to negotiate with, the board of directors of Dade. However, such discussions will be precluded by the continuing obligations of the Dade board under its agreement with Westport as long as the Westport proposal remains the only conversion which will be considered by the Bank Board.

The Bank Board should not, and in our view cannot under applicable regulations, continue to consider only the Westport proposal when a competitive--indeed superior--alternative is available. This conclusion is mandated not only by the terms of the recently amended conversion regulations, but also by a simple consideration of what procedure will produce the best results for the institution involved and the FSLIC.

Examining first the applicability of the new conversion regulations to the pending proposals, both the Westport proposal and that of our clients would constitute supervisory conversions pursuant to 12 C.F.R. Part 563b, Subpart C.<sup>1/</sup> As pointed out in the preamble to new Subpart C, conversions under that Subpart are discretionary with the Bank Board (12 C.F.R. §563b.20), "and the Board has the responsibility of taking action with respect to the institution that it determines is in the best

---

1/ We understand that under the Westport pr. 1 the accountholders of Dade will be granted no subscription rights as would be required under Subparts A and D (12 C.F.R. §§563b.3(c)(2) and 563b.37(g)), and the competing offer provision required under Subpart B (12 C.F.R. §563b.16) would not be included.

KIRKPATRICK, LOCKHART, HILL, CHRISTOPHER &amp; PHILLIP

June 6, 1983

Page Three

interests of the institution, its depositors, the public and the [FSLIC]." 48 F.R. 15599 (April 12, 1983) (emphasis added). In the present case the Bank Board must at least consider whether the Westport proposal is in the best interests of Dade, its depositors and FSLIC, when it is clear that an alternative proposal providing for a greater infusion of capital to Dade and no greater cost to FSLIC is available. It is not enough under the regulations for a particular proposal to benefit Dade, if a competing proposal provides even greater benefits.

Secondly, §563b.30 of Subpart C requires that any offering and sale of shares in a supervisory conversion be a non-public offering and be conducted in accordance with proposed 12 C.F.R. Part 563g (48 F.R. 10684 (Mar. 14, 1983)). We understand that part of the Westport proposal includes an underwritten offering which we believe will be exceedingly difficult to accomplish within the confines of §563b.30 and calls into question the feasibility of the Westport proposal. On the other hand, because the amount of capital to be contributed by our clients is substantially more than (we believe more than double) the capital to be contributed by Westport, our clients have not sought to enlist the support of an underwriter. Of course, it is certainly fair to assume in light of the amount of capital to be contributed by our clients, that an underwriter would be prepared, if necessary, to augment our clients' proposal with an offering in an amount at least equal to the amount to be underwritten under the Westport proposal.

Finally, §563b.26 makes it very clear that in the absence of a complete application for a supervisory conversion, the Bank Board's Principal Supervisory Agent "shall continue to seek appropriate supervisory resolutions of the institution's financial condition pending the filing of a complete application." Under §§563b.27(e) and 563b.27(j), a complete application in the case of the Westport proposal would be required to include, *inter alia*, a complete savings and loan holding company application and "all filings required under the securities offering rules of proposed 12 C.F.R. Part 563g [*supra*]." To the extent these requirements have not been met by Westport, the Bank Board's own regulations dictate that alternative proposals which constitute "appropriate supervisory resolutions" must continue to be considered by Bank Board staff.

Aside from strictly legal reasons which require consideration of our clients' competing proposal for acquisition of Dade, there are policy reasons from the point of view of FSLIC which are based on concerns similar to those underlying the new conversion regulations. Subpart B of those regulations, relating to sale-of-control conversions, requires that in non-supervisory cases possible acquisitions of control of an insured institution must be shown through a competitive bidding option to be the most beneficial course available to an institution. In a supervisory case, where FSLIC is by definition more likely to become involved if an institution is not healthy after conversion, FSLIC a fortiori has an interest in seeing that the best possible price

KIRKPATRICK, LOCKHART, HILL, CHRISTOPHER &amp; PHILLIPS

June 6, 1983

Page Four

for the institution is obtained. While the rigid bidding procedure of §563b.16 may not be feasible in a supervisory case, the interests of FSLIC certainly dictate that FSLIC consider a potentially more favorable proposal where, as here, such a proposal is brought to the attention of FSLIC without undue publicity or risk of harm to the institution.

Moreover, while a particular proposal is pending before the Bank Board, but not yet consummated, FSLIC cannot afford to forego consideration of competing proposals. This approach is embodied in §563b.28 and is the only logical course for FSLIC to pursue as long as it is not certain that a particular solution for a supervisory case will be effected. The chilling effect, on both potential acquirers and an institution's own board of directors, of an approach under which FSLIC considers only one potential solution at a time, even when that solution is significantly far from completion, cannot be overestimated. Such an approach greatly reduces the attractiveness of unassisted acquisitions to potential acquirers who must "wait in line" before they will even be considered, and thereby increases, rather than decreases, the risk of loss to FSLIC.

Finally, we understand the Westport proposal in one form or another has been pending for nearly nine months during which period the situation at Dade has continued to deteriorate. Consideration of alternatives is mandated by a delay of such length if for no other reason.

For the foregoing reasons the Bank Board staff should undertake consideration of our clients' proposal. In addition, we believe staff should confirm that such consideration is in process to the board of directors of Dade. We submit that the above course on the part of the Bank Board is the only one consistent with the Bank Board's own regulations, and will lead to a solution in this case which will truly be in the best interests of Dade, its depositors, the public and FSLIC.

Sincerely yours,

  
 George L. Christopher

Federal  
Home Loan  
Bank  
Board



# Memo

0000059A

OFFICE OF EXAMINATIONS AND SUPERVISION

INTER-OFFICE COMMUNICATION

FROM: Robert J. Moore

DATE August 15, 1983

TO: Mark Rundle  
Regional DirectorSUBJECT: Dade S&LA ("Dade")  
acquisition by  
David Paul ("Paul")

You have requested our opinion regarding the proposed accounting for the acquisition of Dade by Paul. Specifically, the following issues have been raised:

### Push-Down Accounting

It is our understanding that Paul is to acquire 100% of the common stock of Dade (thereby creating "New Dade"). Subsequently the association will issue additional shares of the common stock to the minority shareholders in the Westport Corporation (the entity which Paul controls and the stock of which will be exchanged for the Dade stock) and the general public (via a public offering of stock).

Based upon our understanding, we concur with the Association and their independent public accountants that push-down accounting is proper.

### Valuation Date

Documentation submitted on behalf of Paul supports his contention that he assumed control of the Association in October 1982.

We concur with the Association and their independent public accountants that the proper valuation date for this transaction is October 1, 1982.

### Tax Effecting Purchase Accounting Entries

The Association and their public accountants have concluded that the purchase accounting entries which will be recorded in this acquisition should not be tax effected.

We concur with the position taken by the Association and their public accountants.



Mr. Rundle  
Page Two

#### Valuation of Dade Real Estate Projects

It has been noted that certain of the Dade real estate projects have projected losses as of July 1992. A question has been raised as to how these losses should be addressed in the purchase accounting. In order to determine the proper recordation, it is necessary to assess the point in time at which these losses arose.

##### 1. Losses pre October 1, 1992

If it can be determined that the value of the real estate projects was impaired at October 1, 1992, the proper accounting would be to record the loss as part of the fair-valuing process as of October 1, 1992. The effect of this approach would be to increase the amount of goodwill by the amount of the write down.

##### 2. Losses post October 1, 1992

Should it be determined that the losses arose post October 1, 1992, the reserve should be recorded as a charge to operations in fiscal 1993 (the period from October 1, 1992 to September 30, 1993). This change will have no effect on goodwill and will reduce net worth and fiscal 1993 income by the amount of the loss reserve.

Until such time as it is determined when the losses arose, we cannot opine as to the proper accounting.

#### Valuation of Westport Assets

Appraisals of certain of the Westport assets indicates that the fair value of the net assets which will be exchanged for the Dade stock may not equate to the net book value at October 1, 1992. Paul has stated that the appraisals obtained by the Bank Board in connection with their assessment of the viability of the acquisition met certain FHLBB criteria, but they fail to meet the requirements of GAAP. Both of these positions have merit and will need to be evaluated by Dade's independent public accountants in connection with the valuation of the Dade common stock which will be exchanged for the stock in the Westport Corporation. Until such time as audited financial statements for New Dade are submitted, we cannot opine on the stock valuation (in discussions with David Pitelka of DH&S, Pitelka has stated that his firm has not tested the pro forma value of the Westport equity and that only upon completion of an audit will they do this).

Mr. Rundle  
Page Three

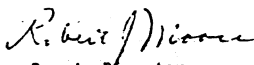
First Year Effect of Purchase Accounting

Since it has been determined that the transaction, if approved, would be effective as of October 1, 1982, this would mean that the operations of the Association to the date the transaction was approved would be combined with the first year purchase accounting effects immediately. In other words, the first year of operations of New Dade would be the period October 1, 1982 to September 30, 1983.

Merger Intangible Life

The association has proposed to amortize the total merger intangible arising in this transaction over a 25 year life on the straight line method.

We believe that this treatment is acceptable for PAP and GAAP purposes.

  
Deputy Director  
Policy/Programs

May 21, 1985

FHLBB No. 2745

Mr. David L. Paul, Chairman  
CentTrust Savings Bank  
P.O. Box 928562  
Miami, Florida 33101

Dear Mr. Paul:

We are writing in connection with CentTrust's investment in below investment grade and unrated corporate debt securities -- "junk" bonds. Representatives of the State of Florida's Office of the Comptroller have advised us that CentTrust has increased its holdings of junk bonds from approximately \$100 million at the time of the latest examination (Summer 1984) to approximately \$700 million at March 31, 1985. This level of investment represented over 16% of CentTrust's total assets at March 31, 1985.

We share the concern of the State of Florida that CentTrust's investment portfolio is comprised of an undue concentration in junk bonds. This concentration presents an excessive level of risk to CentTrust and to the FSLIC which is unacceptable to this office. Therefore, we direct that CentTrust shall not purchase any additional below investment grade or unrated corporate debt securities.

Should you have any questions regarding the foregoing, please do not hesitate to call me.

Sincerely,

Park T. Zimmerman  
Supervisory Agent

cc: Heath  
Rundle  
DeBenedictis

bcc: BBT  
BBT/kr  
#02

January 3, 1985

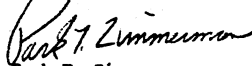
Mr. David L. Paul  
Chairman of the Board and Chief  
Executive Officer  
Centrust Savings and Loan Association  
101 East Flagler Street  
Miami, Florida 33131

Dear Mr. Paul:

Sam Connell and I are grateful for your thoughtfulness in sending us the Centrust ashtrays. They are very attractive and tasteful.

However, under the circumstances we both feel that it would be inappropriate for us to accept your gifts and therefore, we have returned them to you. I'm sure you can find a proper use for them.

Yours truly,

  
Park T. Zimmerman  
Supervisory Agent

cc: Mark Rundle