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CONFIDENTIAL

March 19, 1987

TO: Senator DeConcini

FROM: Laurie A. Sedlmayr LAS

RE: American Continental

The following is in follow-up to our earlier conversation.

What American Continental wants from Gray for concessions:

1) Correction of incorrectly appraised assets. AC would be willing to have an independent third-party Arizona appraiser do the work. (EXAMPLE: Phoenician Country Club appraised by FHLBB at $120 m, AC appraises at $200m.) Because these assets are undervalued, ACs net worth decreases. (FHLBB requires a net worth of 3%)

2) The capital regulation (which determines capital/net worth requirements) has a provision on direct investment. The capital regulation requires direct investments in excess of the FHLBB limit of 10%? made after December 10, 1984 be partially included in net worth requirements. The capital regulation stated that direct investments had to be made, legally committed to be made or that there be a definite plan to make such direct investments. AC has $600 million in disputed direct investments with FHLBB (AC states they qualify for grandfather, FHLBB says they do not.) Under the capital reg., 10% of the not permitted direct investments (10% of $600 million =$60 million) be added to the net worth requirement. For AC that means increasing their net worth requirement from 3% (about $74 million) by an additional $60 million (total of $134 million.)

The problem works out like this. On the one hand the FHLBB is lowering ACs net worth by low appraised values for property. On the other hand they are raising ACs net worth requirements through the direct investment section of the capital regulation.

[NOTE: The issue for which Lee Henkel has gotten in so much trouble is a separate issue, but nonetheless a related issue. Henkel sought to clarify a definition in the direct investment regulation (as distinct from the direct investment section of the capital regulation.) Under the direct investment regulation S&Ls must seek a waiver of the FHLBBs 10% direct investment regulation is they exceed the 10% limit. Because of the dispute of the meaning of the grandfather date, AC is in violation. Henkel sought to clarify the direct investment regulation so as to benefit AC. While this would not have changed the

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capital regulation, certainly it could be expected that after changing the direct investment regulation, the Board would move to put the direct investment section of the capital regulation in harmony with it.]

What American Continental is willing to do:

The major thing that AC is willing to do is remove itself from its status as a Federally insured institution over a 10 year period. While AC argues that they are thereby giving up a $50 million charter they paid for, I am not sure that the FHLBB will see it that way. AC has made a great deal of money through Lincoln and I am frankly doubtful that the FHLBB (Gray) will see this as a great triumph. AC feels that this is a major concession.

Other items:

1) As noted, Lincoln does not make home loans (the ostensible primary purpose of Federally insured S&Ls.) Lincoln is setting up a home-loan program in Southern California beginning April 1987. 55% of new deposits (about $75 million) will be used for the home-loan program. All loans will be resold on the secondary market.

2) Lincoln has already improved the condition of their books and recordkeeping to be in accord with accepted FHLBB practices.

3) Lincoln invests heavily in junk bonds. They would agree to limit that to 15% of assets. (Presently they are at about 11%.) The FHLBB allows federally chartered only 10% and feels that more than that is risky. At this time Lincoln does not invest in hostile takeover junk, but Grogan indicates they would not be willing to make that permanent.

4) Lincoln could agree to limit or curtail further land investments.