

PENN SQUARE BANK FAILURE

HEARINGS
BEFORE THE
COMMITTEE ON
BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES
NINETY-SEVENTH CONGRESS
SECOND SESSION

PART 1

JULY 15; AND AUGUST 16, 1982

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PENN SQUARE BANK FAILURE

THURSDAY, JULY 15, 1982

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, D.C.

The committee met, pursuant to call, at 2 p.m., in room 2128, Rayburn House Office Building, Hon. Fernand J. St Germain (chairman of the committee) presiding.

Present: Representatives St Germain, Gonzalez, Minish, Annunzio, Patterson, LaFalce, Oakar, Vento, Barnard, Garcia, Schumer, Patman, Hoyer, Stanton, Wylie, McKinney, Leach, Parris, Weber, Roukema, Bereuter, and Dreier.

The CHAIRMAN. The committee will come to order.

The witnesses will take their places at the witness table.

The Chair has an opening statement. This committee has looked at many bank failures through the years. Never has a single case presented such a wide-ranging catalog of banking issues as the collapse of Penn Square.

Clearly, the sifting of the debris from the crash has just begun, but already Penn Square bears the earmark of a classic case.

Once again, we have before us a major question about bank supervision. What did the regulators know? When did they know it? And what did they do about it?

Certainly, this committee needs the answers to these questions. But other questions cut a wide swath across banking practices and areas under the direct jurisdiction of this committee.

How were some of the Nation's most sophisticated financial institutions, with all variety of expertise at hand, lured like moths to the glow of this go-go bank sitting in a shopping center in Oklahoma City?

And how did so many small financial institutions decide, in effect, to delegate their judgments and responsibilities to brokers who peddled Penn Square's get-rich-quick interest rates like cotton candy at a carnival?

If no questions were raised about the fact that a shopping center bank in Oklahoma was offering some unique interest-rate bargains, surely someone, somewhere, would have thought to double-check an institution that had a 1,500-percent growth in 7 years?

Unhappily, the Penn Square case brings us up against the age-old question of disclosure in an industry and a regulatory structure built on secrecy.

Penn Square may well cause a rethinking about the banking industry's penchant for nondisclosure.

We do know that the Comptroller of the Currency, as the primary regulator of Penn Square, did know as early as the spring of 1980 that this bank had serious problems.

We do know that as early as September 1980, that the problems had become so severe that the Comptroller's Office forced the bank and its directors to enter into a formal written agreement to cease and desist from unsound and illegal practices. A written agreement that had all the sting of a flogging with a wet noodle.

These facts, of course, were not revealed to the public. They were not revealed to the financial institutions who swallowed the loan packages from Penn Square. They were not revealed to the individuals, the credit unions, and savings and loan associations who invested their depositors' money in Penn Square long after the Comptroller's Office knew the bank had gone sour.

I know the many rationalizations which are presented for this type of nondisclosure. I attempted to deal with the problem in the Safe Banking Act, following the Bert Lance revelations of 1977, but we were only partially successful.

I realize that the regulators are, indeed, sincere in their belief in secrecy on such matters. But, Penn Square brings the issue before us in stark outlines—hundreds of investors placed money—other people's money—in an institution which an agency of the U.S. Government knew to be unsound.

Public moneys were used to examine the bank, to collect data, to analyze the condition, but the public did not receive the results of the work for which they paid.

I am even more concerned, however, about the allegations flowing out of Oklahoma that this bank—like many other failures—was beset with insider and self-dealing problems.

This is an area where this committee has time and time and time again tried to focus regulatory attention.

We have conducted oversight efforts and we have pushed through statutory changes to help regulators deal with the problem.

I am going to be sorely disappointed if at the end of this trail, we find that once again nothing effective was done to curb practices early on.

The supervisors have received enough warnings in this area, and I see little excuse for anything but specific quick action on any unsound insider practices.

As I said in the Bert Lance investigation 5 years ago, these banks are not playpens for their officers and directors. They are chartered for the convenience and needs of the community and they deal with other people's money.

I do not see a middle ground on this issue.

We do intend to pursue our look at the Penn Square case in a vigorous manner and when these hearings are complete, we will have a clear and total picture of what happened and what did not happen.

As has been true in earlier efforts of this committee, our pursuit of the facts does not suggest that we believe that this case is necessarily indicative of financial practices across the Nation.

In fact, I am personally convinced from my many years on this committee that the great majority of depository institutions are,

indeed, run well and controlled by boards of directors and officers who understand the responsibilities and duties imposed by their institutions' public charters. But the issues raised are serious. They must be pursued objectively.

As I announced, today's session is structured as a briefing from the two regulatory bodies closest to the details of the Penn Square failure.

Our interrogation today will be limited and we will be asking representatives of these two agencies back when we open formal hearings and after the staff has completed initial factfinding efforts in August.

We have, of course, begun the process of gathering documents and other data. This will be pursued in the coming weeks. I am hopeful that all concerned will be forthcoming with material pertinent to the case.

It is premature, in my opinion, to talk about subpoenas. If this becomes necessary to elicit the information required to understand the case, I am sure, and I hope that we will have support from both sides.

Let's cross that bridge when we reach it. We have not yet.

I do appreciate the fact that the Comptroller of Currency, C. T. Conover, and the FDIC Chairman, Bill Isaac, have agreed to appear today on such short notice.

We will need and ask your cooperation in the coming weeks as this effort continues.

Both of you will hear what you may consider to be some harsh judgments from time to time, but I am certain you understand the constitutional and statutory responsibilities of this committee.

I will remind everyone that both of these gentlemen have recently assumed their respective jobs and neither was in place at the time that the Penn Square problem was discovered.

Also in fairness to them, I am sure that both agencies have a great deal of investigations to make before they can give us the final definitive picture of what happened from their view.

Mr. Stanton.

Mr. STANTON. Thank you very much, Mr. Chairman. I welcome you in scheduling this briefing here this afternoon.

I compliment you on the program that you have laid out explaining, as you have so well, the responsibilities of this committee in its oversight operations of the regulatory agencies.

I also wish to compliment those participating in the briefing this afternoon because it is my understanding that the chairmen of the related regulatory agencies themselves decided to appear themselves.

The CHAIRMAN. On a voluntary basis, rather than send staff, that is correct.

Mr. STANTON. So, thus the hearings are off to a good start. Once again, I compliment you on the timing of these hearings and look forward to the testimony here this afternoon.

The CHAIRMAN. At this point, I will recognize the Comptroller of the Currency, Mr. C. T. Conover.

I understand that you filed your statement. We will put your entire statement in the record.

I think you have some appendixes as well.

STATEMENT OF HON. C. T. CONOVER, COMPTROLLER OF THE CURRENCY, ACCOMPANIED BY PAUL M. HOMAN, SENIOR DEPUTY COMPTROLLER FOR BANK SUPERVISION, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. CONOVER. Yes, I do, Mr. Chairman.

The CHAIRMAN. Without objection, they will be placed in the record as well.

Mr. CONOVER. If I may, I would like to read my statement this afternoon.

Mr. Chairman and members of the committee, I welcome this opportunity to describe the Office of the Comptroller of the Currency's actions concerning the Penn Square Bank of Oklahoma City, Okla., which I declared insolvent at 7:05 p.m., central daylight savings time, on July 5, 1982.

In brief, the story of the Penn Square Bank is one of rapid and uncontrolled growth centered principally in poor-quality loans. As is typical of banks with asset problems, Penn Square suffered from a variety of related ills, including in this case, insufficient capital and liquidity.

The Comptroller's Office has devoted special supervisory attention to Penn Square since early 1980 when problems were first identified.

Since that time, the OCC's supervisory efforts have included five examinations of the bank, two formal enforcement actions against it, a number of special meetings with the bank's board of directors, and a significant amount of supervisory correspondence.

In the end, however, the bank proved unresponsive to these efforts. Massive losses exceeded the bank's net worth, which, coupled with a liquidity and confidence crisis, rendered the bank insolvent.

By way of history, Penn Square was chartered in 1960 and in 1976 became 100-percent owned by First Penn Corp. From the time it was chartered until 1977, the bank experienced normal growth and was not subject to any unusual supervisory action.

From May of 1977 until its closing, the bank experienced a period of rapid growth.

The bank became a matter of supervisory concern following an examination, dated February 29, 1980, which was concluded in early April of 1980.

This examination revealed, among other things, rapid growth of bank loans and assets, insufficient liquidity, inadequate capital, an increase in classified assets and violation of banking laws.

The majority of the growth experienced by the bank was in the area of oil- and gas-lending, resulting in a concentration of credit.

Participations in many of these loans were sold to other banks. Because of the problems identified, the bank was designated by our Dallas regional office as requiring special supervisory attention and was rated three pursuant to the Uniform Financial Institutions Rating System.

On June 9, 1980, the deputy regional administrator forwarded the report of examination to the board of directors, detailing many of his concerns and requesting a full board meeting in the Dallas regional office.

On the same date, the deputy regional administrator also recommended to Washington that the OCC take enforcement action.

Such action is a routine practice for a bank with the magnitude of problems identified and is in accordance with our standard operating procedures.

On June 19, 1980, the regional administrator and his staff met with the chairman of the board and the executive vice president of the bank to discuss the findings of the examination.

At that meeting, the regional administrator informed the chairman of the board that the bank had been placed in the OCC's special projects program because it required special supervision.

He also said that in light of the bank's problems, it would be placed under formal administrative action by this office pursuant to the cease-and-desist process.

At the request of the regional administrator, the board of directors of the bank convened a meeting on August 27, 1980, in our Dallas regional office to discuss the results of the examination.

At the meeting, the board of directors was presented with a formal agreement pursuant to the cease-and-desist statute (12 U.S.C. 1818(b)).

On September 9, 1980, the board of directors individually signed and consented to the formal agreement, which required the bank to take remedial action to eliminate the problems identified in the report and to establish procedures to prevent them from recurring. [Summary of formal agreement is attached to my prepared statement as appendix D].

From September 9 through September 11, 1980, we visited the bank to review previously criticized loans, past-due loans, new loans, the bank's capital plans, and its liquidity.

The examination disclosed rapid growth with funding heavily dependent upon rate-sensitive deposit sources. Liquidity was strained, and the existing staff was overtaxed by business volume. The bank's capital adequacy was deteriorating.

A general examination, as of December 31, 1980, was conducted from January 5 through February 27, 1981. It disclosed further deterioration in the bank's overall condition.

Major concerns continued to be inadequate capital, poor asset quality, ineffective loan administration, inadequate staffing and policy development, weak internal controls, and deficient liquidity, asset, and liability management practices.

During 1980, the bank had more than doubled in size. Most of this growth continued to be concentrated in the energy-related businesses. Additionally, violations of banking laws and of the formal agreement were cited in the report.

In a comprehensive letter to the board of directors dated July 1, 1981, the Regional Administrator informed the board that the report indicated that the board and management had failed to supervise prudently the bank's activities.

The letter, which accompanied the report, pointed out, among other things, that this lack of supervision had manifested itself in the following: Numerous violations of banking laws; inordinate asset/liability management risk; high levels of poor-quality assets; uncontrolled growth of bank resources; and noncompliance with the formal agreement.

The letter requested that the board of directors arrange a board of directors' meeting in our Dallas Regional Office to discuss the report and to determine future action to be taken by the board and management.

On July 29, 1981, a full board of directors' meeting was held in the regional office with the directors, management, and representatives of the Office of the Comptroller of the Currency regional and Washington offices.

At the meeting, the OCC representatives expressed in detail our supervisory concerns.

A special supervisory examination as of September 30, 1981, was conducted during the period October 8 through October 30, 1981.

This examination revealed modest improvement but the bank's overall condition remained of concern, with particular concern regarding the bank's contingent liabilities.

Although certain problems were highlighted, the report noted that various programs and systems had been established and that there was improvement in the bank's lending staff, its loan policy, and its controls.

In light of the problems still remaining in the bank, representatives of the OCC attended the board of directors' meeting of the bank on January 12, 1982, to discuss the results of the examination.

In addition, the board was informed that a more detailed examination would be conducted near the end of the first quarter of 1982.

As early as June 1980, the OCC supplemented its examinations of the bank by requiring the bank to submit periodic reports on matters of concern to the regional administrator.

The OCC's initial request for periodic progress reports on criticized assets and liquidity, which was made in June 1980, was supplemented by further reporting requirements imposed by the September 1980 formal agreement.

In addition, the Regional Administrator's July 1, 1981 letter highlighting the problems disclosed at the then-recently completed examination requested yet additional periodic reports from the bank.

By requesting and reviewing such reports, the OCC is able to monitor banks on a more constant basis than is permitted through the formal examination process.

Generally, the periodic reports submitted by the Penn Square Bank disclosed progress. Management repeatedly gave assurances that the required corrective actions had been or would be accomplished.

In fact, certain of the promised improvements were noted by our examiners in their October 1981 examination of the bank.

As late as January 1982, we believed the outlook to be favorable and that all substantive areas of concern were being addressed and corrected.

On April 19, 1982, the OCC commenced the examination that led to the bank's being declared insolvent. Several weeks into the examination, the Regional Administrator notified the Washington office that potentially serious problems were being uncovered in the bank.

Also, the bank's activities and condition had begun to be the subject of attention in the press and in the financial marketplace.

As it does with all banks requiring special supervisory attention, the OCC had shared information regarding Penn Square's condition with the FDIC since early 1980.

On June 23, 1982, the Regional Administrator informed the FDIC's regional director of the conditions disclosed by the ongoing examination.

Subsequently, the OCC notified the FDIC in Washington that the problems had grown significantly worse. Responding to the growing public and industry concern over the bank's condition, and mindful that the concern could create a severe liquidity strain on the bank, the OCC invited the FDIC to join its ongoing examination for contingency purposes.

Based on the preliminary findings of this examination, the OCC issued a notice of charges and a temporary order to cease and desist on June 30, 1982, to require immediate actions to rehabilitate the bank.

When the OCC determined that the viability of the bank required an immediate injection of additional capital, the temporary order to cease and desist was amended to require the bank to obtain \$30 million in new equity by the close of business on July 2, 1982.

No additional capital was injected. The OCC subsequently amended the notice of charges and the temporary order to limit transactions with affiliates.

The OCC, in a letter dated July 2, 1982, formally requested that the FDIC begin preparations for a potential purchase and assumption transaction or payout of insured depositors.

The letter explained that the examination in progress reflected losses nearly equaling the bank's total capital funds with additional losses likely.

It further pointed out that the bank had begun to experience adverse publicity which affected market confidence and caused substantial deposit withdrawals.

On July 5, 1982, the Comptroller's Office delivered a letter to the Federal Reserve Bank of Kansas City briefly reviewing the situation and asking to be informed of the Federal Reserve Bank's intentions of providing further loans to the bank.

In a response received the same day, the Federal Reserve Bank of Kansas City indicated that it was not prepared to extend further credit to the bank in its current condition.

Based upon the review done by the examiners, I determined, as of July 5, 1982, that the losses then identified exceeded the capital funds of the bank. I further determined that the bank would not be able to continue meeting the demands of its creditors and depositors.

I became satisfied on July 5, 1982, of the insolvency of the bank. Accordingly, on that date, acting pursuant to my statutory duties, at 7:05 p.m. (CDST), I declared the bank insolvent and appointed the FDIC as receiver.

That ends my formal statement, Mr. Chairman, and at this time, I would be happy to answer questions along with Mr. Paul Homan, Senior Deputy Comptroller for Bank Supervision.

[The prepared statement of Mr. Conover follows:]

STATEMENT OF
C. T. CONOVER
COMPTROLLER OF THE CURRENCY
BEFORE THE
COMMITTEE ON BANKING, FINANCE,
AND URBAN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES
JULY 15, 1982

Mr. Chairman and Members of the Committee:

I welcome this opportunity to describe the Office of the Comptroller of the Currency's actions concerning the Penn Square Bank, N.A., of Oklahoma City, Oklahoma, which I declared insolvent at 7:05 p.m. (CDST) on July 5, 1982. (Attached as Appendix A is a brief chronology of events.)

In brief, the story of the Penn Square Bank is one of rapid and uncontrolled growth centered principally in poor-quality loans. As is typical of banks with asset problems, Penn Square suffered from a variety of related ills, including, in this case, insufficient capital and liquidity.

The Comptroller's Office has devoted special supervisory attention to Penn Square since early 1980 when problems were first identified. Since that time, OCC's supervisory efforts have included five examinations of the bank, two formal

enforcement actions against it, a number of special meetings with the bank's board of directors, and a significant amount of supervisory correspondence.

In the end, however, the bank proved unresponsive to these efforts. Massive losses exceeded the bank's net worth which, coupled with a liquidity and confidence crisis, rendered the bank insolvent.

Penn Square was chartered in 1960 and in 1976 became 100% owned (less directors' qualifying shares) by the First Penn Corporation. From the time it was chartered until 1977, the bank experienced normal growth and was not subject to any unusual supervisory action. From May of 1977 until its closing, the bank experienced a period of rapid growth.

The bank became a matter of supervisory concern following an examination dated February 29, 1980, which concluded on April 4, 1980. This examination revealed, among other things, rapid growth of bank loans and assets, insufficient liquidity, inadequate capital, an increase in classified assets, and violation of banking laws. The majority of the growth experienced by the bank was in the area of oil and gas lending, resulting in a concentration of credit. Participations in many of these loans were sold to other banks. Because of the problems identified, the bank was designated by our Dallas Regional Office as requiring special supervisory attention and was rated "3" pursuant to the Uniform Financial Institutions Rating System. (Appendix B.)

On June 9, 1980, the Deputy Regional Administrator forwarded the Report of Examination to the board of directors, detailing many of his concerns and requesting a full board meeting in the Dallas Regional Office. On the same date, the Deputy Regional Administrator also recommended to Washington that the OCC take enforcement action. Such action is a routine practice for a bank with the magnitude of problems identified and is in accordance with our standard operating procedures. (Appendix C.)

On June 19, 1980, the Regional Administrator and his staff met with the chairman of the board and the executive vice president of the bank to discuss the findings of the examination. At that meeting, the Regional Administrator informed the chairman of the board that the bank had been placed in the OCC's Special Projects program because it required special supervision. He also said that in light of the bank's problems it would be placed under formal administrative action by this Office pursuant to the cease and desist process.

At the request of the Regional Administrator, the board of directors of the bank convened a meeting on August 27, 1980, in our Dallas Regional Office to discuss the results of the examination. At the meeting, the board of directors was presented with a formal Agreement pursuant to the cease and desist statute (12 U.S.C. §1818(b)). On September 9, 1980, the board of directors individually signed and consented to the formal Agreement, which required the bank to take remedial action

to eliminate the problems identified in the report and to establish procedures to prevent them from recurring. (Summary of formal Agreement attached as Appendix D.)

From September 9 through September 11, 1980, we visited the bank to review previously criticized loans, past-due loans, new loans, the bank's capital plans, and its liquidity. The examination disclosed rapid growth with funding heavily dependent upon rate-sensitive deposit sources. Liquidity was strained, and the existing staff was overtaxed by business volume. The bank's capital adequacy was deteriorating.

A general examination, as of December 31, 1980, was conducted from January 5, 1981, through February 27, 1981. It disclosed further deterioration in the bank's overall condition. Major concerns continued to be inadequate capital, poor asset quality, ineffective loan administration, inadequate staffing and policy development, weak internal controls, and deficient liquidity, asset, and liability management practices. During 1980, the bank had more than doubled in size. Most of this growth continued to be concentrated in the energy-related businesses. Additionally, violations of banking laws and of the formal Agreement were cited in the report.

In a comprehensive letter to the board of directors dated July 1, 1981, the Regional Administrator informed the board that the report indicated that the board and management had failed to supervise prudently the bank's activities. The letter, which accompanied the report, pointed out, among other things, that this lack of supervision had manifested itself in the following:

- Numerous violations of banking laws;
- Inordinate asset/liability management risk;
- High levels of poor-quality assets;
- Uncontrolled growth of bank resources; and
- Noncompliance with the formal Agreement.

The letter requested that the board of directors arrange a board of directors' meeting in our Dallas Regional Office to discuss the report and to determine future action to be taken by the board and management.

On July 29, 1981, a full board of directors' meeting was held in the Regional Office with the directors, management (including several new members of management), and representatives of Regional and Washington Offices. At the meeting, the OCC representatives expressed in detail our supervisory concerns.

A special supervisory examination as of September 30, 1981, was conducted during the period October 8 through October 30, 1981. This examination revealed modest improvement but the bank's overall condition remained of concern, with particular concern regarding the bank's contingent liabilities. Although certain problems were highlighted, the report noted that various programs and systems had been established and that there was improvement in the bank's lending staff, its loan policy, and its controls. In light of the problems still remaining in the bank, representatives of the OCC attended the board of directors' meeting of the bank on January 12, 1982, to discuss the results of the examination. In addition, the board was informed that a more detailed examination would be conducted near the end of the first quarter of 1982.

As early as June, 1980, the OCC supplemented its examinations of the bank by requiring the bank to submit periodic reports on matters of concern to the Regional Administrator. The OCC's initial request for periodic progress reports on criticized assets and liquidity, which was made in June, 1980, was supplemented by further reporting requirements imposed by the September 1980 formal Agreement. In addition, the Regional Administrator's July 1, 1981 letter highlighting the problems disclosed at the then-recently completed examination requested yet additional periodic reports from the bank. By requesting and reviewing such reports, the OCC is able to monitor banks on a more constant basis than is permitted through the formal examination process.

Generally, the periodic reports submitted by the Penn Square Bank disclosed progress. Management repeatedly gave assurances that the required corrective actions had been or would be accomplished. In fact, certain of the promised improvements were noted by our examiners in their October 1981 examination of the bank. As late as January 1982, we believed the outlook to be favorable and that all substantive areas of concern were being addressed and corrected.

On April 19, 1982, the OCC commenced the examination that led to the bank's being declared insolvent. Several weeks into the examination the Regional Administrator notified the Washington Office that potentially serious problems were being

uncovered in the bank. Also, the bank's activities and condition had begun to be the subject of attention in the press and in the financial marketplace.

As it does with all banks requiring special supervisory attention, the OCC had shared information regarding Penn Square's condition with the FDIC since early 1980. On June 23, 1982, the Regional Administrator informed the FDIC's regional director of the conditions disclosed by the ongoing examination. Subsequently, the OCC notified the FDIC in Washington that the problems had grown significantly worse. Responding to the growing public and industry concern over the bank's condition, and mindful that the concern could create a severe liquidity strain on the bank, the OCC invited the FDIC to join its ongoing examination for contingency purposes.

Based on the preliminary findings of this examination, the OCC issued a Notice of Charges and a Temporary Order to Cease and Desist on June 30, 1982, to require immediate actions to rehabilitate the bank. (Summary of Notice of Charges and Temporary Order is attached as Appendix E.) When the OCC determined that the viability of the bank required an immediate injection of additional capital, the Temporary Order to Cease and Desist was amended to require the bank to obtain \$30 million in new equity capital by the close of business on July 2, 1982. No additional capital was injected. The OCC subsequently amended the Notice of Charges and the Temporary Order to limit transactions with affiliates.

The OCC, in a letter dated July 2, 1982, formally requested that the FDIC begin preparations for a potential purchase and assumption transaction or payout of insured depositors. The letter explained that the examination in progress reflected losses nearly equalling the bank's total capital funds with additional losses likely. It further pointed out that the bank had begun to experience adverse publicity which affected market confidence and caused substantial deposit withdrawals.

On July 5, 1982, the Comptroller's Office delivered a letter to the Federal Reserve Bank of Kansas City briefly reviewing the situation and asking to be informed of the Federal Reserve Bank's intentions of providing further loans to the bank. In a response received the same day, the Federal Reserve Bank of Kansas City indicated it was not prepared to extend further credit to the bank in its current condition.

Based upon the review done by the examiners, I determined, as of July 5, 1982, that the losses then identified exceeded the capital funds of the bank. I further determined that the bank would not be able to continue meeting the demands of its creditors and depositors.

I became satisfied on July 5, 1982, of the insolvency of the bank. Accordingly, on that date, acting pursuant to my statutory duties, at 7:05 p.m. (CDST) I declared the bank insolvent and appointed the FDIC as receiver.

At this time, I will be pleased to answer your questions.

Appendix A

CHRONOLOGY OF OCC SUPERVISION
OF PENN SQUARE BANK, N.A.
JANUARY 1, 1980 - JULY 5, 1982

February 29, 1980

Conducted a specialized examination as of February 29, 1980. Commenced March 3, 1980, completed April 4, 1980. Revealed rapid and uncontrolled growth. Bank rated "3".

June 9, 1980

Forwarded examination to the board of directors by letter from the Deputy Regional Administrator. The letter identified certain of the major problems and directed the board to within 5 days convene a special meeting to review the report and take remedial action. The letter also requested a full board meeting in the Dallas Regional Office and requested additional reporting.

June 19, 1980

Meeting between Regional Administrator and Chairman of the Board Jennings and executive vice president to discuss the examination report.

June 24, 1980

Notified Federal Reserve Board and FDIC of contemplated enforcement action against the bank.

July 14, 1980

Letter to Deputy Regional Administrator from bank president indicating, among other things, that steps were being taken to improve liquidity. He recognized the need for supervision over the energy credits and indicated that additional people had been added and would be added. More monitoring would be done by the directors and the violations of law had been corrected.

July 15, 1980

Letter to Deputy Regional Administrator from chairman of the board discussing bank's capital plans and growth limits.

August 14, 1980

Letter from Regional Office to the board of directors identifying weaknesses in the capital plan and asking for submission of an acceptable one.

August 27, 1980

Full board of directors' meeting in Dallas Regional Office at which time Regional Office staff discussed the results of the examination. At that meeting, the formal Agreement was presented to each member of the board with a full explanation.

September 9, 1980

Board of directors individually signed and consented to the formal administrative Agreement which was forwarded to the Regional Office on September 10, 1980, with a letter by the chairman of the board who indicated the holding company had agreed to sell stock with \$3.3 million to be contributed to the bank.

September 9, 1980

Commenced visitation September 9, 1980, completed September 11, 1980. Limited review. Rating "3".

October 8, 1980

Sent visitation report to board of directors.

December 31, 1980

Conducted a general examination as of December 31, 1980, beginning January 5, 1981, completed February 27, 1981. Disclosed further deterioration in the bank's overall condition. Rated "3".

July 1, 1981

Letter from Regional Administrator to the board of directors identifying the problems and demanding action including a full board of directors' meeting in the Dallas Regional Office.

July 29, 1981

Full board of directors' meeting plus management in the Dallas Regional Office where the Regional Administrator and his staff and Washington staff identified the problems and demanded correction. Correction was promised.

September 30, 1981

Conducted a special supervisory examination as of September 30, 1981, beginning October 8, 1981, completed October 30, 1981. Identified areas of continuing concern but revealed some improvement and establishment of programs and systems. Rated "3".

December 1, 1981

Regional Administrator forwarded the special supervisory examination to the board of directors.

January 12, 1982

Board of directors' meeting at which time Regional staff of the OCC highlighted the problems as identified in the report.

April 19, 1982

Commenced general examination.

May 11, 1982

Regional Administrator notified Washington Office of problems being uncovered.

June 23, 1982

Regional Administrator notified FDIC regional office about problems in the bank.

June 30, 1982

Issued a Notice of Charges and Temporary Order to Cease and Desist.

June 30, 1982

Asked FDIC to send examiner to assess the prospects for an FDIC-assisted purchase and assumption or payout.

July 2, 1982

Amended Order to Cease and Desist, requiring immediate injection of capital.

July 2, 1982

Sent letter to FDIC formally requesting assessment of prospects for an FDIC-assisted transaction.

July 4, 1982

Amended Notice and Temporary Order to prevent violation of 12 U.S.C. §371c.

July 5, 1982

Sent letter to Federal Reserve Bank of Kansas City advising it of bank's condition and asking its intentions regarding loans to bank.

July 5, 1982

Received letter from Federal Reserve Bank saying it would not extend further credit to bank in its present condition.

July 5, 1982

Declared bank insolvent at 7:05 p.m. (CDST) and appointed FDIC as receiver.

EXAMINING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Examining Circular 159
(Revised)

Subject: Uniform Financial Institutions
Rating System

TO: All Regional Administrators and Examining Personnel

SCOPE

This examining circular revises and rescinds Examining Circular 159 (Revised) dated May 19, 1978.


Mr. Heimann has approved the use of the Uniform Financial Institutions Rating System by this agency.

The System (copy attached) which was recommended recently for adoption by the Federal Financial Institutions Examination Council (FFIEC) provides a general framework for evaluating the soundness of federally supervised banks and thrift institutions and their compliance with law. In addition, the rating system is meant to assist the public and the Congress in assessing the aggregate strength and soundness of our financial system.

The Uniform Financial Institutions Rating System revises the system adopted by the three federal commercial bank regulators on May 12, 1978. The FFIEC's action if adopted by the National Credit Union Administration and the Federal Home Loan Bank Board would bring federally chartered credit unions and savings and loan associations under the System.

The examiner-in-charge will continue to grade each of the five individual categories and the Regional Administrator or his designee shall assign a composite rating consistent with the criteria and evaluating factors defined in the revised rating system.

In order that these composite ratings remain current, the procedures to change a bank's composite rating between examinations (Examining Circular 160) remain in effect. Changes in composite ratings should continue to be forwarded to the attention of the Special Projects Division on Form CC 9060-05.


Paul M. Homan
Senior Deputy Comptroller
for Bank Supervision

Attachment

Date: December 10, 1979

November 13, 1979

UNIFORM FINANCIAL
INSTITUTIONS RATING SYSTEM*

Introduction

The rating system provides a general framework for evaluating and assimilating all significant financial, operational and compliance factors in order to assign a summary or composite supervisory rating to each Federally regulated commercial bank, savings and loan association, mutual savings bank and credit union. The purpose of the rating system is to reflect in a comprehensive and uniform fashion an institution's financial condition, compliance with laws and regulations and overall operating soundness. In addition to serving as a useful tool for summarizing the condition of individual institutions, the rating framework will also assist the public and Congress in assessing the aggregate strength and soundness of the financial industry.

Although it is acknowledged that to some degree each type of financial institution poses its own set of supervisory issues and concerns, the uniform rating system is predicated upon certain features and functions, including qualitative and quantitative factors, common to all categories of institutions. In general, financial institutions provide a wide range of essential credit, depository and related financial services to individuals, private commercial enterprises and governments. In so doing, financial institutions play an important and integral role in the stability and growth of economic activity at the local, regional, national or international level. Institutions are best able to carry out these essential functions and accommodate the demand for financial services when they are operated in a sound and prudent manner in full compliance with relevant laws and regulations.

*The term "financial institution" with respect to the rating system refers to certain institutions whose primary Federal supervisory agencies are represented on the Federal Financial Institutions Examination Council, i.e., Federally supervised commercial banks, savings and loan associations, mutual savings banks and credit unions.

Overview

Each financial institution is assigned a uniform composite rating that is predicated upon an evaluation of pertinent financial and operational standards, criteria and principles. The rating is based upon a scale of one through five in ascending order of supervisory concern. Thus, "1" represents the highest rating and, consequently, the lowest level of supervisory concern; while "5" represents the lowest, most critically deficient level of performance and, therefore, the highest degree of supervisory concern. Each of the five composite ratings is described in greater detail below.

In assigning a composite rating, all relevant factors must be weighed and evaluated. In general, these factors include: the adequacy of the capital base, net worth and reserves for supporting present operations and future growth plans; the quality of loans, investments and other assets; the ability to generate earnings to maintain public confidence, cover losses and provide adequate security and return to depositors; the ability to manage liquidity and funding; the ability to meet the community's or membership's legitimate needs for financial services and cover all maturing deposit obligations; and the ability of management to properly administer all aspects of the financial business and plan for future needs and changing circumstances. The assessment of management and administration includes the quality of internal controls, operating procedures and all lending, investment and operating policies; compliance with relevant laws and regulations; and the involvement of the directors, shareholders and officials. In general, assignment of a composite rating may incorporate any other factors that bear significantly on the overall condition and soundness of the financial institution.

Notwithstanding the use of common summary ratings, specific performance benchmarks, standards and principles will continue to recognize existing structural, operational and regulatory distinctions among different types of financial institutions.

Thus, while each financial institution will be evaluated upon criteria relating to its particular industry, the assignment of a uniform composite rating will help to direct uniform and consistent supervisory attention in such a way that does not depend solely upon the nature of an institution's charter or business, or the identity of its primary Federal regulator. While distinctions among credit unions, savings and loan associations, commercial banks and mutual savings banks are recognized, overall uniformity and consistency of supervision will be strengthened by the existence of common supervisory ratings.

The primary purpose of the uniform rating system is to help identify those institutions whose financial, operating or compliance weaknesses require special supervisory attention and/or warrant a higher than normal degree of supervisory concern. In an effort to accomplish this objective, the rating system identifies certain institutions whose financial, operational or managerial weaknesses are so severe as to pose a serious threat to continued financial viability. These institutions are, depending upon degree of risk and supervisory concern, rated Composite "4" or "5". Such institutions are generally characterized by unsafe, unsound or other seriously unsatisfactory conditions and carry a relatively high possibility of failure or insolvency. The uniform identification of such institutions will help to ensure:

- 1) That the degree of supervisory attention and the type of supervisory response are based upon the severity and nature of an institution's problems;
- 2) That supervisory attention and action are, to the extent possible, administered uniformly and consistently, regardless of the type of institution or the identity of the regulatory agency; and

- 3) That appropriate supervisory action is taken to address those institutions whose financial problems entail the greatest potential for hardship or inconvenience to depositors, borrowers or the public; or those institutions whose potential weaknesses would most seriously disrupt the proper and efficient functioning of the financial system.

The rating system also identifies a category of institutions that have some combination of financial or compliance deficiencies that, while posing little or no threat to financial viability under present circumstances, do warrant more than normal supervisory concern. These institutions are not deemed to present a significant risk of failure, or of loss or hardship to depositors, borrowers, or the public, but do require a higher than normal level of supervision. The delineation of this category will assist supervisory authorities in separating the most serious and critical problem institutions whose viability may be in question from those institutions whose financial or compliance deficiencies may require a specific supervisory response but do not constitute a significant risk of failure, insolvency or bankruptcy. Institutions that warrant some supervisory concern but do not entail a relatively high possibility of failure or insolvency are generally rated Composite "3".

Composite Ratings

Composite ratings are defined and distinguished as follows:

Composite 1

Institutions in this group are basically sound in every respect; any critical findings or comments are of a minor nature and can be handled in a routine manner. Such institutions are resistant to external economic and financial disturbances and more capable of withstanding the vagaries of business conditions than institutions with lower ratings. As a result, such institutions give no cause for supervisory concern.

Composite 2

Institutions in this group are also fundamentally sound, but may reflect modest weaknesses correctable in the normal course of business. The nature and severity of deficiencies, however, are not considered material and, therefore, such institutions are stable and also able to withstand business fluctuations quite well. While areas of weakness could develop into conditions of greater concern, the supervisory response is limited to the extent that minor adjustments are resolved in the normal course and operations continue satisfactory.

Composite 3

Institutions in this category exhibit a combination of financial, operational or compliance weaknesses ranging from moderately severe to unsatisfactory. When weaknesses relate to financial condition, such institutions may be vulnerable to the onset of adverse business conditions and could easily deteriorate if concerted action is not effective in correcting the areas of weakness. Institutions which are in significant non-compliance with laws and regulations may also be accorded this rating. Generally, these institutions give cause for supervisory concern and require more than normal supervision to address deficiencies. Overall strength and financial capacity, however, are still such as to make failure only a remote possibility.

Composite 4

Institutions in this group have an immoderate volume of serious financial weaknesses or a combination of other conditions that are unsatisfactory. Major and serious problems or unsafe and unsound conditions may exist which are not being satisfactorily addressed or resolved. Unless effective action is taken to correct these conditions, they could reasonably develop into a situation that

could impair future viability, constitute a threat to the interests of depositors and/or pose a potential for disbursement of funds by the insuring agency. A higher potential for failure is present but is not yet imminent or pronounced. Institutions in this category require close supervisory attention and financial surveillance and a definitive plan for corrective action.

Composite 5

This category is reserved for institutions with an extremely high immediate or near term probability of failure. The volume and severity of weaknesses or unsafe and unsound conditions are so critical as to require urgent aid from stockholders or other public or private sources of financial assistance. In the absence of urgent and decisive corrective measures, these situations will likely require liquidation and the payoff of depositors, disbursement of insurance funds to insured depositors, or some form of emergency assistance, merger or acquisition.

Performance Evaluation

The five key performance dimensions -- capital adequacy, asset quality, management/administration, earnings, and liquidity-- are to be evaluated on a scale of one to five. Following is a description of the gradations to be utilized in assignment performance ratings:

Rating No. 1 - indicates strong performance.

It is the highest rating and is indicative of performance that is significantly higher than average.

Rating No. 2 - reflects satisfactory performance.

It reflects performance that is average or above; it includes performance that adequately provides for the safe and sound operation of the bank.

Rating No. 3 - represents performance that is flawed to some degree; as such, is considered fair. It is neither satisfactory nor marginal but is characterized by performance of below average quality.

Rating No. 4 - represents marginal performance which is significantly below average; if left unchecked, such performance might evolve into weaknesses or conditions that could threaten the viability of the institution.

Rating No. 5 - is considered unsatisfactory.

It is the lowest rating and is indicative of performance that is critically deficient and in need of immediate remedial attention. Such performance by itself, or in combination with other weaknesses, could threaten the viability of the institution.

Capital Adequacy

Capital is rated (1 thru 5) in relation to: (a) the volume of risk assets; (b) the volume of marginal and inferior quality assets; (c) bank growth experience, plans, and prospects; and (d) the strength of management in relation to (a), (b) and (c). In addition, consideration must be given to a bank's capital ratios relative to its peer group, its earnings retention and its access to capital markets or other appropriate sources of financial assistance.

Banks rated 1 or 2 are considered to have adequate capital, although the former's capital ratios will generally exceed those of the latter. A 3 rating should be ascribed to a bank's capital position when the relationship of the capital structure to points (a), (b) or (c) is adverse even giving weight to management as a mitigating factor. In most instances, such banks would have capital ratios below peer group averages. Banks rated 4 and 5 are clearly inadequately capitalized, the latter representing a situation of such gravity as to threaten viability and solvency. A 5 rating also denotes a bank that requires urgent assistance from shareholders or other external sources of financial support.

Asset Quality

Asset quality is rated (1 thru 5) in relation to (a) the level, distribution and severity of classified assets; (b) the level and composition of nonaccrual and reduced rate assets; (c) the adequacy of valuation reserves; and (d) demonstrated ability to administer and collect problem credits. Obviously, adequate valuation reserves and a proven capacity to police and collect problem credits mitigate to some degree the weaknesses inherent in a given level of classified assets. In evaluating asset quality, consideration should also be given to any undue degree of concentration of credits or investments, the nature and volume of special mention classifications, lending policies, and the adequacy of credit administration procedures.

Asset quality ratings of 1 and 2 represent situations involving a minimal level of concern. Both ratings represent sound portfolios although the level and severity of classifications of the latter generally exceed those of the former. A 3 asset rating indicates a situation involving an appreciable degree of concern, especially to the extent that current adverse trends suggest potential future problems. Ratings 4 and 5 represent increasingly more severe asset problems; rating 5, in particular, represents an imminent threat to bank viability through the corrosive effect of asset problems on the level of capital support.

Management/Administration

Management's performance must be evaluated against virtually all factors considered necessary to operate the bank within accepted banking practices and in a safe and sound manner. Thus, management is rated (1 thru 5) with respect to (a) technical competence, leadership and administrative ability; (b) compliance with banking regulations and statutes; (c) ability to plan and respond to changing circumstances; (d) adequacy of and compliance with internal policies; (e) depth and succession; (f) tendencies toward self-dealing; and (g) demonstrated willingness to serve the legitimate banking needs of the community.

A 1 rating is indicative of management that is fully effective with respect to almost all factors and exhibits a responsiveness and ability to cope successfully with existing and foreseeable problems that may arise in the conduct of the bank's affairs. A 2 rating reflects some deficiencies but generally indicates a satisfactory record of performance in light of the bank's particular circumstances. A rating of 3 reflects performance that is lacking in some measure of competence desirable to meet responsibilities of the situation in which management is found. Either it is characterized by modest talent when above-average abilities are called for, or it is distinctly below average for the type and size of bank in which it operates. Thus, its responsiveness or ability to correct less than satisfactory conditions may be lacking. The 4 rating is indicative of a management that is generally inferior in ability compared to the responsibilities with which it is charged. A rating of 5 is applicable to those instances where incompetence has been demonstrated. In these cases, problems resulting from management weakness are of such severity that management must be strengthened or replaced before sound conditions can be brought about.

Earnings

Earnings will be rated (1 thru 5) with respect to (a) the ability to cover losses and provide for adequate capital; (b) earnings trends; (c) peer group comparisons; and (d) quality and composition of net income. Consideration must also be given to the interrelationships that exist between the dividend payout ratio, the rate of growth of retained earnings and the adequacy of bank capital. A dividend payout rate that is sufficiently high as to cause an adverse relationship to exist suggests conditions warranting a lower rating despite a level of earnings that might otherwise warrant a more favorable appraisal. Quality is also an important factor in evaluating this dimension of a bank's performance. Consideration should be given to the adequacy of transfers to the valuation reserve and the extent to which extraordinary items, securities transactions, and tax effects contribute to net income. Earnings rated 1 are sufficient to make full provision for the absorption of losses and the accretion of capital when due consideration is given to asset quality and bank growth. Generally, banks so rated will have earnings well above peer group averages. A bank whose earnings are relatively static or even moving downward may receive a 2 rating provided its level of earnings is adequate in view of the considerations discussed above. Normally, banks so rated will have earnings that are in line with or slightly above peer group norms. A 3 should be accorded earnings that are not sufficient to make full provision for the absorption of losses and the accretion of capital in relation to bank growth. The earnings pictures of such banks may be further clouded by static or inconsistent earnings trends, chronically insufficient earnings, a high dividend payout rate or less than satisfactory asset quality. Earnings of such banks are generally below peer group averages. Earnings rated 4, while generally positive, may be characterized by

erratic fluctuations in net income, the development of a downward trend, intermittent losses or a substantial drop from the previous year. Earnings of such banks are ordinarily substantially below peer group averages. Banks with earnings accorded a 5 rating should be experiencing losses or reflecting a level of earnings that is worse than defined in No. 4 above. Such losses may represent a distinct threat to the bank's solvency through the erosion of capital.

Liquidity

Liquidity is rated (1 thru 5) with respect to (a) the volatility of deposits; (b) reliance on interest-sensitive funds and frequency and level of borrowings; (c) technical competence relative to structure of liabilities; (d) availability of assets readily convertible into cash; and (e) access to money markets or other ready sources of cash. Ultimately, the bank's liquidity must be evaluated on the basis of its capacity to promptly meet the demand for payment of its obligations and to readily fill the reasonable credit needs emanating from the communities which it serves. In appraising liquidity, attention should be directed to the bank's average liquidity over a specific time period as well as its liquidity position on any particular date. Consideration should be given where appropriate to the overall effectiveness of asset-liability management strategies and compliance with and adequacy of established liquidity policies. The nature, volume and anticipated usage of a bank's credit commitments are also factors to be weighed in arriving at an overall rating for liquidity.

A liquidity rating of 1 indicates a more than sufficient volume of liquid assets and/or ready and easy access on favorable terms to external sources of liquidity within the context of the bank's overall asset-liability management strategy. A bank developing a trend toward decreasing liquidity and increasing reliance on borrowed funds, yet still within acceptable proportions, may be accorded a 2 rating. A 3 liquidity rating reflects an insufficient volume of liquid assets and/or a reliance on interest-sensitive funds that is approaching or exceeds reasonable proportions for a given bank. Rating of 4 and 5 represent increasingly serious liquidity positions. Banks with liquidity positions so critical as to constitute an imminent threat to continued viability should be accorded a 5 rating. Such banks require immediate remedial action or external financial assistance to allow them to meet their maturing obligations.



Appendix C

POLICIES & PROCEDURES MANUAL

Comptroller of the Currency
Administrator of National Banks

Section: Bank Supervision and Enforcement and Compliance Division	Subject	Formal and Informal Administrative Actions
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TO: Deputy Comptrollers, Regional Administrators, Department and Division Heads and Regional Counsels

PURPOSE

This issuance sets forth policies and procedures governing formal and informal administrative actions.

RESPONSIBILITY

Responsibility for the initial decision on whether to commence a formal or informal administrative action rests with the Regional Office. In reaching this decision, involved personnel must adhere to these policies and procedures which are designed to promote uniform regulation of national banks throughout the OCC.

I. Enforcement Policy

- A. Banks rated 4 and 5 - It is OCC policy to take formal administrative action against all banks rated 4 or 5. Formal administrative actions are typically Agreements or Cease and Desist Orders executed pursuant to the Financial Institutions Supervisory Act of 1966 and the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (12 U.S.C. §1818).
- B. Banks rated 3 - It is OCC policy to consider formal administrative action with respect to all banks rated 3. If formal action is determined to be inappropriate for any 3 rated bank, it is OCC policy to undertake informal remedial action through the use of a Memorandum of Understanding between the Regional Administrator and the bank.
- C. Banks rated 1 and 2 - Nothing in these policies precludes the use of either formal or informal administrative actions on a 1 or 2 rated bank.
- D. Exceptions - Conditions prevailing in individual banks may occasionally warrant deviation from the general policies set forth above. The following procedure should be followed in those cases where an exception from the general policy is appropriate.



POLICIES & PROCEDURES MANUAL

Comptroller of the Currency
Administrator of National Banks

Section Bank Supervision and Enforcement and Compliance Division Subject Formal and Informal Administrative Actions

1. Banks rated 4 or 5 - The Regional Office's written recommendation which supports an exception to the general enforcement policy and outlining the reasons why formal administrative action is inappropriate must be sent to the Special Projects Division (SP). The Regional Office's memorandum should detail what other remedial action will be taken in lieu of formal administrative actions. SP, with personnel from the Enforcement and Compliance Division (E&C) will review the recommendation. SP and E&C will develop a joint, or individual if required, written recommendation(s) which will be forwarded, together with the Regional Office's recommendation, to the Deputy Comptroller for Special Surveillance. The Regional Office will concurrently be provided with a copy of the SP/E&C recommendation via telecopier. The Deputy Comptroller for Special Surveillance will decide whether an exception from the general policy is warranted, and will communicate his decision to the Region.
 2. Banks rated 3 - The same exception procedure as applies in the case of 4 or 5 rated banks is to be used except that the matter will be referred for decision to the Deputy Comptroller for Special Surveillance only if the SP/E&C recommendation varies with that of the Regional Office.
- E. Miscellaneous Administrative Actions - The OCC is vested with statutory authority to undertake various administrative actions apart from those discussed above. Included among available proceedings are the following:
1. publication of the Report of Examination;
 2. imposition of a conservatorship;
 3. recommendations to FDIC for termination of



POLICIES & PROCEDURES MANUAL

Comptroller of the Currency
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Section Bank Supervision and Enforcement and Compliance Division Subject Formal and Informal Administrative Actions

- deposit insurance;
- 4. commencement of action to remove individuals from participation in the affairs of the bank; and
- 5. assessment of civil money penalties.

Initiation of such proceedings will depend upon the facts presented in the individual case and banking situations where such supervisory tools can most effectively be employed. In the absence of specific instructions to the contrary, recommendations to undertake administrative actions not covered in these policies and procedures should be sent to SP and E&C. It should be emphasized that these remedies can be used either in lieu of, or in addition to, the Agreement, Cease and Desist Order or Memorandum of Understanding.

II. Matters Delegated to Regional Office

Regional Administrators, or their designees in specific instances, are hereby authorized to execute and terminate formal written Agreements, within the meaning of 12 U.S.C. §1818(b), and Memoranda of Understanding with banks rated 1, 2, or 3, having assets of less than \$50 million.

A. Procedure on Delegated Matters

1. Banks rated 1 or 2 - Copies of executed Memoranda of Understanding and Agreements on banks with less than \$50 million shall be sent to SP within ten (10) days of execution for recordkeeping and statistical purposes.
2. Banks rated 3 - Memoranda of Understanding and Agreements with banks having assets less than \$50 Million are governed by the following procedures:
 - a. Form and Content - When administrative action is to be taken, the Regional Office will provide SP with



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a written memorandum indicating the type of action to be taken and topics to be addressed. The Regional Office's reasoning supporting the type of action to be taken should be included in this written memorandum.

- b. SP Comments - SP will, within ten (10) days after receiving sufficient information, either concur with the Region's recommended course of action or suggest an alternative. (Such information normally will include a copy of the pencil or final Report of Examination, the examiner's SP memo and form 9060-04.)
- c. Drafting and Serving Documents - It is the responsibility of Regional personnel, including the examiner-in-charge, to draft and present Memoranda of Understanding and Agreements to the Boards of Directors of involved banks. Upon execution of the appropriate document(s), a duplicate signed original shall be forwarded, to SP within ten (10) days, for record-keeping and periodic review purposes.
- d. Failure to sign - When, while proceeding with administrative action against a bank, Regional personnel encounter a Board of Directors which is unwilling to execute the remedial document presented, the matter must be referred immediately to SP/E&C for consideration of alternative action, together with the Regional Office's recommended course of action. In these cases, the



POLICIES & PROCEDURES MANUAL

Comptroller of the Currency
Administrator of National Banks

Section	Subject
Bank Supervision and Enforcement and Compliance Division	Formal and Informal Administrative Actions

procedures outlined in section III. below, should be employed.

- e. Periodic review - SP and E&C shall conduct periodic reviews of the Region's activities on delegated matters to ascertain: (a) Regional adherence to policy, (b) extent of coverage of problem areas in executed administrative actions, (c) general effectiveness and appropriateness of administrative actions taken, (d) legal sufficiency of the documents.

III. Non-Delegated Matters

Administrative action required by this enforcement policy or which is otherwise appropriate and has not been delegated to Regional Administrators in section II., above, should be initiated pursuant to the following procedures. Regional Administrators are not delegated authority unless it is specifically given on a case-by-case basis for the following:

- all Notices of Charges and Cease and Desist Orders
- all administrative actions on banks rated 4 or 5
- all Agreements and Memoranda of Understanding on banks exceeding \$50 million in assets
- administrative actions set forth in section I.E. (above)

A. Procedures on Non-delegated Matters

1. Regional draft - Documents (Memoranda of Understanding, Agreements, Cease and Desist Orders and Notices of Charges) should be submitted in draft to SP. The input of the examiner-in-charge should be sought in drafting of the documents.
2. Washington review - SP and E&C personnel will review available information regarding the



POLICIES & PROCEDURES MANUAL

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involved bank, together with the draft enforcement document(s) submitted by the Regional staff. Upon completion of their review, SP and E&C representatives will arrange a conference call with the Regional Administrator or his representatives to discuss any proposed modifications to the enforcement document. Any disagreements between Regional and SP/E&C personnel regarding the proper form or content of administrative actions which exist after the conference call will be resolved when the Enforcement Review Committee considers the action.

3. Enforcement Review Committee

(a) Members

- (i) Senior Deputy Comptroller for Bank Supervision (Chairman)
- (ii) Deputy Comptroller Multinational Banking
- (iii) Deputy Comptroller Specialized Examinations
- (iv) Deputy Comptroller Special Surveillance
- (v) Chief National Bank Examiner
- (vi) Director, Enforcement and Compliance Division
- (vii) Director, Special Projects Division
- (viii) Regional Administrator or Designee, at Regional Administrator's option.

(b) Matters reviewed

- (i) all non-delegated actions

(c) Documents reviewed in advance of committee meeting

- (i) summary memorandum, prepared by SP, which contains:
 - a) general information on the bank, e.g. ownership, affiliation, unusual items, rating, etc.;
 - b) the problems to be addressed in the administrative document, together with brief background information



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- on the more important topics covered;
- c) the Regional Office position;
 - d) the recommendation of SP;
 - e) the recommendation of E&C;
 - f) suggested modifications still in dispute; and
 - g) a listing of proposed Washington attendees, if any, as well as the Region's selected attendees at the Board of Directors meeting at which the documents will be presented.
- (ii) the most recent Statistical Data Sheet
 - (iii) the proposed administrative document(s)
- (d) Decisions -
The Committee will resolve all issues which remain unsettled at the time of its meeting, including, if necessary, the form and content of the document, as well as the attendees at the Board of Directors meeting. The Deputy Comptroller for Special Surveillance will promptly inform the Regional Administrator by telephone and/or telecopy, of any substantive changes resulting from the meeting.
4. Preparation of final documents - After the Enforcement Review Committee meeting, E&C personnel will prepare the appropriate documents in final form and route them for necessary signatures. Documents for the Comptroller's signature must be routed, under a brief summary memorandum highlighting significant elements, through at least:
- (a) Director, E&C;
 - (b) Director, SP;
 - (c) Deputy Comptroller for Special Surveillance; and
 - (d) Senior Deputy Comptroller for Bank Supervision.



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Whenever the particular enforcement action involves novel or unusually significant legal or policy issues, the documents must also be routed through the Chief Counsel or Deputy Chief Counsel. After signature by the Comptroller, the E&C attorney will effect delivery of the documents to the Region.

5. Presentation of documents - The Regional Administrator or his designee will chair the meeting to be held with the Board. The E&C attorney will be charged with the responsibility of presenting the administrative action. If an E&C attorney is not present, the Regional Counsel should present the documents. If an SP examiner is designated to attend the meeting as a representative of the Comptroller, he will actively participate in the proceedings to an extent mutually agreed by the Director, SP and the Regional Administrator.
6. Litigated enforcement proceedings - Upon service of a Notice of Charges (or Notice of Assessment in the case of civil money penalties) enforcement proceedings move into an adjudicative posture. At this point, the OCC is formally represented in the proceeding by E&C. The E&C attorney handling the individual case will make all necessary arrangements for and will represent the Office at any formal administrative hearing. After the service of the Notice, the E&C attorney will also represent the OCC in any settlement discussions with counsel or other representatives of the opposing party or parties. The E&C attorney will consult with the Regional Administrator and SP in settlement decisions. All contacts or information relevant to the involved case which are directed to the Regional or Washington office must promptly be brought to the attention of the E&C attorney.



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IV. Trust Departments and EDP Centers

A. Trust Departments and EDP Centers Rated 5

It is OCC policy to take formal administrative action, either a Cease and Desist Order or an Agreement under the Financial Institutions Supervisory Act of 1966 and the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (12 U.S.C. §1818), on all 5-rated trust departments or EDP data centers.

B. Trust Departments and EDP Centers Rated 4

It is OCC policy to consider formal administrative action under the Financial Institutions Supervisory Act of 1966 for all 4-rated trust departments and EDP centers. If formal administrative action is considered inappropriate, the OCC policy is to take administrative action through use of a "Memorandum of Understanding" between the Regional Administrator and the bank.

C. Trust Departments and EDP Centers Rated 1,2, or 3

Nothing in these policies precludes the use of either formal or informal administrative actions against 1,2, or 3-rated Trust departments or EDP centers.

D. Exceptions

Conditions may require exceptions to this policy. Before administrative action is waived by the Regional Administrator, the concurrence of the Deputy Comptroller for Specialized Examinations must be specifically sought under the following procedures:

1. The Regional Office's written recommendation shall be submitted to the Trust Examinations Division or the EDP Examinations Division outlining the reasons an administrative action is considered inappropriate and indicating alternative remedial supervisory actions proposed. The Trust Examinations Divisions or EDP Examinations Divisions will review each request for an



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exception to the general policy and make their recommendations to the Deputy Comptroller for Specialized Examinations who will decide whether an exception is warranted.

E. Matters Delegated to the Regional Office relating to Trust Departments and EDP Centers

Regional Administrators or their designees in specific instances are authorized to execute and terminate written Agreements and Memoranda of Understanding with Trust Departments and EDP Centers rated 1, 2, or 3, which are departments of banks having assets of less than \$50 million dollars. The procedures to be followed are those detailed in Section II.A above, with representatives of the Trust Examinations Division or the EDP Examinations Division substituting for the Special Projects Division personnel.

F. Non-delegated Trust Departments and EDP Centers

- All Notices of Charges and Cease and Desist Orders
- All actions on Trust Departments or EDP Centers rated 4 or 5 and on all independent EDP Centers.
- All Agreements and Memoranda of Understanding on banks having assets in excess of \$50 million.

The procedures to be followed are those detailed in section III.A, above with representatives of the Trust Examinations Division or EDP Examinations Division substituting for Special Projects Division personnel.

V. Monitoring and Evaluation of Administrative Actions

The Regional Office is responsible for monitoring compliance with all administrative actions. Special care should be taken to evaluate compliance with such documents on an ongoing basis. Additionally, the Regional Office is responsible for initiating additional supervisory action and informing SP when significant areas of noncompliance are found to exist.



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As part of their regular responsibilities when conducting an examination, examining personnel should complete the attached form (Exhibit A) with respect to those national banks, Trust Departments or EDP Centers operating under a Memorandum of Understanding, a formal Agreement, or an Order. Upon completion, the contents of the form should be included in the confidential portion of the report of examination or supervisory examination. Additionally, copies of the completed form, together with appropriate comments and recommendations from the Regional Administrator, should be sent to SP, Trust or EDP Examination Divisions, as appropriate.

VI. Termination or Modification of Administrative Actions

Generally, termination of an action will not be considered unless the bank's overall condition has significantly improved and it has substantially complied with the terms of the action.

- A. Delegated Actions - Regional Administrators are authorized to modify or terminate any action falling within the scope of the delegation contained in section II., above. Copies of the memoranda supporting the need for the modification or termination as well as the documents accomplishing these results should be forwarded, upon completion, to SP, Trust or EDP Divisions, as appropriate.
- B. Non-delegated Actions - Regional Administrators are responsible for recommending modification or termination of actions on non-delegated matters. Regional recommendations are to be in writing and forwarded to SP for joint review and recommendation with EsC. In the case of non-delegated Memoranda of Understanding, Regional and Washington recommendations are forwarded to the Deputy Comptroller for Special Surveillance (Deputy Comptroller for Specialized Examinations) who is empowered to authorize Regional modification or termination of the document. For other types of non-delegated action, the recommendations are forwarded for consideration of the



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Senior Deputy Comptroller for Bank Supervision and decision by the Comptroller. The Comptroller will authorize Regional modification or termination of these Agreements or Orders.

VII. Effective Date

These policies and procedures are effective immediately. Inquiries concerning the applicability of this document to particular fact situations should be referred to the Directors of SP, E&C, Trust and EDP, as appropriate.

JOHN G. HEIMANN
COMPTROLLER OF THE CURRENCY

Attachment A - 1 page
Attachment B - 1 page

EXHIBIT A

EVALUATION OF COMPLIANCE WITH FORMAL OR INFORMAL ADMINISTRATIVE ACTION

- (1) Name of Bank:
- (2) Nature of Administrative Action (ex. Cease and Desist Order, Formal Agreement, "Memorandum of Understanding," etc.):
- (3) Date of Administrative Action:
- (4) Has the bank complied with the provisions of each article of the administrative action:
- (5) If noncompliance exists, which Articles are involved, and what is the nature and extent of the noncompliance?
- (6) If noncompliance exists, what action has been taken to ensure compliance?
- (7) What significant matters requiring attention are not presently covered by the administrative action?
- (8) Discuss the effectiveness of the administrative action and comment as to whether additional administrative action should be taken or whether the outstanding administrative action should be terminated.

Appendix D

SUMMARY OF FORMAL AGREEMENT
DATED SEPTEMBER 9, 1980

Correct all violations of law and adopt procedures to prevent them from occurring in the future.

Develop and implement specific plans to ensure that the equity capital of the bank would be increased and maintained at a minimum of 7.5% of average daily assets.

Obtain and maintain current and satisfactory credit information and eliminate collateral exceptions.

Not grant additional loans unless current and satisfactory credit information were available and the loans were supported by appropriate collateral documentation.

Establish a program for the elimination of criticized assets and preclude the extension of additional credit to borrowers whose extensions of credit had been criticized.

Revise the lending policy and establish procedures to monitor and enforce adherence to the lending policy. The revisions were to include:

- guidelines for the purchase and sale of participations;
- procedures for identifying problem loans;
- identification of the categories of loans where concentrations of credit would be permitted and the limits thereto;
- procedures to limit, control, and document contingent liabilities.

Review and revise the investment policy of the bank.

Establish a committee of the board of directors to perform a management study to evaluate the current management and make appropriate adjustments for the future.

Review the bank's allowance for possible loan losses and establish an adequate level commensurate with the risks and potential for losses inherent in the bank's loan portfolio.

Develop and adopt a written liquidity, asset, and liability management policy to maintain the bank's liquidity at a level commensurate with prudent banking practices and the bank's needs.

File monthly reports with the Comptroller's Office.

Appendix E

SUMMARY OF NOTICE OF CHARGES
DATED JUNE 30, 1982

The bank, in violation of the Agreement and in violation of 12 U.S.C. §84, had extended credit to borrowers in excess of the bank's legal limit.

The bank, in violation of the Agreement and contrary to safe and sound banking practices, failed to maintain and obtain current and satisfactory credit information and granted loans which were not fully supported by the necessary collateral documentation.

The bank, in violation of the Agreement, extended additional credit to borrowers whose loans had been previously criticized.

The bank, in violation of the Agreement, failed to ensure that the bank's Allowance for Possible Loan Losses was maintained at a level commensurate with the risks for loss inherent in the loan portfolio.

The bank was in an unsafe and unsound condition having accumulated criticized assets aggregating in excess of \$81 million which amounted to more than 200% of the bank's gross capital funds.

The bank, in violation of certain statutes and in an unsafe and unsound manner, sold participations in loans originated by the bank without disclosing to the purchasers of those participations material, non-public information known to the bank.

The bank permitted officers without lending authority to extend credit on behalf of the bank.

The bank, contrary to safe and sound practices, had paid interest to participating institutions on participations sold without advising the participating institution that the source of payment was not from the borrower.

The bank, contrary to the Agreement and contrary to safe and sound banking practices, had failed to implement and adhere to procedures to limit, control, and document its contingent liability.

The bank, in violation of 12 U.S.C. §§375a and 375b had extended credit to insiders of the bank.

SUMMARY OF TEMPORARY ORDER TO CEASE AND DESIST
ISSUED JUNE 30, 1982

Immediately undertake actions to provide the bank, by no later than July 9, 1982, with \$30 million in new equity capital.

Comply with the lending limit statute, 12 U.S.C. §84.

Correct collateral and documentation deficiencies with respect to all loans including participation loans.

Not extend additional credit to any borrowers whose loans or extensions of credit were criticized.

Make no loans or loan commitments without first obtaining full collateral documentation and current and satisfactory credit information.

Not make any commitments to extend credit whether for a fee or otherwise without first arranging firm sources with which to fund it.

Engage independent qualified auditors to reconcile various asset accounts of the bank.

Not sell any participation in any extension of credit unless the loan and collateral documentation was in conformity with the terms of the participation agreement and the potential participant was first informed of all material facts with respect to the borrower and the credit.

Not permit officers without lending authority to extend credit or make commitments on behalf of the bank.

The CHAIRMAN. We will be asking a few questions, I am sure. However, we first would like to hear from Mr. Isaac, Chairman of the FDIC, so we can then ask questions of either of you.

Mr. Isaac, we will put your entire statement in the record. You may proceed.

STATEMENT OF HON. WILLIAM M. ISAAC, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. ISAAC. Thank you, Mr. Chairman.

Mr. Chairman, Mr. Stanton, members of the committee, I am pleased to be here and have this opportunity to discuss the role of the FDIC as receiver for the failed Penn Square Bank of Oklahoma City.

I thought it might be useful in view of the complexity of this situation to review the background of the matter and the options available to us.

Then I will discuss generally the implications of this bank's failure.

On Wednesday morning, June 30, the Comptroller's staff called me to set up an urgent meeting at which they described the seriousness of the situation at the Penn Square Bank and indicated that the bank was in danger of failing.

We immediately dispatched about 10 FDIC examination and liquidation personnel to the scene to gather information.

They were instructed to operate out of our Oklahoma City field office, rather than the bank to the extent possible.

On Thursday, the American Banker ran a story on the bank and on Friday, both the American Banker and the Wall Street Journal ran articles.

The story also received local media coverage in Oklahoma City.

In view of the increasing media attention and the possibility of widespread depositor concern, on Thursday, we dispatched about 50 FDIC personnel. They were to begin preparations for handling the

possible failure of the bank through either a purchase-and-assumption transaction or a deposit payoff.

Deposit outflows were modest on Friday, but on Saturday, conditions deteriorated substantially. In fact, the bank did not have sufficient cash on hand to meet depositor demands and issued \$1.8 million in cashiers' checks.

Local TV stations broadcast reports from the bank on Saturday. If the bank had opened for business as usual on the following Tuesday, we and bank officials anticipated extraordinary deposit withdrawals.

Approximately 30 FDIC personnel in Washington and 60 in Oklahoma City worked virtually nonstop through the holiday weekend to prepare for every contingency.

We had essentially three alternatives to consider. One, to arrange a purchase-and-assumption transaction or merger with another institution.

Two, to do a deposit payoff.

Or three, to create a deposit insurance national bank to handle the funds of insured depositors.

Our preferred method of handling the bank failure is to merge it into another institution with FDIC assistance. Very occasionally we are not able to do this.

Either because we have no acceptable acquirers or because the bank has a potentially large amount of contingent or unknown claims which makes it impossible to estimate the cost of a merger.

We cannot under our statute enter into a merger or a purchase-and-assumption transaction unless our board can make a finding that the P. & A. will likely be no more costly than a deposit payoff.

We estimate that our maximum cost under deposit payoff could be as high as \$240 million in this situation, but would likely be very substantially less, depending on the recoveries from the receivership.

In a purchase-and-assumption transaction, the corporation indemnifies the acquiring bank against contingent liabilities or unknown losses caused by the actions of the failed bank.

In providing this indemnification, we must estimate the losses arising from the known contingent claims and satisfy ourselves that other contingencies that might lead to large losses do not exist.

In the case of Penn Square, we were aware of contingent claims, including loan participations, loan commitments, and standby letters of credit ranging between \$2.5 and \$2.9 billion.

In addition, we had reason to believe that there might be irregularities that could give rise to other claims. It was virtually impossible, particularly in view of the time limitations, to estimate the potential losses that could stem from this vast source of contingent claims.

Given our inability to accurately assess and quantify these potential losses, and our statutory limitations, we simply could not arrange a purchase-and-assumption transaction.

Our second alternative was simply to pay off insured depositors up to the \$100,000 maximum limit. This process involves proof of deposit accounts, the determination of the amount held by each de-

positor in his or her separate right and capacity, and the preparation of checks.

Uninsured depositors and general creditors would receive receiver's certificates with payments to follow as the assets of the bank were liquidated.

The process of paying off insured depositors is time consuming and disruptive. Our Division of Liquidation estimated that the payment of insured deposits could not have commenced before the week of July 12.

Furthermore, if this alternative was selected, any checks drawn on deposit accounts in the Penn Square Bank would have been returned.

Given the anticipated press coverage of the transaction, the size of the bank, and the possible adverse effect on public confidence, we were most anxious to reopen the bank's doors on Tuesday.

Our third option was to create a Deposit Insurance National Bank.

We call it a DINB. All insured deposits would be transferred to the DINB, which would continue to honor checks drawn on the Penn Square Bank up to the insurance limit and permit an orderly payoff of insured accounts.

Uninsured depositors would be issued receiver's certificates for the excess of their accounts over \$100,000. It was decided that this was the most desirable course of action.

We decided to pay interest on interest-bearing accounts, transferred to the DINB for 90 days as an assurance to depositors that there was no need to rush immediately to the bank to withdraw funds.

However, it is hoped that the 90-day limit will encourage an orderly transfer of funds to other banks within that time-frame.

We were greatly handicapped in our preparations over the weekend due to the fact that decision to close the bank was not made until 7 p.m. on Monday.

Nevertheless, the DINB opened its doors at the usual hours on Tuesday morning. There were depositor lines throughout the day on Tuesday, but they were much shorter than anticipated for a bank of this size with nearly 28,000 customers.

We announced that we would keep the bank open 24 hours a day if necessary to meet the demands of the depositors.

People remained very calm, and by 7 p.m. on Tuesday, the depositor lines had disappeared and we closed the doors for the evening. Each day since, the bank has operated normally without lines of any note. I would be remiss if I didn't take this opportunity to salute the bank, and FDIC employees who worked around the clock for days in order to provide uninterrupted service to the bank's depositors.

In addition to the activities at the DINB, we have a large number of FDIC personnel involved in the receivership activities relating to the bank.

Their first priority is to assist creditworthy borrowers in locating alternative funding sources. They are also taking an inventory of all of the bank's assets and attempting to determine their value.

We will endeavor to promptly dispose of the assets in an orderly fashion so that we may return funds to uninsured depositors and other creditors as soon as possible.

Our people are also conducting, in conjunction with the FBI, a thorough investigation of the events and activities which led to the bank's demise. Extensive legal proceedings are highly probable.

Many people are asking, how could this have happened? Why did this bank fail? How did so many other financial institutions get involved?

Is this failure evidence of other problems in the financial system?

The first point I should emphasize is that we do not yet know precisely what happened. The FDIC has only just begun to conduct its investigation.

However, we have at this stage a rough outline of the practices and problems which led to the bank's demise.

The short answer is that at best, this bank engaged in shoddy, speculative banking practices. Its problems were not due principally to the economy or even the decline in energy prices.

Its problems were the result of loans which should never have been made at the values placed on them. The bank's growth rate was excessive, causing extensive reliance on volatile and expensive funds borrowed in national money markets.

There was a complete lack of diversification in the loan portfolio. In a word, the problems of this institution were unique, and the bank's collapse is an aberration.

Fortunately, the great majority of insured banks adhere to prudent and rational lending and funding policies. With nearly 15,000 banks in this country, we will occasionally encounter situations like Penn Square. But they will be few and far between.

Much has been said and written about the impact of the Penn Square failure on other financial institutions that either participated in loans originated by Penn Square Bank or provided funding to the bank in amounts in excess of the insurance limit.

Simply stated, a number of financial institutions regrettably have learned an expensive but important lesson, these financial institutions were attracted by the opportunity to obtain high yields on their investments, but failed to take into account the degree of risk being undertaken.

As a result, some institutions will sustain losses.

It is indeed fortunate that these institutions have the ability to withstand these losses. If one can identify a silver lining behind the dark cloud of the Penn Square affair, we should expect that all financial institutions will be more prudent in the future.

We realize that there will be a great temptation to rush through legislation to address the specific practices that led to the Penn Square failure.

This, in our judgment, would be a mistake.

The regulatory agencies have sufficient supervisory and enforcement tools to carry out their responsibilities. As I stated earlier, the problems of the Penn Square Bank were unique. The failure was an aberration, and similar pervasive problems within the financial industry simply do not exist.

Nevertheless, I think this experience should prompt us to reevaluate our financial institutions' regulatory structure.

In conducting a review of the regulatory structure, we should carefully consider the following questions.

First, is there a need for five regulatory agencies to supervise the activities of the Nation's depositor institutions and does our current system function properly?

Second, is there a need for three separate deposit insurance funds?

Third, would it be appropriate to base deposit insurance premiums on the risk posed by the insured entity, rather than to continue the present flat-rate system for all institutions?

Fourth, can and should we revise our deposit insurance system and procedures to provide perhaps even greater protection for smaller depositors while at the same time introducing a greater degree of discipline with respect to the larger creditors?

Fifth, is it possible and desirable to provide more public disclosure regarding the condition and business practices of insured depository institutions?

These are all matters that I have addressed in the past, both before the committee and in other public forums. I firmly believe that significant reforms in our regulatory apparatus are needed.

It is my sincere hope that the experiences of the last 2 weeks will provide the impetus to move forward on these issues.

The worse mistake we could make is to look for a quick fix or to enact punitive measures that would further burden an entire industry to correct the abuses of the few.

We urge you to undertake a dispassionate review of the Penn Square system from a broadly based, long-range perspective.

We appreciate this opportunity to appear before you today and offer our complete cooperation in your future efforts in connection with this matter.

I thank you, Mr. Chairman.

[The prepared statement of Mr. Isaac follows:]

STATEMENT ON

FAILURE OF THE PENN SQUARE BANK
OKLAHOMA CITY, OKLAHOMA

PRESENTED TO

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

BY

WILLIAM M. ISAAC
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

2:00 P.M.
THURSDAY, JULY 15, 1982

ROOM 2128 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, D.C.

Mr. Chairman:

I am pleased to have the opportunity to discuss the role of the FDIC as the Receiver for the failed Penn Square Bank of Oklahoma City. I thought it might be useful, in view of the complexity of this situation, to review the background of the matter and the options available to us. Then I will discuss generally the implications of this bank's failure.

I. BACKGROUND OF FDIC ACTIVITIES

On Wednesday morning, June 30, the Comptroller's staff called me to set up an urgent meeting at which they described the seriousness of the situation at the Penn Square Bank and indicated that the bank was in danger of failing. We immediately dispatched about 10 FDIC examination and liquidation personnel to the scene to gather information. They were instructed to operate out of our Oklahoma City field office, rather than the bank, to the extent possible.

On Thursday the American Banker ran a story on the bank, and on Friday both the American Banker and the Wall Street Journal ran articles. The story also received local media coverage in Oklahoma City.

In view of the increasing media attention and the possibility of widespread depositor concern, on Thursday we dispatched another 50 or so FDIC personnel to the scene.

They were to begin preparations for handling the possible failure of the bank through either a purchase and assumption transaction or a deposit payoff.

Deposit outflows were modest on Friday but on Saturday conditions deteriorated substantially. In fact, the bank did not have sufficient cash on hand to meet depositor demands and issued \$1.8 million in cashiers' checks. Local T.V. stations broadcast reports from the bank on Saturday. If the bank had opened for business as usual on the following Tuesday, we and bank officials anticipated extraordinary deposit withdrawals.

Approximately 30 FDIC personnel in Washington and 60 in Oklahoma City worked virtually nonstop through the holiday weekend to prepare for every contingency. We had essentially three alternatives to consider:

1. to arrange a purchase and assumption transaction,
2. to do a deposit payoff, or
3. to create a Deposit Insurance National Bank (DINB) to handle the funds of insured depositors.

P&A Transaction

Our preferred method of handling a bank failure is to merge it into another institution with FDIC assistance.

Very occasionally we are not able to do this either because we have no acceptable acquirers or because the bank has a potentially large amount of contingent or unknown claims which makes it impossible to estimate the cost of a merger.

We cannot, under our statute, enter into a merger or purchase and assumption transaction unless our Board can make a finding that the P&A will likely be no more costly than a deposit payoff. We estimated that our maximum cost under a deposit payoff could be as high as \$240 million but would likely be very substantially less depending on recoveries from the receivership.

In a purchase and assumption transaction, the Corporation indemnifies the acquiring bank against contingent liabilities or unknown losses caused by actions of the failed bank. In providing this indemnification, we must estimate the losses arising from the known contingent claims and satisfy ourselves that other contingencies that might lead to large losses do not exist.

In the case of Penn Square, we were aware of contingent claims -- including loan participations, loan commitments and standby letters of credit -- ranging between \$2.5 and \$2.9 billion. In addition, we had reason to believe there might be irregularities that could give rise to other claims. It was virtually impossible, particularly in view of the

time limitations, to estimate the potential losses that could stem from this vast source of contingent claims. Given our inability to accurately assess and quantify these potential losses, and our statutory limitations, we simply could not arrange a purchase and assumption transaction.

Deposit Payoff

Our second alternative was simply to pay off insured depositors up to the \$100,000 maximum. This process involves proof of deposit accounts, the determination of the amount held by each depositor in his or her separate right and capacity, and the preparation of checks. Uninsured depositors and general creditors would receive receiver's certificates with payments to follow as the assets of the bank were liquidated.

The process of paying off insured deposits is time consuming and disruptive. Our Division of Liquidation estimated that the payment of insured deposits could not have commenced until the week of July 12. Furthermore, if this alternative was selected, any checks drawn on deposit accounts in the Penn Square Bank would have been returned. Given the anticipated press coverage of the transaction, the size of the bank, and the possible adverse effect on public confidence, we were most anxious to reopen the bank's doors on Tuesday.

DINB

Our third option was to create a Deposit Insurance National Bank. All insured deposits would be transferred to the DINB, which would continue to honor checks drawn on the Penn Square Bank up to the insured limit and permit an orderly pay off of insured accounts. Uninsured depositors would be issued receiver's certificates for the excess of their accounts over \$100,000.

It was decided that this was the most desirable course of action. We decided to pay interest on interest-bearing accounts transferred to the DINB for 90 days as an assurance to depositors that there was no need to rush immediately to the bank to withdraw funds. However, it is hoped the 90-day limit will encourage an orderly transfer of funds to other banks within that time.

We were greatly handicapped in our preparations over the weekend due to the fact that the decision to close the bank was not made until 7:00 p.m. on Monday. Nevertheless, the DINB opened its doors at normal hours on Tuesday morning.

There were depositor lines throughout the day on Tuesday, but they were much shorter than anticipated for a bank of this size with nearly 28,000 customers. We announced that we would keep the bank open 24 hours a day if necessary to meet the demands of depositors.

People remained very calm and by 7:00 p.m. on Tuesday the depositor lines had disappeared and we closed the doors for the evening. Each day since, the bank has operated normally without lines of any note.

I would be remiss if I did not take this opportunity to salute the bank and FDIC employees who worked around the clock for days in order to provide uninterrupted service to the bank's depositors.

In addition to the activities at the DINB, we have a large number of FDIC personnel involved in the receivership activities relating to the bank. Their first priority is to assist credit-worthy borrowers in locating alternative funding sources.

They are also taking an inventory of all of the bank's assets and attempting to determine their value. We will endeavor to promptly dispose of the assets in an orderly fashion so that we may return funds to uninsured depositors and other creditors as soon as possible.

Our people are also conducting, in conjunction with the F.B.I., a thorough investigation of the events and activities which led to the bank's demise. Extensive legal proceedings are highly probable.

II. WHAT WENT WRONG?

Many people are asking: "How could this have happened? Why did this bank fail and how did so many other financial institutions get involved? Is this failure evidence of other problems in the financial system?"

The first point I should emphasize is that we do not yet know precisely what happened. The FDIC has only just begun to conduct its investigation.

However, we have at this stage a rough outline of the practices and problems which led to the bank's demise. The short answer is that, at best, this bank engaged in shoddy, speculative banking practices. Its problems were not due principally to the economy in general or even the decline in energy prices. Its problems were the result of loans which should never have been made at the values placed on them. The bank's growth rate was excessive, causing extensive reliance on volatile and expensive funds borrowed in national money markets. There was a complete lack of diversification in the loan portfolio.

In a word, the problems of this institution were unique and the bank's collapse is an aberration. Fortunately, the great majority of insured banks adhere to prudent and

rational lending and funding policies. With nearly 15,000 banks in the country, we will occasionally encounter situations like Penn Square. But they will be few and far between.

III. RIPPLE EFFECTS

Much has been said and written about the impact of the Penn Square failure on other financial institutions that either participated in loans originated by Penn Square Bank or provided funding to the bank in amounts in excess of the insurance limit.

Simply stated, a number of financial institutions regrettably have learned an expensive but important lesson. These financial institutions were attracted by the opportunity to obtain high yields on their investments but failed to take into account the degree of risk being undertaken. As a result some institutions will sustain losses.

It is indeed fortunate that these institutions have the ability to withstand these losses. If one can identify a silver lining behind the dark cloud of the Penn Square affair, we should expect that all financial institutions will be more prudent in the future.

IV. LEGISLATIVE RESPONSE

We realize that there will be a great temptation to rush through legislation to address specific practices that led to the Penn Square failure. This, in our judgment, would be a mistake.

The regulatory agencies have sufficient supervisory and enforcement tools to carry out their responsibilities. As I stated earlier, the problems of the Penn Square Bank were unique, the failure was an aberration and similar pervasive problems within the financial industry simply do not exist.

Nevertheless, I think this experience should prompt us to reevaluate our financial institutions regulatory structure. In conducting a review of the regulatory structure, we should carefully consider the following questions:

1. Is there a need for five regulatory agencies to supervise the activities of the nation's depository institutions and does our current system function properly?
2. Is there a need for three separate deposit insurance funds?

3. Would it be appropriate to base deposit insurance premiums on the risk posed by the insured entity rather than to continue the present flat rate system for all institutions?
4. Can and should we revise our deposit insurance system and procedures to provide perhaps even greater protection for smaller depositors while at the same time introducing a greater degree of discipline with respect to larger creditors?
5. Is it possible and desirable to provide more public disclosure regarding the condition and business practices of insured depository institutions?

These are all matters that I have addressed in the past both before Congress and in other public forums. I firmly believe that significant reforms in our regulatory apparatus are needed. It is my sincere hope that the experiences of the last two weeks will provide the impetus to move forward on these issues.

The worst mistake we could make is to look for a "quick fix" or to enact punitive measures that would further

burden an entire industry to correct the abuses of a few. We urge you to undertake a dispassionate review of the Penn Square situation from a broadly-based, long-range perspective.

We appreciate this opportunity to appear today and offer our complete cooperation in your future efforts in this matter.

The CHAIRMAN. Thank you and I would like to reassure you, Mr. Isaac, that the reason for the briefing today, the reason that hearings will begin on August 11 and not yesterday or the day before, is that indeed, we are looking at this dispassionately and some of the items that you have suggested in your laundry list at the conclusion of your statement, I think you are aware, have been looked into and discussed by this committee and by this chairman in the past.

As a matter of fact, some of them contain the recommendation of the FINE study in 1975 and 1976.

It is just that some of them, unfortunately, have a long gestation period. But we will get to them.

There is no intent to take any punitive action. We want to know what the causes were other than those which you cited. I think there are a few others that have not as yet been cited that will come out as the factfinding process continues.

At this point in time, I would ask the staff to start the 5-minute clock on the go-around for both sides so that the members can ask questions of either Mr. Conover or Mr. Isaac.

Mr. Conover, obviously you had, or your office, rather, had information about the problems at this bank.

Your examiners were aware of the fact for a long period of time that various institutions were carrying on very extensive participation with Penn Square.

As a matter of fact, it's been cited and we have not been able to determine the exact numbers as yet, one institution, Continental Illinois, may have had as much as \$1 billion in participation with Penn Square.

Now, I ask you, was the information that was gleaned from examinations of Penn Square forwarded to your Chicago office so that the examiners at Continental would have knowledge of the fact that some of those participations and some of those loans in which they had purchased from Penn Square were, as you describe it in your statement, not too well-collateralized?

And was information given to the NCUA and to the Federal Home Loan Bank Board in view of the fact that many of their insured institutions were very heavy investors in jumbo CD's at Penn Square?

So we have a two-pronged question?

Mr. CONOVER. I think I would like to answer the second part of that first, Mr. Chairman, and then ask Mr. Homan if he would

deal with the first part involving the transmittal of information to Chicago.

We learned, Mr. Chairman, late in the week prior to the bank's closing, that there were significant uninsured deposits by a number of credit unions and savings and loan associations in the Penn Square Bank.

I believe late in that week, Thursday or Friday, both Mr. Callahan, the chairman of the NCUA and Mr. Pratt, the Chairman of the Federal Home Loan Bank Board, were advised about the total number of institutions and the approximate number of dollars of insured deposits that they had outstanding at that time.

Over the weekend, I believe it was Saturday or Sunday, I am not sure, I personally talked with Mr. Callahan and with Tom Vartanian, the General Counsel of the Federal Home Loan Bank Board, and told him that we had a precise list of the names of each of their institutions and the estimated dollar amount of uninsured deposits.

That information was provided to them, I believe, Sunday or Monday, July 4 or 5.

The CHAIRMAN. Are you telling the committee that it was not until the first week of July that this information was shared? Was there not evidence of the fact that many of these institutions had jumbo CD's over the insured amount?

Wasn't that knowledge available to the Comptroller's Office as a result of at least the April examination, if not the January examination?

Mr. CONOVER. Well, we knew that there were a number of uninsured deposits in the bank, but we were not focusing on that as part of our examination because we were busy looking at the loan side of the balance sheet.

So the answer is that we knew that information, that there were uninsured deposits, but we didn't focus on it until it became evident that the bank was in severe difficulty.

The CHAIRMAN. Let me ask you this question, in reading your statement, looking at the memorandum, the cease-and-desist order and your chronology, at no point do you mention anything about problems with insider loans. Is that because there were no insider loan problems, or because you would rather not go into that at this point in time?

Mr. CONOVER. It is for the latter reason, Mr. Chairman, that we would rather not discuss any potential violations of law at this time.

The CHAIRMAN. Now, at a given point in time, you asked that additional personnel, more sophisticated personnel, be brought in for reviewing the loans.

Is there any truth to the allegation that, indeed, some were brought in, but that, as a matter of fact, they were told, "You can review a lot of these loans, you new men onboard, but not the energy-related loans?"

Mr. CONOVER. I am not sure.

The CHAIRMAN. Mr. Homan?

Mr. HOMAN. No; when the examiners in the Penn Square Bank became aware that they had a large, large problem in the energy-related loans, we, in fact, brought in some of our examiners from

Houston, Dallas, and other places in the Southwest that were experts in energy credits to aid our Oklahoma crew in the analysis of the credits.

The CHAIRMAN. My question is, Did you insist, as part of that cease-and-desist order that the board of directors bring in new, more experienced personnel to work for the bank, not for the Comptroller's Office? To review the loans?

Mr. HOMAN. No; not as part of our cease-and-desist agreement. We did ask the board to undertake a management study because we were concerned that the bank's growth, that the systems in the bank and the bank's internal management were not keeping pace with the growth of the bank's assets and the type of lending it was undertaking. Both during 1980 and 1981.

So we did ask for that management study. In fact, during 1981, the bank did shore up its management team by bringing in several new managers.

The CHAIRMAN. But not specifically loan officers?

Mr. HOMAN. Yes; I believe there were some loan officers added to the energy division of the bank. The bank also——

The CHAIRMAN. They were allowed to review the energy loans?

Mr. HOMAN. In the summer of 1981.

The CHAIRMAN. They were allowed to review the energy loans, there were no restrictions?

Mr. HOMAN. Yes.

The CHAIRMAN. No restrictions placed on them by management?

Mr. HOMAN. That is correct. They were actual loan officers. We, however, understand the bank's own Internal Loan Review Division was restricted in reviewing energy loans, in self-identifying the problems in that portfolio.

That was told to me.

The CHAIRMAN. Let's get back to the first part of my question, Mr. Homan, that Mr. Conover said he would defer to you on, that was whether or not your Chicago office was made aware of the fact that there were problems with some of these energy-related loans in view of the fact that such a large amount had been purchased by Continental?

Mr. HOMAN. During the course of the examination, as soon as the losses and poor quality loans, both in the bank and that portion that was participated to other banks, became apparent, we did notify all of our offices affected and particularly our larger regional offices that directly supervise Continental Illinois, Chase Manhattan Bank, and Seattle First, and a number of other participants.

We also sent an energy examiner, one of the experts from Oklahoma, to Continental to aid our examiners in the assessment of their portfolio. We have a team working with all of those banks at the present time. They are all presently under examination.

So, yes, information was widely shared between the examiners in all of our affected supervisory units nationwide.

The CHAIRMAN. Thank you.

Mr. Stanton.

Mr. STANTON. Thank you, Mr. Chairman.

Mr. Conover, in colloquy with the chairman, you intimated that you had in the course of conversation, turned over to the Federal

Home Loan Bank Board and to the National Credit Union Administration the names of those institutions that were affected by the failure of this institution.

Is there any information you could give the committee at this time which you would consider nonconfidential regarding the impact of Penn Square's failure upon other commercial banks, savings and loan associations, or the 150 credit unions that were involved?

Put another way, Are you sure they are doing all that they can within their authority to assure there is no ripple effect?

Mr. CONOVER. The purpose of providing the information to them in the first place was so that they would be aware of the potential difficulty that institutions under their supervision were going to be faced with upon demise of the bank.

I think you would have to ask representatives of the Bank Board or the NCUA specifically how serious they think the institutions under their supervision would be impacted by all this.

Mr. STANTON. How about your own?

Mr. CONOVER. We looked at both national banks and at State banks who also had deposits in the Penn Square Bank. We made sure that that information was available to the FDIC. In the case of the national banks, there were very few institutions who had deposits in the Penn Square Bank, and so we concluded that no national bank under our supervision was likely to find itself in any difficulty as a result of its having uninsured deposits with the Penn Square Bank.

Mr. STANTON. One last question, Chairman Isaac. You alluded to the fact that your preference, of your organization, would have been to arrange a merger, of course.

The House of Representatives, as you well know, has passed legislation giving you additional authorities and powers under the regulators bill.

Had this legislation been enacted into law, would that have given you any additional authority or help in this particular situation?

Mr. ISAAC. It is possible that if we had had the regulators' bill we could have arranged an interstate takeover transaction, particularly one involving some of the large banks that already were involved in this situation and knew it so well. I am speculating a bit there.

One of our big problems here was simply lack of time and information about just what had occurred in the bank and having to work feverishly over a weekend to gain this knowledge.

But because those banks as I said did know so much more, in effect, as to what the nature of the loan portfolio was and any contingent claims that might exist, it is conceivable that with that authority we could have arranged a takeover.

Mr. STANTON. I do not want to take up the time of the committee, but what bothers the chairman and the rest of us is that someone really knew about this condition in September of 1980, I think from that point on, or in February of 1981 you came to the conclusion that you had a very, very serious problem, and yet you waited until July of 1982 to take action.

Mr. CONOVER. Are you addressing the question to me or—

Mr. STANTON. Well, it is hard to get into that in a hearing, but there are some things we want to get to the bottom of.

I thank you, Mr. Chairman.

The CHAIRMAN. Mr. Gonzalez.

Mr. GONZALEZ. Thank you, Mr. Chairman.

Actually I look upon this proceeding as sort of a postmortem, and just about as useful as a postmortem, except in cases where it would be helpful to establish pathological causes hitherto unknown. Mr. Minish chairs a Subcommittee on General Oversight and Renegotiation on which I am the ranking member, and we have had the regulators, and I spoke out 1 year ago and asked questions that were pertinent to what is happening now. You all would not answer them. Always as I notice even in the news reports today if anybody raises a question, that may trigger off this avalanche such as is happening now in the case of Penn Square where depositors are lining up and demanding their funds.

Now, I fully realize, Mr. Conover, because I have been here 20 years on this committee, and predecessors of yours have made it clear they are not obedient or responsive to the Congress because you are independent, you take shelter or shield behind the fact that you do not use appropriated funds. You are amenable to the banks because it is the bank fees that pay for the upkeep of your office. But I think it is tragic at this point, and a postmortem in this particular case I think is kind of a wasted exercise; you need not worry about quick legislation unless it is approved by the American Bankers Association coming out of the Congress.

The only questions I have are, I think, what will be pertinent in a postmortem proceeding such as this, that sooner or later something would break open—as a result of this Penn Bank business we are now seeing reports of heavy sale of bank stocks. Now, is this or is this not a relatively new development, and what is its significance? I will address that to all three members of the panel.

Mr. CONOVER. I will try to respond first.

The recent decline in the value of stocks of certain banks is no doubt linked to their connection with the Penn Square Bank. Obviously some of them have incurred, as has been reported in the press, some very significant operating losses. Their bond ratings have been reduced. Their stock prices, as you have indicated, have declined, and their reputations are tarnished as a result of their connection with this situation. I am sorry to say this but I think that that is the way it should be in this particular case. Bank stocks are selling at very low price-to-earnings ratios, at very low ratios of market price to book value, and that is no doubt reflective of the market's judgment about the future earnings potential of the banking industry. The banking industry, although healthy today, is in for a difficult time over the next several years for a variety of reasons. I think that the marketplace is recognizing that, and that is the reason why bank stocks have been depressed of late. Certainly the Penn Square affair has contributed to such declines in the stock of banks with certain characteristics and those who have participated in this matter.

Mr. GONZALEZ. Well, Mr. Isaac, do you see such an optimistic—rather affirmative or happy note as Mr. Conover in what I consider to be a very dire development? Is that your interpretation? Do you

agree with that? Is there anything that should cause us apprehension? If so, should not the Congress know the extent of the weakness and the forecasted weakness of these financial institutions? What is your capacity to assist?

There is an ancillary question I was going to ask later, and I can delay it to give you an opportunity to answer the first one, and that is, Why did you not all follow the same procedures that you have in other bank cases in making an arrangement to salvage Penn Square and keep it from completely going under?

Mr. ISAAC. I will tackle the second question first, because the answer to it leads into the first question.

Mr. GONZALEZ. Fine.

Mr. ISAAC. We did not handle this transaction the way we almost always do, which is to merge the institution into another one, because when we do that kind of transaction we are required to step in and make the acquiring institution whole with respect to any contingent or unknown claims.

In this case we had massive contingent claims and evidence that other claims might well exist.

Under our statute we must make a finding before we can do a merger involving FDIC assistance that the merger would be less expensive than a deposit payoff would be. We could not make that finding here because of the very large potential exposure for contingent claims.

Now that leads me to respond to your first question by saying that this situation was unique. It is not symptomatic of conditions in the banking industry. This bank did not fail due to problems in the economy. This bank did not fail due to problems in the energy industry.

This bank failed because it was very poorly managed. It made speculative loans. It grew at excessive rates. It borrowed excessively in national money markets to fund its activities. It concentrated its loans in one industry, instead of having a diversified loan portfolio.

This is not a problem that exists in the banking industry. This is a problem that existed in this bank.

Mr. GONZALEZ. Mr. Isaac, then why this continued impact and forecasted impact on the most precious ingredients, the capital stocks of these banks?

Mr. ISAAC. The banks that have been most affected in the stock market these days are the ones that had deposits in the Penn Square Bank or that had purchased loan participations from the Penn Square Bank. I think Mr. Conover was referring to the fact that for several years the market for bank stocks has been somewhat depressed in terms of price-to-earnings ratios and he was, I gather, forecasting that it might continue to be somewhat depressed. I do not make those kinds of forecasts.

The CHAIRMAN. The time of the gentleman has expired.

The Chair on a point of personal privilege will take a moment at this point to state that the American Bankers Association does not dictate to the Chair whether legislation will be written, introduced, or brought before the committee. I take issue with that statement.

I wanted it clear on the record on that immediately and not let it go.

Mr. ISAAC. Mr. Chairman, if I might just say a word related to that I think it would be very unfortunate if this committee did not look at the Penn Square situation for what it is, an aberration. It is not typical of what is going on in the banking industry, and it would be very unfair for this committee to consider some kind of sweeping punitive legislation which would further overburden the already overregulated industry.

The CHAIRMAN. I said that already.

Mr. Isaac.

Mr. ANNUNZIO. Would the chairman yield for a moment?

Mr. Chairman—that is what you say about every bank that goes under, it is an aberration. When are you going to change the tune, every time a bank goes under it is a one-shot deal.

The CHAIRMAN. Mr. Wylie.

Mr. ANNUNZIO. We have had too many one-shot deals.

Mr. WYLIE. I think I will let that go, but I am glad to hear you say this is an aberration from my standpoint. But can you tell me what is the present situation, and I say that because Chairman St Germain mentioned the uninsured depositors or investors; Mr. Stanton referred to the fact that there are a lot of credit unions involved here, and I am not going to ask how they got into that mess, but I am referring now to an article in the Wall Street Journal which says there are other ripple repercussions, worries among big investors about the safety of uninsured deposits in financial institutions; for the first time in the failure of a bank a large number of uninsured depositors and creditors are likely to lose money. Can you tell me about that, will uninsured depositors lose money? What is the present situation?

Mr. ISAAC. Yes; we believe uninsured depositors will lose some portion of their uninsured deposits. At this stage we really cannot say exactly how much. We are going to have a better evaluation of the assets of the failed bank in the receivership now, and we are also going to have to have an opportunity to work through any contingent claims that may be asserted against the receivership. We would expect and hope to give the uninsured depositors a substantial recovery as soon as possible, but I think that it would be terribly overoptimistic for me to say that they are going to get all their money back.

Mr. WYLIE. I am quoting now from The American Banker, wherein you say that basically what you have here is a very small shopping center bank 5 years ago that was probably \$40 million in size, maybe \$50 million. It went out and tried to make a lot of high-risk loans in the oil business and energy related and grew faster than it should have. This bank would not have remained a shopping center bank, which probably is what it should have done, Mr. Isaac said.

At the time of the failure it was somewhere in the neighborhood of \$500 million; is that correct?

Mr. ISAAC. That is correct.

Mr. WYLIE. Now, it is my belief that there was a failure here, apparently due to what was characterized by you as excessive and uncontrollable growth. Did you have the authority to preclude that? In other words, could you have gone into the back office and said, "We think that you are making loans which you should not

be making, and making investments which you should not be making" and stop the bank from doing that? Or are you merely limited to giving advice?

Mr. ISAAC. The FDIC had no regulatory jurisdiction with respect to this bank except for one power, and that is if we had thought that the bank was a threat to our insurance fund, we could have initiated a proceeding to terminate insurance. Unfortunately that is a proceeding that generally takes a year or two to complete and it is not a terribly effective instrument. Aside from that, however, we had no power in this circumstance.

Mr. WYLIE. How about you?

Mr. CONOVER. Mr. Wylie, if I may, as I think I indicated in my prepared statement, we in the Comptroller's office did recognize the explosive growth of this bank and did point out to the bank, to its management and to its directors, that we felt that its growth was too rapid, that it lacked controls, that its loan portfolio was poor quality, and that it ought to do something about it. We pointed that out to them on several occasions, including bringing the board of directors of the bank from Oklahoma City to Dallas, and in at least one of those cases we actually got 17 of the 19 directors to get on an airplane to go to Dallas and talked to them about their situation in their bank.

Those warnings, those requirements on our part in the formal agreement that we put on the bank, which was signed individually by those directors, went unheeded. They did not pay any attention to it.

Mr. WYLIE. Now it is my understanding—and I know this is not really a very good analogy—but if the SEC finds that one of its regulated brokerage houses is expanding too rapidly or is doing something that the SEC does not think they should, they are making investments in new business which the SEC feels that they do not have the ability to perform, that they do have the authority to stop them from making those imprudent investments.

You do not have that kind of authority under the present statute as I understand it?

Mr. HOMAN. No. There is nothing wrong with growth per se. It is growth in poor-quality assets that usually gets—as in the instant case—a bank in trouble. If that is deemed to be a large problem, as it was in this case, we do have the authority to curtail it. We attempted to do that in a controlled way in our September of 1980 formal agreement.

But the bank, after having made progress in controlling its contingent liabilities, its unfunded liabilities, as well as the growth of the loans on its own books, nevertheless chose to ignore that in the end, and during the last 6 or 8 months of its life originated another \$800 million in loans participated out. This was after our examination of September of 1981.

Mr. WYLIE. You were pointing out that Penn Square was investing in activities which you regarded as perhaps being unwise. And there were some promises extracted that those practices would be corrected, am I right about that? Is that what you said?

Mr. HOMAN. That is absolutely correct. In fact during 1981 they did show significant progress in overcoming some of their problems.

Mr. WYLIE. But you have no authority other than to extract a promise from them that they will correct their mistakes?

Mr. HOMAN. We could require it, but they ignored the requirements of the legal contract we had with the bank's board, which is a formal agreement under our cease-and-desist power.

Mr. WYLIE. My time is expired.

Mr. HOMAN. They violated it in numerous ways.

The CHAIRMAN. Mr. Minish.

Mr. GONZALEZ. Mr. Chairman, will the gentleman yield just to follow up on a question here that I think we should ask, because there is a great deal of concern here on the Hill.

Will the gentleman yield?

Mr. MINISH. All right.

Mr. GONZALEZ. At least for the record, and maybe you can answer later. Since you indicated it would be a dim hope to expect reimbursement of the noninsured depositors, the Wright Patman Credit Union here has, I understand, about \$1 million there. What do you think would be the chances for institutions of that nature to have some kind of priority, creditors or depositors' priority? What portion of that \$1 million will be covered. Could you give us an idea?

Mr. ISAAC. I hope I didn't imply that the uninsured depositors would not receive funds back. We certainly hope to return a substantial portion of the funds as soon as possible from the liquidation of the assets. I can't give you a percentage.

As far as giving these institutions preferred status, I think that would be the worst mistake the Congress could make. Then whatever discipline there would be left in the financial system would be gone.

The CHAIRMAN. Amen.

Mr. ISAAC. These are the very institutions that need to discipline banks that are engaged in these kinds of practices.

The CHAIRMAN. Amen.

Mr. MINISH. Mr. Conover, on the bottom of page 1 of the statements it says the Comptroller's Office devoted special supervisory attention to Penn Square since early 1980 when problems were first identified. While I realize you were not serving the agency at the time in your present capacity, I must ask what went wrong? Why did it take them so long to wake up?

Mr. CONOVER. I think first of all I would like to clarify what special supervisory attention means, if I may.

There are probably 300 national banks at the moment that we have under what we call special supervisory attention. I took a look at the number that were rated 3, 4 and 5 under that rating system back at that time to see what had happened to them since then. The vast majority of them, I recall the number as 65 percent, had returned to health and were now rated 1 and 2 under this system.

I forget the disposition of the remaining 35 percent but I think the point is that special supervisory attention is something that we have a number of banks in at any given time and for the most part it works.

This was obviously a case in which it did not. It did not, not because our efforts were not sufficient, I think, but because the

people that we were trying to get to save their bank weren't going to go along with us.

I really think it is that simple.

Mr. MINISH. Let me ask you this; you were concerned early on and you asked the board of directors or trustees or the appropriate officers of the bank to appear at a meeting in Dallas where I assume you dressed them down and they ignored the recommendations your people made.

Don't you have any alternative in dealing with a situation like this?

Mr. CONOVER. Well, in that particular case what we got was recognition of problems and assurances that they would correct that situation. In fact, we received periodic, progress reports, on a monthly or sometimes even more frequent basis, on certain aspects of the things that we asked them to do. In late 1981, we actually found that some modest improvement had taken place.

From about September 1981 to June of 1982, obviously that bank got totally out of control.

Mr. MINISH. Well, the meeting in Dallas was held when?

Mr. HOMAN. I think the last meeting in Dallas was on January 12, 1982.

I believe there was a meeting in August. It is in the chronology.

Mr. MINISH. Mr. Isaac.

Mr. HOMAN. July 29, 1981.

Mr. MINISH. You used the figure of \$240 million as a possible cost to the insurance fund. That is the top figure, did I understand you correctly when you said that?

Mr. ISAAC. That is what we believe would be our maximum exposure in this case. We did not expect to lose anywhere near that.

Mr. MINISH. Let me ask you this; is it possible that some of the banks that got involved with Penn Square may find themselves in difficulty because of their association with Penn Square which would have a further impact on the insurance fund?

Mr. ISAAC. We do not expect any significant additional problems resulting from this affair.

Mr. MINISH. Thank you. That is all, Mr. Chairman.

The CHAIRMAN. Mr. McKinney?

Mr. MCKINNEY. Gentlemen, this is just so reflective of a whole system that quite frankly to me is horrible.

Mr. Conover, I certainly won't make insinuations about your office, but you are supervising the banking system; a bank goes under and you say to Mr. Isaac: "Pay for it."

To me the system just doesn't make sense, Mr. Chairman. I think we better do something about it.

The CHAIRMAN. We are being told over and over, during the Drysdale security disaster; Oh, don't worry about it, Chase looks at their performance. We look at this, they are a couple hundred million into this one.

Mr. Conover, are your people looking at these banks that seem to be financing go-go stock brokers, go-go money market changes, go-go commodities markets and everything else? What are these banks doing with their depositors' money?

It is fine to sit here and say this is, as Mr. Isaac said, an aberration, but 1 month it is Drysdale; next month it is Penn Square; next month it is something else.

What is happening?

Mr. CONOVER. Well, in this case and obviously in the Drysdale case, it is quite obvious that some banks engaged in some practices they shouldn't have without any decent controls or carrying out of prudent banking practices.

That, unfortunately, is going to happen from time to time. The only way I know of to absolutely keep it from happening is to have a very, very different kind of banking system in which the degree of regulation and supervision is a quantum jump over what it is today and, in effect, Government examiners or regulators are present in banks, watching virtually every decision being made as it is being made. I don't think that is appropriate.

Mr. MCKINNEY. Don't you think it's about time we start making a survey to find to what extent these nonprudent banking practices are occurring?

Mr. CONOVER. That's certainly true and we do so as a matter of course through the off-site surveillance system by which we track banks with different characteristics all the time. As I said, we have 300 or so banks under special supervisory attention at this time.

Mr. MCKINNEY. We already live under the biggest imaginary face in the world. We look at an asset portfolio and say it's worth such and such. What is a loan worth to Zaire? What is a loan worth to a lot of these third world countries? What is the worth of a tax-free bond that pays 5¼ percent?

There is something else that bothers me. You were not there, but you made an agreement with the directors of this bank; your Department gave them a cease-and-desist order but they kept right on going. Can't you go in and run that bank right, then and there, instead of telling them they had better straighten up and go on down the nice narrow road we told them to go down?

Mr. CONOVER. As a matter of fact, the answer is no because in order to do that, we end up closing the bank and turning it over to the FDIC which is exactly what we did.

Mr. MCKINNEY. I would think it would have been better to turn it over to the FDIC in July 1981 rather than July 1982.

Mr. CONOVER. I suppose you can always have a debate as to what is precisely the appropriate time to close the bank.

I am sure that we will be criticized both for closing it too early and for closing it too late.

Mr. MCKINNEY. I am not in the business of criticizing you but a victim in the business of trying to find out how we try to stop this. Here is a little shopping center bank that went from \$50 million to \$500 million to \$2 billion worth of contingent liabilities. Isn't there a bell that rings somewhere; red lights go on and warns you that banks don't double in size in a year and don't have \$2 billion worth of liabilities? Isn't there something that tells you there has to be a crook or there has got to be something drastically wrong here?

Mr. CONOVER. There obviously was something drastically wrong.

Mr. MCKINNEY. I'll say.

Mr. CONOVER. But to answer your question, we don't have this authority.

Mr. MCKINNEY. We better give them the authority they need, Mr. Chairman. Because somehow or other, we are going to run out of FDIC funds if this kind of thing keeps going. There has to be some kind of early warning system. There has to be some broader communication. I just hope now that you are the new man on the block and I know you will work hard but you are going to have to take a hard, long look at quote, unquote prudent banking practices by money market banks.

You know, some of us on this committee are beginning to wonder when the next shot is going to come. We are finding out that practices which theoretically are thought to be prudent banking practices are far from that. Our money market banks have probably more examiners than the Federal Government has in some of them, but it doesn't really matter how many examiners there are. The energy people are over here and the commodity people are over there—there is just no communication. What good is any portfolio that is a combination of worthless accounts.

The CHAIRMAN. Mr. Annunzio?

Mr. ANNUNZIO. I don't have any questions.

Mr. MCKINNEY. I would like to ask one last question if my chairman will give me 2 seconds. What would you tell us to do, Mr. Conover, or Mr. Isaac, to anticipate this and stop it before it goes to the next full year, so we don't get insolvency July 5 at 7:05 p.m.?

Mr. ISAAC. As I mentioned in my opening remarks, I think we need to make some changes in our regulatory system. I don't think the regulatory agencies need more power to take specific kinds of actions. I think we have plenty of authority in that area. I think we need to look at the overall system under which we are operating.

But I would also point out that you mentioned Drysdale and then this affair and then you said how do we stop that from happening?

I don't think you can stop that from happening. Humans are fallible. We make mistakes every day. What you hope is that you have spread out your risks far enough—diversified far enough—and that you have adequate controls in place so that when the occasional mistake occurs, it doesn't do serious harm to your institution or to your personal financial situation if you are an individual.

We can't expect that the financial system, if it is going to perform the kind of service we want it to perform, is never going to experience a problem. You wouldn't want that kind of system, one where banks were not taking any risk and thus not suffering any losses.

The CHAIRMAN. Tell you what, we will go through the 5-minute rule, we are trying to adhere to that; and I am sure that by the time all of these erudite people have asked their questions you will have had an opportunity to make all of your points. If not, we will hear you at the end.

Mr. Annunzio?

Mr. ANNUNZIO. Thank you, Mr. Chairman.

I want to remind my colleague from Connecticut that the bell went off but nobody heard the bell. That is our problem.

Mr. Isaac, you state that there are some 260 banks on the FDIC problem list. My information is that there are some banks that are in critical shape. In fact, I have been informed that Penn Square is

just a tip of the iceberg. There is talk that a bank in the size range of Penn Square is on the verge of collapse and might have even collapsed this week had it not been for assistance from the Federal Reserve in the form of injected money.

Can you tell this committee, with the weekend approaching, are there any bank failures that are likely to occur over this weekend? Just don't keep it a damn secret. You have got an opportunity to tell us now.

Mr. ISAAC. First of all, there are 268 banks on our problem list, That is somewhat higher than average, but not a whole lot. It is certainly lower than it was in 1976.

Mr. ANNUNZIO. We got through 1976 and we are all the way to 1982. We are talking about now. The American people are not concerned about 1976. Now, tell me about these banks. Tell me, is there another one going down?

Mr. ISAAC. We got through 1976, Mr. Congressman, and we are going to get through this period quite nicely.

Mr. ANNUNZIO. I hope so.

Mr. ISAAC. For your information, I plan to be in Ohio, visiting family this weekend.

I do not agree with the characterization that this is the tip of the iceberg or that a number of institutions are affected by it.

Mr. ANNUNZIO. I don't expect you to agree. You are appointed to your jobs, we have to go out and get elected.

Mr. Conover, a columnist in the Washington Post this morning indicated that one of the reasons Penn Square was attracting so many depositors was that it was paying 2 percent premium for uninsured deposits.

I have made preliminary checks this morning and found that this 2-percent bonus did not exist to all such uninsured deposits.

Does your office have information that the 2-percent bonus was paid for all uninsured deposits or that it might have been paid in only some of the cases?

The impression of the columnist this morning was that everyone who put money in Penn Square was doing it because of greed in order to make the other 2 percent.

Do you subscribe to that theory?

Mr. CONOVER. We have no evidence that the Penn Square Bank was paying 2 percent premium for its deposits.

The number that I am aware of is closer to 25 to 50 basis points. In addition, it would not be unusual for this bank or any other bank to pay different rates for different amounts of money in a different time period, so you would have a number of uninsured depositors who at any given time might be earning different yields on their deposits.

Mr. ANNUNZIO. I am particularly disturbed about the failure of your office to monitor or control the use of brokers by national banks. The money you talk about the brokers received.

Federally insured financial institutions are prohibited from paying a premium to an individual depositor which costs more than \$20. That means that if a housewife makes a deposit, she can get a set of pots and pans, a toaster, but the premium cannot be more than \$20.

I have even been told that financial institutions that exceed the \$20 limit have been threatened with substantial fines by the regulators. I know, my small banks tell me this.

Now, my question is this, If it is wrong for a bank to pay an individual depositor more than \$20 in a premium in order to obtain money, why is it right for the same financial institution to pay a broker thousands upon thousands of dollars to bring money into the financial institution?

Mr. HOMAN. Congressman, I am aware of no law which prohibits a bank from paying a money broker a fee for money over \$100,000, which, in this case, was the type of money market funds gathered.

That may apply to certain small depositors under regulation Q. But it was—does definitely not apply to—

Mr. ANNUNZIO. I say federally insured financial institutions are prohibited from paying a premium to an individual depositor which costs more than \$20. That is exactly what I am saying.

They are prohibited from paying \$20 to the average American housewife that goes in, but if you are a money broker, you can collect thousands and thousands of dollars, like what happened in Penn Square and some of the other banks that are going to go down with it.

When is that going to stop?

Mr. HOMAN. That is common practice among the money markets. They have to attract money and fund themselves.

The CHAIRMAN. The time of the gentleman has expired.

Mr. ANNUNZIO. Thanks, Mr. Chairman.

The CHAIRMAN. Mr. Leach.

Mr. LEACH. In reading the two statements, I am frankly more impressed with the operations of the FDIC than I am with the Comptroller's Office in this situation.

Mr. Isaac properly rejected the purchase-and-assumption option. You, sir, Mr. Conover, laughingly say some will criticize you for acting too soon, others for acting too late. The fact of the matter is I know of nobody who will criticize you for acting too soon. I think the previous speaker is exactly right. The warning system worked; you simply didn't act.

Let me give a couple of examples. In your testimony, you cited an examination 2½ years ago, from February to April of 1980, which concluded not only that there were problems with the bank, but that there were violations of U.S. banking laws. One and one-half years ago, based on an examination, you concluded that there were numerous violations of U.S. banking laws. A violation of banking law is illegal behavior. In view of this, where was the FBI 2½ years ago and 1½ years ago?

You cited uncontrolled growth, yet you did very little to moderate that uncontrolled growth. One reason for such phenomenal growth was the willingness of larger banks to participate in loans. My question, then, is what did the larger banks know and when did they know it? For example, what did you tell Continental and Chase and when did you tell them?

Mr. CONOVER. I think I would like to comment first on your statement in regard to violations of law.

It is very common in the examination of a bank to find violations of law. It happens every day to many, many banks.

For the most part, those violations are pointed out by the examiners during the examination or in the examination report and they are corrected by the management because most bank managers and boards of directors are law-abiding citizens and want to abide by the law.

Mr. LEACH. Let me interrupt you there. I follow banking in my State of Iowa very closely, and I guarantee that there are not numerous violations of banking law in Iowa.

As the Banking Committee of the U.S. Congress, as Members of Congress, we write laws, and we take the laws we write very seriously. When you cite numerous violations of banking laws, what do you do about it? Is the president of the bank removed? Do you demand a change of top personnel?

Mr. CONOVER. What we do is point out the violation of the law and discuss the circumstances.

Mr. LEACH. Do you bring charges against the bank?

Mr. CONOVER. We point out the violation of the law and understand the circumstances behind it and depending on its seriousness, we may very well take such action.

In many cases, the violations of law are inadvertent, for example, and they get corrected rather quickly.

Mr. LEACH. In the case of Penn Square, were the violations corrected between 2½ years and 1½ years ago?

Mr. CONOVER. In many cases, they were, yes.

Mr. LEACH. The first examination turned up violations, the next examination numerous violations of banking laws.

Getting away from this for a second, can you tell me when Continental and Chase were informed of problems in Penn Square and what they were told?

Mr. HOMAN. We informed Continental of the problems during the week before the bank failed. Chase was informed, I believe, 2 days later.

Mr. LEACH. When you see massive problems in a bank, when you see that the engine of growth is other banks' willingness to participate in the problem bank's loans, don't you feel a responsibility to inform the other banks that are involved?

Mr. HOMAN. We do, but the backbone of the correspondent banking system is loans participated between upstream and downstream correspondent banks. They typically take out overlines or lines that are larger than a small bank's lending limit throughout the Middle West.

Mr. LEACH. You are referring to the whole banking system of the United States, not to a single bank. If one bank is affected by problems at another bank, isn't it proper to inform the affected bank?

Mr. HOMAN. It is if we think there is a significant problem that it creates for the other bank. In this case—

Mr. LEACH. Based on your examination, didn't you ever think it important to inform Chase or Continental?

Mr. HOMAN. Previous to this last examination, there were not significant problems in the portion of the loan portfolios sold to the other banks that we had identified.

Mr. LEACH. Let me ask one other question. It appears in this instance there was extraordinary use of letters of credit. It also seems that this extraordinary use of letters of credit is becoming a

national phenomenon. Is there any thought in the banking community that this phenomenon deserves far greater scrutiny than it has received in the past?

Mr. HOMAN. The letters of credit in this particular bank played no part in the failure of the bank. Not at all. As a matter of fact, out of \$138-odd million in letters of credit, less than \$400,000 were criticized.

So we do not consider that to be a contributory cause of the bank's failure.

Mr. LEACH. My final question is whether there is something from a regulatory standpoint to be learned from the Penn Square experience. When problems of this nature develop, perhaps you should inform the very banks that are partly responsible for the situation. To say that the correspondent banks are not partly responsible would be very foolish because it never would have occurred without them. May I ask you, are you going to reexamine your practices in this area?

Mr. CONOVER. We are certainly going to reexamine our practices regarding looking at loans that are participated in by a number of banks.

Mr. LEACH. Is that an admission that past practices perhaps were inadequate?

Mr. CONOVER. No, sir; it is not.

Mr. LEACH. Thank you, Mr. Chairman.

The CHAIRMAN. I must observe, because of your initial questions, Jim, that in my opening statement, I stated that the first agreement had all the sting of a flogging with a wet noodle.

I am very serious about that.

As I listen to our witnesses, it occurs to me that the restraint that was exercised by the Comptroller's Office was just unbelievable.

When I went to school, grammar school, if you were a naughty boy, the teacher just whacked you. Now we try to talk to them, talk children into being nice and obedient.

It seems as though the Comptroller's Office has gone that way, too. I agree with Jim. I don't think you would be criticized if you rang the bell earlier, rather than too late. Keep that in mind.

Not only you, Mr. Conover, but those people in the Comptroller's Office who were there 10 years and will be there another 20 years.

Mr. VENTO.

Mr. VENTO. Thank you, Mr. Chairman.

Mr. Conover, I noted with interest your comments in the last instance where you said that violations of the law go on every day. I look at the top of the page 2 in the series of charges, summary of notice of charges given to us as of June 30, 1982, the bank permitted officers without lending authority to extend credit on behalf of the bank; the bank, in violation of certain statutes, in a unsafe and unsound manner sold participations in loans originated by the bank without disclosing to the purchasers of those participations material, nonpublic information known to be public to the bank.

These charges are not the type of violations, I hope, that go on every day in my State and across this country. This sounds like fraud to me.

I understand your reluctance to talk about criminal charges, about a variety of other things. I sure hope that this is an aberration but the amazing thing to me and I think to other members, is that over a period of time, this went on with no action on the part of the Comptroller of the Currency in terms of your regulatory supervision, and one wonders with the type of hindsight I suppose it is easy to criticize, I mean, why not?

Are these the charges you are talking about that this just developed in the last year? Or is this a culmination of charges that have been repeated over the last 4 or 5 years by this particular bank?

Mr. HOMAN. The civil violations contained in the notice of charges which you are reading from, Mr. Vento, were significantly different from the types of violations that went on in the past.

They were the basis for our temporary cease-and-desist order requiring correction. Many of the violations which occurred in the December 31, 1980, report and subsequent reports, while numerous, were technical in nature and subsequently corrected in the following months.

We monitored that closely through progress reports and through five examinations that were conducted over the period. None of the violations were in the nature of a criminal or fraudulent violation.

We deal with that separately by the referral process.

Mr. VENTO. It also appears that this time between that that things became worse. In other words, you came in and started putting pressure on it looks like that the situation went from bad to worse in terms of violations.

These do not sound like civil violations to me.

Mr. HOMAN. Between the September 1981 examination and the final examination, they did go from bad to worse. And there were significant violations of the law.

We are not trying to——

Mr. VENTO. Sounds like as a regulator, you are trying to regulate in good faith and you are bending over backward to keep this bank open and it sounds like they took you to the cleaners, in terms of participation, that is what it sounds like, in terms of their reaction to your regulation.

That does not speak well for your role in terms of disciplining and that does not bode too well in terms of the future with regards to how you regulate banks.

Mr. HOMAN. With the benefit of hindsight, that may be true, but you can lead a horse to water, you can't make him drink.

Mr. VENTO. Doesn't look to me like you got him to do anything except run the other direction. Sounds to me like you went back to the range, did not even have him in the corral the way this looks to me.

The fact is you notified the Federal Reserve Board and you notified the FDIC in 1980, did you not? What was the purpose of that particular notification?

Mr. CONOVER. That is a very standard notification. Whenever a bank is rated three as a result of an examination and is put under special supervisory surveillance, we normally, as a matter of policy——

Mr. VENTO. What are we telling the FDIC, protect your turf, we are protecting ours?

Mr. HOMAN. We provided the FDIC with copies of our pertinent correspondence and supervisory actions taken in respect to all three-, four- or five-rated banks, together with reports of examination.

They independently review those examination reports to determine their own insurance risk.

Mr. VENTO. To determine their own insurance risk. What did that mean to you, Mr. Isaac, that standard notification that came in in 1980 that concerned Penn Square?

Mr. ISAAC. It did not mean anything to me personally because I did not receive it, but—

Mr. VENTO. You are speaking for your institution, that is one of the things that goes with that appointment.

Mr. ISAAC. I understand. But what it would mean to our people is that there is a bank that is under increased surveillance; I doubt very much, in fact I know, they would not have been alarmed by it.

A three-rated bank is not considered a problem bank.

Mr. VENTO. Do you think you ought to have received additional communication beyond that considering the chronology that we have before us today, together with the discussion that has gone on here today?

Mr. ISAAC. I would like to finish that one thought. A three-rated bank is not considered a problem bank. It has to be a four or five to be considered a problem bank.

A three-rated bank is simply one that is requiring closer-than-usual scrutiny.

Mr. VENTO. This was never reclassified, was it?

Mr. CONOVER. No; this was a three-rated bank until the time of its failure.

Mr. ISAAC. We would have liked to have known about the seriousness of the problem sooner, of course. It would have facilitated the handling of the failure if we could have been in there earlier.

Mr. VENTO. Why weren't they notified earlier, Mr. Conover, based on the disposition? As you say, things went from bad to worse.

Why wasn't this bank classified as a four or five, based on where it was going?

Mr. CONOVER. Well, it would have been in the current examination. However, at the time we started this examination in April, we recall that the bank had shown progress through September 1981's examination and they were providing us with periodic reports indicating they were making progress.

What we actually expected to find when this examination began in April was a significantly improved situation for this bank.

Obviously we were very surprised. As soon as the nature of the problem became obvious to us, we did inform the FDIC.

Mr. VENTO. June 30, 1982. In other words, in April when you completed the work, it took you 3 months to notify the FDIC and the Federal Reserve Board.

That is when they were notified again according to your chronology. Is there some communication going on that the members of the committee should know or do I misunderstand what I have?

Mr. CONOVER. Mr. Vento, the examination began in late April. As of the date of March 31.

We began to recognize the seriousness of the problems in the loan portfolio approximately 4 weeks into the examination. So it would have been mid- to late-May when the nature of the problem in the loan portfolio became obvious to us and that it was evident that it was——

Mr. VENTO. Did the FDIC get its notification?

Mr. CONOVER. No, they did not.

Mr. VENTO. The point is you waited another 6 weeks to notify them. If you wanted them to do their job in protecting these funds, it would seem that the 6 weeks was insufficient.

Mr. HOMAN. I think we notified them on June 23 in the regional office. On June 30, we notified the Washington office.

You have to recall that during this examination, we were midway through this examination when the bank failed.

We had not had an opportunity to go through the loan portfolio in full. In fact, our examiners are still trying to complete that examination.

But midway through, we determined that the losses eventually might exceed the net worth of the bank. We worked continuously through the last weekend analyzing the credits and eventually that did happen.

What triggered the failure earlier than we had expected, in a sense, and denied us an opportunity to make a more orderly arrangement with the FDIC, was the liquidity crisis that occurred. That essentially was triggered in the final week.

Mr. VENTO. My time is up, I have to cut you off. The same question goes to the Federal Reserve and I know Mr. Isaac's answer, but he may want to say it for the record in terms of whether he would like to have been notified earlier.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Parris.

Mr. PARRIS. Thank you, Mr. Chairman. I think all of us on this committee accept the fundamental premise that this was a case of a small shopping center bank whose board of directors adopted an aggressive loan and deposit policy.

They wanted to play in the big league and they were bush league. Let's accept that.

Let me reduce the discussion if I might, in amplification with one of my previous colleagues comments to a provincial matter. The name of this room is the Wright Patman room. They have a Wright Patman Credit Union in this building serving congressional employees.

This is a provincial case, but it is perfectly typical in this whole situation. That credit union was just one of 150 credit unions nationwide who had \$106 million in deposits in this institution.

This credit union is estimated to lose about \$200,000, or 20 percent of its deposits. A District of Columbia credit union with \$1 million in an Oklahoma bank and it is only 1 out of 150. The real problem is, only \$100,000 is insured.

It gets receivership certificates for the remaining or \$900,000, but even after all of that, it earns no income on the \$900,000.

Federal policy, as I understand it, allows the credit union to borrow up to 80 percent of the face value of the receivership certifi-

cates from the Federal credit window and then reinvest that to earn additional interest.

So, we have come full circle. After a very long history of questionable operations by a nationally regulated bank that fails, it takes with it a substantial deposit of a nationally regulated credit union, the credit union gets receivership certificates issued by national regulators and then because of the loss of the income, it can borrow 80 percent of that paper in the national financial market.

All the money there is in all of that is the initial \$100,000 that Mr. Isaac has got in the FDIC insurance fund.

I have heard a lot of instances of creative bookkeeping, but that is a con game and there are many of us in this committee, I think, who wonder about the blind subservience to the concern for earnings per share or return on deposit or whatever it is that brings all of that about.

My question really is, it is bad enough for one bank, Continental Illinois, to have more than \$1 billion in participation or correspondent relationship loans in this institution.

It had bought \$1 billion worth of loans. Is there no procedure or should there not be one, for the Comptroller of the Currency to monitor this?

Is there not a procedure by some appropriate regulatory agency to recognize that there is massive shifting of deposits of other institutional assets around the Nation over a period of over 2½ years?

Is there not a process or shouldn't there be one? If there is, why did it not work in this instance?

Mr. HOMAN. I think that is the way that most large banks raise their money. It has been a principle of the money and capital markets for as long as I can remember. It is advantageous to have a free flow of funds between institutions and this occurs every day in the correspondent banking networks and the payment systems through the Federal Reserve and elsewhere.

It also occurs through various sweep accounts and invested fund accounts used by pension funds and other large money market participants in terms of distributing money nationwide, short and long term, on a daily basis.

To interrupt that flow with rules and regulations just seems to be almost an impossible task to even approach.

Mr. PARRIS. I am not suggesting, Mr. Homan, that it be necessarily interrupted. The thrust of my question, I apologize if it was not clear to you, but the thrust of my question is should there not be some smoke that is going to set off the bell that we have heard about earlier here today that you gentlemen will know there is a fire or at least recognize as smoke?

There has got to be a reason why the gentleman who runs the credit union in this building wants to deposit his money in Oklahoma. Now, if there is 150 of those, there has to be some evidence, some information on the street that would lead you to the suggestion that there is a problem in a bank in Oklahoma that needs to be a matter of concern to the regulators. Isn't there?

Mr. CONOVER. Apparently not.

Mr. PARRIS. Shouldn't there be?

Mr. CONOVER. When the manager of a credit union or a savings and loan association makes a decision to make a deposit in another

financial institution, or a bank that we are responsible for does that, he needs to follow some prudent guidelines regarding concentration.

We often criticize banks for undue concentrations of assets.

On the surface, it seems ridiculous to me that we have had 150 credit unions, some number of savings and loans and a number of banks from all over the country that ended up making deposits in this particular bank without seemingly doing a very good job of doing their homework.

If anything, what we need to do is have some kind of a system whereby people have sufficient information to analyze the affairs of institutions in which they are making deposits.

Mr. PARRIS. My time has expired, but I would simply make the observation to you that it seems to me this is very much like leeching a patient who is bleeding to death. We are too late with the wrong medicine. Certainly we were this time.

Thank you.

The CHAIRMAN. Mr. Barnard.

Mr. BARNARD. Mr. Conover, how often does the Office of the Comptroller examine banks?

Mr. CONOVER. That depends on the size of the bank, sir.

Mr. BARNARD. Give me an example.

Mr. CONOVER. The large multinational banks are examined on an annual basis. In fact, we have almost continuous contact with them.

Mr. BARNARD. Large what?

Mr. CONOVER. The large multinational banks. Bank of America, Chase and Manhattan, Citibank, and so forth.

Mr. BARNARD. Smaller banks?

Mr. CONOVER. Smaller banks tend to be examined less frequently.

Mr. BARNARD. On this particular bank, what would the frequency be?

Mr. CONOVER. A normal frequency for a bank of this size would have been what, 18 months?

Mr. HOMAN. Would have been in this period of time 18 months. But Penn Square was an identified bank requiring special supervisory attention. For such banks, we do, as a matter of policy, one full examination each year, together with a short visit.

Mr. BARNARD. Short visit.

Mr. HOMAN. Yes.

Mr. BARNARD. Just one short visit?

Mr. HOMAN. Each year, yes, We do a full comprehensive examination once a year and a second visitation or limited-purpose type examination during that year.

Mr. BARNARD. Mr. Isaac, do you get copies of his examination reports?

Mr. ISAAC. Yes.

Mr. BARNARD. What do you do with them?

Mr. ISAAC. We review them in our Division of Bank Supervision and if the bank is accorded problem status, a memorandum is prepared and distributed to various people throughout the corporation, including myself, that, as I said in this case, that wouldn't have occurred because it was not considered a problem bank.

Mr. BARNARD. Even with the unfavorable reports that Mr. Homan has just talked about, it would not be regarded as a problem bank by FDIC?

Mr. ISAAC. It was rated a three bank.

Mr. BARNARD. Is that bad?

Mr. ISAAC. That is a bank that requires closer-than-usual scrutiny, but is not a problem.

Mr. BARNARD. It is not customary for FDIC to pay any particular attention to that bank?

Mr. ISAAC. No.

Mr. BARNARD. When do you become alarmed?

Mr. ISAAC. We, obviously, would become more concerned when a bank is rated four, which is a problem status, and even more alarmed or concerned when it is rated five, which is a bank in danger of failing.

I get a weekly list of any banks that are in that condition.

Mr. BARNARD. If you had received a copy of the examination report, and you saw some very obvious things in it which might require classification by the Comptroller as three, yet in your judgment or that of the FDIC, would be worse than a three—such as a bank selling 80 percent of its loans, is that unusual?

Mr. ISAAC. For a bank this size to sell that volume of loan participations is very unusual.

Mr. BARNARD. I take a little issue with you—

Mr. ISAAC. I am not sure that would have shown up in the examination report. It might, I don't know.

Mr. HOMAN. Yes, it does. Congressman Barnard, the FDIC reviews each of our ratings and we have an interagency dispute procedure in the case where they would disagree with a rating of ours on a national bank.

In this case, they reviewed it and did not dispute it.

Mr. BARNARD. I am trying to support the present system, which is difficult to do. If I thought the FDIC was backing up the Comptroller's Office or a State supervisor—you do examine State banks, right, on your own?

Mr. ISAAC. That is correct.

Mr. BARNARD. You don't take a State supervisor's bank examination on face value, do you?

Mr. ISAAC. In most States, we alternate.

Mr. BARNARD. At least you are in there pitching.

Mr. ISAAC. We will go in and do another report at a later date.

Mr. BARNARD. But you take the examination of the OCC and the Federal Reserve at face value.

Mr. ISAAC. That is correct.

Mr. BARNARD. Do you think that is right? On reflection, do you think that is right?

Mr. ISAAC. I don't think that the present regulatory system at the Federal level—

Mr. BARNARD. Under the present system, don't you think it is a responsibility of the FDIC to be a little more careful in looking at these examinations?

Mr. ISAAC. We have not been assigned regulatory responsibility for national banks or for State banks that are members of the Federal Reserve System and we don't exercise that authority.

Mr. BARNARD. You are the one that will have to close it out.

Mr. ISAAC. That is correct.

Mr. BARNARD. You are the one that has that ultimate responsibility.

Mr. ISAAC. We have no regulatory authority.

Mr. BARNARD. Mr. Conover, one of the recent press accounts of this bank indicates that in evaluating the collateral of a loan, which so often in this bank was oil reserves, the reserves used as collateral were only determined after the loan was made.

Are you familiar with that?

Mr. CONOVER. I am not aware personally whether that is true or not. I think I am aware that the lending practices in the oil and gas division of this bank were unusual, to say the least, compared to those of other banks who are experienced in making oil and gas loans.

Mr. HOMAN. Congressman, our examiners have indicated to us that many of the engineering reports estimating the values of the reserves were in their words "made as instructed."

That is that they could have been falsified or very optimistic and generous in terms of evaluation on these particular types of loans.

Mr. BARNARD. Well, you know, I don't know how much more I could develop from my questioning, but I just want to take friendly issue, with Mr. Isaac.

I don't think this is an aberration at all. It would be an aberration if Penn Square was a good, solid, sound, properly run bank that went broke under your capable supervision and examination, but in this case, all the flags were here for a failure 2½ years ago.

So it is not an aberration at all. It was a foregone conclusion which direction this bank was going and it went that way and it failed.

This one bank is going to call for a very thorough reappraisal of what our bank supervising practices are. We may need to get back to one agency with all the responsibility.

Thank you.

The CHAIRMAN. I have got to observe something.

Mr. Conover and Mr. Isaac, did I hear you say this was classified as a number three up until the date of the failure, when the bank failed?

Mr. CONOVER. The bank was rated number three up to this examination. Obviously had the examination been completed, and the bank survived the examination, it would have received a lower rating.

But up until the time of the examination, it was a three-rated bank, yes, sir.

The CHAIRMAN. So there was no deterioration from April 1980 until the conclusion of the examination and the failure in 1982?

Mr. CONOVER. I think, as I indicated earlier, we saw some improvement in the bank in September 1981 and fully expected at the start of the April 1982 examination to find that they were in a much improved position.

The CHAIRMAN. Mr. Weber.

Mr. WEBER. Thank you, Mr. Chairman.

I would like to have the panel clarify what in your opinion was the reason that the supervision turned out to be ineffective to prevent the failure of this bank.

Mr. CONOVER. When all is said and done, I think the reason that the supervision was ineffective in this bank was that it was not heeded by the supervised.

Mr. WEBER. Mr. Homan, do you agree?

Mr. HOMAN. I agree. I think you can only do so much in a bank in terms of guiding it, in terms of advising it, in terms of suggesting to it the proper recipe to solve its problems. We do not run banks; we do not manage banks. We are there once a year, or in this case, twice a year.

We do not make the loans in a bank. To do so would be to nationalize the institution.

We do not think that the Congress or anyone else in the United States wishes the Federal Government to nationalize its banking institutions and have the Government run them. So we followed our proper procedures in this respect.

The bank chose to ignore it, chose to ignore the law, if you will. It chose to ignore the common recipes that we gave it to solve its problems, and there is very little more that one can do in that type of a circumstance.

The CHAIRMAN. Would you yield, Mr. Weber?

Mr. WEBER. I would be happy to yield.

The CHAIRMAN. What restrictions are there on the Comptroller from doing more? Other than those you have self-imposed upon yourself and the fact you have used cease-and-desist orders like pabulum?

Mr. HOMAN. We are not in the habit of managing banks, Mr. Chairman. In this case, we had no power to remove the management because we had no evidence of any dishonest acts, which is a requirement in the law.

The CHAIRMAN. You cite illegalities throughout in your report.

Mr. HOMAN. This was a bank that was mismanaged.

Those were civil violations of law. There is no statute which gives us the power to remove a manager for civil violation of the law, a violation of the lending limits, a violation of the insider laws. So long as they are civil.

There has to be evidence or act of dishonesty.

The CHAIRMAN. I apologize, my blood pressure was going up there.

Mr. WEBER. I was glad to have the chairman follow that line of questioning. Did you have any different opinion, Mr. Isaac, about the reason for ineffective supervision which prevented failure in this case?

Mr. ISAAC. At this stage I would not be prepared to express an opinion on that. We have been very busy over the past 2 weeks, as you might imagine, trying to make sure that depositors are taken care of and that we get the receivership activities under way so that the loan customers of the bank are taken care of properly. We are just beginning our investigation, in conjunction with the FBI, into what went wrong.

If you were to give us another month or two, I think we would be more knowledgeable on that subject.

Mr. WEBER. I know we will be looking forward to that.

To come back to the question you had an agreement with them called a cease-and-desist agreement that the officers and directors, of the bank signed on September 9, 1980, according to your testimony.

You chose, apparently, not to enforce the provisions of that agreement. I think the chairman has characterized it beautifully as a slap with a wet noodle.

What powers do you have to enforce that type of agreement? If the agreement means nothing, why did you take the trouble to have them sign it.

Mr. HOMAN. We had numerous meetings with the management of the bank and the board of directors after that particular agreement. We had evidence to suggest that they were complying in certain respects.

They gave us assurances throughout that period that they were trying to come into compliance with the terms and conditions of the agreement.

Mr. WEBER. Do you not have power to go to court and enforce that agreement if necessary?

Mr. HOMAN. Yes.

Mr. WEBER. What other powers do you have.

Mr. HOMAN. We could have filed a notice of charges, yes, and had them stipulate to a final cease-and-desist order. After review by the courts, after opportunity for hearing it would be enforceable in court.

Mr. WEBER. And you are saying in the exercise of your discretion, you chose to give the bank the benefit of the doubt?

Mr. HOMAN. In this case, yes.

Mr. WEBER. You also said it was up to the investors in these jumbo CD's to exercise better protection for themselves, reviewing, and so forth. There is an article in the Wall Street Journal of July 8, 1982 in which there is a quotation from one of these asset managers is that Penn Square's latest financial statement certificated by Peat, Marwick & Mitchell gave them a complete bill of health.

Is that true? Were the auditors at fault for not footnoting the statement in some way? Why didn't they know the same things that you knew as to the condition of this bank?

Mr. CONOVER. I think it would be inappropriate for us to comment about the auditors' role and the audit report at this time.

Mr. WEBER. I can understand that. But is that correct? Did you communicate the information to Peat, Marwick? Would they have known of this?

Mr. CONOVER. Peat, Marwick would have known about the existence of the formal agreement, yes, and they did know.

Mr. WEBER. You are not expressing an opinion as to whether Peat, Marwick, under their standards of good accounting practice and the law, would require them to footnote the statement to point out that cease-and-desist agreement that had been signed?

Mr. CONOVER. No; I am not.

Mr. WEBER. What self-protection are you referring to then on the part of the investors that was lacking?

Mr. CONOVER. Well, it seems to me that the potential depositor who is going to make a \$1 million deposit in an institution of

any kind, ought to first of all choose an institution that it has some confidence in and will be a safe resting place for that deposit, as opposed to simply seeking the highest return it can find.

Mr. WEBER. In relation to this bank, what would have led a depositor to believe that it was not a safe and secure resting place for that amount of money?

Mr. CONOVER. I know of no information that would have been available to investors that would have helped them make that decision.

Mr. WEBER. So, Mr. Conover, it is improper to fault the investor or place the responsibility on the investor or to cast them in the light of persons who did not know how to make a sophisticated investment of \$1 million.

Mr. CONOVER. Not necessarily. They might very well have chosen a larger, stronger institution on which information was available to them.

The CHAIRMAN. Like Franklin National; and the U.S. National Bank of San Diego.

Mr. WEBER. My time is expired.

Thank you, Mr. Chairman.

Mr. ISAAC. Can I interject at this point in response to that, because I would take issue with saying that there was nothing to alert an investor here to this situation. I think there was information available that should have alerted an investor.

Mr. Parris was asking earlier why the Wright Patman Credit Union and 150 other credit unions place their money in this bank in Oklahoma? They did so because the bank was paying above market rates for that money.

Why was that? If I had been an investor I would have wanted to ask that question. I would have wanted to know more about that institution.

I think that there was information out on the street about this institution that could have been uncovered through closer scrutiny.

I hope other financial institutions, will be more diligent in doing that in the future as a result of Penn Square—that they will have learned some lessons and make that kind of inquiry. I hope they will invest in an institution based not just on rate, but on quality—whether it is a small or large bank and wherever it is located.

Mr. WEBER. I am still at a loss as to what this information on the street is when the audited financial statements don't show it.

The CHAIRMAN. They tell me that there is a footnote in the Peat, Marwick, Mitchell audit report, very cryptic and you would have to have the wisdom of Solomon and be prophetic in wisdom to understand that perhaps they should have—the investors should have recognized this as a caveat.

But you know I have to observe, if the fact that this deposit was paying that high a rate, obviously that is what attracted the deposits from around the country, shouldn't that have said to the Comptroller, hey, there is something wrong here, and to the FDIC, that there is something wrong here?

Why did it just—why should it just say that to sophisticated investors?

Mr. HOMAN. It is very common to see in the money markets every day certain tiering between classes of institutions that

exceed 20 to 25 basis points, which, for the most part, this institution was paying.

The CHAIRMAN. In a shopping center bank?

Mr. HOMAN. Yes.

The CHAIRMAN. With the brokers' fees being paid on top of that?

Mr. HOMAN. Smaller banks generally pay higher in the national money markets than the top AAA- and AA-rated institutions.

The CHAIRMAN. My expert here, who used to be a small banker, is wincing at that. That is Mr. Barnard.

Mr. Patman.

Mr. BARNARD. I don't know if I want to be classified as a banker now.

The CHAIRMAN. Excuse me, Mr. Schumer.

Mr. SCHUMER. Thank you, Mr. Chairman.

I am really appalled by this testimony today. I am most appalled by this statement, made by either Mr. Homan or Mr. Conover.

What went wrong, we were unheeded by the supervised.

That is like saying we have crime in this country because the criminals don't obey the laws. It is unbelievable. We also have a great deal of contradiction.

Mr. Isaac is saying we need no new laws to protect ourselves. Of course, he wants the FDIC or other single agency to take charge of all regulatory functions, including those performed by the Comptroller of the Currency and maybe even those handled by the Federal Reserve.

But Mr. Conover and Mr. Homan are saying we have no laws that allow us unless there is a criminal violation which, of course, is very, very difficult to prove.

That is a direct contradiction. We either need new laws, which means that we have to act and Mr. Isaac is wrong; or we don't need new laws and it means that you, Mr. Conover, and you, Mr. Homan, were negligent in performing your duties.

I would like a direct answer to that statement by Mr. Conover and Mr. Isaac.

Mr. CONOVER. It seems to me that it is important to insure that the regulators have adequate powers to do their jobs.

Mr. SCHUMER. You feel you don't, correct?

Mr. CONOVER. I didn't say that; no.

Mr. SCHUMER. Then what went wrong here?

Mr. CONOVER. I think I have already answered the question.

Mr. SCHUMER. Well, what you have answered and what I heard was that the supervisor didn't listen to us. That, to me, says that you think happened here, you don't have the power to do more.

Mr. CONOVER. I think it is essential that in regulating banks that the banks we are trying to regulate do listen to us, obviously.

Mr. SCHUMER. What happens when they don't? This one didn't.

Mr. CONOVER. The vast majority of banks on which we uncover violations of law, unsafe or unsound banking practices, and so forth, do listen and do correct.

Mr. SCHUMER. What happens when one doesn't? The vast majority of banks didn't prompt this hearing.

Mr. CONOVER. When one doesn't and the bank deteriorates significantly, it probably fails. And I frankly think that the price we pay for having a private-sector, competitive financial services in-

dustry is that with the right to succeed and prosper goes the right to fail.

Mr. SCHUMER. I understand that point.

Basically you are saying the role of the Comptroller in all but the most criminal violations is to be advisory and if advice is not heeded, that's too bad; not only too bad for the Penn Square board but too bad for Chase Manhattan and other banks that bought participations and too bad for other investors that happened to put more than \$100,000 into this bank.

That is what you are saying?

Mr. Isaac, do you stand by the statement that there are no further laws needed to give the Comptroller or whatever other agency might assume jurisdiction for the Comptroller's responsibilities in the future to get these few negligent banks to heed advice from the regulators?

The CHAIRMAN. Would the gentleman yield to me?

Mr. SCHUMER. I sure will.

The CHAIRMAN. Let me ask Mr. Homan because he is the professional here, are you familiar with the excerpt from Public Law 95-630, dated November 30, 1978, that refers to removal from office, notice of intent?

Mr. HOMAN. Yes; I am.

[The excerpt from Public Law 95-630 referred to by Chairman St Germain follows:]

PUBLIC LAW 95-630—NOV. 10, 1978

92 STAT. 3657

“(c) (1) Whenever, in the opinion of the appropriate Federal banking agency, any director or officer of an insured bank has committed any violation of law, rule, or regulation or of a cease-and-desist order which has become final, or has engaged or participated in any unsafe or unsound practice in connection with the bank, or has committed or engaged in any act, omission, or practice which constitutes a breach of his fiduciary duty as such director or officer, and the agency determines that the bank has suffered or will probably suffer substantial financial loss or other damage or that the interests of its depositors could be seriously prejudiced by reason of such violation or practice or breach of fiduciary duty or that the director or officer has received financial gain by reason of such violation or practice or breach of fiduciary duty, and that such violation or practice or breach of fiduciary duty is one involving personal dishonesty on the part of such director or officer, or one which demonstrates a willful or continuing disregard for the safety or soundness of the bank, the agency may serve upon such director or officer a written notice of its intention to remove him from office.

Removal from office, notice of intent.

The CHAIRMAN. We thought we gave some pretty good checks and powers. That is what Mr. Isaac meant.

We gave them the powers. They didn't use them.

Thank you for yielding.

Mr. SCHUMER. Yes.

Mr. HOMAN. I am familiar with that, as I said earlier. We have applied that statute. You read a lot of “or’s” there, but it has to be one from each part of that law with the operative language “and that such violation or practice or breach of fiduciary duty is one involving personal dishonesty,” and that has to be present in order for us to remove any bank officer.

The CHAIRMAN. Or willful.

Mr. HOMAN. No; it is "and." Our interpretation is, I am advised by counsel, is that that has to be present.

Mr. SCHUMER. Do you think that ought to be changed?

Mr. HOMAN. I do, yes.

Mr. SCHUMER. I think the astute questioning of the chairman and everybody else today has brought out, I think, at least in the preliminary opinion that this committee has of the Comptroller of the Currency's role, that we knew the problem existed for a long time, it was ignored, it was understated and no positive action was taken.

I would like to turn to Mr. Isaac once more. Once the bank failed, there were, of course, two alternatives—liquidation and merger.

The newspapers reported that Chairman Volcker was in favor of a merger and that you were opposed. You prevailed.

Can you tell me his reasoning? If everything is so good in the banking community and this is a complete aberration not to be repeated, and you are going to go visit your family in Kentucky this weekend—

The CHAIRMAN. Ohio.

Mr. SCHUMER. Excuse me, Ohio, across the river. Why was Mr. Volcker so eager to spend Federal Government money to cover the extra, whatever it is, \$190 million—some of uninsured deposits?

Mr. ISAAC. I will be happy to respond to that. Before I do, I would like to respond to another point you made earlier—that I was here testifying that we should have a single agency—

Mr. SCHUMER. I was tweeking you. You know I respect your ability so tremendously, it might not be a terrible thing.

Mr. ISAAC. I have long been of the opinion that five Federal regulatory agencies is either three or four too many.

Mr. SCHUMER. Right.

Mr. ISAAC. I don't know whether the FDIC or some other agency will survive that process. However it comes out, it ought to be done.

As far as myself being the chairman, as quickly as I can get this term over with, I intend to find an easier lifestyle.

Mr. SCHUMER. A weak tweek.

Mr. ISAAC. I am going to find a cornfield in Ohio and I am going to plow it.

Turning to your question, I read that in the New York Times that Paul Volcker and I had a disagreement about this matter. That is incorrect.

There were really two policy issues involved here. One was that if you paid off the deposits in this bank and some large depositors, including other financial institutions, took some losses, you would have a lot of media attention and congressional hearings. That would be disruptive.

The easiest way to handle this situation would be to merge Penn Square into another institution at whatever costs and not make waves.

Mr. SCHUMER. Probably shortsighted.

Mr. ISAAC. A merger was very tempting.

It was difficult to arrive at the conclusion we did in this situation.

On the other hand, if we had taken the merger route, with as much mismanagement and possible other irregularities as seemed to be involved in this situation, how would we ever achieve any marketplace discipline in the financial system?

How would we get credit unions like the Wright Patman Credit Union to start making intelligent investment judgments about the institutions with whom they do business?

So on the one hand, there was a natural concern about not creating a lot of waves, and on the other hand, there were concerns about where the system was headed if we didn't impose some discipline on it.

Furthermore, we have an FDIC statute which very clearly sets out a cost test, and we couldn't make that cost test finding here because of the contingent liabilities.

So even if we had decided to go the other direction and smooth it out, we didn't feel we could legally do that under the laws you have provided for us.

I am frankly not here to ask that the laws be changed.

I don't think Paul Volcker was on one side of the issues, and Bill Isaac on another side. I think we both recognized the same issues. We had a lot of discussions about them and in the end, we were all in agreement—including Mr. Conover—on how this situation should be handled.

Mr. SCHUMER. One of the few victories against socialism for the rich in this administration.

The CHAIRMAN. Would you repeat for me, Mr. Isaac, your description of the management and what was wrong, the irregularities?

Mr. ISAAC. I stated that it was mismanaged.

The CHAIRMAN. That it was mismanaged.

Mr. ISAAC. And other possible irregularities.

The CHAIRMAN. I want to insert an excerpt from the committee report pertaining to the section of Public Law 95-630 that was cited to Mr. Homan a moment ago. This is under section "C, Removal and Suspension of Insiders."

[The excerpt from the committee report referred to by Chairman St Germain follows:]

C. Removal and Suspension of Insiders

The agencies have also forcefully stated that present law authorizing removal of an insider from his position is unduly restrictive upon the agencies in their performance of their duties to insure that the nation has a safe and sound banking system. Presently, an individual may be removed only on a showing that the individual is engaging in unsafe and unsound practices which have an adverse effect on the institution and that the individual's activities involve personal dishonesty. This standard has hampered the agencies in their efforts to take timely action to make certain that individuals whose actions are seriously damaging the institution may be removed from their positions.

Your committee has provided statutory language which will give the regulatory agencies a less burdensome test under which they may institute removal proceedings. The provisions would authorize removal when an individual has evidenced personal dishonesty (current standard) or has demonstrated willful or continuing disregard for the safety and soundness of the financial institutions.

This new standard will allow the agencies the opportunity to move against individuals who may not be acting in a fraudulent manner but who are nonetheless acting in a manner which threatens the soundness of their institution. As with the other powers given the agencies, requirements for due process are built into the removal statute.

The language in the bill also corrects existing law with respect to removal and suspension of individuals indicted or convicted of specified crimes. In the *Feinberg v. FDIC* case, the court held that the suspension and removal statute was deficient since it did not provide opportunity for hearing and review of an agency's action. Under the provisions of H.R. 13471 an individual will now have that opportunity.

Mr. HOMAN. Mr. Chairman, I—

The CHAIRMAN. Have any of these been brought to court? Has there been a removal or intent to remove in a court case, in suit? In other words, has there been a court interpretation of the revised statute or would the court ignore the committee report?

Mr. HOMAN. I am not sure I know the answer to that. I do not know the answer to that question. There have been very few removal proceedings.

The CHAIRMAN. You don't know if any have gone to court?

Mr. HOMAN. I think each one has been settled prior to that determination by a court. I am not sure. We can research that question.

The CHAIRMAN. I hope you would. We will be revisiting this.

Mr. HOMAN. We will be glad to provide our legal interpretation of that statute and how we as an agency interpret that.

[In response to the information requested by Chairman St Germain, the following letter was received from Mr. Homan for inclusion in the record:]



Comptroller of the Currency
Administrator of National Banks

Washington, D. C. 20219

July 29, 1982

Dear Mr. Chairman:

The purpose of this letter is to clarify the testimony before your Subcommittee on July 15, 1982, regarding removal powers under 12 U.S.C. §1818(e). That statute permits each of the Federal financial institutions regulators to institute removal proceedings against an officer or director of an insured financial institution under certain specified conditions. In order to justify removal under the statute, the regulator must establish at a formal hearing before an administrative law judge that the following criteria have been satisfied:

- I. That the officer or director of the insured bank has committed:
 - A. any violation of law, rule, or regulation or of a cease and desist order which has become final; or
 - B. has engaged or participated in any unsafe or unsound practice in connection with the bank; or
 - C. has committed or engaged in any act, omission, or practice which constitutes a breach of his fiduciary duty as such director or officer; and
- II. The agency determines that the bank has:
 - A. suffered or will probably suffer substantial financial loss or other damage; or
 - B. that the interests of its depositors could be seriously prejudiced by reason of such violation or practice or breach of fiduciary duty; or
 - C. that the director or officer has received financial gain by reason of such violation or practice or a breach of fiduciary duty; and

III. That such violation or practice or breach of fiduciary duty:

- A. is one involving personal dishonesty on the part of such officer or director; or
- B. one which demonstrates a willful or continuing disregard for the safety or soundness of the bank.

The removal provisions of the Financial Institutions Supervisory Act of 1966 (FISA) as amended by the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRA), as described above, may be invoked only under the combination of special circumstances delineated in the statute. 12 U.S.C. §1818(e) has not been subjected to direct judicial review; nevertheless, Congress made it clear when it gave the agencies the removal power that it was an extraordinary power and was not to be used by the agencies to remove an officer or director from a bank on simple grounds of incompetence or poor judgment.

The removal power is an extraordinary remedy which this agency has used on only a few occasions. The reason the agency has not needed to utilize the power is that, ordinarily, when management problems are brought to the attention of the directorate, the directorate takes action to correct them. It is a principal responsibility of the board of directors to ensure that the institution is properly managed. Thus, in the normal course, where problems are identified the board of directors will resolve the difficulties through management changes. If the board of directors does not take action to change management and there is a statutory basis to remove the individual from the bank this Office would not hesitate to consider the need to use the removal statute.

In the instant case, while problems existed in the bank prior to the April 1982 examination, in our opinion, based on the information known at the time, these problems did not then rise to a level satisfying the strict three-criteria removal standards of 12 U.S.C. §1818(e). The problems as identified in prior examinations indicated that the management team needed strengthening. The formal cease and desist Agreement required, among other things, that the board of directors evaluate and make adjustments to the current management team both in quality and depth. Because of that Agreement, the bank responded by augmenting its management through the hiring of personnel from other financial institutions. This was viewed as a positive

response to the previously identified management problems. Under the circumstances, removal was viewed as neither appropriate under the statute nor necessary to effect management changes.

Sincerely,



Paul M. Homan
Senior Deputy Comptroller
for Bank Supervision

The Honorable Fernand J. St Germain, Chairman
Committee on Banking, Finance and Urban Affairs
2129 Rayburn House Office Building
Washington, D. C. 20515

The CHAIRMAN. Our intent—remember this was in response to a complaint that we received prior to 1978 when we adopted this statute. Our intent was to give you the power that you needed without a finding of fraud or illegality. If that wasn't enough maybe we ought to revisit it. I think you ought to have that power. I think you have it.

Mr. HOMAN. We would be glad to give you our internal analysis. I do know that is how our agency applies it. That there must be a personal act of dishonesty present before we start a removal.

The CHAIRMAN. In other words, you ignore the statute.

Mr. HOMAN. No; that is the advice that our general counsel gives us, that we must have that factor present before we are able to go forward.

That may be a fallacious interpretation, but it is the agency's legal opinion.

The CHAIRMAN. How does the FDIC interpret that?

Mr. ISAAC. I think we have different legal interpretations.

The CHAIRMAN. You agree with me?

Mr. ISAAC. That is what my lawyer tells me.

The CHAIRMAN. Good. Excellent counsel.

Mr. Patman?

Mr. PATMAN. Mr. Conover, was First Penn the parent company of Penn Square?

Mr. CONOVER. Yes; it was.

Mr. PATMAN. How many banks did First Penn own?

Mr. CONOVER. It is a one bank holding company.

Mr. PATMAN. Did it perchance drain off any assets of Penn Square?

Mr. CONOVER. I don't think it did, no.

Mr. PATMAN. Were there any unusual or excessive charges made of Penn Square by First Penn?

Mr. CONOVER. Not that I am aware of.

Mr. PATMAN. OK.

Mr. HOMAN. There were some intercompany transactions which we moved to abate during the final few days of the examination. We had no evidence of any particular abuse between the bank and the holding company in previous examinations.

Mr. PATMAN. First Penn didn't own interest in any other banks or financial institutions?

Mr. HOMAN. I don't believe it did.

Mr. PATMAN. Was it the characteristics of the loans or transactions of this bank that the bank, its directors, its parent company, any of its subsidiaries, officers, or employees would take a proprietary interest in business deals brought to the bank?

In other words, did they try to take a piece of the action?

Mr. HOMAN. Yes; there were substantial insider transactions between the bank and certain directors, officers, employees, and shareholders.

Mr. PATMAN. They would try to take a part of a drilling deal or something like that and gain some interest in it?

Mr. HOMAN. Generally, yes.

Mr. PATMAN. Has your office been contacted by any person in political office or associated in any way with a particular governmental office during your examination of Penn Square?

Mr. CONOVER. No; not that I am aware of.

Mr. PATMAN. Is that true of all three of you?

Mr. ISAAC. I don't know that I understand the question.

Mr. PATMAN. Has your office been contacted by anyone in political office during your examination?

Mr. ISAAC. We didn't examine Penn Square, so, no. The answer is no.

Mr. HOMAN. Other than the people in the Federal Government? We were in contact with a good many people in the Federal Government in counterpart agencies, with the U.S. Treasury and the like.

Mr. PATMAN. Any elected officials contact you?

Mr. CONOVER. No.

Mr. PATMAN. You are each saying no?

Mr. ISAAC. Contacting about Penn Square?

Mr. PATMAN. Yes, that is right.

Mr. ISAAC. No.

Mr. PATMAN. Why didn't you have a person in the bank on the job at all times during this difficult—especially in the last few months?

Mr. CONOVER. Since the examination started in late April we would have had examiners on the scene in the bank, I believe, virtually every working day. We had a presence in the bank certainly during the week prior to its failure and every day over that weekend.

Mr. PATMAN. Now, Mr. Isaac, you say that there are no similar pervasive problems within the financial institutions in the industry. Are there similar problems in the industry that do not exist? When you say pervasive, do you mean throughout the financial industry or aside from the 365 banks that you have identified as having problems?

Mr. ISAAC. First of all, the number is not 365 that we have on our problem bank list; it is approximately 268. Those institutions do not have the characteristics of Penn Square, because Penn Square was a unique case.

There are always going to be some problems in the system. You have 15,000 institutions and occasionally one of them will get into

trouble, and occasionally one of them is going to fail. Right now our problem bank list is somewhat higher than average. Not as high as you would think it might be in light of the high interest rates and economic turmoil we have experienced.

But I think it might be a serious mistake to say that what happened in Penn Square exists elsewhere. This is not evidence of any widespread problems at all.

Mr. PATMAN. You are not saying that problems similar to those found in Penn Square do not exist elsewhere in the banking system?

Mr. ISAAC. That there are not banks somewhere that have made bad loans sufficient to threaten the institution? No, I wouldn't say that.

Mr. PATMAN. Those are the only problems you see in common? Those are the only problems you see in common between Penn Square and any other banking institution?

Mr. ISAAC. Right. Earlier, Mr. Annunzio said each time you have a bank failure you say it is unique. He asked, how can you keep on saying that these are unique? Isn't there a pattern?

The answer is no. If you stop and think about the number of institutions in the country and the number that fail, I think it is very easy to come to the conclusion that the problems of those institutions that have failed are unique. In some cases you have outright fraud involved. In other cases you have gross mismanagement.

Mr. PATMAN. This insider dealing Mr. Conover described, you didn't see any insider dealing that Mr. Conover described?

Mr. ISAAC. I am not ruling out there may have been insider dealing in Penn Square.

Mr. PATMAN. I am asking did you see any of it?

Mr. ISAAC. We did not examine the bank. We are starting to examine it now.

Mr. PATMAN. So you don't know if it is there or not.

Mr. ISAAC. We do not know yet.

Mr. PATMAN. Really you can't testify about how unique this situation is then, can you?

Mr. ISAAC. I know enough about it to know that the banking practices in which this bank engaged are not generally practiced throughout the industry.

Mr. PATMAN. But you have not examined the bank, so you really don't know a great deal about it; is that true?

Mr. ISAAC. We don't know as much as we should know, but we do know generally what caused the problems.

Mr. PATMAN. Thank you very much. My time has expired.

The CHAIRMAN. Mr. Homan, were you with the Comptroller's Office when Franklin National failed?

Mr. HOMAN. Yes; I was.

The CHAIRMAN. You know it occurs to me—correct me if I am wrong in my memory. I am trying to refresh my memory by partisan staff work. As I recall it, one of the principal reasons for failure of Franklin was they were speculating in foreign currencies. They had a little cellar where they were speculating in foreign currencies. During the examination process, the examiners had examined that particular facet of it and gone on to others, and while the

examiners were still in there Franklin National failed. Is that correct? Is my memory correct?

Mr. HOMAN. Congressman, I was an examiner in California at the time, and I just cannot—I do not know the answer to that question. I do know—

The CHAIRMAN. The further point is—

Mr. HOMAN. You are right, the foreign exchange losses in the bank were a contributing factor to Franklin's failure. I don't know whether our examiners were there continuously.

The CHAIRMAN. My recollection is that the examiners had been through that phase of the bank and gone on to others, and were still there examining. That points out two things: first, it was admitted by the Comptroller at the time that one problem was the examiners who went through that phase of it didn't know enough about it to really evaluate it; second, the enormity of some of these examinations really imposes a tremendous burden. It is a great responsibility for the Comptroller's Office.

I want to cite the fact that I appreciate that. I agree to it.

Mr. Homan, you said to the members here while it is wonderful hindsight, you know, having been here through Sharpstown, the Rent-A-Bank thing in Cariso Springs, Franklin, USNB, those are just the ones where we really looked into them thoroughly. When do you cease talking about hindsight and start talking about foresight? That is why we gave these additional powers in 1978.

I didn't even mention the Calhoun Bank in Georgia. As you recall, that one we looked into as well.

I had a question of Mr. Isaac, which you probably answered, but I would still like to ask it. How come 150 credit unions, a number of S. & L.'s and a number of other jumbo depositors put money into a shopping center bank in Oklahoma City, Okla. How did it get there?

Anybody care to respond to that?

Mr. CONOVER. I think it got there in two ways. Much of it got there through money brokers who attracted funds from all over the country, because there certainly were financial institutions from a good number of States with no particular geographic concentration as I recall.

Second, I believe that the bank did some direct advertising on a nationwide basis, also, to attract funds.

The CHAIRMAN. Was the advertising saying they were paying more than other institutions?

Mr. CONOVER. I am not sure that it was, Mr. Chairman, but I would presume it probably did.

The CHAIRMAN. What fee does a money broker get for placing a \$1 million deposit? Do you know what the average fee is?

Mr. HOMAN. I have heard it may be up to 25 basis points.

Mr. CONOVER. I don't know.

The CHAIRMAN. Is there any way for us to find out at future hearings?

Mr. HOMAN. We can find that out.

Mr. CONOVER. We can find that out.

The CHAIRMAN. Before you go back too far, FDIC has a credit union.

Mr. ISAAC. Yes; it does.

The CHAIRMAN. Do you know whether or not?

Mr. ISAAC. I don't know, but I am told by one of your staff people that it does not have any investments in Penn Square.

The CHAIRMAN. Am I correctly informed that these receivership certificates can be taken to the discount window at the Fed at this point?

Mr. CONOVER. Yes; that is correct.

The CHAIRMAN. Do you know what they are paying?

Mr. ISAAC. The receivership certificates held by depository institutions?

The CHAIRMAN. That was my next question.

Mr. CONOVER. As I understand it, they are lending 90 percent of the face value of the receiver's certificate at the discount rate.

The CHAIRMAN. Ninety percent.

Does that indicate to Mr. Isaac that—

Mr. ISAAC. They are lending 90 percent of the 80 percent.

The CHAIRMAN. Ninety of the eighty.

Mr. ISAAC. In other words, they lend 72 percent against the face amount.

The CHAIRMAN. That is the number that I had here.

My next question was to whom?

Mr. ISAAC. To depository institutions—credit unions, S. & L.'s and commercial banks.

The CHAIRMAN. So that little old widow who worked hard all her life can't use the discount window if she had \$1 million dollars in there.

Mr. ISAAC. You would have to talk to the Federal Reserve about that, but it is my understanding—because this is an issue we discussed over the course of the weekend when we were trying to resolve this situation—that the Federal Reserve does not have authority to make that available in these circumstances to the individuals as much as it might like to.

The CHAIRMAN. Continental was informed of the fact there were problems at this bank 6 days before?

Mr. CONOVER. I don't know if that is the precise number, but it was during the previous week. Yes.

The CHAIRMAN. And 2 days later Chase Manhattan was informed.

Mr. HOMAN. I believe that is correct.

The CHAIRMAN. They were told what?

Mr. HOMAN. We advised them that they had significant problems in their portfolio as a result of loans they had purchased from Penn Square and that we were placing them under examination in terms of our trying to come to grips and having their internal people come to grips with the loss exposure in those particular loans.

The CHAIRMAN. So that would indicate to them they should not have any further dealings with Penn Square?

Mr. HOMAN. That was a business judgment that they had to—

The CHAIRMAN. Well, you hope they are sophisticated enough.

Mr. HOMAN. Right, absolutely.

The CHAIRMAN. All right. This bothers me. Again my bipartisan staff informs me that some moneys in credit unions were deposited as late as Thursday before the closure, which would be subsequent

to the time or the date which Continental and Chase were informed of the problems, and put on notice, so to speak.

Is that accurate? Do you know if there were large deposits—

Mr. HOMAN. I am unable to verify that.

The CHAIRMAN. We will be able to get that information later, though, won't we?

Mr. HOMAN. Yes.

The CHAIRMAN. Those are things that are bothersome, and Mr. Isaac brought that up in his formal statement about notice. When do you let people know that there is a big problem? We have been wrestling with that for a long time.

On that point, we all have a concern that the fate of Penn Square centers on adequacy of information available to investors and depositors on the bank's financial condition. Many statements have been made that the information on this bank was either inadequate or misleading whereas others think that someone who was very sophisticated should have—could have known.

I have a few questions. One, what information is now publicly available on our banks?

Mr. CONOVER. Well, obviously their own published financial statements would be and their call reports are available to anybody who would like to get them. I think more recently there is something called the Uniform Bank Performance Report, which is also available to the public through the Examination Council, that has a multipage, approximately 10-page document that has a 5-year history, financial ratios and comparisons with peer groups.

The CHAIRMAN. Is there a \$25 fee for that?

Mr. CONOVER. I believe that is correct.

The CHAIRMAN. So you feel therefore that that information you just cited is easily accessible particularly to people who invest over \$100,000.

Mr. HOMAN. It is, and a good many of the private firms use the same public call report information on tapes and provide investment advisory services to market participants.

The CHAIRMAN. Now, Mr. Isaac, as well as Mr. Conover, is this information sufficient to make an informed judgment about the advisability of depositing or investing in given banks?

Mr. ISAAC. In addition to that, if the holding company is publicly held or the bank is publicly held, you have a significant amount of information through filings required under securities laws.

I believe I said earlier that there was probably enough information out about this institution so that a sophisticated investor could have been—perhaps with the use of some investment advice which many of these credit unions were buying—alerted to some greater than usual risk in this situation. But while I—

The CHAIRMAN. If a money broker is running an investment service for a group of institutions, wouldn't it seem that broker has a fiduciary responsibility since that broker is earning a fee to make these investments?

Mr. ISAAC. If I were in that situation, I would certainly want to make sure I knew everything I could know about that bank, particularly when I was handling that volume of money. I probably would have visited the bank personally and talked to other people in the town if I were pumping in tens of millions of dollars which

apparently was being done here. While I believe there was enough disclosure that a sophisticated investor could have been placed on alert, I would not argue that there should not be more disclosure. I think we ought to search for ways to get more meaningful information about institutions out in a more timely fashion.

The CHAIRMAN. The Examination Council has recommended that we pull back or make some changes; to wit, in one area in particular where we have available in the regional offices reports on insider lending and correspondent lending. That was put into the act of 1978.

Mr. CONOVER. Right.

The CHAIRMAN. In view of what is happening here and what I anticipate we will be receiving as the story unfolds, since both of you are on the Examination Council, and I spoke with Preston Martin from the Fed this morning, I would hope you review that Examination Council recommendation because even if—remember, you just said you are in favor of disclosure, Mr. Isaac.

Mr. ISAAC. Yes. I am in favor of meaningful disclosure and my problem with those particular reports is that they are not meaningful. I think FIRA has accomplished a lot of good, and there are certainly parts of FIRA that have had positive effects. But the disclosures under title VIII and IX are not useful to our people or to people outside the agency.

I would hate to see more institutions file more paperwork with Government agencies if the paperwork is not useful.

The CHAIRMAN. I bet when we finish this you will see credit unions and S & L's looking to see those reports in the future. Let's wait and see.

Mr. Conover, there was an article when there were hearings earlier by another subcommittee wherein it was stated that you would like to streamline your agency, reduce the number of regional offices and the number of examiners.

Are you still embarked on that effort?

Mr. CONOVER. Well, I think there are several different issues there. We are looking and do intend to restructure our field organization. That does not necessarily mean that we are going to reduce the number of offices in the field or the number of examiners.

The CHAIRMAN. Or the number of examinations?

Mr. CONOVER. That is correct. To be sure that you have all the facts, we have also said that we want to look at the examination process to see if there is a way to streamline it because we find that we have something like 70 percent of our examiner hours and the cost of examinations spent on banks with approximately 20 percent of the assets, if I recall the numbers correctly.

When I first saw that information that seemed to me to be a misallocation of the agency's resources, so I suggested that what we ought to do is take a look at that and see if there is some way to modify it. What we have proposed to do is to change the frequency of examinations for small first- and second-rated banks—that is to say healthy financial institutions—to reduce the frequency of a general examination and supplement that with abbreviated examinations in between and greater off-site surveillance. We are in the process of reviewing how we would go about doing that and doing some testing on it to see if we think it would be effective.

The CHAIRMAN. A continuation of what Jim Smith started right after USNB.

Mr. CONOVER. I am not sure.

The CHAIRMAN. Oh, I am.

Mr. Parris?

Mr. PATMAN. Thank you, Mr. Chairman. I just have a couple brief observations, and then one or two brief questions.

Throughout the great portion of this hearing I have been sitting here just incredulous, frankly, because those of us who have had the opportunity to have experiences as members of boards of directors of a bank or other financial institution—and I happen to be one of those—when the Comptroller of the Currency's office classified a loan at my bank we went bananas and between Tuesday and Friday afternoon we increased the compensating balance or curtailed the loan or pledged additional collateral or we did something. I simply fail to understand why there was total non-compliance, apparently, in this situation.

I am not being personally critical of any of you gentlemen or of your agency. I just don't understand this to be honest. Because in my banking experience it can't happen. This is not possible to happen in the real world. But it happened. I think that is really why we are all sitting here in a kind of a state of shock.

Mr. BARNARD. Will you yield?

Mr. PATMAN. I would be delighted to yield to my banker friend from Georgia.

Mr. BARNARD. I have the same observation. I worked in a small country bank and it threw us into a trauma if we got criticized by an examining agency, whether it was Federal or State supervisory authority. I hope this meeting can be kept secret, because if the banks of this country find out that you don't mean business, Lord help us what the banking business will come to.

But all the banks I have ever known just stayed in fear of being criticized by an investigation. Especially if they came back the second year and you still had that bad loan or it was not properly collateralized, and he rolled that card out and said, "Now last year when we were here you had a loan to ABC Co."—man that puts you in shock.

So let's keep this a secret because you are going to have trouble if this story ever gets out.

Mr. PATMAN. To follow up on what the chairman alluded to earlier, the reason why the institutions deposited money there was because it maximized their profits, made the management look good, and I submit to you that if they are not preferential creditors they have de facto preferential treatment because the point I was making in my earlier question is they can take receivership certificates and get 80 percent of the total deposits which they have already gotten 10 percent in cash, and they can roll those back with taxpayers' money again and do the same thing in another lousy institution in a different town.

That is the system under which we live. There is a problem with that. I submit there is a problem with that.

Just one other brief observation concerning Mr. Isaac's comments. Things that might tend to prohibit recurrence of this, and I submit to you that in the five regulatory institutions everybody's

business is nobody's business, and maybe that is what we found here. But on the question of uniform insurance fees, the point I was trying to make earlier, if the institution is getting in trouble and they pay an exorbitant or extraordinary or above competitive rates, what you would do if you classified that as a troubled institution presumably would increase its fees. Then they just have to raise their prices again to cover their costs through the increased fees. It seems to me at least that the question of uniform insurance fees is one of those kinds of things that, an issue whose time has come but you have a long way to go to prove to this member that it is true.

Mr. ISAAC. If an institution is on the verge of failure, increasing its fees is certainly not going to do much except hasten its demise. I would hope that institutions sliding from a class 1 bank to class 2 would get a fee increase, and going from class 2 to 3 would initiate another fee increase. So you catch the problems before the bank gets to the brink. But that is not the whole solution to the problem. That is just one suggestion that might help us. Also, it would be more equitable than the present system.

Mr. PATMAN. I understand what you are saying and there may be some merit to that, but I now have an advanced case of terminal cancer so you want to give me whooping cough so I can hurry. That is just one point.

Mr. CONOVER says in his original statement that this bank was rated 3 pursuant to the uniform financial institutions rating system. And the last sentence of that in the composite 3 category says, overall strength and financial capacity, however, are still such as to make failure only a remote possibility.

My question is, when did somebody, whoever it was, determine that there was more than a remote possibility of failure of this bank?

Mr. CONOVER. The answer to that is, during the examination that began in April 1982.

Mr. PATMAN. So from the beginning of the classification of two and a half years ago it was rated 3 throughout the entire process?

Mr. CONOVER. That is correct.

Mr. PATMAN. Or something in the vicinity of 2½ years?

Mr. CONOVER. Early 1980 to early 1982.

Mr. PATMAN. The question of pending insolvency and failure was not changed to category 4 or 5 during that entire period? Was it in fact seriously considered?

Mr. CONOVER. I don't know if it was.

Mr. HOMAN. No, it was not until the final examination. As a matter of fact, during the September 1981 examination we felt and the examiner reported that the bank was making progress, that its condition was improving. We continued to believe that until we commenced the final examination and we discovered that the problems had grown significantly worse.

Mr. PATMAN. How many of the 268 rated banks are number 3, Mr. Isaac?

Mr. ISAAC. None. They are all category 4 and 5. Only category 4's and 5's are problem banks.

Mr. PATMAN. So it is possible that in addition to your 268 trouble banks you can have a whole batch of number 3's that might have modest problems?

Mr. ISAAC. There are not a whole batch, but there are other banks in the category 3 which require closer than usual scrutiny.

Mr. PATMAN. Could you furnish the committee information as to the number or do you have the number of banks that might be rated as 3?

Mr. CONOVER. I don't know the numbers precisely, but of the national banks there are approximately 260 3-rated banks; approximately, I believe, 30 4-rated; and about 10 5-rated banks. That is out of 4,500 total banks. I have the numbers here. Would you like the precise numbers?

Mr. PATMAN. I would be very much interested.

Mr. CONOVER. This is as of June 30, 1982.

The number of banks rated 3, 260.

Number of banks at 4, 32. Number of banks rated 5 is 9, for a total of 301.

Mr. HOMAN. Those are only national banks.

Mr. PATMAN. Are these in addition to or included in or different than the 268 banks?

Mr. ISAAC. They are included in our list.

Mr. CONOVER. The 4's and 5's would be in Mr. Isaac's list.

Mr. PATMAN. But not the 3's?

Mr. CONOVER. Not the 3's.

The CHAIRMAN. Mr. Barnard?

Mr. BARNARD. Mr. Conover, I am interested in the banks that were so willing to participate in these loans. How many banks are there involved? Is it primarily just two?

Mr. CONOVER. There are approximately 60 banks who were purchasing participations from the Penn Square Bank.

Mr. BARNARD. How do they feel? Are they adequately covered?

Mr. CONOVER. If by "covered" you mean as a result of this will they lose money, that is hard to say on all of them. There have been several of the major ones who have already reported that they will incur significant losses for either the first half year or perhaps for the total year of 1982.

Mr. BARNARD. Sixty banks are going to be involved plus all the other financial institutions that have got deposits there. This is spreading like wild fire; right?

Mr. HOMAN. I think for most of the 60 the participations were just relatively insignificant.

Mr. BARNARD. Two or three were rather significant. Five or six had significant numbers. One as much as \$1 billion.

Mr. HOMAN. That is right.

Mr. BARNARD. Now in case of the participating banks, especially those having a billion dollars in them, will you followup to see what kind of documentation they have for those loans? If the collateral is there, and so forth?

Mr. CONOVER. We are in the process of doing that.

Mr. BARNARD. All right. That would concern me.

Mr. Conover, I noticed in some publication, that as the Comptroller you are making some organizational changes. Is that true?

Mr. CONOVER. That is correct.

Mr. BARNARD. Are any of those changes coming about because of this incident?

Mr. CONOVER. No; they are not because we have not had a chance to even assess whether there is a need for an organizational adjustment as a result of this incident.

Mr. BARNARD. I see. Thank you very much.

The CHAIRMAN. I want to assure you, Mr. Barnard that hopefully if you don't leave the committee that we are going to be asking a lot of questions of a lot of people on this.

Mr. BARNARD. I have another question, Mr. Chairman.

Mr. Conover, inasmuch as the chairman has an interpretation of the law, and Mr. Isaac agrees or he says he thinks he agrees with his interpretation of the law, what are you going to do about your interpretation of the law?

Mr. CONOVER. I can assure you I am going to check on our interpretation of the law.

The CHAIRMAN. If it is a BU graduate, you are in good shape. BU is a good law school. Probably Harvard, though.

Mr. BARNARD. Thank you very much.

The CHAIRMAN. Mr. Patman.

Mr. PATMAN. I just have a short question for all three of you gentlemen, I guess, Mr. Isaac and Mr. Conover and Mr. Homan. Did any elected official, State or Federal, put any pressure on you or your offices in regard to the Penn Square Bank after the problems became evident in 1980?

Mr. HOMAN. Not to my knowledge.

Mr. PATMAN. What do you say, Mr. Conover?

Mr. CONOVER. Not to my knowledge.

Mr. PATMAN. Same with you, Mr. Isaac?

Mr. ISAAC. The same with me.

Mr. PATMAN. That is all I have. Thank you very much.

The CHAIRMAN. Mr. Conover, I would ask you since taking office have you had any discussions with the eminent Mr. Heimann, your predecessor, about Penn Square either previous to the failure or since the failure?

Mr. CONOVER. I have talked with him once on the phone since the Penn Square failure, yes.

The CHAIRMAN. Did he have anything significant to contribute?

Mr. CONOVER. My conversation with him was limited to asking him to please give me some information about what his assessment was of what was going on in the financial markets, and he did that.

The CHAIRMAN. Well, the Chair is going to mull over in his mind whether we should ask the eminent Mr. Heimann to join us at some point in these proceedings. That might help you out.

Gentlemen, I want to express the deep appreciation of the committee for all three of you for your participation today. We all have a great deal, great many more questions but this is only a briefing session, so though I would be prepared to stay to 8 o'clock or 9 o'clock, it is not unusual for this committee to sit that way when we are engaged in interesting dialog. It is my understanding that you have to be up bright and early in the morning for another round on this. You have answered a great many of the questions that are predominant at this point and would really appreciate

your attendance and assistance, and as Bill Stanton said, your willingness to come yourselves, the principals, along with Mr. Homan.

It has been very, very helpful, and we look forward to your continuing cooperation with our staffs as we proceed on this matter.

Thank you.

Mr. HOMAN. Thank you.

Mr. CONOVER. Thank you.

Mr. ISAAC. Thank you.

The CHAIRMAN. We are adjourned.

[Whereupon, at 5:08 p.m., the committee was adjourned, to reconvene subject to the call of the Chair.]

PENN SQUARE BANK FAILURE

MONDAY, AUGUST 16, 1982

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Oklahoma City, Okla.

The committee met, pursuant to notice, at 9:30 a.m., Congress Room, Lincoln Plaza Convention Center, 4345 Lincoln Boulevard, Oklahoma City, Okla., Hon. Fernand J. St Germain (chairman of the committee) presiding.

Present: Representatives St Germain, Evans of Indiana, Barnard, Leach, Weber, and Wortley.

The CHAIRMAN. The committee will come to order.

This morning we start phase one of this committee's effort to find out why Penn Square Bank failed and what can be done to minimize the possibilities for a rerun of this episode.

A failed bank causes severe economic shockwaves in any community. This time the ripples have been felt in the boardrooms from Seattle to New York as bankers have scrambled to find out just what they brought home from the Penn Square supermarket in Oklahoma City. In fact, not even my State of Rhode Island has escaped the repercussions.

The failure of Penn Square Bank comes at an unfortunate time. Our economy is filled with doubts and uncertainties and the prolonged period of high interest rates has produced more concern about our financial system than at any time since the Great Depression.

While our banking system remains unquestionably strong, Penn Square does not help. Nor do the revelations to date inspire confidence that our Federal bank supervisory network has the vigor and the imagination to deal with unusual situations in the financial community. In the case of Penn Square, the creativity of some of the bank's high-powered salesmen may have outstripped the imagination of our regulators.

If bankers are going to drive supercharged, souped-up vehicles, the policemen on the beat are going to have to get out of their slow-moving jalopies lest they be left behind in this economy.

The failure of Penn Square has not been easy on the State of Oklahoma. We realize that the community would prefer to avoid the glare of this type of publicity.

At the same time, I know it is understood that the U.S. House of Representatives has assigned this committee the responsibility and jurisdiction to deal with legislative issues bearing on the Nation's depository institutions. The committee also is assigned the over-

sight function concerning the various Federal financial, regulatory, and supervisory agencies.

Knowing what happened to Penn Square and why it happened is essential to the mandate of this committee. The failure of Penn Square is bad enough. The only thing that could make the fallout worse would be for the agencies and branches of Government which have responsibility for these institutions to sweep the facts under the rug and make no effort to determine whether there is preventive medicine to immunize the banking system against an epidemic of Penn Squares.

We have come to Oklahoma City to make this process as easy as possible for the local people to testify, minimize disruption, and to assure that the committee have input from the people most directly involved and who can help us understand what happened.

For the most part, our efforts have been responded to with fine cooperation. I know that much of this is painful for many of you. But you are to be commended for accepting your responsibility to help establish the facts and to place the tragedy of Penn Square in perspective. Voluntary cooperation of this sort is part of the strength of our economic system. Our American free enterprise system may not be perfect. But when mistakes are made we correct them in the open in keeping with the spirit of an open society that insists on having the information necessary to make its own decisions. In too much of the world, mistakes are hidden and papered over and denied and the interests of the public ignored. In America, thank God, we do it differently.

Six weeks after its death, Penn Square remains a mystery in many respects.

It is true that the bank had massive problems cited in its 1980 examinations by the Office of the Comptroller of the Currency. These were important enough that the Comptroller felt it necessary that a full fledged written agreement be signed. By the spring of 1981, however, the bank had come up with new management, and by the end of that year both the bank's independent auditor, Peat, Marwick & Mitchell, and the Comptroller's examiners tell us they had found at least "modest improvement," yet the bank remained with serious problems.

Six months later, the patient lay dead, despite its yearend medical report of improvement.

Were the "improvements" simply cosmetic and the underlying illness never treated? Or did something drastic happen during the early months of 1982 to completely change the picture?

Despite all the bank's troubles, through all the ups and downs of the 1980-82 period, Penn Square's paper pipelines between Oklahoma and Seattle, Chicago, Michigan, New York and virtually all the points in between continued to flow with both loan sales and purchases of high-priced money.

Was Penn Square caught in the middle of some high-stakes poker game, unable to fold its cards for fear that it would lose everything? As the ante was raised, was it forced to take back some of its least attractive participations for fear the big banks would shut off the pipeline for future participations? And did the frenzy to find money at whatever cost result from the need to keep making massive interest and principal payments on nonperforming

loans participated out to the big banks but serviced by Penn Square?

Was the sudden downturn in the fortunes of the oil and gas industry the final tilt that brought this delicately balanced game crashing down?

And through all this, was anyone really in total control? Or were lines of authority actually split among ownership and management factions in a manner that made any overall control an impossibility?

And did the Office of the Comptroller of the Currency, despite wearing a rut in the road between Dallas and Oklahoma City, ever really understand the dynamics of the inner workings of the Penn Square management and ownership team and its high flying portable energy supermarket? Or did the OCC simply go from A to B to C to D through its manuals without grasping the big picture?

The final cease and desist order issued by the Comptroller comes down hard on insider lending. But this was entered only in the last hours of the bank's life. Did the OCC spot insider problems in time and did they make any effort to track the insiders upstream through the participation loans and the possibility some of this paper found its way back to Penn Square from time to time?

In Penn Square, has a new device been found for that age-old nemesis of sound banking, insider self-dealing? How much self-dealing is buried in the mounds of participations generated in the Penn Square shopping center? We thought Bert Lance had defined insider lending for all times, but Penn Square may have invented a new mail-order variety of an old banking game.

I remain deeply concerned and troubled by the fact that so many investors were caught short in the Penn Square debacle. Certainly, there is strong evidence to suggest that investors should have been more prudent and that they should have engaged in a greater degree of original research before sending their funds off to Oklahoma City for an extra quarter or half a point.

But, the fact remains that a few knew a great deal and that many knew very little about Penn Square. It is difficult for me to reconcile the fact that Government agencies, the Comptroller, the FDIC, and the Federal Reserve, had intimate knowledge of the deteriorating conditions of Penn Square, but allowed the bank to continue to reach out with offers of high yields to investors within hours of the institution's demise. Something is very wrong about this.

The regulators were filling every corner of Penn Square on Friday afternoon, July 2. They knew everything that was happening and everything that was about to happen. Yet, I know that credit unions were allowed to invest hundreds of thousands of dollars that very day in an institution literally clinging to the edge with only the cash infusion from the Federal Reserve to maintain any semblance of solvency.

This committee has looked at more problems and failed banks than all the rest of the congressional committees combined, and never have we seen so many questions funneled into the operations of a single institution.

We intend to continue these hearings and our factfinding mission until we find the answers to all of these questions.

At this time I would like to note the presence of my colleagues. To my right, on the majority side, Congressman Annunzio of Illinois, who is also chairman of the Subcommittee on Consumer Affairs and Coinage; Congressman David Evans of the great State of Indiana; and Congressman Doug Barnard of the great State of Georgia. To my left, we have the Honorable Jim Leach, our ranking minority member here; Congressman Weber of Ohio; Congressman Wortley of New York.

I would also like at this point in time to take this opportunity on behalf of the committee, both the majority and the minority, because we have had our staffs working together on this, to compliment and thank our staffs for the long hours they have been spending on this. Many of you out here and out there in the public who could not be here this morning are probably saying to yourselves, well by now they should have all the answers. That is not the case because indeed and in truth, the entire situation is very complex and complicated and involves reams and reams and crates and crates of records.

For that reason I want to compliment our staffs, both majority and minority, for the many, many hours they have been spending on this, weekends and right through the night, and the many hours they will be spending on this in the weeks and months ahead.

And at this time I would like to recognize our colleague Mr. Leach for an opening statement on behalf of the minority.

Mr. LEACH. Thank you, Mr. Chairman.

I am sure I speak for the committee in stressing we have no desire to participate in a witch hunt for individuals called upon to testify, but rather it is our obligation to unearth just what has transpired in this extraordinary banking situation.

The scandal we are dealing with here is not just how a particular bank operated. It may be and probably is an aberration. The real scandal is how large money center banks greedily participated in poor lending practices; how credit unions risked their deposits; how a major accounting firm failed to register public concern in its audit; and perhaps most of all, how Federal regulators came to understand the problem but failed to act before it was too late.

The Penn Square scandal, in short, is not of men and their foibles; it is of a system and its failures. There are several startling ironies in this breakdown in prudential banking practices. In this banking huckstering, those that were duped were the biggest and most powerful. Continental Illinois, our sixth largest bank; Chase Manhattan, our third largest, both have to write off enormous financial losses.

But losses in the final measure are the public's. The failure of Penn Square involves the largest number of unsecured depositors in recent history. It reflects the greed of money managers across the country who have bid interest rates up to unsustainable levels. My own State of Iowa, for instance, has been swept of funds by money market mutual funds and these in turn have been deposited in money center banks where lending practices were assumed—falsely in this instance—to be prudent.

Oklahoma has been a short-term beneficiary of several billion dollars in loan participation authored by Penn Square. But it is very likely their imprudent lending practices will prove to the

long-term disadvantage of the State and the oil and gas industry. Because of the problems of Penn Square, money center banks may well shy away from lending to the oil industry and cut back on risk loans in general. The flight to quality of government securities that is going on today may help reduce the interest rates of Uncle Sam, but it bodes poorly for those Americans who want to borrow to take risks in a competitive economy—which is what a free enterprise society is all about.

The question that remains now is whether the liquidity crisis in the petroleum industry will not only jeopardize the viability of particular companies but also endanger a significant segment of the U.S. banking system. For the public, the ultimate, catch-22 involved in Penn Square-style banking is that not only did the bank's capacity to package and sell oil and gas loans at a premium push interest rates higher in good times for the petroleum industry, but it keeps them higher during bad. As the cost of money is coming down, money center banks are not allowing the prime rate to fall proportionately. They are in effect asking the public to help them recoup losses sustained through their own imprudence.

I think this is something of concern to the national economy and not simply to the Oklahoma situation we are facing.

Thank you, Mr. Chairman.

The CHAIRMAN. At this time the Chair would note that in compliance with House and committee rules, copies of those rules are available at the witness table. In addition, each witness has been furnished in advance by mail with a copy of the rules.

Since I understand that a number of the witnesses here today will be accompanied by counsel, I want to clarify at the outset what the role of counsel will be. Under clause 2(k)(3) of rule 11 of the House rules and clause (g)(3) of rule 7 of the committee rules, witnesses at investigatory hearings may be accompanied by counsel for the purpose of advising them concerning their constitutional rights and their rights under the House and committee rules, and the relevant statutes of the United States. Counsel will not be allowed to address the committee unless the Chair grants permission to do so. Any inquiries about the treatment of a witness before this committee must be addressed to the Chair by the witness, not by counsel. The Chair will do all within his power to protect the rights of witnesses under the rules and the Constitution.

The Chair will note for the record that there are seven members present, a quorum under the rules for the taking of testimony.

Our first witness this morning is Mr. Eldon Beller, president of the Penn Square, N.A., at the time of its closing.

Mr. Beller, would you be good enough to approach the witness table?

Now, if you would, I would like to swear you in under our rules, Mr. Beller.

If you would raise your right hand.

[Witness sworn.]

The CHAIRMAN. Please be seated.

Now, would you please identify yourself.

**TESTIMONY OF ELDON BELLER, PRESIDENT, PENN SQUARE
BANK, N.A.**

Mr. BELLER. I am Eldon Beller, previously the president of the Penn Square Bank.

The CHAIRMAN. Mr. Beller, if you have a prepared opening statement or a written one, we are prepared to receive it. Otherwise, do you have any opening remarks? If you have any opening remarks, we would be happy to hear them. Otherwise we will go to a question and answer period.

Mr. BELLER. Yes, I have some written comments relative to the time that I became associated with Penn Square Bank, and if you think it is appropriate, I will read those.

The CHAIRMAN. If you would.

Mr. BELLER. When I came to the bank it was under criticism by the Comptroller's office. This was in the spring of last year. It had been placed under a letter of agreement the previous year. The agreement had 10 points, and the bank was out of compliance with 10 of 10.

In July the board was asked to attend a meeting in Dallas, Tex., at the Comptroller's Office. Mr. Clifford Poole, the regional administrator, chaired the meeting. Mr. Poole advised the board that he had called the meeting to place the bank under a cease and desist order. However, because of some new faces he was not going to do so at that time, but that the bank would be examined again in about 90 days.

Mr. Jennings, the chairman and CEO, addressed the group and pledged more effort, and I stated that as the new president, I would use the criticisms of the last examination and the letter agreement as my blueprint for corrective action.

My first observations of Penn Square Bank as the new president was that it was understaffed in all areas and some departments that would have been normal did not exist. For example, there was no overall loan administration, there was no loan review department, there was no collateral department, there was no loan closing department, there was no in-house legal department, there was no financial services department, there was no chief financial officer. The credit department, such as it was, was in chaos. The accounting department was understaffed and behind in workload. The energy department was understaffed, with the head of the energy department controlling the credit department, and he also held letters of credit under his control, and there was no way to determine what contingency the bank had under the letters of credit or loan commitments, either written or verbal.

The need, then, as I perceived it, was to bring together a management team to form management committees, establish departments that didn't exist, hire people to head the departments, and hire staff for the departments.

During the year I was there I hired and developed a management team, formed management committees, executive management committee, asset and liability committee, corrections committee, examination and correction committee, loan review committee, credit policy committee, benefits committee, et cetera, and established all the departments that I referred to earlier that

were necessary, and staffed them with personnel and increased the personnel from 180 people to 400.

In October of 1981 the Comptroller's Office sent a team of examiners to the bank to perform an examination. The written report of that examination was to commend us for the significant progress made in all areas.

At our January 1982 board meeting, Mr. Preston Morrow of the Comptroller's Office addressed the board and repeated the findings of the examination, and commended us for our progress. I asked Mr. Morrow if he agreed that at this time that now, instead of being out of compliance with 10 out of 10 of the articles of the agreement, that we were in compliance or substantial compliance with 10 of 10? He agreed with this.

I further asked him if we could expect to be removed from the letter agreement, and he implied that this might occur in April. All this gave me comfort that the task I had assumed was being accomplished.

In the fourth quarter of 1981, we engaged the firm of Peat, Marwick, Mitchell & Co. to do our yearend audit. The reason for choosing this firm was that they had the staff and expertise necessary, as they do more bank audits in Oklahoma City than any other accounting firm, and I felt they were the best available, and I certainly felt that the bank at this point needed the best.

The result of their yearend audit was to have essentially some of the same findings as the previous Comptroller's examination and to commend the new management for the restructuring and progress that had been made in such a short period of time.

Again, this gave me additional comfort that proper progress was being made.

In April of 1982 the Comptroller again sent a team of examiners to examine the bank. This team consisted of 20 to 30 examiners at different times and continued for almost 3 months, with the final result that they charged off more loans than the capital of the bank and the bank became insolvent.

Only time will tell how many of the charged off loans will be collected.

That gives you a brief history of the year that I spent at the Penn Square Bank, what I found when I got there, and some of the things that I did about it, and the final results.

The CHAIRMAN. Mr. Beller, do you feel today, as you sit before the committee, despite the recitation of that which you were able to do, improving management, internal controls, that you had full cooperation from Mr. Jennings in order to correct all of the areas that needed correction in Penn Square Bank?

Mr. BELLER. I never had complete control or control over Bill Patterson; or the energy department as such. At the time that I assumed the job of president of the bank, I advised Mr. Jennings that even though I had banking background, certain expertise in certain areas, that I was not an energy lender. He concurred that he knew that, that he was an energy lender, and that he would be responsible for Bill Patterson and the energy department.

So the answer to your specific question, sir, is that no, I never did have that complete control.

The CHAIRMAN. Well, we know that Mr. Jennings was an energy borrower, as was Mr. Patterson, is that not correct?

Mr. BELLER. Yes.

The CHAIRMAN. And quite a few of their loans not only from Penn Square but from other banks are also in default.

Do you suppose you could be an expert energy lender if you are not too good an energy borrower? Should you not be good on both sides of that spectrum or coin?

Mr. BELLER. You would think so, wouldn't you?

The CHAIRMAN. As to Mr. Patterson, had you worked with him previous to working with him at Penn Square Bank?

Mr. BELLER. Yes, sir. The previous bank that I was employed by within my supervision fell several departments, and several years ago, roughly 5 years ago, Mr. Patterson was employed in one of those departments that came under my supervision. He was employed in the capacity of more of a PR person.

The CHAIRMAN. PR, that is public relations?

Mr. BELLER. Public relations, making calls on existing accounts and relationships to make them aware that we were knowledgeable they had accounts in the bank, depository relationships, thanking them for the business, things of that nature, and to solicit business, but his primary responsibility at that point was good will calls.

The CHAIRMAN. Therefore, did he have any real—any authority over loan making or loan processing?

Mr. BELLER. He did not have lending authority. He had requested that from me previously and I declined to give it to him.

The CHAIRMAN. To your knowledge, did Mr. Patterson undergo a training program or any formal education of any type, shape, manner, or informal education that would have increased his capacity and ability as an expert in energy loans between the time that you knew him and his departure from his previous employment and the time that you met him in his new capacity at Penn Square Bank when you went to Penn Square Bank?

Mr. BELLER. Certainly this was a question that I had on my mind, and in conversation with the chairman of the board, Mr. Jennings, at the inception, I raised this issue and he said well, you know, when he worked for you or at least under your supervision, that was 4 to 5 years ago, and since that time he has been well trained and in my opinion is an expert in the energy lending business, and I had no reason to doubt that in its entirety because certainly the bank had a reputation of doing a lot of energy business, and they were doing it with sophisticated upstream banks who are supposed to be the authorities in that area with expertise and staff and know what they are doing. And so certainly it was considered by me that he had learned a lot from them.

The CHAIRMAN. Whereas, as a matter of fact, in retrospect at this point in time, would you agree that those sophisticated upstream banks thought that Mr. Patterson was the expert and they were relying on him, so that here you were saying to yourself, well, I guess he has learned a great deal because these big, important institutions in those big cities up north are relying on him.

Mr. BELLER. If they had considered him the expert and they in fact had the reputation of being the experts, certainly it wouldn't have taken many questions from them to him to determine that.

The CHAIRMAN. But as we see from the results, they obviously did not ask many questions, did they?

Mr. BELLER. I don't know.

The CHAIRMAN. What would your opinion be? Do you think they asked many questions when we look at what has occurred?

Mr. BELLER. I still don't know. I was not with them, so I don't know what they asked him or did not ask him, or what they neglected to ask him.

The CHAIRMAN. Well, if the point of the matter is there are quite a few of these participations that they purchased that are nonproductive, nonproducing that there are going to be some rather adequate losses inuring to these upstream banks, is that not a fact?

Mr. BELLER. I don't know that as a fact, but I will accept that, to tell you the truth.

The CHAIRMAN. Some of these banks have already written down those loans to a substantial degree.

Mr. BELLER. Yes, sir, you are correct.

The CHAIRMAN. And did they not have loans on which the interest was being paid by Penn Square Bank, even though the borrowers were not paying either interest or principal to Penn Square Bank?

Mr. BELLER. That is correct.

The CHAIRMAN. By the way, were you aware of the fact that that situation existed?

Mr. BELLER. No, sir, I was not aware of it until my chief financial officer made me aware of it. I directed him and with his people to pursue it, to identify and find out what was being paid upstream to whom, how much, get a list, and we developed the list and immediately started work on it and shared that information with the Comptroller's office as soon as we had it.

The CHAIRMAN. When did you receive that or develop that list, Mr. Beller, do you recall?

Mr. BELLER. Near year end.

The CHAIRMAN. That would be year end 1981?

Mr. BELLER. Yes, sir, which I came there in the spring of 1981.

The CHAIRMAN. And you would have provided that information to the Comptroller's office approximately when, January of 1982 or December 81?

Mr. BELLER. I don't recall when. I just know that we did.

The CHAIRMAN. Would it be possible for you to look at your records and determine when you did indeed provide that information?

Mr. BELLER. Well, sir, I do not have any records.

The CHAIRMAN. Who was it who did this for you, Mr. Beller?

Mr. BELLER. Who?

The CHAIRMAN. Yes.

Mr. BELLER. My chief financial officer, who was Jim Gunter.

The CHAIRMAN. Is this one of the gentlemen you brought to Penn Square with you?

Mr. BELLER. Yes, sir.

The CHAIRMAN. Is Mr. Gunter here this morning?

Mr. BELLER. I don't think so. He was not a director.

The CHAIRMAN. I would like to ask you maybe one or two more questions; then turn it over to my colleagues.

Did you tell us that you made the decision to change from Arthur Young to Peat, Marwick, Mitchell & Co. as auditors and accountants?

Mr. BELLER. Did I make that decision?

The CHAIRMAN. Yes, was that decision made by you?

Mr. BELLER. Yes, sir, basically it was made by me. It was also made by me based upon my knowledge of the firm, as I said before, our need, and also on the recommendation of our chief financial officer who said he needed their expertise and abilities and their responsiveness which we did not have with the other firms.

The CHAIRMAN. Now, again, this chief financial officer was Mr. Gunter?

Mr. BELLER. Yes, sir.

The CHAIRMAN. Who made this recommendation to you.

Mr. BELLER. It was also my decision.

The CHAIRMAN. Did Peat, Marwick & Mitchell do the work at the institution that you were previously employed at?

Mr. BELLER. Yes, sir.

The CHAIRMAN. So as a matter of fact, you had worked with them before and had a knowledge of their procedures and their personnel.

Mr. BELLER. And their abilities, yes, sir.

The CHAIRMAN. And their abilities as far as you were concerned.

Did you have cause to feel that the Arthur Young firm was not performing their functions in a proper manner, or was it merely the fact that you were more familiar with the Peat, Marwick & Mitchell than the Arthur Young firm?

Mr. BELLER. Well, the facts are that the chief financial officer complained to me that the AY people would not return his telephone calls.

The CHAIRMAN. They would not return his phone calls?

Mr. BELLER. Right. So how are you going to work with them?

The CHAIRMAN. Our information is that Arthur Young's firm, the gentleman who heads that firm up here in Oklahoma City, indeed, has written quite a few books and manuals on procedures for examination and auditing banks.

Are you familiar with that?

Mr. BELLER. I am not familiar with that. I never met the gentleman.

The CHAIRMAN. You never met the gentleman.

Mr. Leach?

Mr. LEACH. Thank you, Mr. Chairman.

Mr. Beller, it is quite clear you were brought in to tighten things up, and you took some steps in the right direction. It would appear, however, that you were more president in name than in power because this is an energy bank and you obviously have limited jurisdiction regarding energy loans.

I would like to ask a couple of questions. In terms of Penn Square's loan committee, there have been indications that loans were made outside the scope of the loan committee. Were you aware of loans being made without loan committee approval?

Mr. BELLER. Yes, sir.

Mr. LEACH. Was that normal banking practice?

Mr. BELLER. No, but then on the other hand, you have to—I think, at least I rather perceived that the tremendous volume of loans that was going through the bank being participated in through the upstreams, that there were commitments of many kinds, written and verbal, in place that I had no way of knowing anything about on the verbal ones. The pipeline, so to speak, was full but no one knew how much was in it, and I and my management people in our attempts to identify that were very frustrated by it because we could never identify the commitments outstanding, either in the lending or the letters of credit area until such time as we finally were able to get the letters of credit under control and get a punch list on those through the computer.

Mr. LEACH. In any industry there are ups and downs. For example, in the oil industry there have been some strong ups, and it appears now that the industry is in a bit of a down.

Did the bank ever reconsider its bullishness on oil and gas lending based upon the downturn in the oil industry? I ask this in a general sense and in terms of the rules which banks set up regarding how much will be lent in relationship to proven reserves. Did your bank have any rules in that regard, and were those rules kept?

Mr. BELLER. There was an engineering department, petroleum engineers, that reported to and are under the supervision of the head of the energy department. They did the engineering evaluation of reserves, and they discounted those reserves, and that became the basis under which you could make a loan, the amount of the loan, and the discount on the reserves that the engineers determined were there, and with relation to that, not only our own engineers but in the upstream correspondents with their engineering staffs obviously must have concurred with the appropriateness of the amount of reserves and the discounted values.

Mr. LEACH. I have just one further question.

One of the unusual features of your bank, as I understand it, is that you sometimes had bank officers from other banks present. Is that accurate? I mean, for example, did Continental Illinois have a desk in your bank?

Mr. BELLER. Not in that sense of the word. There were almost always bank officers from the other upstream banks in our bank building, but they did not have offices or desks as such. They were there doing due diligence on their part, visiting with the customers in which loans were participated to them through our bank, working with Mr. Jennings, Mr. Patterson and other lending officers in the energy area. So the answer to your question, Mr. Leach, is that yes, constantly they were there, but they did not have offices and desks assigned to them.

Mr. LEACH. How frequently was a Continental or a Chase officer present in your bank?

Mr. BELLER. It would be a guess on my part. I would say weekly.

Mr. LEACH. Once a week.

Mr. BELLER. Certainly, not all weeks.

Mr. LEACH. But there was no desk or place where they would hang their hats?

Mr. BELLER. No they had no assigned desk or office and I did not consider them as a person that was on retainer for the bank, if you will.

Mr. LEACH. Several weeks before the bank failure, was the situation different? Were there many representatives of large banks present?

Mr. BELLER. Yes, and at that time, certainly, there were representatives of all the major upstream banks there constantly for probably a number of weeks. They would be there, 5 from this bank, 11 from that bank. They were in checking the documentations on the various loans that were made, obviously trying to find out where they were in the documentation of the loans that had been participated to them, doing their diligence with their counsel and so on.

Mr. LEACH. I yield to the chairman.

The CHAIRMAN. Could you be a little more specific timewise, Mr. Beller? I would assume that frankly there would have been a great presence for a week, a week and a half prior to the Fourth of July weekend because we have been told—

Mr. BELLER. I agree with that.

The CHAIRMAN. We have been told that within that period of time, the regional offices of the Comptroller of the Currency in Chicago and for New York as well as that for Seattle, Wash., informed the larger participants upstream that they had better take a good look at those loans. In other words, a bit of a red flag went out at that point.

Mr. BELLER. I agree.

The CHAIRMAN. I am wondering, I would be very surprised if they had not been there for 1 week to 10 days prior because that is about the timing of the information given to those upstream banks.

But you, a few seconds ago in answer to Mr. Leach's question, said that there was a larger presence for a few weeks.

Can you be more specific as to when this larger, more continued presence began?

Mr. BELLER. I will try.

As I had said earlier in my statement, in my opening statement, that in the final examination that there was 20 to 30 representatives of the Comptroller's Office there for a period of about 3 months when they finally charged off enough loans and made the bank insolvent. From my memory and my best guess on the timing basis—and now I am answering your questions at this point as specific as I know how—about 30 days prior to the closing of the bank, the examination took a different turn. It was declared to be that more of a national share examination which means that the findings of the Comptroller's Office would then be encumbered upon the upstream banks, so to speak. At that point is when the upstreams started coming in with a lot of people to check out where they were.

If I have answered your question—

The CHAIRMAN. If the gentleman would yield further.

Mr. LEACH. Of course.

The CHAIRMAN. You are aware of the fact that within a few days of the closing that Fourth of July weekend, there was some rather

substantial withdrawals of funds by some of the customers of Penn Square.

Could you tell us what you know about the withdrawals and how they came to your attention and when you learned of them?

Mr. BELLER. The only withdrawal of significance that came to my attention in a specific fashion was when the so-called Hefner withdrawal was made, and that was conveyed to me by my chief financial officer the day it occurred, and that is all I know about it.

The CHAIRMAN. That appeared on which day?

Mr. BELLER. It seems to me that it was probably on the Tuesday before the bank was closed on a Monday, about 1 week before, 5 days, something like that.

The CHAIRMAN. Now, the amount of that withdrawal was—

Mr. BELLER. It has been reported to be \$21 million and \$25 million, and I honestly don't know what the number is now.

The CHAIRMAN. You mean your financial officer at that time—

Mr. BELLER. Well, he knew the number and I knew the number at that time, exactly the amount, but today maybe I have read too many newspapers.

The CHAIRMAN. Well, having read—we have both been reading a great number of newspapers, I am sure, as well as members of the entire committee who are here present. One of the reports we had is that this withdrawal came about as a result of advice from a financial consultant, anonymous, in New York City.

Mr. BELLER. I read the same article, and that is as much as I know about that.

The CHAIRMAN. You would not have any indication as to what might have prompted this withdrawal.

Do you have any opinion, personal opinion as to what might have prompted this withdrawal?

Mr. BELLER. I have no knowledge of what prompted it other than what I read in the newspaper. Other than that, it was common knowledge in Oklahoma City that the bank examiners had been there 3 months.

The CHAIRMAN. But that wasn't unusual. Bank examiners had been there previously for 3 months when previous letters of criticism had been issued, and board of directors meetings held in Dallas. Was that not the case? That is what brought about your taking over the bank.

Mr. BELLER. I don't know how long they were there that time. I wasn't there.

The CHAIRMAN. And if the gentleman would yield further, in addition to that, now we find out that there was a presence, an increased presence of people from the upstream banks, right?

Mr. BELLER. Yes, sir.

The CHAIRMAN. Chase Manhattan, Continental, et cetera.

Mr. BELLER. Yes, sir.

The CHAIRMAN. Do you think that might have come to the attention of some people, some of the more sophisticated people in Oklahoma City dealing with Penn Square Bank?

Mr. BELLER. Well it was difficult to get in and out of the bank because of the number of people that were in there. [General laughter.]

The CHAIRMAN. Now, Mr. Jennings would have known that all of those people were there, right?

Mr. BELLER. I don't know anyone that wouldn't have known they were there.

The CHAIRMAN. And if the gentleman would yield 1 more second, I would like to ask a question now and I will have a followup on it a little later on.

I would like to read this one very carefully. It is a rather important question, and the next one will be as well. We are almost ready with it.

Do you know of any loans from Penn Square Bank to any officers or directors or high level employees of any of the money center banks with which Penn Square was dealing on these rather substantial participation loans?

Mr. BELLER. The only loan that I am aware of in that category was a home loan that was made to Mr. Lytle by Mr. Patterson.

The CHAIRMAN. Mr. who? Mr. Lytle?

Mr. BELLER. Mr. Lytle.

The CHAIRMAN. And he was with which institution?

Mr. BELLER. Continental Chicago.

The CHAIRMAN. Do you know what the amount of that loan was?

Mr. BELLER. I do not recall the amount.

The CHAIRMAN. Did you look at that particular loan?

Mr. BELLER. I saw it after the fact.

The CHAIRMAN. You are aware of the requirements of FIRA legislation with regard to a few years ago, and that also asked that we look at loans to officers of correspondent banks as well, correct?

Mr. BELLER. Yes.

The CHAIRMAN. That being the case, when you looked at that loan, did you look at it rather carefully to see if the loan terms were the same as they would be for anyone else?

Mr. BELLER. I don't recall the details of the loan. I just remember that the loan was made.

The CHAIRMAN. Again, any idea as to what the amount of the loan was?

Mr. BELLER. No, sir. The only thing I can recall about it is that it was a real estate residential loan, as I remember.

The CHAIRMAN. Would the number \$500,000 be within the ball park?

Mr. BELLER. That would be an awful big residential loan. I doubt that, but if I knew the answer, I would give it to you.

The CHAIRMAN. I am sure you would. Believe me, we are most appreciative of the assistance you are giving us here this morning.

Mr. Leach, thank you for yielding.

Mr. LEACH. I have one final question, which does not relate particularly to your jurisdiction but to the committee's. In the last month, there were major numbers of bank representatives present at your bank, but were there any representatives of credit unions present? I raise this because there are those who believe that some banks were tipped off to the problems in Penn Square but credit unions were not. For the record, can you tell us whether there were any credit union representatives present?

Mr. BELLER. To my knowledge, none.

Mr. LEACH. This is important because there are a large number of uninsured depositors and the nature of bank deposits shifted toward those belonging to depositors who lacked insider knowledge and insider protection.

Mr. BELLER. I understand the significance of the impact of that. To my knowledge, none.

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

The CHAIRMAN. Mr. Annunzio?

Mr. ANNUNZIO. Thank you, Mr. Chairman.

Now, Mr. Beller, in your testimony you painted a picture when you became president of Penn Square, you found a situation where there was no loan committee.

Mr. BELLER. There was a loan committee, sir.

Mr. ANNUNZIO. Would you repeat the conditions that you found in the bank? In other words, you came in about 1 year ago?

Mr. BELLER. Yes, sir.

Mr. ANNUNZIO. As you were reading that, the thought occurred to me, here was a large financial institution doing business with other institutions throughout the entire country.

Mr. BELLER. Well, sir, I guess the point that you are probably after, and maybe I can help you reach that point, is that the growth of the bank had been so dynamic that it had literally outstripped its management, its people, its personnel, its physical plant. That growth had been so rapid that the personnel had not been hired to cope with it.

For example, I would say that a bank with a couple of billion in loans, of gross loans that it was servicing, would need more than 180 people, and certainly that bank needed them, but they had not organized it to the point where they could keep up with their own growth. That is the point, and that is when I came in and tried to do something about it.

Mr. ANNUNZIO. And what did you do about it? You are the president of the bank?

Mr. BELLER. The very things that I read to you in my opening statement.

Mr. ANNUNZIO. And what was that?

Mr. BELLER. That I formed these various committees, hired people, set up departments, staffed departments in order to get a control and get a hold of that growth.

Mr. ANNUNZIO. Now, you did all of this to bring about improvement in the internal running and operation of the bank?

Mr. BELLER. Correct.

Mr. ANNUNZIO. However, the bank still failed.

Mr. BELLER. Yes.

Mr. ANNUNZIO. Is that right?

Mr. BELLER. Correct.

Mr. ANNUNZIO. Now, can you tell me what the Comptroller of the Currency did to correct some of the situations that you found, that you were trying to correct?

Mr. BELLER. The Comptroller of the Currency was aware of these situations. They were aware that I came to the bank because of those problems. They were aware on a weekly reporting basis that we sent to their office of the progress being made in the different areas.

Mr. ANNUNZIO. Now, could you put your finger on whose fault we can attribute this failure to, poor management to the Comptroller of the Currency?

Somebody has been at fault.

Mr. BELLER. That's true, but I can't give you that answer. I'm not that smart.

Mr. ANNUNZIO. You know, I find it hard to believe every time you are asked a question, you can't give an answer. I mean, who was running the bank? Were you running the bank? You are the president? Was Patterson running the bank?

We've got to find out who was running this institution if we are going to correct the situation that existed so that it will not happen again.

Mr. BELLER. I understand that and I am trying to cooperate with you, sir.

Mr. ANNUNZIO. I know you are, but I want some answers.

Mr. BELLER. My answer is that I was not the chairman of the board and I was not the chief executive officer. I was the president and chief administrative officer.

The CHAIRMAN. If the gentleman would yield to the Chair, the Chair would like to state that to date Mr. Beller has been most helpful to the staff. Unfortunately, a lot of the records he would like to have he is not in possession of because they were taken by the regulatory agencies when they swept in. But indeed, we find that Mr. Beller has been cooperative. Unfortunately, again, No. 1, the records are not available to him, but second, the other problem that Mr. Beller faces is that, as he states, he was brought in and given partial authority but not total authority.

Mr. BELLER. That is correct.

The CHAIRMAN. I thank the gentleman for yielding.

Mr. ANNUNZIO. Mr. Beller, I am aware of the fact that I have listened to your testimony and I know that you are a very cooperative witness, but on the other hand, you know, it is difficult for me to conceive—and you have answered the question that you were the chief operating officer—you were not the chairman of the board, and other people had and knew more about the inner workings of the bank than you did, but can you tell the committee if there are any customers of the bank who are not officers?

Mr. BELLER. Could you repeat the question?

Mr. ANNUNZIO. Were there any customers of the bank who are not officers?

Mr. BELLER. I give up. I don't understand the question.

Mr. ANNUNZIO. Did anybody borrow money at your bank that was not an officer?

Mr. BELLER. Yes.

Mr. ANNUNZIO. Well, I'm glad to hear that.

You know, as you keep with your testimony, I do not know how often it snows in Oklahoma, but somebody was doing a snow job in portraying this situation at Penn Square.

I have no further questions except that I want to say that for your sake I hope that if the situation arises again, that you will become more cautious about these snow jobs. That is exactly what happened, and this reminds me of a picture of a lot of con artists you see that were conning each other, and they conned some of the

biggest institutions of this country, including some of our own Federal credit unions and thrift institutions. It was like a confidence game. You know, we would all be up in arms if a confidence man had taken some of these very reputable institutions to the woodshed.

Here it was, the Penn Square in little Oklahoma City, took a lot of these big city bankers to the woodshed. Somebody is at fault, and we are trying to find out where that fault lies. It is in either the Comptroller's Office or in the management end of Penn Square, and most important, we want to find out, if we can, if there is any violation of Federal law that occurred so we can pinpoint where these Federal violations were made.

Thank you.

Mr. BELLER. I have some material here that I will read a short paragraph which will help answer one of the questions you asked me a while ago.

Mr. ANNUNZIO. I would be deeply grateful.

Mr. BELLER. Or would more better define the answer, if you will.

Mr. ANNUNZIO. Would you read it, please?

Mr. BELLER. I will read you the first paragraph of the job description of the president of the bank. Under the overall direction of the chief executive officer, "manages all of the bank's activities except the energy division." I will now read you the executive vice president of the energy department's job description, first paragraph. "Directs, coordinates and controls departmental activities concerning the extension of commercial credit to oil and gas customers in accordance with established policies and procedures; reports to the chairman and chief executive officer." The job description of the chairman of the board and chief executive officer, "organizational relationships, reports to the board of director and supervises the president and the executive vice president in the energy division."

The CHAIRMAN. Mr. Beller, let me ask you this.

Mr. ANNUNZIO. I am familiar with job descriptions.

Did you read these job descriptions before you accepted the job as president of the Penn Square Bank?

Mr. BELLER. Yes.

Mr. ANNUNZIO. You did, and you accepted the job that would give you absolutely no authority? After all, you were brought in—you were brought in when this bank was in this situation because the Comptroller of the Currency, as I understand it, had issued a cease-and-desist order back in 1980.

Now, when did you come in as president?

Mr. BELLER. 1981.

Mr. ANNUNZIO. And the cease-and-desist order did exist, and did you know that?

Mr. BELLER. No, sir, there was not an order to cease and desist at that time.

Mr. ANNUNZIO. What was it?

Mr. BELLER. It was a letter agreement.

Mr. ANNUNZIO. Well, a letter agreement is practically the same thing, is it not?

Mr. BELLER. No, sir.

Mr. ANNUNZIO. Where you agree to do—

Mr. BELLER. You agree to do certain things, but it is different from a cease-and-desist order.

Mr. ANNUNZIO. They did not tell you what not to do, just not to do certain things, but the letter was there, but you knew that the bank was in trouble, is that right?

Mr. BELLER. That is why I was hired, to try to help straighten it out, yes, sir.

Mr. ANNUNZIO. Well, they did a hell of a good job. They hired you to straighten it out and gave you no authority. That is the only conclusion I can figure.

The CHAIRMAN. Thank you, Mr. Annunzio.

At this point, was the Office of the Comptroller of the Currency aware of the fact that these job descriptions were in place when you were retained and brought on board?

Mr. BELLER. I don't know.

The CHAIRMAN. Was this job description available to the Office of the Comptroller of the Currency in the documents at Penn Square Bank?

Mr. BELLER. The job descriptions were retained in the personnel department files.

The CHAIRMAN. Those personnel department files were available to and open to the OCC, the Office of the Comptroller of the Currency?

Mr. BELLER. Yes, sir, as everything in the bank is.

The CHAIRMAN. Well, I am in agreement with what Mr. Annunzio has just said, that the curious thing here is that the Comptroller of the Currency was elated about the fact that you were brought in, new management, new personnel being brought in, but it seems a little peculiar that they were not concerned about the fact that you as president did not have the authority you should have had; to wit, as far as energy loans were concerned you were told, hey, that is sacred territory, do not transgress, stay away. That in essence was what it was, was it not?

Now, you may have been willing to buy this, but the thing that bothers me is the auditing firms and the Comptroller's Office gave these reports saying oh, how wonderful, how things have improved. Mr. Beller is there, and he brought in other personnel. You would think that they might know of the limitations placed upon you by these job descriptions.

Mr. Weber?

Mr. WEBER. Thank you, Mr. Chairman.

Mr. Beller, I want to express my appreciation to you the same as the committee chairman for your cooperation and your candor in this testimony today.

Just to set the record straight, is it not true that there was no order to cease and desist until June 30, 1982, as a matter of fact?

Mr. BELLER. That is correct.

Mr. WEBER. And that order was amended then on July 2, 1982, all of which was only a few days before the bank failed on July 5, 1982?

Mr. BELLER. Yes, sir.

Mr. WEBER. And one of the problems, it seems to me, is we did not have an order to cease and desist anywhere nearly soon enough to remedy some of the problems that were existent at the bank.

Mr. Beller, were you ever approached to become the chief executive officer of this bank?

Mr. BELLER. No, sir.

Mr. WEBER. Your duties were to be administrative and limited to the commercial real estate lending department of the bank?

Mr. BELLER. No, sir, that statement you just made is not correct. You said commercial real estate department; did I understand you correctly?

Mr. WEBER. Yes, I did. In other words, what lending functions did you oversee, if you did not oversee the energy lending of the bank?

Mr. BELLER. I was chairman of the credit policy committee, which was formed when I got there, that I put members of the staff in place on, and we reviewed all of the loans that were going through the bank.

Mr. WEBER. Did you also review the energy loans?

Mr. BELLER. The loan review department, which did not exist at the time I got there, which I had to find people to staff it with, it reviewed loans that were classified by the Comptroller's Office and charged off loans, in order to attack those things that we knew were wrong. And those that were classified in the energy department, we reviewed those that were classified.

The department had not been put together long enough to get into the review of the loans in the energy department. It took time to form the department, to find people, hire them, staff them, organize them to get the review started.

Mr. WEBER. Well, did you at any time, Mr. Beller, have the power to deny a loan that had been recommended by Mr. Patterson?

Mr. BELLER. That power was circumvented.

Mr. WEBER. You're saying you did not have that power to deny the loans that were recommended from his energy department?

Mr. BELLER. That is correct.

Mr. WEBER. Not at any time?

Mr. BELLER. The loans were committed ahead of time.

Mr. WEBER. What lending powers did you have, the power either to approve or to disapprove?

Mr. BELLER. Outside the energy area, there was no problem.

Mr. WEBER. There was no problem?

Mr. BELLER. Outside of the energy area.

Mr. WEBER. When you came to the bank—and what was the date that you became the administrative officer?

Mr. BELLER. I came to the bank April 24, 1981.

Mr. WEBER. Were there particular kinds of loans at that time that were causing the bank difficulty?

Mr. BELLER. A tremendous amount of loans that were causing the bank problems, in the form of past due loans that had been made by a previous loan officer at the bank who had resigned the week before I got there, that had created a lot of problems in the bank at that time, and that is where I devoted my efforts in trying to review those loans and determine what the problems were and restructure the loans and file suits in some cases against people who were not paying.

That was the thrust that I gave.

Mr. WEBER. The type of those loans, were those energy related or were they commercial?

Mr. BELLER. No, sir.

Mr. WEBER. They were not energy-related loans at that time?

Mr. BELLER. No, sir.

Mr. WEBER. What was the category for those loans?

Mr. BELLER. The majority of them were horse loans.

Mr. WEBER. I beg your pardon?

Mr. BELLER. Horse loans.

Mr. WEBER. When you became president, I assume that you made some judgment or assessment about the financial health of Penn Square, right?

Mr. BELLER. Correct.

Mr. WEBER. Did you have any feeling that this bank could not be saved at that time?

Mr. BELLER. No, sir, I did not have that feeling.

Mr. WEBER. Did you have any guess as to what the odds would be that the bank would fail within a year?

Mr. BELLER. I had no such feeling.

Mr. WEBER. You had no inclination at all?

Mr. BELLER. I did not expect it to fail.

Mr. WEBER. In retrospect—as Mr. Annunzio has very carefully pointed out, nevertheless the bank did fail—what corrective actions in your judgment should have been taken to have saved Penn Square which were not taken? What could have been done to save this bank?

Mr. BELLER. Stop making so many loans, stop the growth, which is what I was attempting to do.

Mr. WEBER. To operate the bank more conservatively?

Mr. BELLER. Stop the growth, slow it down.

Mr. WEBER. At any time would you have welcomed a more forceful regulation by the Comptroller of the Currency?

Mr. BELLER. I don't know. That would be dependent upon what the situation was, and what that was, I don't know how to answer that.

Mr. WEBER. At any time did you seek a more forceful regulatory policy? Did you have any policies that you wanted to see enforced or brought about that you were unable to bring about, that you would have welcomed the assistance of the OCC with?

Mr. BELLER. I can think of none.

Mr. WEBER. What corrections were taken relative to the Arthur Young qualification? They were the auditors that did the year-end statement for 1980 and they qualified their report with the statement:

We were unable to satisfy ourselves as to the adequacy of the reserve for possible loan losses at December 31, 1980, due to the lack of supporting documentation of collateral values on certain loans.

What corrective action was taken to your knowledge?

Mr. BELLER. As you are aware, that was prior to my coming to the bank. But my opening statement and the various things I itemized to you that were not in place at the bank were the things that were put in place that corrected those situations.

Mr. WEBER. Are you telling us—

Mr. BELLER. The loan closing department, the collateral department, the loan review department; trying to upgrade the credit filings, the functions of the credit department, et cetera. Does that answer your question?

Mr. WEBER. You're telling us that that had nothing to do with the fact that you changed auditors, their qualification—

Mr. BELLER. No, it had nothing whatsoever to do with it.

Mr. WEBER. Mr. Chairman, I have other questions, but I think I should probably surrender to the other members of the committee.

The CHAIRMAN. Thank you, Ed.

At this time the Chair would like to ask two additional gentlemen to join Mr. Beller. They're colleagues of his or were colleagues of his at the bank, Mr. John Preston and Mr. Richard Dunn. Are they here?

[Witnesses sworn.]

The CHAIRMAN. Please be seated. Mr. Preston, if you would briefly identify yourself, I will ask Mr. Dunn to do the same and then we can continue to pursue the questioning.

I would say to the members of the committee that both these gentlemen came in as part of the management team, the new management team with Mr. Beller. The Chair felt that at this point, rather than have them go separately later on, it might be wise to have them join Mr. Beller.

Mr. Preston, if you would just identify yourself to the committee.

TESTIMONY OF JOHN PRESTON AND RICHARD DUNN

Mr. PRESTON. My name is John Preston. I am former general counsel of Penn Square.

The CHAIRMAN. Prior to that you were affiliated with?

Mr. PRESTON. Prior to that time I was senior vice president and general counsel and secretary of the First Oklahoma Bancorporation and vice president, general counsel and secretary of its subsidiary, the First National Bank & Trust Co. of Oklahoma City.

The CHAIRMAN. Which is the institution that Mr. Beller was with prior to coming with Penn Square?

Mr. PRESTON. That is correct, Mr. Chairman.

The CHAIRMAN. Mr. Dunn?

Mr. DUNN. My name is Richard Dunn. I was an executive vice president of the Penn Square Bank. Prior to that I was with First National Bank as senior vice president of the loan administration division.

The CHAIRMAN. At Penn Square you were executive vice president. In what area were you functioning?

Mr. DUNN. As of April 1, I took over the commercial nonenergy, non-real-estate-loan division, and I was hired in to head up and form the loan administration division.

The CHAIRMAN. Thank you.

Mr. Evans?

Mr. EVANS of Indiana. Thank you, Mr. Chairman.

Mr. Beller, did you ever discuss Bill Patterson with Bill Jennings?

Mr. BELLER. Yes, on numerous occasions.

Mr. EVANS of Indiana. Could you elaborate on that?

Mr. BELLER. Well, to the extent that I was seeking Mr. Jennings' assistance in controlling Mr. Patterson from some of his activities insofar as continuing this fast growth in the lending area that I referred to earlier.

Mr. EVANS of Indiana. Could you describe the Patterson-Jennings relationship, please?

Mr. BELLER. Well, Jennings hired Patterson probably 4 to 5 years ago. I'm not sure how long he was there, about 5 years. During that period of time it was my observation after I came to work there that they had become very close friends and worked together as business associates in the energy area with the energy customers, and that they had become extremely close, more like father and son.

Mr. EVANS of Indiana. Could you tell us what happened when you tried to control Patterson's energy department?

Mr. BELLER. Well, the thing that would happen is that you would become circumvented in whatever you were attempting to control, and if then, when you pursued that, Mr. Patterson would secretly inform Mr. Jennings in that regard.

The CHAIRMAN. Would the gentleman yield at that point?

Mr. EVANS of Indiana. Yes.

The CHAIRMAN. Let me ask this. You certainly were interviewed by members of the OCC examining team, the Comptroller of the Currency's examining team, subsequent to your arrival in April, is that correct?

Mr. BELLER. Say that again, Mr. Chairman?

The CHAIRMAN. When OCC, the Office of the Comptroller of the Currency, came—when did they first come into the Penn Square Bank subsequent to your arrival upon the scene in April of 1981?

Mr. BELLER. The first time I met with them after becoming affiliated with the bank is when they called the directors to Dallas for a meeting in July.

The CHAIRMAN. In July. Subsequent to that what was the next instance?

Mr. BELLER. We had an examination in the fall of that year.

The CHAIRMAN. That was in September, correct?

Mr. BELLER. September or October, yes, sir.

The CHAIRMAN. When those personnel were in there during the exam, did they stop into your office and discuss the problems of the bank with you on a 1 to 1 basis?

Mr. BELLER. Yes, sir.

The CHAIRMAN. Either in the meeting in Dallas or in September, did you communicate to the Office of the Comptroller of the Currency, again getting somewhat akin to the job description situation, the problems you were having in controlling the activities of Mr. Patterson and the circumvention of your authority by the team of Patterson and Jennings?

Mr. BELLER. No, sir, I did not have conversations with them in that specific regard. I'm sure they were aware of all of those things.

The CHAIRMAN. Well, how would they be aware of it unless you told them?

Mr. BELLER. They had been examining the bank.

The CHAIRMAN. Pardon?

Mr. BELLER. Through their examination of the bank. Well, I don't know.

The CHAIRMAN. You assumed that they would know that control and authority over energy loans and energy-related loans was being retained by Mr. Jennings and Mr. Patterson, and even though this is one of the big problem areas, this continued quick growth in motivation by Mr. Patterson, you didn't mention this to the regulatory agency representatives in the bank when they came to the bank or the board of directors' meeting?

Mr. BELLER. No, sir.

The CHAIRMAN. You felt that they had ESP?

Mr. BELLER. No, sir. I certainly knew that they knew that Mr. Patterson was the executive vice president in charge of the energy lending.

The CHAIRMAN. And that you had no control or authority over him?

Mr. BELLER. I don't know that.

The CHAIRMAN. I thank the gentleman for yielding.

Mr. EVANS of Indiana. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Wortley?

Mr. WORTLEY. Thank you, Mr. Chairman.

Mr. Beller, what percentage of Penn Square's loans is in the area of energy?

Mr. BELLER. In the neighborhood of 80 percent.

Mr. WORTLEY. Eighty percent?

Mr. BELLER. Yes, sir.

Mr. WORTLEY. The remaining 20?

Mr. BELLER. The remaining 20 were the remaining commercial loans, industrial loans, real estate loans, consumer loans.

Mr. WORTLEY. You mentioned horse loans previously. Are horse loans a special category of loans?

Mr. BELLER. Well, when I said horse loans, that means that the loans were made, the collateral for the loan being horses.

Mr. WORTLEY. Were many of those written off?

Mr. BELLER. Substantial.

Mr. WORTLEY. Were many of those loans made to insiders of the bank?

Mr. BELLER. Not to my knowledge.

Mr. WORTLEY. There were no insiders to whom these loans were written off?

Mr. BELLER. Not to my knowledge, no.

Mr. ANNUNZIO. Would the gentleman yield?

Mr. WORTLEY. Yes, I will, to Mr. Annunzio.

Mr. ANNUNZIO. In answering the question of the gentleman from New York, you again made the statement that 80 percent of the loans were energy related, which means that when you became president you had nothing to say about 80 percent of the bank's business, is that correct?

Mr. BELLER. You could draw that conclusion, I guess.

Mr. ANNUNZIO. Then will you please tell the committee how you could have stopped this growth if you had nothing to say about 80 percent, the energy-related loans?

Mr. BELLER. The facts are I didn't, did I?

Mr. ANNUNZIO. The bank failed.

Mr. BELLER. Yes, sir.

Mr. ANNUNZIO. Thank you.

Mr. WORTLEY. If I could reclaim my time.

The CHAIRMAN. You're on.

Mr. WORTLEY. Mr. Beller, who was responsible in the bank for either selling off or obtaining participation of upstream banks in the loans?

Mr. BELLER. That was Mr. Patterson's responsibility and the area that's known as the correspondent department, who worked under Mr. Patterson's supervision.

Mr. WORTLEY. So the correspondent department was under his jurisdiction as well as the energy loans, is that correct?

Mr. BELLER. That's correct.

Mr. WORTLEY. Is that standard operating procedure in most banks?

Mr. BELLER. Not to have the correspondent department under the energy department, no. But this bank was certainly unique in that area.

Mr. WORTLEY. Did you make any effort to revise that relationship when you came aboard?

Mr. BELLER. To revise it in what regard, sir?

Mr. WORTLEY. Since this was not the procedure in other banks, as the principal administrative officer, did you make a recommendation about changes in that relationship?

Mr. BELLER. The difference between having a correspondent department under the energy department in that bank as opposed to other banks is that we did not have the downstream relationships that you normally use a correspondent department for. So in effect the correspondent department in Penn Square Bank under the supervision of the head of the energy department was more of a syndication department, working with the upstream and downstream banks on loan participations.

Mr. WORTLEY. Was there a limit on the amount a loan officer could make on his own?

Mr. BELLER. Different loan officers had different lending authority, different amounts.

Mr. WORTLEY. What was the maximum of any one officer?

Mr. BELLER. One officer was the legal lending limit of the bank, the legal lending limit of the bank, which was \$3 million.

Mr. WORTLEY. You mean one officer could make a decision of that magnitude?

Mr. BELLER. Yes.

Mr. WORTLEY. Did you make any recommendations about changes in this particular area?

Mr. BELLER. Yes, I made recommendations at different times about different things pertaining to lending authority, yes.

Mr. WORTLEY. Were any of your recommendations adopted in that particular area?

Mr. BELLER. The lending authority of the energy department was separate from the rest of the bank.

Mr. WORTLEY. In other words, none of your recommendations was adopted if it affected the energy department?

Mr. BELLER. Correct.

Mr. WORTLEY. During the first week of December 1981, a choice was made to go to Peat, Marwick, Mitchell & Co. Did you make that decision unilaterally or was that made in conjunction with other officers or the chairman of the board?

Mr. BELLER. To change from one accounting firm to the other?

Mr. WORTLEY. Yes.

Mr. BELLER. That change was made based on the combined judgment of my chief financial officer, myself, the chairman of the board, and others.

Mr. WORTLEY. Had you had any previous experience with Peat, Marwick?

Mr. BELLER. Yes, sir.

Mr. WORTLEY. Would you care to elaborate on that?

Mr. BELLER. Yes, sir. I must say that I worked with the different people of Peat, Marwick, Mitchell & Co. at the place of my previous employment and I considered them to be—to have the expertise that I needed in that bank to give us assistance.

Mr. WORTLEY. Was Peat, Marwick, Mitchell & Co. hired to audit the bank in December? Had any other audit been initiated by another firm prior to Peat, Marwick, Mitchell & Co.'s engagement? In other words, would there have been any duplication?

Mr. BELLER. Not to my knowledge, no.

Mr. WORTLEY. Thank you, Mr. Beller.

I yield back the balance of my time.

The CHAIRMAN. Thank you.

May I ask a few questions before I get to you, Mr. Barnard?

Mr. Beller, the funds that were brought into Penn Square came from around the country, and basically a lot of the funds that were brought in, deposits made, came in as a result of the activities of money brokers around the country; is that a fair evaluation?

Mr. BELLER. Yes.

The CHAIRMAN. Now, do you know when the money brokers were contacted by Penn Square and who at Penn Square was responsible for contacting the money brokers and saying, hey, we need some money and we're going to pay maybe a quarter point over, and what have you?

Mr. BELLER. Well, part of the question was when, and the bank was using brokers for funds at the time I went to work there.

The CHAIRMAN. Prior to your arrival?

Mr. BELLER. Which was normal, for banks to use broker funds.

Later, after I had had a chief financial officer and he had hired a man under him as our money manager, then I guess for the second part of your question, as to who contacted them, our money manager is the one that ended up working with them in the time frame that you're referring to.

The CHAIRMAN. Now, do money brokers get a fee from the institution into which the deposit is made, rather than from the depositor? In other words, money brokers don't work for nothing?

Mr. BELLER. Yes, the answer is yes.

The CHAIRMAN. Would you sort of describe what the process is to the committee?

Mr. BELLER. Well, the brokers put funds into the institution and you paid them agreed-on, negotiated rates for those funds, depending on what market conditions are, with a fee which is also a nego-

tiated rate depending upon what market conditions are with the other people who are bidding for the same funds.

The CHAIRMAN. So those rates, those fees, would vary from time to time?

Mr. BELLER. Daily.

The CHAIRMAN. On a daily basis?

Mr. BELLER. They could, yes.

The CHAIRMAN. Do you know where we might find a record of what those fees were? Where in the bank's records would we find those?

Mr. BELLER. Yes, sir. The financial services department of the bank.

The CHAIRMAN. That was headed up by whom?

Mr. BELLER. That was headed up by Mr. Jim Gunter, chief financial officer, and Mr. Bert Davis, who was the money manager. And they would have those exact records of the funds, where they came from, what day, how much, and what rate.

The CHAIRMAN. Thank you.

Prior to coming to Penn Square, you were with—refresh my memory.

Mr. BELLER. First National Bank of Oklahoma City.

The CHAIRMAN. And had been there for about 10 years?

Mr. BELLER. Twelve.

The CHAIRMAN. Twelve years. At the time you left First National Bank of Oklahoma City, your salary and bonuses, et cetera, amounted to what approximately?

Mr. BELLER. In the neighborhood of \$80,000.

The CHAIRMAN. Then you came to Penn Square National Bank. Is it accurate to state that you came to Penn Square, that they gave you an agreement to employ you for a 5-year period?

Mr. BELLER. That is correct.

The CHAIRMAN. And that was a 5-year period and the agreement included salary plus bonuses?

Mr. BELLER. Yes, sir.

The CHAIRMAN. And could you tell the committee what the salary, basic salary, was?

Mr. BELLER. The beginning salary was, the basic salary, was \$125,000 a year, with a guaranteed bonus of \$30,000.

The CHAIRMAN. So that would amount to a guarantee of \$155,000 per year for the first 5 years.

Mr. BELLER. It was on a sliding scale. That was the first year, yes, sir.

The CHAIRMAN. Would you give us the scale, please?

Mr. BELLER. As I can recall it, I will. The second year the bonus would become \$50,000 or a percentage of the profits of the bank not to exceed 1 percent, and the salary would be \$140,000. And the third year, as I recall, \$150,000, and so on.

The CHAIRMAN. So in the fifth year you would be up about the \$250,000 category, is that accurate?

Mr. BELLER. Correct.

The CHAIRMAN. Mr. Barnard, our real expert here at the hearing on the nitty-gritty.

Mr. BARNARD. Mr. Beller, did you make application for the job as president of the Penn Square Bank?

Mr. BELLER. No, sir.

Mr. BARNARD. How was this association established?

Mr. BELLER. Mr. Jennings solicited me for the job.

Mr. BARNARD. And what was his reason for picking you out for this job?

Mr. BELLER. I don't know his reasons. I know as far as picking me out the reasons he gave me for needing someone was that the growth of the bank was so accelerated that he needed additional help, and that the then-president of the bank's health was not good, and that for those purposes he needed additional help.

Mr. BARNARD. Were you comfortable being president of the bank, being hired under these circumstances, and still not being given the position of chief executive officer?

Mr. BELLER. That was the condition.

Mr. BARNARD. In other words, you agreed to come into this bank as president and yet you were not the chief executive officer and you really had only administrative responsibilities?

Mr. BELLER. That is correct, that I came in not as the chief executive officer, yes, sir. And the chief executive officer was the chairman of the board.

Mr. BARNARD. On the other hand, though, you were chairman of the loan policy committee.

Mr. BELLER. That is correct.

Mr. BARNARD. And what responsibilities were assigned to you as chairman of that committee?

Mr. BELLER. To staff that committee and to look at loans on their submittal basis, to review the loans, to approve or disapprove the loans, and to do other different jobs, as the committee minutes reflected.

Mr. BARNARD. So you might have been chairman, but it was more of an administrative chairman as opposed to a decisionmaking chairman?

Mr. BELLER. The attempt was to do the other, but we didn't get it done, you might say.

Mr. BARNARD. Mr. Beller, you came into office, I believe, in April of 1981, right?

Mr. BELLER. Correct, sir.

Mr. BARNARD. April of 1981. Do you feel that you were successful in bringing in your experience and expertise and changing the direction of the bank?

Mr. BELLER. Successful to a degree that I felt was—during the period of time accomplishments that were made were more than I had hoped to make in that time frame, yes, sir.

Mr. BARNARD. In other words, between April and December the 31st of 1981, you were pleasantly satisfied with your results?

Mr. BELLER. I was satisfied with the results that I had obtained at that time in being able to attract enough people, to set up enough departments, to do the job that needed to be done to try to control the growth of the organization and monitor things through the departments and through the people that were established. And with the examination of the Comptroller's Office in the fall of that year, with their commendation that there had been significant progress in all areas, the answer to your question is, Yes, sir.

Mr. BARNARD. You were satisfied with that result?

Mr. BELLER. I was not satisfied. I was pleased with the accomplishments to date.

Mr. BARNARD. How long did you think it was going to take you to get the policies of the bank developed so you would be satisfied?

Mr. BELLER. My stated target was 3 years. I was there 1.

Mr. BARNARD. Well, in the Peat, Marwick, Mitchell & Co. report of their findings as of December 31, which I'm sure you are familiar with—

Mr. BELLER. Yes, sir.

Mr. BARNARD. It is just replete with criticism on criticism stating that the policies were not working; and went on to talk about the inadequate asset-liability management, the poor liquidity, the no monitoring of credit and collections. From the basis of the statement which was made as a result of the December 31 audit, it appears the practices that you were putting into place didn't have much of an effect on the overall operation of the bank.

Mr. BELLER. They had not had time yet to become effective to the degree that they needed to be.

Mr. BARNARD. But you were satisfied, though, that in spite of all that you were trying to do, without your supervision and control over the energy loans, that you would never be successful in bringing this bank back into compliance, right?

Mr. BELLER. Well, at the end of the year, 1981—I came to work there in the spring of 1981. At the end of 1981 the record shows that bringing it into compliance under this letter agreement had been accomplished almost in its entirety.

Mr. BARNARD. Well, I think we are going to have to determine that. It was determined by the Comptroller of the Currency at one point, to some degree, but they surely did an about-face in April.

Mr. BELLER. I agree.

Mr. BARNARD. Do you think the Comptroller of the Currency was too harsh on your bank?

Mr. BELLER. I don't know how to answer that question, sir. But I will say that the amount of recoveries of the loans that were charged off, that created the insolvency of the bank, may answer part of that question, depending upon the recovery of those loans. And I don't know what that is going to be.

The CHAIRMAN. Would the gentleman yield?

Mr. BARNARD. Yes.

The CHAIRMAN. On the letter that you were reading from, the harsh criticism, I think it should be made clear in the record and to the public at this point that that was a private letter. It is known as a management letter, to the management alone from Peat, Marwick, Mitchell & Co., unfortunately not available to the public, because, had it been, certainly some of those large depositors over \$100,000 might have thought twice, correct?

Mr. BARNARD. Mr. Beller, what was the bank endeavoring to accomplish? What was really the goal of the Penn Square Bank, in view of the fact that you said 80 percent of the loans were in energy, and that it was acting as a brokerage house for three of the large national banks in the country? What actually were you trying to accomplish?

Mr. BELLER. Let me try to answer you this way. At the time I joined the bank, I think it was well known that the stated philos-

ophy of the chairman of the board of the bank was that he wanted this bank to be an energy bank. It was located in a geographical energy area. He had strong relationships with large customers who were energy customers; and that his stated position was that this should be a concept of a merchant bank, which is to say that this bank would put together loans with their customers and participate those loans to other banks who had need for additional loans.

This was the philosophy of the bank.

Mr. BARNARD. Well, Mr. Beller, didn't that violate every principle of banking that you had known of before, because of the element of concentration? I'm sure the First National Bank of Oklahoma City would not have recommended concentration, even in Government bonds, to the tune of 80 percent.

Mr. BELLER. The answer to that, sir, is that when I got there and when I had time to do so and hire people to do so, I established another type of lending known as industrial lending, and staffed it with people that I knew, expanded the real estate area, established a leasing company within the operation, all for the purpose of giving diversification to the portfolio as you related.

Mr. BARNARD. The information we have before us is that even with that there was an unusual and a continuing large volume of energy loans being made and sold. I think the information I've got here is that \$150 million worth of participations went to the First Seattle Bank from November 1, 1980, until the first week of January 1982, which means to me that you were continuing to develop that concentration.

Mr. BELLER. Yes, sir, that is true. That was all previous commitments of things that were being funded at the time.

Mr. BARNARD. Do you think that that is contrary to good banking practices, to concentrate in one area to that degree?

Mr. BELLER. Well, normally that is considered to be true, yes, sir. I would only answer that if you are in a geographical area that is energy you can concentrate in energy pretty significantly, whatever bank you are. If you are in an area that is lumber, well, you would concentrate in that.

It all depends upon how you diversify within the credits, within the industry within which you are concentrating.

Mr. BARNARD. Did you feel like you had that diversity?

Mr. BELLER. It would appear that we did have, yes.

Mr. BARNARD. I have no further questions, Mr. Chairman.

The CHAIRMAN. Mr. Beller, it becomes increasingly clear—and this can be addressed to Mr. Preston and Mr. Dunn as well—that the bank was operating its loan sale program in an unsafe and unsound manner. The bank was attempting to be a merchant bank. However, the procedures for correctly implementing such a program were lacking.

In a memo dated—and I think you referred to this earlier—December 8, 1981, the bank staff outlined the major problems in current operations at that point in time. In particular the memo outlined the problems of interest advances by Penn Square to participating banks on commercial loans.

The memo states:

Correspondent banking is making verbal agreements with the participating banks contrary to the standard participation certificates, such as paid monthly interest

when interest payments terms to the customer are much longer, paid interest to date of extension when extensions are granted, repurchased or recalled participating principal, and recouped interest on granted extensions. The correspondent banks are setting the terms that PSB, Penn Square Bank, must agree with to keep the relationships and maintain reputation of Penn Square Bank.

The memo further states that: "As of November 30, 1981, there was \$2,177,969 of interest alone advanced to participating banks on the loans that were reviewed," only those reviewed.

Now, those are the numbers that you didn't have earlier right, when I questioned you about this?

Mr. BELLER. Right.

The CHAIRMAN. These advances cost the bank approximately \$46,319 in opportunity cost for the funds advanced, because they couldn't lend those out to anyone else, is that correct?

Mr. BELLER. That's correct.

The CHAIRMAN. Given the severity of this problem, what steps were taken to correct these problems, both from operational and an accounting sense, as well as from a legal sense?

Mr. BELLER. When it was learned that this was occurring——

The CHAIRMAN. This is that rather lengthy memo and the pages are numbered here, exhibit A, exhibit B, etc. And this is a memo to James Gunter, executive vice president, financial planning, from Arlyn C. Hill, vice president, dated December 8, 1981. Do you have that memo at this point, a copy of it?

[A copy of the memorandum is inserted in the record at this point.]

TO: James J. Gunter, Executive Vice President, Financial Planning
 FROM: Arlyn C. Hill, Vice President
 DATE: December 8, 1981
 SUBJECT: Interest Advances to Participating Banks on Commercial Loans

Requested:

Review procedures and determine amount of interest advanced to participating banks on commercial loans that is included in Interest Earned, Not Collected account (IENC).

Review large loans and determine cause for increases on those loans.

Identify large customers and participating banks.

Compare extensions to participation certificate agreements.

Review reconcilements of general ledger to trial balance.

Recommend improvements to (1) internal accounting records and controls and (2) operating procedures.

Scope of Review:

Our review included discussing procedures with Commercial Discount and Correspondent Banking Department personnel, tracing accounting entries to supporting records on a test basis, reviewing general ledger account reconcilements, and reviewing each loan, \$500,000 or more, as of November 30, 1981 that was partially or wholly participated in by other banks.

Findings:

Our findings can be classified as (a) causes for advanced interest (b) amount of advanced interest and (c) condition of accounting records and controls.

CAUSES FOR ADVANCED INTEREST:

Correspondent Banking is making verbal agreements with the participating banks contrary to the standard participation certificates, such as:

- a. Pay monthly interest when interest payment terms with customer are much longer.
- b. Pay interest to date of extension when extensions are granted.
- c. Repurchase or recall participated principal and accrued interest on granted extensions.

Accrued interest is not being collected to date of note extension. Extension agreements call for payment of interest "at maturity" of the extension in nearly all cases.

The correspondent banks are setting the terms that PSB must agree with to keep the relationships and maintain reputation of PSB.

Some notes have had as many as 10 extensions without a principal collection and interest is to be collected "at maturity."

AMOUNT OF ADVANCED INTEREST:

As of November 30, 1981, there was \$2,177,969 of interest advanced to participating banks on the loans reviewed. Exhibit A.

The amount of available funds lost during 1981 was \$112,708,796 on the loans outstanding and reviewed as of November 30, 1981. (Amount X number of days of an advance.) This amount does not include paid out, renewed or recalled participation loans and minor adjustments on interest received and forwarded. Exhibit B.

Using a Federal Funds rate of 15%, this operating procedure cost PSB \$46,319 in 1981 on the loans reviewed. (Available funds lost ÷ 365 days x 15%).

CONDITION OF ACCOUNTING RECORDS & CONTROLS

Reconciliation of general ledger accounts was about one month late for both principal and IENC. The "Other Asset-Advances of Interest on Participations" account started November 3, had not been reconciled. The number and gross amount of reconciling items as of October 27, to Commercial Loans, not including Real Estate and Construction to both computer system and general ledger was 135 items totaling \$52,528,381. As of November 30, 1981, the net reconciling amount was \$2,656,629 on loans outstanding and \$88,751 on IENC. Exhibit C.

Prior to November 16th, daily transactions input to the system were not being reconciled to computer output which caused most of the reconciling problems.

Entries to the general ledger are not segregated as to new loans, payments received, interest collected, interest advanced, and other adjustments, etc.

The note transactions by participating bank and PSB (in the note jackets) do not balance to total note on a number of loans.

Recommendations:

Review and revise operating procedures to collect accrued interest from loan customers before forwarding to participating bank. Exceptions to procedures should require the Chairman's or President's written approval.

Review and revise operating procedure to limit number of extensions and require a percentage principal reduction before additional extensions may be granted.

Revise or develop accounting records in the Commercial Discount Department to:

1. Provide totals that can be traced to computer system reports for new loans, payments received, and other adjustments, etc.
2. Provide detail entry totals by transaction type for general ledger posting.
3. Insure loan jacket histories balance to total note and trial balance. (May require revision in payment schedule format.)
4. Provide information on interest advanced on participated notes until current operating procedure is corrected.

Reconcile the general ledger accounts daily to computer system reports for daily transactions. When the reconciling backlog is current, the transaction and balances should be reconciled daily for all accounts. The reconciliation function should be independent from those making the initial entries.

Exhibit A

Penn Square Bank NA
Advance of Interest to Participating Bnks
as of November 30, 1981

<u>Customer Name</u>	<u>Note No.</u>	<u>Participating, Bank</u>	<u>Prepaid</u>
B F & B Drilling	26837	Chase	\$ 28,568.15
Richard Buck, Jr.	26467	Mich. Nat'l.	22,542.46
Executive Airways, ILc.	27267	Chase	114,727.77
J. P. Exploration	26232	Cont'l. Chgo.	4,173.44
Robert Hefner III (1)	28123	Nat'l. McAlester	1,047.95
Robert Hefner III (11)	27383	Chase	469,463.63
Robert Hefner III (1)	23174	Nat'l. McAlester	12,120.05
E. Peter Hoffman (2)	28312	Chase	58,577.26
Jenkins 1980 Drilling Prg.	25502	Cont'l. Chgo.	19,282.79
Robert P. Lammerts (3)	28322	Chase Cont'l. Chgo.	12,928.04 60,655.37
William Lockridge	24399	Mich. Nat'l. Hibernia	16,273.97 92,027.40
Lorghorn Oil & Gas (12)	27623	Utica Nat'l. Mich. Nat'l.	110,027.40 38,509.59
Magnet Drilling (4)	27478	Chase	15,404.79
Mahan-Rowsey, Inc.	27333	Mich. Nat'l.	82,849.31
Maximo-Mooring, Inc.	26650	Chase	178,859.59
Mikes Dozers, Inc.	29059	North Trust H.bernia	15,801.37 1,809.59
W. D. Newsom & Assoc. (5)	26965	Mich. Nat'l. Chase	59,188.77 29,803.93
W. D. Newsom (5)	26959	Sea First Chase	43,996.93 15,797.71
W. D. Newsom & Assoc. (6)	25162	Chase	6,398.63
Oilfield-California Ltd. (Newsom) (7)	26964	Cont'l. Chgo.	11,161.78

<u>Customer Name</u>	<u>Note No.</u>	<u>Participating Bank</u>	<u>Prepaid</u>
Oklahoma-Hughes, Ltd. (Newsom)	(5) 26961	Cont'l. Chgo.	15,164.87
Otex Energy, Inc.	(8) 24319	north Trust	331,714.60
David Palm	25771	Cont'l. Chgo.	8,375.02
Robinson Bros., Drilling	27451	Cont'l. Chgo.	70,170.02
Ramco Well Service	28740	Chase	5,885.48
Samantha Petroleum Corp.	27423	Chase Mich. Nat'l.	52,150.68 5,794.52
Second Geostratic	27135	Mich. Nat'l.	8,687.39
O. L. Scott, Jr.	27188	Chase	52,459.51
Swan Petroleum	(9) 22625	Cont'l. Chgo.	11,749.38
Texas Upsetting & Finish.	(10) 29195 29012	Cont'l. Chgo. Cont'l. Chgo.	12,779.45 24,575.34
Texoma Resources, Inc.	27485	Mich. Nat'l.	12,438.22
Daniel R. Urschel	28646	Bk. of Red Oak	4,824.66
Western Wells Company	21852	Mich. Nat'l. North Trust 1st Wagoner	39,202.40
			<u>\$2,177,969.21</u>

- (1) Interest paid monthly
(2) Interest payment due 9/13/81 extended to 1/18/82
(3) Principal and interest extended from 9/18/81 to 4/17/82
(4) Principal and interest extended from 10/5/81 to 4/5/82
(5) Principal and interest extended twice from 7/31/81 to 12/8/81
(6) Principal and interest extended twice from 6/10/81 to 12/8/81
(7) Principal and interest extended 7/31/81 to 12/8/81
(8) Principal and interest extended 9/30/81 to 12/16/81
(9) Collected \$165,375 11/24; Forwarded \$177,125; Extended 5/5/81 to 5/5/82
(10) Principal and interest extended 10/31/81 to 12/15/81
(11) Principal and interest extended 7/20/81 to 12/20/81
(12) Changed interest quarterly to "at maturity"

Exhibit B

Penn Square Bank, N.A.
 Lost Available Funds by Customer
 11 Months Ended November 30, 1981

<u>Customer</u>	<u>Note No.</u>	<u>Amount of Advance</u>	<u>No. of Days (1)</u>	<u>Lost Available Funds</u>
B F & B Drilling	26837	\$ 28,568.15(2)	87	\$ 2,485,429.05
Richard Buck, Jr.	26467	(1,243.84	28	34,827.52
		(22,542.26 (2)	47*	<u>1,059,495.62</u> 1,094,323.14
Greg L. Cook	25770	20,938.72	175	3,664,276.00
Cromling Drilling Co.	28756	(104,506.85	40	4,180,274.00
		(102,698.63	8	<u>821,589.04</u> 5,001,863.04
Robert Hefner III	28123	(54,340.27	1	54,340.27
		(1,956.16	35	68,465.60
		(2,058.09	8	16,464.72
		(1,047.95(2)	27	28,294.65
	27383	469,463.63(2)	10	4,694,636.30
	23174	(3,294.04	4	13,176.16
		(2,033.50(2)	81	164,713.50
		(5,905.86(2)	60	354,351.60
	(4,180.69(2)	29	<u>121,240.01</u> 5,515,682.81	
E. Peter Hoffman	28312	58,577.26(2)	52	3,046,017.52
Executive Airways, Inc.	27267	114,727.77(2)	51	4,703,838.57
Jenkins Berkey Jt.V.	22793	34,563.73	105	3,629,191.65
Robert P. Lammerts	26706	112,960.27	21	2,372,165.67
	28322	73,583.41 (2)	35	2,575,419.35
	26707	107,979.48	20	2,159,569.60
	19328	5,679.59	7	39,757.13
	26708	25,768.64	14	360,760.96
	19341	10,843.84	6	65,063.04
	19385	(7,608.90	2	15,217.80
		(8,404.11	6	50,424.66
20783	30,682.60	6	<u>184,095.60</u> 7,822,473.81	

Customer Name	Note No.	Amount of Advance	No. of Days (1)	Exhibit B-2
				Lost Available Funds
William Lockridge	24399	\$ (16,273.97(2) (92,027.40(2))	45 89	\$ 732,328.65
				8,190,438.60
				<u>8,922,767.25</u>
Longhorn Oil & Gas	27623	(110,027.40(2) (38,509.59(2) 29,534.25	59 31 123	6,491,616.60
				1,193,797.29
				<u>3,632,712.75</u>
				11,318,126.64
Mahan-Rowsey, Inc.	27333	82,849.31(2)	47	3,893,917.57
Maximo-Moorring, Inc.	26650	178,859.59(2)	33	5,902,366.47
W. D. Newsom:				
W. D. Newsom & Assoc.	26965	(27,759.78(2) (61,232.92(2)	94 33	2,609,419.32
				2,020,686.36
W. D. Newsom	26959	(4,166.14(2) (55,628.50(2)	101 33	420,780.14
				1,835,740.50
W. D. Newsom & Assoc.	25162	6,398.63(2)	33	211,154.79
Oilfield-Calif. Ltd.	26964	11,161.78(2)	33	368,338.74
Oklahoma HXghes	26961	15,164.87(2)	26	<u>394,286.62</u>
				<u>7,860,406.47</u>
J. P. Exploration	26232	(16,972.27 (14,578.43 (4,173.44(2)	1 104 95	16,972.27
				1,516,156.72
				<u>396,476.80</u>
				<u>1,929,605.79</u>
Otex Energy	28247 24319	13,715.75 331,714.60(2)	38 20	521,198.50
				<u>6,634,292.00</u>
				7,155,490.50
David Palm	25771	8,375.02(2)	305	2,554,381.10
Samantha Petroleum	27423	57,945.20(2)	74	4,287,944.80
Joseph Sanson	25093 25109	24,302.93 24,532.77	115 116	2,794,836.95
				<u>2,845,801.32</u>
				5,640,638.27
O. L. Scott, Jr.	22261 27188	10,399.90 52,459.51(2)	2 47	20,799.80
				<u>2,465,596.97</u>
				2,486,396.77
Texoma Resources	27485	(72,123.29 (12,438.22(2)	18 14	1,298,219.22
				<u>174,135.08</u>
				<u>1,472,354.30</u>
Western Wells Co.	21852	(16,688.01 (105,944.56 (47,880.21 (39,202.40	1 14 30 14	16,688.01
				1,483,223.84
				1,436,406.30
				<u>548,833.60</u>
				<u>\$3,485,151.75</u>
Subtotal				\$103,872,643.27
Others, less than \$1 million in Lost Available Funds				<u>8,836,153.04</u>
				<u>\$112,708,796.31</u>

(1) The number of days outstanding is through November 30, 1981 and does not include transactions in December.

(2) Outstanding advances as of November 30, 1981

Exhibit C

Penn Square Bank, N.A.
General Ledger/Trial Balance Comparison
November 30, 1981

	<u>General Ledger</u>	<u>Computer Trial Balance</u>	<u>Difference</u>
<u>November 30, 1981</u>			
Commercial, Real Estate & Construction loans outstanding --PSB portion	<u>\$236,549,125</u>	<u>\$233,892,496</u>	<u>\$2,656,629</u>
IENC - Commercial, Real Estate & Construction	\$ 16,977,505	\$ 18,270,678	
Other Assets-Advances of Interest on Participations	1,381,924	--	
	<u>\$ 18,359,429</u>	<u>\$ 18,270,678</u>	<u>\$ 88,751</u>
Commercial, Real Estate & Construction loan income and fees--11 months	<u>\$ 37,654,454</u>		
% IENC to loans outstanding	<u>7.76%</u>		
%IENC (ending) to income, annualized	<u>44.69%</u>		
<u>December 30, 1980</u>			
Commercial, Real Estate, & Construction loans outstanding--PSB portion	<u>\$179,765,574</u>		
IENC-Commercial, Real Estate, & Construction	<u>\$ 6,483,400</u>		
Commercial, Real Estate & Construction loans income and fees	<u>\$ 22,708,892</u>		
% IENC to loans outstanding	<u>3.61%</u>		
% IENC (ending) to income	<u>28.55%</u>		

Penn Square Bank, N.A.

Advances of Interest to Participating Banks
as of November 30, 1981

Chase	\$1,041,025.17
Michigan National	246,284.23
McAlester	13,168.00
Hibernia	93,836.99
Utica	110,027.40
Northern Trust	347,515.97
Seattle First	43,996.93
Continental (Chicago)	238,087.46
Bank of Red Oak	4,824.66
1 (Northern Trust	39,202.40
(First Wagoner	<u>52,177,969.21</u>
(Michigan National	

(1) Could not distinguish prepaid by bank.

Mr. BELLER. Which part are you referring to now, Mr. Chairman?

The CHAIRMAN. I just gave you the question based upon the entire memo from Arlyn Hill to Mr. Gunter, that was then forwarded to you, that you discussed earlier. This is about the fact that Penn Square Bank was paying interest to the upstream banks when the borrowers were not paying the interest to the Penn Square.

Mr. BELLER. Yes, sir, that is what we discussed earlier, where I think that I said that as we found this had occurred that I asked the chief financial officer to identify in detail and to have his people work on it so that we could correct that and also stop it from occurring in the future, and we did collect the interest from the customers and notified the upstream correspondents what had occurred and tried to put monitoring into place to make sure that it wouldn't happen on an accidental basis again, and advised all the people not to pay interest upstream.

The CHAIRMAN. And so once this was brought to your attention in this December 8 memo—was that Pearl Harbor Day?

Mr. BELLER. Close.

The CHAIRMAN. That was the end; you stopped it?

Mr. BELLER. That is when it was brought to my attention, is when we went to work on stopping it, yes, sir.

The CHAIRMAN. Now, we have been told that you didn't have much authority over energy-related loans and that portion of the bank's business. Did your cease and desist order in this area apply to participations in energy loans as well, controlled by Patterson and Jennings?

Mr. BELLER. I don't understand the last question. Could you say that again, please?

The CHAIRMAN. Earlier this morning you told us that your authority did not exist over energy-related loans and participations, is that not correct?

Mr. BELLER. That is correct to a degree, yes, sir.

The CHAIRMAN. Now, the problems related in this memo of December 8 were primarily problems on energy-related loans that had been sold upstream, correct?

Mr. BELLER. Yes, sir.

The CHAIRMAN. Did you have therefore the authority to stop that practice, since you didn't have authority over energy-related loans?

Mr. BELLER. By working through the chief financial officer and his personnel, through the accounting department, yes, sir.

The CHAIRMAN. You were able to stop it?

Mr. BELLER. We got it stopped, yes, sir.

The CHAIRMAN. And was this, a copy of this memo, forwarded to the Office of the Comptroller of the Currency as well at the time this occurred?

Mr. BELLER. I don't recall.

The CHAIRMAN. But it was available to them when they came to the bank?

Mr. BELLER. Yes, sir.

The CHAIRMAN. You were sending them periodic reports on a voluntary basis, were you not?

Mr. BELLER. That is correct, sir.

The CHAIRMAN. You didn't feel that this was the type of memorandum and practice that they should be made aware of?

Mr. BELLER. The reports that were being sent were the reports that were required to be sent under the letter agreement.

The CHAIRMAN. But as an individual brought in to straighten out this institution, you didn't think that this was a rather unique practice, an erroneous practice that should be stopped, and therefore wouldn't you have fared well with the Comptroller's Office by saying, hey, look at what we found here that was being done, that was certainly improper, we're going to put a stop to it? You didn't feel that was a good report to send forward?

Mr. BELLER. I don't know.

The CHAIRMAN. But you didn't?

Mr. BELLER. To my knowledge, no.

The CHAIRMAN. Mr. Beller, with all due respect, they brought you in because the Comptroller's Office had swooped down and said, hey, unless you make changes you've got bad days ahead. So they brought you in, but they tied one and a half arms behind your back and put you in a wheelchair. Yet they increased your salary to I think what is a rather adequate amount, as a matter of fact a very adequate amount for an institution of this size.

Did you ever go to bed at night and lie down in bed—because that's when I do a lot of thinking and reflection—and say to yourself, am I being used by Mr. Jennings and Mr. Patterson?

Mr. BELLER. No, I did not consider I was being used. I considered that I certainly wanted to accomplish more faster than I was accomplishing it. But on the other hand, some of the things that were being done, I felt that was making great strides.

The CHAIRMAN. I didn't mean that as being disrespectful, Mr. Beller, because I say, these fellows conned Chase Manhattan, they conned Continental Illinois. They conned the best.

Mr. ANNUNZIO. You were in good company. [Laughter.]

The CHAIRMAN. So if they conned you, you shouldn't feel badly, really. I think they conned the Comptroller, too. In fact, I'm becoming more and more convinced of the fact that they conned the Comptroller of the Currency's Office—the past Comptroller, the acting Comptroller, and the new Comptroller. So that they are exceptionally adept at it, and that is why I say, don't feel badly.

But boy, as I sit here and analyze this situation, I have my doubts.

Mr. Beller, in those final days, that last week when not only the temperatures in Oklahoma City got very high, but the temperatures within Penn Square Bank, the shopping center bank, got very high and the tempers got very short, at any point did you consider just giving it up and saying, hey, here are the keys, I'm taking off, I've had it?

Mr. BELLER. No, sir, I did not, because I never thought the bank would close. And I didn't undertake a very, very difficult job just to quit in the middle of it.

Mr. BARNARD. Mr. Chairman, would you yield for a question?

The CHAIRMAN. Why, of course.

Mr. BARNARD. Mr. Beller, in your opinion—and I want to ask this question again—do you think the Comptroller of the Currency

acted hastily in their decision to demand \$30 million of you to replenish your capital and then close the bank?

Mr. BELLER. Well, that was their decision to make and it was not something that we could negotiate.

Mr. BARNARD. But you have an opinion on it, don't you, sir?

Mr. BELLER. Sir?

Mr. BARNARD. You have an opinion? Here you are telling us that you thought everything was going well and that they were implementing the policies that you brought to the bank and things were just going just fine, except that the market price of energy sort of hit the bottom, which I bring up in conjunction with this matter of concentration.

But still, things were going so well. Didn't the Comptroller act a little impulsively, impetuously?

Mr. BELLER. I am not in a position to call that shot. But I think before this hearing is over with it will probably be more apparent than it is today to a lot of people.

Mr. BARNARD. When did you think the bank was doomed?

Mr. BELLER. The day after it was closed. [Laughter.]

Mr. BARNARD. You didn't have that feeling the first day you went to work, though, did you, sir?

Mr. BELLER. No, sir. I never thought the bank would be closed.

Mr. BARNARD. Did you think the FDIC was going to come up with all of that money they have got and bail you out and let you make a good financial merger or an acquisition and then you would be scot-free?

Mr. BELLER. Well, as I've read in the newspapers, I think maybe it's the third time that a bank has been closed that way in about 50 years. What is normal is hundreds of banks are reorganized every year. That is normal.

Mr. BARNARD. That is normal. But on the other hand, if that is what people are looking for as the salvation of their depositors while they run rampant with loose banking policies, that ain't going to happen no more.

The CHAIRMAN. I would like to associate myself with the gentleman's remarks. It's unfortunate for a lot of people. We wish that it wouldn't have happened. But people have got to learn. They have to go a little further, you know.

In reading material since arriving here that the staff has gleaned—did you have any connection with the holding company, Mr. Beller?

Mr. BELLER. Yes, I was vice president of the holding company.

The CHAIRMAN. Were you with the holding company when they were looking for—when they made a private placement to sell some stock in the holding company?

Mr. BELLER. They sold some—

The CHAIRMAN. I'm trying to look for the staff to give me the date of that.

Mr. BELLER. That is what I was going to ask.

The CHAIRMAN. That was May 18, 1981. The reason I asked that is that when I looked at that particular—

Mr. BELLER. May of 1981. No, sir, I would not have been a director—I mean, a vice president—of the holding company.

The CHAIRMAN. They had not put you on board there yet?

Mr. BELLER. No, sir.

The CHAIRMAN. The reason I asked that is that, very frankly, if anyone had seen that private placement letter they would be amazed at the fact that that particular letter did indeed cite many of the problems that existed at Penn Square Bank.

Do you have a question, Mr. Annunzio?

Mr. ANNUNZIO. Thank you, Mr. Chairman.

The CHAIRMAN. Why don't you ask that while I try to find this letter.

Mr. ANNUNZIO. Mr. Beller, for the record I would like to have answered: Who ran the bank?

Mr. BELLER. Who ran the bank?

Mr. ANNUNZIO. Yes.

Mr. BELLER. In all banks, the chairman of the board and chief executive officer run banks on a daily basis, and the board of directors run it overall.

Mr. ANNUNZIO. So that—I want you to tell me, what was the man's name who ran the bank? Who was the chairman of the board and the chief executive officer?

Mr. BELLER. Mr. Jennings.

Mr. ANNUNZIO. Mr. Jennings.

Mr. BARNARD. Mr. Chairman, while you're looking, could I ask another question?

The CHAIRMAN. Mr. Barnard.

Mr. BARNARD. I would like to ask Mr. Dunn a question, if I might. Mr. Dunn, as loan administration officer during this time, as oil prices, energy prices, declined how did the bank adjust its reserves to support the loans that had been made? How was that done?

Mr. DUNN. The engineers in the department, as a matter of normal practice—and I think this is prevalent throughout the industry—would take the discounted cash flow of the proven reserves and come up with a figure. Then they would discount that figure by 50 percent, in essence, to give you a 50 percent cushion.

This is a rather complicated formula, but the annual discount figure could be adjusted upward or downward. It was adjusted upward as inflation and the interest rates continued to remain high. It was adjusted from 12 to 15 percent, as I recall. On the other side, these escalating oil prices that had been prevalent throughout 1979, 1980, and so forth, there was I think an 8 percent factor that was used.

We followed the lead of—I believe I was told we followed the lead of Continental Illinois in this regard and their standards exactly. The normal 8 percent factor applied to oil prices was deleted and through the formula used in coming up with the engineering reserve values the prices were held to be flat for 2 years. This practice was begun I believe in the first quarter of 1982, around January or February.

Mr. BARNARD. Now, you were relying on the estimates of your own engineers, right? They were not outside engineers offering you an unbiased opinion?

Mr. DUNN. In most cases I believe outside engineering was put together and reviewed by our in-house engineers, and also by the participating bank's engineering division.

Mr. BARNARD. Well, was there some type of certification or documentation by outside engineers?

Mr. DUNN. Yes, sir, there were reports put together that were very lengthy and very technical. Our in house engineers had a way of going through the same technical gyrations and coming up with a very simple loan analysis, a page or two which would give you the amount of the loan that you could lend against the reserves based upon the report.

Mr. BARNARD. And your participating banks very agreeably accepted your engineers' reports and estimates?

Mr. DUNN. I wasn't present when any representative—and it was my belief and is my belief that they had their own engineering department in most cases, in the large cases, Continental and some of the others.

Mr. BARNARD. Did their analysts or engineers ever come to Penn Square and make an onsite inspection of your loan portfolio?

Mr. DUNN. Engineers? I don't think I ever met any engineers. However, it would not surprise me if they had. Some of the loan officers with those banks had a petroleum geology degree in their background, or experience with oil companies, before they had gone to work for the banks.

Mr. BARNARD. The staff of your department, the loan administration department as far as the engineers and those administering these loans, did they have prior bank experience?

Mr. DUNN. In some cases. The engineers were not under my jurisdiction.

Mr. BARNARD. Under whose jurisdiction did they work?

Mr. DUNN. Bill Patterson.

I'm not aware of any of them who had prior banking backgrounds. However, they had experience with oil companies. They were very technical, analytical type individuals.

Mr. BARNARD. Thank you, sir.

The CHAIRMAN. Mr. Leach?

Mr. LEACH. Mr. Beller, I think it has been well established that you're not responsible for the bank practices. There is some question however, as to whether you were entirely blind to what was happening. I stress this because some of the losers in this bank failure are local people who bought commercial paper from the bank.

In offering commercial paper for sale, the bank presumably was acting in good faith. On the other hand, there wasn't a lot of disclosure about the bank's problems. Can you tell us the mechanisms by which commercial paper was sold to customers, how much of it was sold, and how much was disclosed at the time of its sale?

Mr. BELLER. Well, it was normal for commercial paper to be sold to some of the major companies that would purchase the paper on different time schedules. I don't know really what I can tell you about that.

Mr. LEACH. The bank holding company sold commercial paper?

Mr. BELLER. Yes.

Mr. LEACH. You were not responsible for that, is that what you're saying?

Mr. BELLER. Well, sir, to my knowledge everything was—commercial paper that was being sold at the bank had been sold there

for a long time, and everything was done in accordance with the manner in which it should have been done.

The CHAIRMAN. Would the gentleman yield?

Mr. LEACH. Of course.

The CHAIRMAN. Well, I just read here that "At present the company invests"—that is, the holding company—"the proceeds of sales of commercial paper in deposits in the bank. Interest paid by the bank by the company is less than interest paid by the company on its commercial paper."

[Chairman St Germain read an excerpt from "Confidential Offering Circular" which appears in the appendix to the hearing as appendix A.]

The CHAIRMAN. In other words, they were selling commercial paper, taking that money, putting it in Penn Square Bank, and getting less from Penn Square Bank for the commercial paper than they were paying to the purchasers of that commercial paper.

Do you think that that is standard order or procedure?

Mr. BELLER. What is the date of that?

The CHAIRMAN. May 1981.

Mr. BELLER. May 1981. What you have read was correct at that time, but I think you will find that later on that we recognized that and we made some changes with it, and that that situation was reversed.

Mr. LEACH. Let me ask about one aspect of your commercial paper sales that alarms me a great deal. In referring to the oil and gas division, you mentioned that some commitments were made in writing and some verbally and that you had a very difficult time understanding them. Is the making of verbal commitments a standard operating procedure of any bank? And, if there were verbal commitments that could not be understood, how could you as president of a bank in good faith sell commercial paper to the people in your community? After all, such an investment is not protected by the Federal Deposit Insurance Corporation.

Mr. BELLER. Well, I do not know how to answer that.

Mr. LEACH. Thank you very much.

The CHAIRMAN. Mr. Annunzio?

Mr. ANNUNZIO. One last question, again, Mr. Beller. I would like to, as you reflect back on being president of the bank, can you give us an opinion? Do you feel that the Comptroller of the Currency knew what he was doing?

Mr. BELLER. Well, I hope he did. My opinion at the time was that, yes, he knew what he was doing.

Mr. ANNUNZIO. But the bank failed. You agree with the decision?

Mr. BELLER. Do I agree with what, sir?

Mr. ANNUNZIO. The decision they made to shut down.

Mr. BELLER. Well, of course, the bank failed because it was rendered insolvent, because they charged off so many loans, and I do not know what those loans are as of this day. I have not seen a list of those loans that were charged off, and the collectability of those loans. How good it is, I have no way of knowing, because I still do not even know what loans were charged off.

Mr. ANNUNZIO. We have been through this before. In other words, you were selling this commercial paper and paying x number of dollars of interest, and actually paying out more than

you were buying for the paper. It reminds me of the deficit that the Federal Government has got. We spend more than we take in.

Mr. BELLER. I became aware of that shortly after I got to the bank, and was very disturbed about it. I did not agree with it, either.

Mr. ANNUNZIO. So what did you do about it?

Mr. BELLER. Well, certainly, we changed it to the point where, as I recall, that that was not the case later.

Mr. ANNUNZIO. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Wortley?

Mr. WORTLEY. Thank you, Mr. Chairman.

One last question, Mr. Beller. Why did Penn Square continue to lend heavily in the face of the oil and gas slump that the industry was going through?

Mr. BELLER. Well, as I said before, trying to relate to what was referred to as the loans within the pipeline, the loans that were previously committed to by Penn Square Bank and their participating banks, those loans were ongoing, and committed to many, many months before the actual funding of those loans. So, as the energy continued to build, the loans and the base that the loans were based off of continued to pyramid itself.

Mr. WORTLEY. In other words, the only loans that were made during the slump were those that previously had been committed?

Mr. BELLER. No, sir. I did not say that. No. There were other loans. None that I can specifically relate to you but certainly it was not all that.

Mr. WORTLEY. And is not prudence the trademark of a good banker?

Mr. BELLER. It should be. Yes, sir.

Mr. WORTLEY. Why wasn't the board of directors—and I am not trying to lay this specifically at your doorstep, because I realize that you had little to do with the loans in the energy area, but why would the board of directors ever tolerate some imprudent action?

Mr. BELLER. I do not think I can answer for them.

Mr. WORTLEY. Were they part of the group that was borrowing?

Mr. BELLER. Well, I think there were some of them, yes, that had loans from the bank, which was normal.

Mr. WORTLEY. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Evans?

Mr. EVANS of Indiana. Thank you, Mr. Chairman.

Mr. Dunn and Mr. Preston, as you know, the Comptroller's Office continually criticized Penn Square for its failure to institute proper asset-liability management systems. In fact, the last examination states that the bank had continued this practice to the end, and had huge volumes of lending commitments and letters of credit outstanding. As major officials of this bank, what steps did you take to address these concerns of the Comptrollers' Office?

Mr. PRESTON. Do you have a preference as to who goes first?

Mr. EVANS of Indiana. No, whatever.

Mr. PRESTON. In the fall of 1981, I was asked by the president to look into letter of credit matters from a legal viewpoint, and at that point I made a recommendation in regard to how letters of credit should be prepared, how they should be booked, that the is-

suance of letters of credit should be removed from the energy division and set up under the loan administration division.

Subsequent to making those recommendations, those steps were put in place, as I recall, in the first month of 1982. In terms of the commitments that were in place, many of those commitments, as I understood them, I did not participate in the lending side of the bank, and was not on those committees, but as I understood them, existed at the time that I joined the bank, because I recall that the Comptroller's Office referred to the large number of commitments at the July 29 board meeting in Dallas. Those commitments were not going to go away, and they would have had to have been funded or they would have had to have been denied by the bank to be funded with the resultant litigation that would arise over them.

Mr. EVANS of Indiana. Mr. Dunn?

Mr. DUNN. I think the first step in the process would be to identify commitments and continue these so that you did not know it existed. As John pointed out, around year end, we sought to put together a new and well staffed letter of credit function, and of course letters of credit are only one part of the whole area of contingent liabilities, but this was one area in which we made some attempts to staff that area, identify the letters of credit that were already on our books as commitments, and to put in place procedures to control future letters of credit in terms of the operational matters involved, what were their terms, their maturity, collateralized or uncollateralized, as well as the legal aspects of the form and substance within the letter itself.

Mr. EVANS of Indiana. And so policies were instituted then to assure that loan commitments and letters of credit could be funded when they were called?

Mr. DUNN. Yes, sir. Could be funded. If the letter is called, you have no choice other than to fund it, so that was not really what we were after. We were trying to gain insight into what already existed within the bank, what had already been committed to, what the bank was liable for.

Mr. EVANS of Indiana. So controls were placed on lending officers?

Mr. DUNN. From an operational standpoint. Yes, sir. In other words, certain procedures were to go into effect before a letter was to be issued. The form had to be approved by not only the lending committee supposedly but the general counsel, and steps were provided from an operational standpoint, was where we made the best gains to identify the portfolio with a minicomputer we put in place in another area outside of letters of credit. The overall contingent liabilities and unfunded loan commitments, for example.

If a loan for \$10 million is committed and initially or at any point the total \$10 million, say, is not funded, the balance remains as a contingent liability of the bank. That had not been identified, and it was a very difficult process with the computer systems and the operations in place to do so, but after months of attempts that was done and provided to the Comptroller when they came to the bank at their normal examination.

Mr. PRESTON. As a member of the asset and liability committee, and as a director, my recollection was that in, I believe, the early part of 1982, there was a policy put in place, if it had not been put

in place before that, that was confirmed, as I recall, to the board and to that committee, that in fact no additional commitments were being made or could be made—that would be policy—without that commitment having been what the bank referred to as presold or in fact a participation in place with a corresponding bank relating to that commitment prior to the time that that commitment was passed on to the borrower.

Mr. EVANS of Indiana. Thank you, Mr. Chairman.

Mr. LEACH. Mr. Chairman?

The CHAIRMAN. Mr. Leach.

Mr. LEACH. It is my understanding that the Comptroller's Office was informed by you at their September 30 supervisory examination that you had placed a \$50,000 limit on Mr. Patterson and his operation. Is that an accurate statement?

Mr. BELLER. I had placed a \$50,000 limit on any funding going out of the bank without it being reviewed before it went to the discount department for funding, because the bank was in a tight situation in regard to loans to deposit ratio, and we were concerned about liquidity. Yes, sir.

Mr. LEACH. You had informed the Comptroller's Office that you had a \$50,000 limit?

Mr. BELLER. Yes, sir.

Mr. LEACH. And yet you have told us that you had no control over Mr. Patterson. Which is the accurate description of the situation?

Mr. BELLER. The accurate description is that I was attempting to control, but was unable to do so.

Mr. LEACH. Was the Comptroller's Office subsequently informed that you were unable to exercise control?

Mr. BELLER. In a formal fashion, I do not know.

Mr. LEACH. I would like to make one final observation relating to Mr. Dunn's comments on the letters of credit. The letter of credit issue should be examined both as a banking problem and an investor problem. As we look at the problems of this bank, which also reflect problems in the oil and gas industry, it is fair to raise some red flags to the American public about highly leveraged letters of credit type operations. They are not as safe as many of us had once thought they might be. While a bank may prudently seek letters of credit to protect itself, the American investing public should be very, very concerned about any leveraged investment involving substantial letters of credit which while they might appear unlikely to be called upon might well have to be called upon.

Would you agree with that, Mr. Dunn?

Mr. DUNN. As general investment advice to the general public, yes, sir.

Mr. LEACH. Thank you very much.

The CHAIRMAN. Mr. Preston. Wait. First, Mr. Dunn, on letters of credit you gave us a nice description of the policy, et cetera, but did that apply to letters of credit as far as Mr. Patterson and his machinations were concerned? Maybe you thought it might apply, but did it indeed in fact apply?

Mr. DUNN. Not totally. No, sir.

The CHAIRMAN. No, because we are aware of the fact that there are some lawsuits pending, are there not, with respect to some of those machinations?

Mr. DUNN. I have read of those. I do not know if those were committed 3 years ago or 1 year ago. I do not think they are recent letters of credit that are involved in those lawsuits. I want to distinguish here between the operational aspects of controlling the portfolio versus the actual lending decisions made. The systems that we were attempting to put in place was step 1, which was to find out what you have so that you can take a look at it and manage it, and see if it is laced with efficiencies and so forth, and set about to correct those, and efforts were made in that area.

The CHAIRMAN. Mr. Preston, as chief legal officer of Penn Square, or general counsel, is that title correct?

Mr. PRESTON. That is correct, sir.

The CHAIRMAN. Did you ever advise the officers of the bank concerning the memorandum that I discussed with Mr. Beller, that is, the payment of interest and principle on nonperforming participation loans to those people who purchased these participation loans without informing the purchasers of the participation loans that interest was being paid by Penn Square on behalf of the borrower?

Mr. PRESTON. To answer your question, first, I have not seen this memorandum to my knowledge until today. I did become aware of the problem of paying upstream correspondents interest when the bank had not collected it from its customer, I believe in May or June of this year, during an examination, and at that time I had been asked by the president to look into the issue. I did, and referred the issue to our outside regulatory counsel. I do not recall whether I wrote a memorandum or not of a general nature or a specific nature dealing with that issue.

The CHAIRMAN. You, I believe, were here when Mr. Beller read us the limitations on his authority as president of Penn Square.

Mr. PRESTON. I was here when he read those, yes, sir.

The CHAIRMAN. Were you aware of those limitations prior to this morning?

Mr. PRESTON. Not until he read them, sir.

The CHAIRMAN. Not until he read them. Did they have intercom telephones in the Penn Square Bank?

Mr. PRESTON. I am sorry, I do not know what you mean.

The CHAIRMAN. Well, I mean, could you call Mr. Beller's office or Mr. Dunn's office on a telephone? Was your office in the Penn Square Bank?

Mr. PRESTON. Yes, sir.

The CHAIRMAN. In the shopping center?

Mr. PRESTON. It was originally removed from where Mr. Beller's was. It was ultimately next to Mr. Beller's.

The CHAIRMAN. OK, but you had communication facilities?

Mr. PRESTON. Yes, sir.

The CHAIRMAN. And there were Xerox machines in the bank?

Mr. PRESTON. Yes, sir.

The CHAIRMAN. And there were secretaries who could type and take shorthand?

Mr. PRESTON. Yes, sir.

The CHAIRMAN. It seems to me there was a lot of lack of communication here. Would you think so, Mr. Preston?

Mr. PRESTON. I do not know how you mean that question.

The CHAIRMAN. Well, you were not aware of this memo that I just referred to until May or June, yet it was a December 8, 1981, memo. You were not aware of the limitations placed upon the gentleman who asked you to come along to Penn Square from your previous employment. Wouldn't that have given you cause to wonder? In other words, I am going over there with a president of an institution, but he is limited jurisdictionwise to about 20 percent of the activities of that institution. Do you not think you should have known about that?

Mr. PRESTON. I believe I should have known about it, but I did not know about it.

The CHAIRMAN. But in all truth, you should have known about it, should you not, so you would be better able to analyze what you were stepping into?

Mr. PRESTON. Yes, sir.

The CHAIRMAN. Is this a promotion or demotion or what? Correct?

Mr. PRESTON. It would have been helpful to know that.

The CHAIRMAN. Well, I would certainly like to know those things if somebody asks me to go along with them.

Let me ask you this. There is a suspicion of the fact, and this is sort of being corroborated because of the facts that are being brought out, to wit, that we are finding participation loans that were sold to upstream banks that were not performing too well, and the next thing you know, they are back in Penn Square, almost to a point, and as I say, I want to make this clear, we do not have it capped yet, we do not have it signed, sealed, and delivered, but it looks very much as though there is a possibility on these loans that there was a tacit agreement, A, you buy this loan, if it ends up being a nonperforming loan, we, Penn Square, will take it back.

Did that come to your attention at any point, any suspicion of that practice?

Mr. PRESTON. It did in, I believe, May or June of this year.

The CHAIRMAN. Did that come to your attention, Mr. Beller?

Mr. BELLER. Not that there were any agreements to buy them back.

The CHAIRMAN. I said tacit agreement. Sometimes you may not see it in writing, but by crackey, the facts as we in the law know, the facts speak for themselves.

Mr. BELLER. I do not know.

The CHAIRMAN. My colleague, the eminent banker from Georgia, tells me *res ipsa loquitur*. I have just been handed a letter by staff, January 28, 1981, Mr. Patterson, from John R. Lytle—L-y-t-l-e. Is that the fellow that got the loan?

Mr. BELLER. That is correct.

The CHAIRMAN. We are checking that a little further. By the way, homes in the Chicago area, Mr. Annunzio informs me, if you live in the right area of Chicago, \$500,000 is not a lot for a house. It is a lot in Woonsocket, R.I., I will tell you.

[The letter, in part, follows:]

DEAR BILL: Just want you to know that Caroline Janda had her meeting with Arnold Middeldorf and his people at Michigan National determined that they are pleased with the package of credits we put together last November. I feel they are grateful both to you and to us for the help. It looks like they are growing both in confidence and understanding of oil-related lending. Bill Patterson and Bill Dell were given these people's reference, but as we did previously, I reassured them that we would take the credits out at maturity or whenever they felt unconfident.

[The letter in its entirety follows:]

CONTINENTAL BANK

CONTINENTAL ILLINOIS NATIONAL BANK AND TRUST COMPANY OF CHICAGO • 231 SOUTH LA SALLE STREET, CHICAGO, ILLINOIS 60606

January 28, 1981

JOHN R. LYTL
VICE PRESIDENT
312/828-434

Mr. William Patterson
Executive Vice President
Penn Square Bank
1919 Penn Square
Oklahoma City, Oklahoma 73126

Dear Bill:

Just want you to know that Caroline Janda and her crew had a meeting with Arnold Middeldorf and his people at Michigan National and determined that they are pleased with the package of credits that we put together last November. I feel they are grateful both to you and to us for the help. It looks like they are growing both in confidence and understanding of oil related lending, but as we did previously, I reassured them that we would take the credits out at maturity or whenever they felt unconfident.

Thanks again for your help. I think that this is a service, that working together, we can provide to others.

Sincerely,

JS

Michigan Nat'l Participation loans

Lada Cup

Old Dominion

Dobbins & Sons (partial)

Not Informal take out agreement for certain loans by Continental - The subject loans were either renegotiated or repurchased by PSR subsequent year end - No disclosure of above agreement is proposed. ul 4/71

08173 JPC

SUBSIDIARY OF CONTINENTAL ILLINOIS CORPORATION

ES 11

The CHAIRMAN. Mr. Preston, does that not sound to you like an agreement to take it back, to repurchase? And this one is not too tacit, is it?

Mr. PRESTON. Well, I do not have that document in front of me.

The CHAIRMAN. Do we have a copy to give to the gentleman?

Mr. PRESTON. I do not recall seeing it, but I agree with your statement.

The CHAIRMAN. The date of this is January 28, 1981, an informal takeout agreement to purchase by Continental, and who signed this? This is from Peat, Marwick, Mitchell, & Co. Oh, Arthur Young, 1981; 1981. In January of 1981. Did you retain Peat, Marwick, after April of 1981?

Mr. BELLER. Yes.

The CHAIRMAN. So they had that informal agreement. We will send it down and let you take a look at it.

Mr. BARNARD. Mr. Chairman, didn't our legal counsel tell us that maybe against the law?

The CHAIRMAN. Well, we discussed it with our counsel last night, in our late hour briefing, and it seems to us that it should be looked at very thoroughly to see about its legality or illegality, but I think we are going to find that illegal things in this institution were not out of the ordinary.

Mr. BARNARD. Well, of course, this is locking the door after the horse's loan has gone.

[General laughter.]

Mr. BARNARD. But it looks to me, though, that the Comptroller's Office or the FDIC would classify a participation loan with a buy-back provision as a deposit against which reserves are supposed to be made. Is that not true?

The CHAIRMAN. Well, I would have to agree with the gentleman.

Mr. BARNARD. Mr. Beller, would that not be true?

Mr. BELLER. I believe that you would look at it that way, yes, sir.

Mr. BARNARD. Thank you.

The CHAIRMAN. Mr. Beller, you were on the board of directors of Penn Square in 1982?

Mr. BELLER. Correct.

The CHAIRMAN. Now, I have here a series of minutes of meetings of the board of directors, January 12, 1982. At that meeting, the secretary noted "that loans associated with Bill Patterson in the amount of \$650,000, board approval required", and he did indeed get it, and then later on Mr. Patterson again—where are we—March 16, 1982, "Bill Patterson totaling \$2,800,000." That was the March 16, 1982, meeting.

Then there is another meeting on April 2, 1982. The total amount of the loan to Bill Patterson was \$3 million. "Extension of any loans previously made to Bill by said officers is hereby specifically ratified and approved." Were you at these meetings with the escalation of loans to Mr. Patterson, where it was occurring?

[A copy of meeting minutes from April 14, 1981 through June 15, 1982, appear in the appendix section as appendix B]

Mr. BELLER. In those directors' meetings?

The CHAIRMAN. Yes, sir.

Mr. BELLER. Yes, sir.

The CHAIRMAN. Do you recall what the purpose of those loans was?

Mr. BELLER. Not in the specific amounts. I can recall conditions. There was one loan that was to Mahan-Rowsey, an affiliated loan for Mr. Patterson and a couple of other gentlemen, where they borrowed money to purchase—it was not Mahan-Rowsey. Let me think about that a little bit and try to figure out which loan it was. Maximo, that is what it was. It was where he and a couple of other gentlemen borrowed funds to acquire the Maximo-Mooring for the ultimate sale, as I recall, to the Heller Co.

The CHAIRMAN. At this point in time, I would like unanimous consent for the committee to put in the memorandum dated December 8, 1981, which I have been quoting from, with respect to the payment of interest on participation loans, and then there is the private placement letter that was quoted from earlier, from May of 1981. That is the one, the placement letter from the holding company offering in May of 1981, and then I think we have another memorandum we want to put in. I have got the private placement and the December 8, 1981, and the letter to Mr. Patterson that I just showed Mr. Preston from Mr. Lytle of Continental Illinois. Without objection, those will all be placed in the record.

The CHAIRMAN. Mr. Beller, one of the very prominent members of the Oklahoma City community who was, I think, a director of the bank and a rather substantial borrower or business customer of the bank was a gentleman named Carl Swan.

Mr. BELLER. Yes.

The CHAIRMAN. Did you meet Mr. Swan?

Mr. BELLER. Yes, sir.

The CHAIRMAN. Would you say he was rather influential as a member of the board of directors of that institution? Did he participate in the board of directors meetings?

Mr. BELLER. Yes, sir. He was at the board meetings, and he was a substantial borrower through the bank, with his loans being funded by the upstream correspondents. Yes, sir.

The CHAIRMAN. Tell me, do you feel he was, and I do not mean this in a derogatory fashion in any way, but from what I have read, he is a rather influential, rather substantial individual. As a member of the board of directors, was he what you would call on the boards of directors you have, people who go to the meeting, and they sit back and they listen, and you have those who go to the meeting and are real, actual, active participants, because they have knowledge of the background and what have you.

Mr. BELLER. Yes.

The CHAIRMAN. How would you classify Mr. Swan?

Mr. BELLER. I would classify him as a director who fell in between the two extremes.

The CHAIRMAN. But did you feel that he gave helpful input?

Mr. BELLER. He would make comments in the directors' meetings relative to what he anticipated was going to happen to drilling rigs in the future, what he thought was going to occur as far as pricing in the energy field in the future, oil prices, gas prices, things of that nature, which would give input.

The CHAIRMAN. And this was his area of expertise, I am told.

Mr. BELLER. Yes, which would, I am sure, gave some comfort to not only me but other directors, that his input was assisting in us trying to evaluate what was happening in the industry in which we were concentrating efforts.

The CHAIRMAN. However, he did not attempt to evaluate individual loans?

Mr. BELLER. No, sir.

The CHAIRMAN. Or collateral for individual loans?

Mr. BELLER. No, sir.

The CHAIRMAN. Now, we just read about Mr. Patterson's line of credit with the bank. Mr. Swan also was a substantial borrower from Penn Square.

Mr. BELLER. Yes, sir.

The CHAIRMAN. Do you feel as though as far as his borrowings and those of his affiliated companies were concerned, that there was no—at any time did they exceed the limits that are placed on insiders, such as members of the board of directors or major stockholders?

Mr. BELLER. It certainly never occurred in a deliberate fashion. It was never intended. We had systems and procedures set up to try to cope with that. We had lines of credit established for the directors ahead of the fact, and if there was such occurrence, I am not aware of it.

The CHAIRMAN. You say there were loans that were bought by some of the upstream banks and institutions. Were any of those sent back as we were told might happen in the letter I just read to Mr. Preston? Were any of those participations that went upstream in which Mr. Swan was involved as a borrower? Were any of those returned to Penn Square or repurchased by Penn Square?

Mr. BELLER. I do not know. I would not be surprised if some were for the purposes of the loan was being reworked, redone, and was becoming a different type of loan, and was moving out of one category and into another category, and maybe into a production loan for a term out, and things of that nature that would seem to be normal in that type of lending.

The CHAIRMAN. Lastly on this issue, to the best of your knowledge, at the time Penn Square was shut down on the 5th or the 6th, did Mr. Swan or any of his affiliated companies have any loans with Penn Square that were classified loans or problem loans?

Mr. BELLER. Yes, sir.

The CHAIRMAN. There were some of those loans that were classified by the Comptroller's Office?

Mr. BELLER. Yes, sir.

The CHAIRMAN. Does anyone else have any further questions at this point?

[No response.]

The CHAIRMAN. If not, the Chair would like to express its deep appreciation to the panel. Despite the fact that some might think it is warm in here, when you go outside, it is cooler in here than it is outdoors. Mr. Beller in particular. I do not know if you are employed at the moment or not. If you are not, we would certainly be most grateful to you if you could be with us a little longer, in case something comes up through further witnesses that might evoke a situation where we could need your assistance and guidance.

Mr. BELLER. I will stay available.

The CHAIRMAN. If you are able to.

Mr. BELLER. I will.

The CHAIRMAN. It is common practice with the committee, I know, but I would like to ask if we could look for cooperation from you gentlemen in this instance as well. Oftentimes questions come to mind that did not occur to us at the time of the hearing, and we have a practice of sending questions in writing. If this should occur, we would either do that or have staff contact you. Would that be acceptable?

Mr. BELLER. Yes, sir.

Mr. PRESTON. Yes, Mr. Chairman.

Mr. DUNN. Yes, sir.

The CHAIRMAN. Well, under the circumstances again, on behalf of the committee and myself, I want to express our deep appreciation to you for all of your assistance this morning.

Mr. BELLER. Thank you, Mr. Chairman.

Mr. PRESTON. Mr. Chairman, I have been reemployed, so if I could be excused.

The CHAIRMAN. Yes. Thank you, Mr. Preston, and congratulations. [General laughter.]

The CHAIRMAN. Now, we will call our panel composed of Mr. Richard Haugland, Mr. James Randolph, Mr. Gary Cook, Ms. Elizabeth Merrick Coe, W. A. Ross, Jerry Richardson, and Gene Smelser. So, if you would all be kind enough to come up to the witness table, we will go through the process of swearing you in.

[Witnesses sworn.]

TESTIMONY OF RICHARD HAUGLAND, JAMES G. RANDOLPH, GARY COOK, ELIZABETH MERRICK COE, W. A. ROSS, JERRY RICHARDSON, AND GENE SMELSER

The CHAIRMAN. As I think you all know, we did not, because of the circumstances, we do not look upon you as professional witnesses, as we do the high-powered, highly paid lobbyists that usually come before us in Washington, so we did not require any written or prepared statements, but I understand from staff that Mr. Randolph would like to make an oral statement, and you are all public directors, outside directors of Penn Square, correct?

Mr. ROSS. Yes, that is correct.

The CHAIRMAN. Mr. Randolph, we would be happy to hear from you at this point.

Mr. RANDOLPH. Thank you. I would like to speak on behalf of the seven outside directors. Is this on?

The CHAIRMAN. Unfortunately, you have to almost swallow it. Pretend you are eating an ice cream cone, and you have not had any ice cream in a month.

Mr. RANDOLPH. Well, perhaps some background just to show the diversity of the board.

I am a graduate of the University of Michigan in engineering. I have a master's degree from George Washington University, and I attended the advanced management program of the Harvard Business School. I am also a graduate of the Army Command General Staff College and the National War College, so you might ask me

why I am a banker. Well, I spent almost 28 years' active service with the Air Force, and left the Air Force as a major general in 1976, and immediately joined, as president, a new company that had been formed to develop coal reserves and to market those coal reserves headquartered here in Oklahoma. We have built two mines and have started a third one. Last year our production ranked about 12th or 13th in the Nation in terms of volume.

I met Bill Jennings while I was still in the Air Force here at the local base, and he asked me to join the board shortly after I left the Air Force. I declined at the time, but after a number of additional requests, I did join the board in the summer of 1979. As I mentioned, I had no prior experience in banking nor as a bank director, although I had a limited period of service as a director of a half-billion-dollar savings and loan association.

Bill's reason for wanting me on the board was to get my help in assisting him in guiding the board and developing the bank organization and management team, and he felt that my experience in managing rather large organizations would be of value to the board, particularly since most of the other board members' primary experience was in small businesses.

My first impressions after joining the board were: It was different from a savings and loan, the bank was operated somewhat as a proprietorship, as opposed to a public company. There was no formal monthly plan or budget. The management depth was thin. Bill at that time, was really running the bank, and he had no heir apparent at that time to take over in case something should happen to him. And more importantly, there was no automated management information system.

And so, some of my first contributions or suggestion to him was that the bank certainly needed to develop a budget plan, because that gave you a tool to measure where you had been and to explain the differences and see what was happening.

The CHAIRMAN. What was the date of this again?

Mr. RANDOLPH. This was in the fall of 1979, early 1980. And I felt we needed a longer range plan to define the manpower and capital requirements for the organization, and certainly we needed to get away from the manual management information flow and to use computers to improve the quality of the management information, and we certainly needed additional senior management personnel.

I don't think we—first of all, being the new man on the block and the young guy on the board, you do not come in and make a lot of waves initially, because you feel your way in, but I had expressed these points to Bill, and I think he recognized that these needed to be done, but he had not had a chance to react to them.

The CHAIRMAN. Could I say something to you, Mr. Randolph? I do not think the outside members of the board get paid very much compared to auditors like Peat, Marwick, or Arthur Young, but I must say that you know, you tell Mr. Jennings what the bank had to pay big numbers for through these accounting firms, so I congratulate you, because you were telling them exactly what they were told. You gave it to them practically free, and they paid a lot. Subsequently, I assume, you saw these management letters where that which you are stating now was recommended, so that is fantastic.

Mr. RANDOLPH. Well, of course, I had been on the board only a few months when we got the first examination, and being from a military background, I characterized this as an IG inspection, of which I had had a few. Before the examination the board had already been discussing with Mr. Jennings the need for additional capital. We recognized that we needed to place additional capital in the bank.

But the points of the examination that stood out in my mind were the need for additional capital and the need for an additional or stronger management team, because most of the conditions they cited were really because of a lack of adequate management staff, and the lack of procedures and controls, there was also a need to better manage the liquidity either by increasing the deposits in the bank or by restraining the lending actions. All other points that I remember from that first examination, in which we went to Dallas in August of 1980, were primarily what I would call technical discrepancies, more of form rather than substance.

When we went to Dallas in August of 1980, Mr. Poole briefed us of his findings, and his briefing basically reinforced my initial impression that there was definitely a need for greater management control and planning, a need for additional quality people to manage the growth and change. And as far as I am concerned, the meeting was very instructive to me, because it kind of reinforced and lent credence to some of the points that I had initially.

As a result of that meeting, the board did see that additional capital was put into the bank, additional shares of stock were sold in the holding company, and we brought our capital reserves up to our peer group, and we tried to maintain it at about 7½ percent throughout the remainder of the life of the bank.

We then put additional pressure on Bill to hire additional experienced bank managers, and Mr. Beller has been testifying, that he was hired as a result of that search, which took longer than we had hoped. But it is difficult to find experienced, qualified people. We also during the same period of time added additional technical people in the oil and gas department, and we were told that we had developed—that the bank had developed—the largest and the most qualified oil and gas technical staff in the State.

At the same time there was a considerable effort to develop additional procedures and systems and training programs, and certainly manuals were written which were forwarded to Dallas, and some of us reviewed and looked at them, and I thought personally they were quite good. In summary, during this period of time, after that first examination, a new president was hired, a new general counsel, chief loan officer, financial officer, a new vice president in charge of the real estate department, plus other additional experienced bank officers were added to the staff. As Mr. Beller said, the bank more than doubled in size during this period of time.

The second examination, which occurred in the spring and summer of 1981, started really before these new people were barely in position. They had no real opportunity to correct any of these fundamental problems of management, and more importantly, the time of the absolute top staff was consumed in trying to resolve loan problems in real estate and agriculture which Mr. Beller char-

acterized as horse loans which had been caused by the lending actions of a dismissed senior loan official.

So, it was not a surprise to the board to receive the report in the summer of 1981 that there had been little improvement in the bank's management practices, because we realized that the new management team had not really had time to correct these particular problems.

So, when we went to Dallas for the second trip in July of last year, and met with Mr. Poole and his team when they reported the conditions, we were not terribly surprised. That meeting was quite lengthy, and Mr. Poole dwelt at considerable lengths, which I considered almost like a lecture that you would expect in a university, on how to manage to achieve liquidity goals, he used several graphs, and went into some more details of his views on how a bank could manage to insure that they maintained appropriate spread between what they were paying for money and what they were charging for money.

At the end of the meeting, the examiners at Dallas were very complimentary about the quality and the reputation and the experience of the new people that had been recruited by the bank, and so that the overall flavor of that meeting was not one of a great deal of criticism, but one we thought was helpful and hopeful, because we felt, as outsiders, the bank were moving in the proper direction.

After the meeting, the board expressed concern about an alleged lending limit violation mentioned at that meeting, and it was explained to us that it was a technical violation in the sense that the combination of the value of a loan, a letter of credit, and perhaps an honored overdraft caused the bank to have a technical lending violation. This explanation at a subsequent board meeting was further expanded to include that it was an administrative error in not insuring that the terms of a loan from Penn Square corresponded to the dates of coverage for the loan from the upstream corresponding banks.

As a result of this latter, second examination and trip to Dallas, the management reported to us very serious efforts to correct all of the deficiencies, and to obtain release from the letter of agreement perhaps as early as 1982, and certainly by the spring of 1983, since this relief was essential in order for the bank to receive authority or permission from the Office of the Comptroller of the Currency to move into new bank premises that were being constructed.

During the fall of 1981 at the board meetings the bank management reported and displayed results of numerous actions to establish appropriate checks and balances: The formalization of the asset and liability management committee, detailed procedures, loan policy committee, additional people, and further elaboration and sophistication of the data system for the oil and gas department.

The Comptroller of the Currency reported to us in our January 1982 board meeting that the bank had made extensive progress, and they were very complimentary on work that had been done, and I believe it was reported to us that the bank had accomplished a great deal more than they expected to find.

Mr. BARNARD. May I interrupt at this point? Who made this observation?

Mr. RANDOLPH. I believe it was Mr. Morrow who was the spokesman at the time.

Mr. BARNARD. For whom, the Office of the Comptroller?

Mr. RANDOLPH. That is right.

Mr. BARNARD. In January?

Mr. RANDOLPH. In the January 1982 board meeting.

Mr. BARNARD. Thank you.

Mr. RANDOLPH. And there was some discussion, and I do not recall whether it was at that time concerning the letter of compliance, and they said, well, that they expected that we would be able to lift that letter after the next regular examination, which was scheduled to commence in March, but actually commenced in the latter part of April.

In April, then, we received a report from the outside auditor. He confirmed that there were a number of problems in the bank, but that for all of the problems that they had identified, management was aware of them and were working on solutions. They were complimentary that significant improvement was evident, which had taken place since the previous independent audit, and since the last examination by the Office of the Comptroller of the Currency. So we felt that finally things were moving in a very positive direction. The final examination started shortly after that particular board meeting.

In the May board meeting, management, I believe Mr. Beller reported that the examiners were still here, that they were looking deep, and at all areas. At our June 1982 meeting, he reported that the examiners were still here, and in response to one of the directors about the amount and extent of chargeoffs, he said he really did not know, and someone said, well, about \$5 million, and he said, yes, make it that or perhaps a little more. And so that was the last word we as a group learned until probably Tuesday or Wednesday at the end of June, when we were notified that there would be a special meeting at the bank on Thursday morning—July 1.

Several members at this table continued to make sizable uninsured deposits in the bank up until the end. So, even after the 2-day meeting that ended on the 2d of July, the board left there on Friday night expecting that the board would have until the 9th of July, under the terms of the proposed or proffered cease-and-desist order, to raise additional capital to keep the bank open.

In response to the relationship with upstream banks, the board did discuss this matter at considerable length at different times. It was characterized to us, and we agreed with that characterization, that placing of loans with the upstream correspondent banks were really considered to be a strength for us rather than weakness for several reasons. One, that this area is a capital-poor region, and the oil and gas industry is capital-deficient persistently, and they needed the additional capital.

It was also an additional source of earnings for the bank, but more importantly from our perspective is that we felt we were getting an independent backup evaluation of reserves. One could agree easily on the assumptions on what is going to happen to oil

and gas prices, the inflation rate, and perhaps what will be the trend of gross production, but to go in and agree upon the amount of oil gas reserves in rock—several thousand feet below the surface is a matter that not many people would agree on, by dealing with major banks experienced in oil and gas lending, we were getting an independent valuations.

By verifying the evaluation of the independent engineering firms that were being provided by the loan applicants, coupled with the evaluation by the bank staff, and then further confirmed by these very experienced energy lenders we felt gave the bank, at least us, greater assurance that we were acting in a more prudent fashion.

The CHAIRMAN. Mr. Randolph, I am constrained to—and hopefully you will not lose your train of thought, but I am constrained at this point and on that point to ask you to halt.

Mr. RANDOLPH. I could go for about one more minute, and I would be finished.

The CHAIRMAN. Well, indeed and in fact, are you and your colleagues satisfied that that which you just described did really and truly occur, that Continental and Seattle First and Chase sent engineers in and had these participation loans thoroughly reviewed by their experts in energy, or, as has been described to us, the impression we are getting is that that did not happen, that they sort of took carte blanche, face value, in most instances, what was being sent to them by Penn Square.

Mr. RANDOLPH. All I am trying to do is to present to you the impression that we as board members gained from the management that these banks were in fact independently evaluating these credits, and these were nonrecourse loans.

The CHAIRMAN. Wait a second. Are any of the outside directors present at this table, can any of you say that of your own personal knowledge, that what Mr. Randolph just described gave you comfort and gave you confidence? The management said, oh, we are selling these participations to the big city banks, and they are bringing their “hifalutin” experts in, and their highly educated engineers in. You were told that, but of your own knowledge, did you discuss this? Are you aware of any energy loan experts in these large banks that looked at these loans and said, these are great, these participations we are buying are great? Are you aware of any engineers coming in and setting up shop and examining and getting their own independent appraisals of reserves in that rock, as you were just describing it? Are any of you aware of that to your personal knowledge? Mr. Smelser?

Mr. SMELSER. No, sir, we were not aware of it.

The CHAIRMAN. You took management’s statements?

Mr. SMELSER. Well, we also felt that we were assured by the fact that certainly the upstream banks who supposedly had the expertise and the knowledge and the staffs to evaluate these loans before they took them.

The CHAIRMAN. But why don’t you have one other word, and you probably relied upon the fact that they were prudent business people, and would evaluate these very carefully before purchasing them, right?

Mr. SMELSER. We felt that would be true, yes, sir.

The CHAIRMAN. But that is as far as you went, Mr. Richardson?

Mr. RICHARDSON. I was not aware that any of them were coming into town. However, based on the fact that Continental Illinois is one of the largest oil lending banks in the country, and they were buying the loans, I would assume that.

The CHAIRMAN. That made you feel comfortable?

Mr. RICHARDSON. I felt they knew what they were doing.

The CHAIRMAN. Mr. Ross?

Mr. ROSS. That is the same for me.

The CHAIRMAN. No personal knowledge?

Mr. ROSS. No personal knowledge.

The CHAIRMAN. Ms. Coe?

Ms. COE. I felt the same way.

The CHAIRMAN. Mr. Cook?

Mr. COOK. I felt even more strongly, because the loans were being sold without recourse, which was clear to me, that those upstream banks had all of the obligation and the potential liability, and therefore they should have the strongest possible interest in evaluating those loans to the degree that they felt was appropriate.

The CHAIRMAN. At any point were you made aware of the fact that indeed what was happening on some of these loans, that Penn Square was paying interest to the upstream banks on these loans, even though they were not getting the interest from the borrowers? Were you aware of that?

Mr. COOK. Mr. Chairman, I was made aware of that, and I think the other members here, the other directors were made aware of that fact in the June board meeting, but at that time we were all—

The CHAIRMAN. When you sat down with the Comptroller?

Mr. COOK. No, not on the July 1981 meeting with the Comptroller, but the June 1982 meeting of the board, we were told by management of some \$10 million in potential moneys that had been paid upstream without having—without us being paid at the bank level, that in fact only about \$200,000 was outstanding, and the practice had been ended, as Mr. Beller pointed out.

The CHAIRMAN. And were you aware of the fact that there was a possibility that in some instances, that indeed though they appeared to be nonrecourse participations, that there was a tacit agreement, as I think you were here earlier when I read from the letter to Mr. Patterson from Mr. Lytle, or whatever his name was.

Mr. COOK. Mr. Chairman, in the spring of this year, I remember asking the president, and for that matter the other members of management, whether or not nonrecourse in their terms meant the same as it did my terms, which was to say that those loans were sold without any recourse whatsoever, and I was assured that in fact that was the case.

The CHAIRMAN. Mr. Randolph, I would like you to answer the same question I have asked of your colleagues.

Mr. RANDOLPH. I concur with everything he said.

The CHAIRMAN. Mr. Haugland? And would you please pronounce your name for me?

Mr. HAUGLAND. Haugland.

The CHAIRMAN. Thank you.

Mr. HAUGLAND. I believe that the energy departments and representatives from Chase and Continental and Seafirst in Seattle were

in fact coming down here, and I also was led to believe by our management that some of the people that we staffed the Penn Square energy division, some of the technical people, petroleum engineers, actually came in part from some of those banks.

The CHAIRMAN. But my question, sir, you have not answered. You say you believed this. Did you have personal knowledge?

Mr. HAUGLAND. Did I have personal knowledge?

The CHAIRMAN. Did you have personal knowledge that these reserves were being independently evaluated by engineers from these upstream banks?

Mr. HAUGLAND. No, I just assumed they were.

The CHAIRMAN. You assumed it, and you were given sort of to understand that from management, but you do not have personal knowledge of the fact?

Mr. HAUGLAND. No.

The CHAIRMAN. It was just like, have you ever been to China?

Mr. HAUGLAND. No, sir.

The CHAIRMAN. Neither have I. I have read that it is there, but I do not really know it is there. That is the manner in which I ask this question.

Mr. Randolph, you have another minute and a half, I believe, sir.

Mr. RANDOLPH. I would just like to say that in the last year, when it was quite apparent that the drilling business was getting soft, and that people were curtailing their plans for additional drilling, we asked what happens, what is the exposure, how secure are our loans, and we were assured that they felt the loans were being made with strong collateral. They were against reserves in the ground, and at the very worst, that the period of payout would be extended, but that the loans were still on a sound basis.

You asked a question at the beginning this morning as to why the bank closed. I do not know, and I do not think anyone else here at this table does. And we would like to learn the reason. And so therefore we pledge our cooperation in many ways and in all ways. We are very much victims of this debacle. We have some questions that we hope that you will be able to answer, or find the answers to: such as, were objective criteria used to classify the loans, or were they highly subjective? As the district director [of the OCC] has been reported as saying, in one of our local newspapers.

And a second question, if the bank management was so weak as reported by the OCC in your July 15 hearing, why didn't the Office of the Comptroller of the Currency approach us the outside Directors some time in May or some time after the start of the exanimation and say, you have got to get rid of all of these clowns and let us try to do something to stave off this disaster? Although we represented a very small minority in terms of stock ownership of the bank, I believe that we would have been able to bring about some management changes to hopefully avoid the ultimate consequences.

The CHAIRMAN. I think that the confidence in the institution would have been shaken had all of you as a group said, well, wait a minute, now, unless you do this, we as a body and as a group are resigning. Certainly a report of that in the press would give rise to a great deal of apprehension.

Let me ask you this. Were the bulk of you recruited by Mr. Jennings to join the board of directors in Penn Square? Is there anyone here who was not approached by Mr. Jennings?

Mr. SMELSER. I.

The CHAIRMAN. Mr. Smelser, how did you come to join?

Mr. SMELSER. I was approached by Mr. Cravens. I had been on the board since 1965.

The CHAIRMAN. 1965, a period of time when Mr. Jennings was not at the institution?

Mr. SMELSER. That is correct.

The CHAIRMAN. Mr. Richardson?

Mr. RICHARDSON. My company has had a long association with the bank, and they have owned stock in the bank since the inception at the time the bank was sold to Mr. Jennings.

The CHAIRMAN. To the holding company?

Mr. RICHARDSON. No, the stock from the previous owners. We had a number of shares of stock, and my father basically had the stock, and he requested at the time the previous owners sold out to sell his stock, too. That was not done. He asked Mr. Jennings if he would be interested in buying his stock, and he said no, since had already bought this amount of stock, he would not be interested in buying any more at this time, and so my father said, well, why don't you put my son on the board to give him some banking experience? [General laughter.]

And basically, that is how I got on the board, and I got the banking experience. [General laughter.]

The CHAIRMAN. You sure have. Well, ladies and gentlemen, you were here this morning, and I would like to ask you a few questions. You heard Mr. Beller state that though he was brought in as president, that nonetheless his duties, or rather not his duties but his actual authority was rather limited by the memoranda that he read to us, in that he was subservient to Jennings and Mr. Patterson in certain areas. Were you as members of the board of directors aware of those limitations that had been placed on Mr. Beller's authority at the Penn Square Bank?

Mr. ROSS. No.

Mr. RICHARDSON. No.

The CHAIRMAN. All in the negative? Mr. Haugland, you are affiliated with a financial institution in the area other than Penn Square?

Mr. HAUGLAND. Yes.

The CHAIRMAN. How large an institution is it? How would it compare with Penn Square in size?

Mr. HAUGLAND. It is \$80 million in total assets, much smaller.

The CHAIRMAN. It is much smaller. Were you aware of the employment contract that was given to Mr. Beiler when he was brought in to Penn Square National Bank as the members of the board of directors?

Mr. HAUGLAND. Yes, sir.

The CHAIRMAN. Mr. Randolph stated that, and this is with all due respect to Mr. Beller, but he stated that it was difficult to find somebody to come in and take over as president of Penn Square. Am I quoting you—

Mr. RANDOLPH. I am not so sure how difficult it was because we were not involved directly in the search, but Mr. Jennings reported that it was taking a while to find what he was looking for, a real strong man, and it was difficult to find a real strong man.

The CHAIRMAN. Now, you heard Mr. Beller testify or inform the committee of the fact that his strong point, his forte is not energy, oil and gas related loans, did you not?

Mr. RANDOLPH. Yes, sir.

The CHAIRMAN. And Penn Square's principal involvement was in this area. I think you stated that in your opening statement to us.

Mr. RANDOLPH. Yes.

The CHAIRMAN. Were you people aware of the fact that Mr. Jennings' strong points were not in that field, but in the other commercial lending and leasing and things like that? I mean, Mr. Beller's strong points.

Mr. RANDOLPH. I personally was not aware of the actual experience.

The CHAIRMAN. Of the limitations that he was under at Penn Square?

Mr. RANDOLPH. No, I was not. He came from a bank that does do quite a bit of energy lending.

The CHAIRMAN. But in fact he did not do it. Did you think it a little curious that Mr. Jennings probably spent a lot of time trying to find a man with good experience who would be looked upon as a strong president, but who admittedly had not the experience in the energy related loans. Did that not seem a little strange? I know it is Monday morning quarterbacking.

Mr. COOK. Mr. Chairman, I thought considerably about that question when Mr. Jennings was talking about hiring Mr. Beller, and frankly, I considered it a plus that Mr. Beller had administrative and operational experience in a significantly larger bank than Penn Square. It was also clear to me that Mr. Jennings owned a significant chunk of Penn Square Bank, and that it was important to find an individual who had the kind of operating and administrative experience but who could nonetheless work with Mr. Jennings. As you know, and Mr. Randolph said, in some respects the bank was almost a proprietorship when we first came on the board.

The CHAIRMAN. A one-man show?

Mr. COOK. Exactly, so it was important to find someone who in effect could take over the reins, and it was clear that there were administrative problems that had to be solved, so I felt that it was a strong plus that we be able to attract a man from a larger bank which had a strong reputation, who himself had a good reputation, to whom we had basically given a no-cut 5-year contract, so he should not be reluctant to make comments to us as directors about the situation at the bank.

I viewed all of those as very strong positives.

The CHAIRMAN. Mr. Cook, let me make an observation.

Mr. BARNARD. Mr. Chairman, may I follow that up?

The CHAIRMAN. Yes, but I want to follow up on that also.

Mr. BARNARD. Mr. Cook, because of that, did you ever feel that Mr. Beller was not getting the responsibilities which you thought he should have in this role?

Mr. COOK. Mr. Barnard, over the course of the last year, at least two or three times after board meetings I went in to talk to Mr. Beller and to ask him how things were going, because I was very much concerned that again Mr. Jennings owned a substantial chunk of the bank, and I knew that he had a very close relationship with Mr. Patterson, and it was clear that the salvation of our bank in terms of taking the corrective measures that we had been asked by the Comptroller to take lay with Mr. Beller's ability to make those measures stick. Mr. Beller's comments to me typically were that no, he felt he did not need any more support from the board of directors, that we still had a long way to go, and he said that on several occasions, but he would repeatedly say that he thought he was making significant progress.

The CHAIRMAN. He never complained to you about what he enunciated this morning?

Mr. COOK. No, he did not.

The CHAIRMAN. The fact of that lack of control over Mr. Patterson?

Mr. COOK. No, sir, he did not, and frankly, I hoped that I had given him that opportunity, because I was concerned that that might be a possibility.

The CHAIRMAN. Well, he did not tell the Comptroller about that either.

Mr. BARNARD. Thank you.

The CHAIRMAN. One word of caution about one-man bands in the banking business. This committee went to Carrizo Springs a few years ago, where there was a bank failure that affected a substantial area in Texas, a one-man show. Then there was C. Arnholt Smith, who controlled USNB of San Diego. He had two entire crews, loan officers, everything. The fellow worked two shifts. Of course, one shift did not know what the other shift was doing. When that thing came down and came tumbling down, there was the largest bank failure in the Nation. Of course, that was followed by Sindona and Franklin National Bank.

So, in the future, always be cautious of a one-man show, the one-man band, because again, here it appears to me that the last thing Mr. Jennings wanted was someone to come in strong enough to take over the overall operation. He wanted somebody to sort of placate the Comptroller's Office, keep the Comptroller's examiners happy, but he still wanted to share with Mr. Patterson control of that lucrative area, those energy loans.

Mr. Cook, you mentioned Bill Patterson. Did you privately and on your own do any checking into Mr. Patterson's activities in the oil and gas lending division generally?

Mr. COOK. The only thing I did, Mr. Chairman, was that in the early part of this year, several people had said to me on the street that they had heard that Penn Square was being more aggressive in its lending policies than some other energy banks. At that time, I was serving on the board of a company that wanted to purchase oil and gas properties in Texas, and it had received a preliminary indication from a bank in Denver that that bank would supply approximately, if I remember the number, \$3.2 million on the collateral of that reservoir.

I decided to take that property to Penn Square Bank to see what kind of collateral value they would give to that property, and I did it frankly in part because I thought it was appropriate from the standpoint of my interest in this other company, but also I was very curious to see if these comments that I had heard were accurate. The reservoir engineer I talked to, whose name at the moment I do not remember, but I think I have it in my notes somewhere, came back to me——

The CHAIRMAN. This engineer where, sir?

Mr. COOK. At Penn Square Bank, came back to me and said that based upon what he had seen, that Penn Square would loan \$2.8 million on that property, and I quizzed him at some length as to how he got to the \$2.8 million, and he reflected to me precisely the loan criteria, which we had spent a great deal of time in various board meetings talking about as being appropriate given the decline in oil and gas prices. So, frankly, sir, that gave me a warmer feeling that in fact the loan practices in which we were actually engaging were commensurate with the ones that we thought we were engaging in, and that they were appropriate. They were not unusually aggressive.

The CHAIRMAN. Mr. Haugland, you, I understand, did spend some time with the Comptroller's Office?

Mr. HAUGLAND. Yes, sir, 1 year.

The CHAIRMAN. In what capacity?

Mr. HAUGLAND. I was an assistant national bank examiner at, I guess, the first level.

The CHAIRMAN. Now, you were present at the meeting in Dallas in the summer of 1981, but not in 1980. Is that correct?

Mr. HAUGLAND. Yes, sir.

The CHAIRMAN. Let me ask you, what was your impression of those meetings?

Mr. HAUGLAND. Well, of course, I was not in attendance at the first one.

The CHAIRMAN. On the second one?

Mr. HAUGLAND. Because I was not on the board at that time. I joined the board in April of 1981, and after the third meeting that I attended, we were invited to Dallas for the meeting that was held on July 29, I believe. My impression at that time was that the representatives of the Comptroller's Office were still very concerned about the lack of compliance that the bank was in relative to the administrative letter that was in effect. Also, that they were very pleased with the people who had just recently been hired by the bank, namely Mr. Beller, Mr. Preston, and Mr. Dunn, and an additional number of other senior officers.

At that point, the bank was just beginning to draft the various committees and restructure its entire lending function and its administrative function, and I got the feeling from that July 29 meeting that the Comptroller's Office was not letting up in their pressure on the bank to continue to move toward greater compliance, but that they were very pleased with the staff that we had brought on board, and they so stated that the members of the staff were well known to them through their association and examination process with the other banks before they came to us.

The CHAIRMAN. Did you get the impression that the Comptroller felt that Mr. Beller, the new president, had experience in energy lending? Do you think the Comptroller's Office was aware of the fact that Mr. Beller was not brought in for his expertise in the energy area, but in other areas? In other words, 20 percent rather than 100 percent of the operation?

Mr. HAUGLAND. I really did not feel that that was a critical problem with bringing in a man of Mr. Beller's ability, because he was an administrative lending officer at a very high level at his previous employer, and I do not think that his speciality in energy lending or lack of specialty in energy lending was critical to his position for what he was supposed to do at Penn Square.

The CHAIRMAN. But the primary problems of Penn Square were related to the energy lending area, were they not, the criticism by the Comptroller's Office in 1980?

Mr. HAUGLAND. I think they were the concentration of lending in the energy area, but not as specific credits at that point in time.

The CHAIRMAN. How about the loans that were criticized? In which area were they primarily located? Were they not in the energy and oil related areas?

Mr. HAUGLAND. Not specifically, no, sir.

The CHAIRMAN. You say no. I will have to have my staff check it out again, because I have been misinformed then.

Mr. HAUGLAND. Well, naturally, I think you could say that if you had 80 percent of the loans in the energy field, there would be a larger percentage as a rule of classified loans coming from the energy area, but I do not believe that the energy lending at the point we were aware of through examinations had produced any sizable classification of energy loans as opposed to horse loans.

The CHAIRMAN. Let me ask you, Mr. Haugland, did you sign the August 1980, agreement after joining the board?

Mr. HAUGLAND. No, sir.

The CHAIRMAN. And then I would ask, other than Mr. Cook, I think all of you were at the July 1981, meeting in Dallas with the Office of the Comptroller of the Currency. I am wondering about the impression you got of that meeting with Mr. Poole and his staff. Now, did Mr. Poole—am I quoting correctly—comment that the Washington office of the Comptroller of the Currency had reviewed the association's funds management and found the same unacceptable on a national standard? He noted that he had gone to bat with the Washington office to keep from having a cease and desist order issued. Is that an accurate report of what Mr. Poole said to you at that meeting?

Mr. ROSS. I think so.

Ms. COE. Yes.

The CHAIRMAN. I see everybody nodding in agreement.

Mr. RANDOLPH. I do not remember specifically whether those words were stated.

The CHAIRMAN. Now, subsequent to that July 1981, meeting, and my reading of the minutes of that meeting is that he really harranged the entire board and management, what steps did you people on the board take when you returned to Oklahoma City at your next meeting with management, after Mr. Poole's harranguing of you, of the entire board? Do you recall?

Mr. RANDOLPH. I think I summarized. What I think we did was basically get everyone in high gear in the management team. We had this new group that had just joined the bank, and there were a number of things that had to be addressed, and as I recall, they were spending a great deal of extra time to in fact get these things accomplished that had been promised to be done the year before.

And I believe the results—at least we felt that the results showed that the management was taking these actions we had promised in the fall of 1981 and further confirmed then by the Comptroller's report to us in January, and further reinforced then by the independent auditor's report in April, and every meeting that we had, Mr. Dunn and the financial officer would report on the status of these promises that we had made to the Comptroller.

The CHAIRMAN. Let me ask you this. Were you people shown the management letter from Peat, Marwick, Mitchell & Co., that was referred to earlier this morning, the rather lengthy letter that was rather caustic in its criticism of things that had not been done?

Mr. RANDOLPH. A summary of that report was discussed at our June, 1982, meeting.

The CHAIRMAN. But you did not see the entire letter?

Mr. RANDOLPH. I do not think so. The highlights only.

The CHAIRMAN. Well, the beginning of that letter is rather complimentary, but as you get into the last three or four pages, it is rather caustic and critical.

Mr. COOK. Mr. Chairman, we did have some discussion about that, because several of us on the board asked what the status was of the various criticisms that had been made, and the gentlemen from Peat, Marwick, Mitchell & Co. said there were a number of criticisms they had made, but that—the word was “most” or “many,” but I think the word was “most”—most of those were in the process of being addressed by management, and indeed we had a summary which also had management's analysis of what they were doing to analyze those questions.

I asked the Peat, Marwick, Mitchell & Co. auditors specifically if there was any material problem that they had uncovered that they thought was of such significance that it should be drawn to the attention of the board, to which we were told no, that there was no such problem. There were a number of other problems, again, as related in the management letter, but that management was in the process of correcting those problems.

The CHAIRMAN. Mr. Haugland, the minutes of the board meetings show your criticism of the high amounts of overdrafts and the monitoring of overdrafts. On April 14, 1981, you abstained from voting on the overdraft report, and in that instance the overdraft report showed that it was in the amount of \$2,833,731. Was that because you had just arrived on the board, or because you thought that it was excessive?

Mr. HAUGLAND. No, I thought it was excessive for the size of the bank at the time, and in fact I continued to discuss the level of overdraft in subsequent meetings.

The CHAIRMAN. In September, you discussed it again when Mr. Patterson gave his report, correct?

Mr. HAUGLAND. I discussed it for several months, and I was finally—it was suggested that I not beat a dead horse any more, that I

was talking too much about overdrafts, and using up too much time.

The CHAIRMAN. Again, you do have experience being involved with another financial institution, and having spent time at the Comptroller's Office, yet you were told you were beating a dead horse. It seems as though that horse was a lot livelier than you were told. So that it is obvious that the overdraft situation did not improve. How about the large overdrafts reported by Mahan-Rowsey and Instapipe Co.? Do you recall those?

Mr. HAUGLAND. I recall one discussion we had at the board meeting on the Instapipe, which I believe was a classified line of credit at one point, and subsequent to the classification of that line of credit by the regulators, I recall that there was an instance when that account was overdrawn. The checks issued by that company were allowed to go into an overdraft status which would be an additional extension of credit.

The CHAIRMAN. Over and beyond the statutory limits?

Mr. HAUGLAND. Over what would have been ordinarily classified, and my understanding is that the management was not to make an additional extension of credit to this particular entity, and I raised the question again about overdrafts.

The CHAIRMAN. Let me ask you, you say that, you will excuse the expression, that you were told to knock it off, that you were beating a dead horse. Was it a fellow member of the board of directors, the outside board, or was it somebody in management that asked you to cease and desist?

Mr. HAUGLAND. Management.

The CHAIRMAN. Could you be more specific? Do you recall?

Mr. HAUGLAND. Mr. Jennings suggested that I did not need to take quite so much time on the amount of overdrafts.

The CHAIRMAN. As one, Mr. Haugland, who is well versed in the profession of banking, could you tell us as far as the participations were concerned, the loan participations at Penn Square in the sale of the same to upstream banks, did you at any point compare that with the manner in which you handled the participations at your bank in Muskogee?

Mr. HAUGLAND. Well, we had participations from Penn Square in our bank, and as we also had from about five or six other larger institutions in the Southwest.

The CHAIRMAN. Did you rely upon the evaluations of the institutions from which you purchased the participations, or did you make your own evaluations?

Mr. HAUGLAND. We made our own evaluations.

The CHAIRMAN. You made your own evaluations?

Mr. HAUGLAND. Of course, you always have to rely upon the originating bank to some extent for some of the information.

The CHAIRMAN. Thank you.

Mr. Leach?

Mr. LEACH. For the record, during the 7-year period, did any director resign?

Mr. COOK. I do not think so.

Mr. LEACH. For the record, too, other than the stock that any of you might have held, did any of you lose money in the bank closing?

Mr. ROSS. Yes, sir, I did.

Mr. BARNARD. Jim, did you mean that beyond that being insured?

Mr. LEACH. Beyond that being insured, of course.

Mr. ROSS. Yes, sir.

Mr. LEACH. Mr. Smelser, you lost money?

Mr. SMELSER. Yes, around \$75,000 in commercial paper.

Mr. LEACH. Mr. Richardson?

Mr. RICHARDSON. Around \$56,000 in company and personal money.

Mr. LEACH. Mr. Ross?

Mr. ROSS. I lost a little over \$2 million.

Mr. LEACH. Wow.

Mr. BARNARD. Was that in deposits or stock?

Mr. ROSS. It was in CD's in the company and personal.

Mr. LEACH. I think it is worth noting that at least with regard to the directors, there were no inside dealings for self-protection.

The CHAIRMAN. Would the gentleman yield?

Mr. LEACH. Certainly.

The CHAIRMAN. I think one of the mysteries that is going to evolve in this entire situation is that here are the members of the board of directors, quite a few of whom lost very substantial amounts of money as a result of this bank closing, and yet we look at a prominent depositor who pulled \$20 some odd million out. I think he sent his secretary across the street to pull it out for him. And that is because some financial consultant told him to do so. I think that is going to be, if any of you are of the Catholic religion, we have the mystery of the Holy Trinity, and I think this one sort of comes in that classification. [General laughter.]

Mr. ANNUNZIO. Mr. Chairman, that is exactly right. I was going to ask if any of you had the same opportunity to draw money out before. I know you said you lost \$50,000, and \$2 million, but did any of you? Mr. Haugland, did you have an opportunity to draw money out in advance?

Mr. HAUGLAND. Well, No. 1, I had an opportunity. No. 2, I did not have any money on deposit in that institution.

Mr. ANNUNZIO. Mr. Randolph?

Mr. RANDOLPH. I had an opportunity, and I have on deposit a grand sum of \$112.93, which is still frozen.

Mr. COOK. I did have an opportunity, but I only had \$500 in the bank.

Mr. ANNUNZIO. Ms. Coe?

Ms. COE. I had no opportunity. I lost under \$200,000, but I had a considerable amount of stock.

Mr. ANNUNZIO. Mr. Ross?

Mr. ROSS. I had no opportunity.

Mr. ANNUNZIO. Mr. Richardson?

Mr. RICHARDSON. Well, I deposited \$228,000 in the bank about 7 or 8 days before it went down.

Mr. ANNUNZIO. And you never withdrew anything out in advance?

Mr. RICHARDSON. Of the \$228,000, I drew out \$60,000. About the same time I put the \$228,000 in, I drew \$60,000 out. But I still had about \$150,000 in there when the bank was closed.

Mr. ANNUNZIO. Mr. Smelser?

Mr. SMELSER. I had an opportunity to draw it out, and I did not.

Mr. ANNUNZIO. Thank you.

Mr. HAUGLAND. Mr. Chairman, I just want to clarify that when I said I had an opportunity, I meant I was there on the Thursday before the fatal weekend, so if I had had money, I was present at the bank. That is what I meant.

The CHAIRMAN. I think if the gentleman would yield further, I think that the question is not whether you had the opportunity, but rather did you have knowledge that would indicate to you that the ax was about to fall?

Mr. HAUGLAND. No, sir.

Mr. ROSS. No.

Mr. COOK. No.

Mr. RICHARDSON. No.

The CHAIRMAN. That is Mr. Leach's point.

Mr. LEACH. In any institution, one must deal both with the abstraction and with people and their personalities. I would like to address a question to you, General Randolph, because you have a history of distinguished public service. As a former general, if you had a wing commander or a company commander acting the way Bill Patterson, Penn Square's vice president, did in terms of keeping figures and in terms of community activities, would you promote him, would you demote him, would you think that his tenure should come to an end? As his commander in chief, how would you have reacted?

Mr. RANDOLPH. Obviously, in the stewardship role here, you could not afford to have someone acting like that. I personally was not aware of Bill Patterson's activities that have been extensively reported after the failure of the bank. I met Bill only at board meetings, and had social dealings with him, and for instance I heard no rumors of his extraordinary activities until after this happened.

The CHAIRMAN. You do not go to the Cowboy Club?

Mr. RANDOLPH. I have never been there. I know where it is. It is on the way to the airport. But I have never stopped in. I do not own any cowboy boots. [General laughter.]

Mr. LEACH. It strikes me that Mr. Jennings knew what he was doing to bring someone with your respectability to the board.

Generally, boards of directors take final responsibility for loans, and this is not simply a proforma approval in board meetings. Oil to me is a very fast track, and racehorses are an even faster track. How seriously and how deeply did you go into loans? How much discussion was there at board meetings regarding loans, and how much effect do you think your input had?

Mr. RANDOLPH. I think as a group the board was probably never satisfied with the amount and the scope of information that was available to review the actions that had been taken by the bank, and it became apparent to me later this spring, in April and May and June, that the bank was probably not doing the kind of cash flow analysis that they should have to assure that they had a coverage ratio to meet the various interest payments, and I think you will notice in some of the board meetings in either April or May, while we raised and had extensive discussions on this whole ques-

tion of evaluating the ability of a borrower to repay the money, and I guess it is just regrettable that we did not get wise sooner. Perhaps we would have been able to bring about some changes enough so that this whole episode could have been avoided.

Mr. COOK. Mr. Leach, a number of us were speaking specifically to one of the areas you mentioned. A number of us early last year were concerned that there might be a downturn in the energy economy, and we knew that oil rigs, oil service companies were the first to be hit, so we actually requested of management an analysis of our rig loan portfolio, how large it was, and to what extent was that rig loan portfolio secured by underlying assets as such oil and gas properties as opposed to just the collateral, the rigs themselves, because we all knew that if the energy economy deteriorated, that the rigs would be worth perhaps 15 cents on the dollar.

We had that kind of analysis presented to the board in the summer of last year, and we were assured that we were changing our lending policy so that we were not making rig loans except to our ongoing customers, and that those rig loans were secured by underlying oil and gas properties as opposed just to the rigs themselves. So, during this period of time I would say that we did not spend a great deal of time talking about specific loans, but we did spend a great deal of time talking about loan policies, about loan loss reserve ratios.

I remember in January of this year we spent a lot of time talking with management about whether or not the loan loss provisions should be increased if oil and gas prices declined.

The CHAIRMAN. Could you please speak into the microphone?

Mr. COOK. I am sorry.

In January of this year, we spent considerable time talking about loan loss provisions, because we could see obviously that oil and gas prices were declining, and we were concerned about the value of the collateral standing behind these various loans, and in fact management in February of this year raised loan loss reserves accordingly. So, a number of the others of us here felt that the kinds of concerns that we were raising in board meetings were having a positive impact on the policies of the bank.

Mr. LEACH. Thank you very much. I would conclude with a comment, Mr. Chairman, that I think we have an example here of an extremely intelligent outside director board that has been caught up in the circumstances, and it is going to be a lesson, frankly, to all boards of directors of all banks throughout the country. I appreciate your testimony.

The CHAIRMAN. I could not agree with the gentleman more. As I stated to the previous witnesses, do not feel bad because some of the sharpest people in the country were conned in this operation. You can just react and act based on the facts and the knowledge presented to you, but that which is not being presented to you or is essentially hidden from you, gosh almighty, it is rather difficult for you to react, and the mere fact that some of you lost such substantial sums—Ms. Coe, I understand some of your deposits went in—

Ms. COE. On the 30th.

The CHAIRMAN [continuing]. On the 30th, so that certainly had you been apprised of this picture as we see it now, and your background indicates that you are a very, very astute business lady,

certainly you would not have made that deposit. So, as Mr. Leach just said, it is a lesson to bank directors around the country that you really have to be—and I do not ascribe any lack on my own part, any lack of efforts to exercise a fiduciary responsibility to any of you. I think you did your utmost, and despite that you got burned. So, it is a lesson to everybody who serves on bank boards that it is a very, very heavy responsibility, and it is a very difficult one.

Mr. Annunzio?

Mr. ANNUNZIO. Thank you, Mr. Chairman.

As the people on the board know, some of the larger institutions received a 5-day notice that the bank was closing. So it is apparent—did anybody here have that same information, that the bank was closing?

[No response.]

Mr. ANNUNZIO. When the Comptroller asked that \$49 million be written off as bad loans, Mr. Randolph, how much of this was discussed at the board meeting? How serious were the discussions?

Mr. RANDOLPH. As I mentioned, we were never—in the regular board meetings, we never had a discussion of any specific loans, and at the time of our last board meeting in the middle of June of this year, Mr. Beller—

Mr. ANNUNZIO. You had no knowledge?

Mr. RANDOLPH. Mr. Beller said they were still there. We do not know how many loans. And someone said, well, how much, \$5 million, and he said, yes, perhaps more. That was the extent of it. Now, when the meeting was held on the 1st of July, and I must say I am speaking of what I have read and what these gentlemen tell me, they were presented with a list of about \$30 million.

Mr. ANNUNZIO. Does that apply to any person here?

Mr. HAUGLAND. The meeting that Mr. Randolph refers to on Thursday morning, the July 1, the board was convened at 9 o'clock, and a representative of the Comptroller's Office was present, and at that time served each member of the board with a cease and desist order.

Mr. ANNUNZIO. These loans, when the Comptroller of the Currency writes off, as you know, \$49 million in bad loans, do you mean these loans were not discussed weeks before, months before?

Mr. HAUGLAND. No, sir. They may have been discussed with management after the examination commenced the April 19, but we have not ever heard anything officially or unofficially except what you read in the newspaper.

Mr. ANNUNZIO. In your honest opinion, what kind of shape did you think that the bank was in?

Mr. HAUGLAND. From my information that I got from management on the 15th of June in our regularly scheduled board meeting, and from what they had been able to find out from the ongoing examination, I suspected that we were going to have to raise maybe \$10 million or \$15 million worth of new capital, but I did not have any inclination that we were in that kind of shape.

Mr. ANNUNZIO. Mr. Randolph?

Mr. RANDOLPH. As I mentioned, we had no previous knowledge, and did not have any specifics on the loans that were considered to be bad, and the management guessed that it would be somewhere

around \$5 million or perhaps greater, and I do know that there were a list of entities on the cease and desist order, and it is supposedly reputed to be about \$30 million in bad loans, and I do know that at least in one or two instances, those loans have already been fully satisfied and have been removed from the bank in the ensuing time since the bank was closed.

So, how many of those really and truly were bad and did not have collateral and appropriate resources, it is hard for us to guess at this time.

Mr. ANNUNZIO. Mr. Cook?

Mr. COOK. Mr. Annunzio, I assumed at the board meeting on the 15th that we might have to raise somewhere between \$5 million and \$10 million, but I never in my wildest dreams thought that the bank would close or that the charge-offs would be anywhere near what they ended up being.

Mr. ANNUNZIO. Ms. Coe?

Ms. COE. Well, needless to say, I was very surprised. I was certainly not prepared for the bank to close, obviously. I did not think it was going to close, or I would not have put some money in the bank. We were not given anything but the one list on July 1 by the Comptroller, and you just heard Mr. Randolph say that some of those loans have already been paid off. The Comptroller really gave us no information, or if they gave it to management, management did not give it to us.

Mr. ANNUNZIO. Mr. Ross?

Mr. ROSS. I would have to concur with my fellow directors 100 percent.

Mr. RICHARDSON. We had no indication. We knew the examiners were in there, of course, for 3 or 4 months, 3 months or 2 months, whatever it was. However, during the course of the examination, the examiners left for about a period of 1 week or 2, I understand, to go to some kind of a training seminar, and we felt that if it was that bad, they should not have left.

The CHAIRMAN. Do you know where that seminar was held?

Mr. RICHARDSON. I have no idea.

The CHAIRMAN. Does anyone on the board know?

[No response.]

Mr. RICHARDSON. But anyway, apparently, if it was in that dire a shape, I thought they would have stayed around. We were not notified until that Thursday before it went down that we were in that bad a shape.

Mr. ANNUNZIO. Mr. Smelser?

Mr. SMELSER. Mr. Annunzio, we met all day practically on Thursday and Friday prior to the 4th, the closure. When the board left the bank Friday evening, we were under the impression we had been getting constant information from the Comptroller and the Federal Reserve, who was meeting with Mr. Jennings and Mr. Beller. We had been getting information all day long, and when we left the bank at 5 o'clock that evening, we were under the impression and had been told that the bank would reopen Tuesday morning. It would be necessary for Mr. Jennings to raise capital, which he stated he had pledged at that time, but that the bank would be open Tuesday morning.

We did not hear another word until late Monday, when we were called in to an emergency meeting, and told that the bank would be closed as of that time.

Mr. ANNUNZIO. All you heard from the Comptroller was open your wallet and shut your mouth. [General laughter.]

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Weber?

Mr. WEBER. Thank you, Mr. Chairman.

Ladies and gentlemen, I am very troubled by the question about the board's responsibility in this matter. I think you are in a situation where you were probably doing your best and it is very difficult to control a strong-willed management, a management that I think in many ways was devious, and as the chairman has said, demonstrated a capacity to con some of the best banks in the country, or some of those that we would normally think would be the most sophisticated.

Nevertheless, let me just recount some of the factors in the situation to review what has taken place. First of all, each one of you—let me do a little bit of preaching perhaps—took an oath of office established by the United States Code that you would diligently and honestly administer the affairs of the association, and will not knowingly violate or willingly permit to be violated any of the provisions of the United States Code.

You, as a board, were informed on numerous occasions through various reports, letters, and meetings, and I will refer to these in just a moment, with the regional office of the Office of the Comptroller of the Currency about the condition of the bank. All of this raises the very obvious question to me whether you did not breach the fiduciary duty which you took in your oath of office by failing to monitor and failing to restrain the officers of the bank.

Now, let me just refer to the staff report on June 9, 1980. The OCC forwarded its examination to the board of directors. Did you receive that? I mean, was that mailed to you, or was it not mailed to you?

Mr. ROSS. It was not.

Mr. RANDOLPH. It was mailed to the bank.

Mr. COOK. I went into the bank and read the examination. There was a copy in the bank. But we were not sent it individually.

Mr. WEBER. How many of you, if you would raise your hands, are saying you did not receive that examination which was forwarded to the board of directors? Would you raise your hand if you are saying you did not receive it?

Mr. ROSS. We did not.

Mr. RICHARDSON. I did not.

Mr. SMELSER. I did not.

Mr. HAUGLAND. Mr. Weber, they only mail one, and it goes to the bank. They do not send them out to the directors.

Mr. WEBER. So at that point it is up to the bank apparently to disseminate the information, and I think that is very helpful for us to know. On August 14, 1980, a letter from the regional office to the board of directors identifying weaknesses in the capital plan, asking for submission of an acceptable one, how many of you received that letter?

Mr. RANDOLPH. Again, that was mailed to the bank. I am sure we saw it at a board meeting, but not individual copies. We did not receive it independently of the bank.

Mr. WEBER. On August 27, 1980, a full board of directors meeting in Dallas at the regional office was held, at which time these matters were discussed. Now, how many of you did not attend that meeting?

Mr. COOK. I did not attend.

Mr. HAUGLAND. I was not on the board at that time.

Mr. WEBER. The two of you? Well, Mr. Cook, were you subsequently given minutes of that meeting?

Mr. COOK. No. That was the time that I read the examination. I felt since I had not been at the meeting, I ought to go in and read the examination, and I did, cover to cover.

Mr. WEBER. Were there not minutes that were taken?

Mr. ROSS. I have never seen a copy of minutes, if there were, of that particular meeting.

Mr. WEBER. Did you not customarily have minutes of your board of directors meetings that were subsequently mailed to the directors?

Mr. RICHARDSON. No.

Mr. RANDOLPH. They were not mailed to the directors.

Mr. COOK. We did have copies of minutes that were in our board books at each subsequent meeting, which were reviewed.

Mr. WEBER. The minutes from the previous meeting were not mailed? Instead, they were reviewed and approved at the subsequent meeting of the board of directors?

Mr. COOK. That is right.

Mr. HAUGLAND. Yes.

Mr. WEBER. I see. On September 9, 1980, the board of directors individually signed and consented to an administrative agreement and each of you then signed it, except perhaps Mr. Haugland. You, I take it, were not a member of the board at that time.

Mr. HAUGLAND. That is correct.

Mr. WEBER. October 8, 1980, the OCC sent a visitation report to the board of directors. Again, how many of you did not receive that report?

Mr. RANDOLPH. I do not remember seeing it or having it even discussed.

Mr. WEBER. How many remember that they did receive it? That was October 8, 1980, a visitation report from the OCC. Do any of you remember receiving that?

Mr. RANDOLPH. No.

Mr. ROSS. No.

Mr. WEBER. On March 13, 1981, Arthur Young signed their certificate to the yearend report of the bank. Did all of you receive copies of the yearend financial statement certified by your auditors?

Mr. RANDOLPH. I do not have a copy.

Mr. WEBER. Is there any person that did not review that statement, the yearend report?

[No response.]

Mr. WEBER. You are telling me as members of the board of directors that you did not review the financial statement for the year-end, 1980, prepared by your auditors?

Mr. COOK. I reviewed it.

Mr. WEBER. How many did not review that statement?

Mr. ROSS. It was reviewed at a board meeting.

Mr. WEBER. At a board meeting?

Mr. SMELSER. Yes, sir.

Mr. WEBER. On July 1, 1981, a letter from the regional administrator to the board of directors identifying problems and demanding action. Again, did any of you receive that letter?

Mr. COOK. No.

Mr. WEBER. A full board of directors meeting was held again at the Dallas regional office on July 29, 1981. Were there any of you who were not present at that meeting?

Mr. COOK. I was not present.

Mr. WEBER. Did you inform yourself as to what went on?

Mr. COOK. Yes, I did.

Mr. WEBER. On December 1, 1981, the regional administrator forwarded the special supervisory examination to the board of directors. How many did not receive that report? Did anyone receive that report?

Mr. ROSS. No.

Mr. COOK. No.

Mr. WEBER. Then on May 4, Peat, Marwick did their confidential report on the management initiatives that they would recommend. How many of you received and reviewed that? How many of you received that report?

Mr. HAUGLAND. That was delivered in the board meeting of June.

Mr. WEBER. That was not delivered to the directors until the June board meeting?

Mr. COOK. Right.

Mr. HAUGLAND. Right.

Mr. WEBER. It seems to me that that may identify a failing of procedure. If I wanted a communication out to the board of directors, I would have their names and addresses and mail directly. The agreement that you personally executed on September 9, 1980, I am informed by staff, was violated in a number of different areas: Violations of section 84 on the lending limits, you failed to get sufficient credit information, the bank failed to get collateral documentation, additional credit, and criticized borrowers without prior board approval, and notice to the regional administrator failed to keep the APLL adequate—I am not sure even what that means—failed to limit control of document contingent liabilities.

The examination of December 1980 identified substantial problems with the growth of the bank. You made commitments to the regional office in the July 1981 meeting about the growth of the bank. Mr. Beller previously testified this morning that if you had one corrective action to make that would have saved this bank, it would have been, stop making so many loans. Nevertheless, the bank under your direction, your control, grew from \$200 million of loans in December 1980 to \$380 million of loans at the time of closing. The loans that were declared lost in the preliminary report of

the bank as of July 5, 1982, totaled approximately \$49 million, of which \$30 million appeared to have come into the bank subsequent to September of 1981.

Also, approximately \$1 billion of additional loans were made and participated in during the period of September 1981 to the closing of the bank. That does not sound to me as though you were doing very much to slow down the growth of the bank.

Now, we obviously have something of a failure in communication between the Office of the Comptroller of the Currency and the members of this board of directors. I do not know whose responsibility that is. I am certainly not going to accuse any of you of doing anything willful or deliberate in this situation. I believe if anything my observation would be that this is an indictment of the regulatory system that places excessive reliance on outside directors such as you good people, who are lay persons, each with your own activities, your own primary occupations and duties, to override a very strong-willed management to whom many of you probably owe some natural feeling of loyalty for having been serving on the board of directors in the first place.

Those would be my observations about this whole situation, and I would be happy to entertain any of your comments. It strikes me as a situation in which an attempt was made on numerous occasions, almost a dozen times, to bring these matters to your attention, and rightly or wrongly, apparently, the Comptroller of the Currency was placing a great deal of reliance on you people to clean up the act, and it did not happen, and I am not saying that I would have done any better if I had been in your shoes, but it did not happen, and I guess what I am saying is that perhaps it is the fault of the regulators for waiting for you to act in a situation where they should have taken stronger action themselves. Am I right or am I wrong?

Mr. Cook. Mr. Weber, the only comment I would make is that as Mr. Randolph pointed out, we felt from sometime last fall through the spring of this year that the combination of the new management team which we as outside directors had helped to put in place coupled with the kinds of policies and procedures which that management team was putting into place and subsequent changes in the bank's lending philosophy such as strengthening the loan loss reserve, changing the policy on rig loans, et cetera, that those changes were resulting in the elimination of the kinds of problems that the Comptroller had indicated. In fact we further felt then that in January of this year, by the Comptroller's own comments, from his staff's comments to us, that a substantial number of those problems that they had raised in 1980 had finally been solved, and we felt that there was further confirmation of that in the Peat, Marwick, Mitchell & Co. audit later this year.

So, in fact, we felt that, yes, there had been substantial problems, but not only had we exercised a fair amount of diligence in trying to change the situation, but there seemed to be some evidence, independent evidence that the situation was changing substantially for the better.

Mr. WEBER. Well, I can sympathize with the situation that you were in. Does anyone else care to make a comment?

[No response.]

Mr. WEBER. Mr. Chairman, I yield back my time.

The CHAIRMAN. I am trying to get to the bottom of something here. As members of the board of directors, let me ask you this question. Did you not get copies of the examiners' reports at the conclusion of each examination for you to read and sign and return?

Mr. ROSS. No.

Ms. COE. No.

Mr. SMELSER. No.

Mr. RANDOLPH. We received those in the course of the board meetings, Mr. Chairman, and would review them there.

The CHAIRMAN. And is there any requirement that you initial them or sign them once you have seen them?

Mr. RANDOLPH. I do not recall whether we had to or not.

Mr. SMELSER. We never had a report or a letter or a memo or anything that was sent to us personally and that we could take outside of the bank board room.

The CHAIRMAN. At any time when you were at meetings in Dallas, and I will ask Ms. Coe and the ladies in the audience to forgive me for using this term—and now I am reading from a news clip—but at any time were you told at any of these meetings at the Comptroller's Office that there were a lot of "crappy loans?" Was that word used by anyone in the Comptroller's Office in meetings with you, that there were a lot of crappy loans at Penn Square?

Ms. COE. No.

Mr. ROSS. No.

Mr. RANDOLPH. I do not recall that expression.

[The news article referred to follows:]

[From the Daily Oklahoman, Aug. 1, 1982]

PENN BANK WARNED IN 1980 TO GET HOUSE IN ORDER

(By Judy Fossett)

These were people who weren't used to being scolded. They called the shots in their own businesses, and if there were ever any scoldings to be given, they would be the givers. But on this late August day in 1980 sat an array of corporate executives being warned by a government official who told them "in no uncertain terms" that Penn Square Bank would fail if they, the bank's directors, didn't make some swift and sure changes in the way they were running their bank.

That was the government's position: If they failed, the bank would fail, and it would be their fault. No one else's. Just under two years later, Penn Square Bank did fail. Federal regulators, who for years kept the bank's troubles a secret as they sought to save it, are saying publicly now that the bank collapsed because the bank's directors didn't change the way the bank was run. They say instead of improving its conditions, the board allowed the institution's condition to grow progressively worse under free-wheeling and possibly, as several lawsuits claim, fraudulent dealings.

The role the bank's directors played in the Penn Square Bank saga isn't being told by the directors themselves. They are not talking. The story is instead being told through the steps federal regulators say they took in the last two years.

Apparently not all of Penn Square Bank's directors attended that Aug. 27 meeting in Dallas. It isn't clear exactly who was there, but the entire board had been summoned by Cliff Poole, the regional administrator of national banks, because the bank was in trouble.

Ordered to assemble were bank directors Bill P. Jennings, the board chairman; Frank L. Murphy, board president, and Ronald H. Burks, chairman of Burks Investments Inc.; Elizabeth Merrick Coe, president of the Merrick Foundation; Gary M. Cook, then chairman of Trend Construction Corp., now of Tulsa; C. F. "Tag" Kimberling, then owner of Kimberling's Food Markets, now in investments and real

estate; Dr. Marvin K. Margo with McBride Clinic; L. F. Rooney, Tulsa, president of Manhattan Construction Co.; Jerry Richardson, president of Dub Richardson Ford Inc.; W. A. "Dub" Ross, president of Dub Ross Co.; Gene Smelser, president of Val Gene's Food Service; Bill Stubbs, real estate; Carl W. Swan, independent oil producer, and James G. Randolph, president of Kerr-McGee Coal Corp. and former commander of the Oklahoma City Air Logistics Center at Tinker Air Force Base.

These well-known civic and business leaders listened as the chief examiner who had scrutinized the bank's books listed the violations that had been found. There should have been no surprises. Two months earlier, on June 9, the regional office had requested the Dallas meeting because of problems found in an examination dated Feb. 29, 1980, and completed that April.

Comptroller of the Currency C. T. Conover told the House Banking Committee recently it was after that examination that "the bank became a matter of supervisory concern. This examination revealed, among other things, rapid growth of bank loans, and assets, insufficient liquidity, inadequate capital, an increase in classified assets and violation of banking laws."

The examination also noted that the bank's loans were concentrated in the oil and gas industry.

On June 19, 1980, the regional administrator met with bank chairman Jennings and the executive vice-president, who is identified by records as Tony W. Williams, to discuss the bank's problems. Then on Aug. 27, it was the full board's turn for the lecture. When the examiner concluded his presentation, the regional administrator began comparing Penn Square Bank's operation to that of a "prudent" bank.

He told them the responsibility for the Oklahoma City bank was theirs. He also reminded them, as Poole said he always does when the officials of any bank are brought in for a reprimand, that "they can't say they weren't warned in time. If the bank is in crappy condition, the blame is at their feet."

For a regulator, there is a fine line to walk between making things too easy for the directors and making them mad, Poole said. Just being ordered to Dallas is already enough of a reprimand for people of the stature of bank directors, he said. "They're usually sufficiently contrite or remorseful and find the situation distasteful and immediately want to correct the problems."

On Sept. 9, 1980, a week after the Dallas meeting, Penn Square Bank's directors signed an agreement in which they promised to: Stop violating banking laws by exceeding lending limits; increase capital; stop loans without adequate collateral; stop lending to poor quality borrowers; document loans they get other banks to participate in; make more accurate estimates and set-asides for possible bad loss loans; make monthly reports on the bank's progress under the agreement.

From Sept. 9 to 11, 1980, examiners reviewed the bank's books and discovered the institution's liquidity was strained, its existing staff overtaxed by the volume of business and its capital adequacy deteriorating, banking officials have testified.

Nonetheless, the required reports filed with the regional administrator by bank officials showed progress and "repeatedly gave assurances that the required corrective actions had been or would be accomplished."

The examiners returned in January 1981 for another, longer look at the bank's circumstances and reported "further deterioration of the bank's overall condition." They said they also found "insider lending violations, and officers who borrowed without the bank board's knowledge or approval."

Sometime in 1981, unknown then to the examiners, the bank would institute a policy of forbidding its own internal loan review committee from scrutinizing the millions of dollars in gas and oil loans being generated by its Energy Department, congressional investigators have been told.

It was in the period between Dec. 31, 1980, and the bank's final April 1982 audit that the Energy Department wrote \$1.6 billion in oil-related loans and sold virtually all of them to other banks.

How these loans were written, who they were written for and whether or not they should have ever been written at all are the subjects of a federal grand jury probe beginning Monday and two simultaneous congressional inquiries that began earlier this month. Federal regulators are also sifting through the bank's documents for clues about these loans and the participation of major banks such as Continental Illinois, Chase Manhattan and Seattle First National.

For all their demands of the bank and its directors, the examiners failed to make note of the large volume of energy loans when a limited examination was conducted in the fall of 1981. Earlier, on July 1, 1981, the regional administrator had notified the bank's directors that an examination conducted that spring showed that the "board and management failed to supervise prudently the bank's activities."

In particular, the examination report said the lack of supervision showed up in "numerous violations of banking laws, inordinate asset/liability management risk, high levels of poor-quality assets, uncontrolled growth of bank resources, and non-compliance with the formal agreement" of the previous September. On July 29, 1981, the bank's board of directors was once more summoned to the Dallas regional office. A new member of the board by this time was Bill Patterson, the man in charge of generating Penn Square Bank's millions of dollars in energy loans.

As a follow-up, a special supervisory examination was conducted Oct. 8-30, 1981, which revealed "modest improvement" although some concerns remained, Comptroller Conover told the House Banking Committee. "As late as January of 1982, we believed the outlook to be favorable and that all substantive areas of concern were being addressed and corrected," Conover testified.

Then came the April 1982 audit and the discovery of all those oil loans, about \$900 million of which had been written since the fall audit. None of the previous \$600 million-plus in loans had been checked because the examiner was directed to review only previously criticized loans and those that had been generated by the bank's loan review committee—and that committee (which includes bank directors in its membership) wasn't seeing the oil loans.

Examiners who had been checking the books since April have found "proof" of falsified and altered documents, "insider loans throughout the examination, throughout the entire period," and "massive violations of law," bank regulators have testified.

Poole, whose office began altering Penn Square Bank's directors more than two years ago of problems in the bank, commented: "Any board of directors has the full responsibility laid at their feet. The board bears the ultimate responsibility. "We try to get them to face facts if they've got crappy loans, poor documentation, all kinds of violations of the law.

"Usually when we get them down here to talk to them, they think, 'We're getting the hell beat out of us here.' They look over at their management and say, 'You told us you could do it this way and you're fired.' "That's the way it ought to happen."

The CHAIRMAN. Now, let me ask you this. There is a firm known as Petro Industries. Does that ring a bell with anyone on the board of directors?

Mr. RANDOLPH. Not me.

Mr. HAUGLAND. No.

Mr. COOK. No.

The CHAIRMAN. They did have some loans with—and I am reading here from minutes of the meeting of the board of directors. Is this all April 14, 1981? No, this is June 15, 1982. The chairman commented he believed the loan to be sufficiently collateralized. Mr. Patterson noted that it would be charged off per the examiner. He further noted that on Petros Energy and Land, Nos. 25705, 26506, 26999, 27046, the loans had been paid off by the customer selling off its production to another customer." You do not recall that one? This is a board of examiners—I am sorry, a board of directors, the minutes of a meeting of the board of directors. How about a fellow named Creamer, a former vice president at Northern Trust. Does that ring a bell?

[No response.]

The CHAIRMAN. Mr. Beller, does that name ring a bell with you, Creamer, Northern Trust?

Mr. BELLER. No, sir.

The CHAIRMAN. How about the Petros, P-e-t-r-o-s Energy and Land?

Mr. BELLER. Yes, sir.

The CHAIRMAN. Did they have a line of credit with Penn Square?

Mr. BELLER. They had loans with Penn Square, Mr. Chairman, but I don't recall which bank had participated in the loan. But the name Creamer, I don't remember.

The CHAIRMAN. But they had a loan with Penn Square that was participated out, or did Penn Square buy a participation from someone else, do you recall?

Mr. BELLER. It was normal to participate them out.

The CHAIRMAN. Most of yours were participated out, right?

Mr. BELLER. I remember the name. I don't remember the details.

The CHAIRMAN. What we are trying to find out, you say you recall a real estate loan to Mr. Lytle. Was it a direct loan, or did that come from another institution, or was it purchased?

Mr. BELLER. That was a loan from Penn Square Bank.

The CHAIRMAN. Direct to him?

Mr. BELLER. Yes.

The CHAIRMAN. For a mortgage on real estate?

Mr. BELLER. Yes, as I recall.

The CHAIRMAN. Well, that was just a 2-minute news flash. We will get back to this on later on. We are going to track this one down before the day is out.

Mr. Wortley?

Mr. WORTLEY. Thank you, Mr. Chairman.

Mr. Haugland, why did Bill Jennings ask you to come on the board of the bank?

Mr. HAUGLAND. I represented a larger stockholder who owns stock in Penn Square in the bank holding company organization.

Mr. WORTLEY. You did not come on until April of 1981.

Mr. HAUGLAND. Yes, sir. I replaced a man who was deceased about 6 months prior to that, who also represented that block of stock.

Mr. WORTLEY. In other words, you did not come on the board because the Comptroller of the Currency was reviewing things and said this board needs to be beefed up with people who understand the banking process a little better? Would that have been a reason why you came to the board?

Mr. HAUGLAND. No, sir. It had nothing to do with the Comptroller.

Mr. WORTLEY. I know it was not because you were a large depositor.

Who did you replace?

Mr. HAUGLAND. Well, I didn't replace the man, but Mr. L. F. Rooney was a board member of the bank until his death in October of 1980. Then subsequent to that period of time I joined the board to represent their family interest in the holding company.

Mr. WORTLEY. Were they a substantial stockholder in the bank?

Mr. HAUGLAND. They owned about 7 percent of the holding company stock as of the last day of the bank operation.

Mr. WORTLEY. I see they owned 6.7 percent of the stock.

I will address this to any of you out there.

When did you first begin to realize the commitments that you had given to the Comptroller of the Currency to clean up Penn Square Bank, that those recommendations were not being followed by the management?

Ms. Coe?

Ms. COE. Well Mr. Wortley, I think certainly that with the new administrative officers, that things were going very well. The Comptroller's Office had said they were. They had told us that in

January. Peat, Marwick had told us that. I had no reason to believe the bank was going down.

Mr. WORTLEY. Mr. Cook?

Mr. COOK. I concur 100 percent. As I just mentioned, we felt that particularly in the last 9 months substantial improvements had been made, and the Comptroller himself said that a substantial number of the items which were in the compliance letter we had in fact complied with, as Mr. Beller testified earlier today.

Mr. WORTLEY. In other words, none of you sitting out there as directors of the bank realized until the Fourth of July weekend that the bank was in serious trouble? Is that correct?

Mr. ROSS. That's right.

Mr. COOK. That's correct.

Mr. HAUGLAND. Mr. Wortley, I think we recognized that the bank was under an administrative letter of restraint and had problems. It is a semantics problem when you are talking about whether it was in trouble or whether it had problems. We all recognized that there were problems.

Mr. WORTLEY. During the last several months did any of you ever discuss the financial condition of the bank with outsiders, casual cocktail party conversation or luncheon conversation?

Mr. COOK. Well, the condition of the bank was discussed with me by a couple of outside people who would ask me what condition we were in. It was well known that we were a substantial energy lender, and obviously people then said, well if the energy business is in trouble, perhaps Penn Square Bank is in trouble.

Mr. WORTLEY. Did you have any discussions with any major depositors of the bank who might have started a run on the bank earlier?

Mr. COOK. I certainly didn't.

Mr. RICHARDSON. No.

Mr. SMELSER. No.

Mr. WORTLEY. Did any of you as directors ever receive special privileges of overdraft in your accounts for any extended period of time, not overnight, for example?

Mr. ROSS. No.

Mr. SMELSER. No.

Mr. COOK. No.

Mr. WORTLEY. Do you really feel that the management of this bank was a good and prudent management, knowing full well that the president himself was unaware of and was not highly knowledgeable of energy type loans, and you put a major concentration of the bank's resources in the area of energy loans?

Now, Mr. Haugland, you are a banker. You are on there because you are a prudent man. Did you ever bring up—you mentioned overdrafts. You cited that in at least one or two board meetings, that you were urged to cool it somewhat.

Did you ever raise the question about having concentration of bank loans in the energy field?

Mr. HAUGLAND. I think we were all aware—at least I was aware that we were an energy concentrated lender. We did not suffer in the past, and I guess history would tell us what the actual losses we did suffer, but we have not suffered significant losses from energy lending.

Mr. WORTLEY. Where did you suffer significant losses if it was not in the area of energy?

Mr. HAUGLAND. The significant losses that the bank apparently suffered were in some of the loans that were on the books as a result of some poor judgment by officers who are no longer there, that is, some of the agricultural loans and some of the real estate loans. It is my understanding we have not had significant losses up until the most recent examination which apparently is still ongoing.

Mr. WORTLEY. What was the ratio of Penn Square's loan losses compared to the industry's?

Mr. HAUGLAND. I can't recall it.

Mr. WORTLEY. Well, were your level of losses higher in the area of energy loans than other competitive banks?

Mr. HAUGLAND. I don't have a way of making that comparison.

Mr. WORTLEY. I wonder if Mr. Beller could refresh our memory on that.

Mr. BELLER. Could you state the question again, sir?

Mr. WORTLEY. The question was the level of loan loss, your loan loss ratio. Was it higher at Penn Square in the area of energy loans than it was at other banks in the area?

Mr. BELLER. I think not. My memory is that I came there with the amount of chargeoffs of the bank, that it had incurred in the previous examination before I arrived. The chargeoffs were practically all in areas other than energy.

Mr. WORTLEY. In other words, this bank was doing a fine job on its energy loans, is that right?

Mr. BELLER. That is what the chargeoff records would show, yes, sir.

Mr. WORTLEY. Well, what led to its demise?

Mr. BELLER. The chargeoffs of substantial energy loans by the Comptroller's office that rendered the bank insolvent.

Mr. WORTLEY. So it was really—

Mr. BELLER. If you want the bottom line, that's what happened. How many of those loans are bad, only time will tell.

Mr. HAUGLAND. Just because you charge a loan off doesn't mean the borrower doesn't necessarily have to pay it. It doesn't necessarily mean it is a bad loan. That is the judgment that is subjective, and you and I could both look at a loan and come up with a different conclusion. Just the fact that the chargeoffs were of the magnitude they were means that it rendered the bank insolvent, but it is not inconceivable that they could all be collected.

Mr. WORTLEY. No, but you did have a larger proportion than normal of loans in which the interest was deficient, is that correct, in the area of energy? Did Penn Square Bank have a larger ratio of loans in which the interest and principal were not being reduced?

Mr. HAUGLAND. I don't know that.

Mr. WORTLEY. Well, why would the Comptroller of the Currency single out Penn Square Bank from all the other banks that there are in this country for making energy loans?

Mr. HAUGLAND. Are you addressing that to me?

Mr. WORTLEY. Well, you were responding. You are the banker sitting up there and are perhaps more knowledgeable than the rest.

Mr. HAUGLAND. As I say, I have not seen or heard anything official from the Comptroller's Office relative to the examination that was started on April 19, so I really don't know.

Mr. WORTLEY. I would ask any of you, when did you first become aware that the internal loan review program was precluded from reviewing energy credits?

Mr. COOK. Well, I think I just heard that right now because I remember this spring there was a review of the internal loan review program. Mr. Dunn reviewed that program, and energy credits were included in the reviews that he had conducted to date, if I am not mistaken. I also remember that he was asked if the profile of loans of the bank that had not yet been reviewed would be in any different distribution in terms of poor quality versus good quality loans compared to the profile of the loans that had been reviewed, and he said he had no way of knowing but he didn't believe that was the case. So I assume the loan review program was in fact covering energy loans and that it was going along well. It wasn't going as fast as we wanted it to, but he was working on a number of potential chargeoffs, and he had not been able to devote as much time to it as I think many of us would have hoped he would have been able to.

Mr. WORTLEY. But in fact, the energy loans were being precluded from the overall review of the credit policy.

Mr. COOK. That is news to me.

Mr. RANDOLPH. I was going to confirm that that is news to us. We were not aware that it was excluded, that he made restrictions on reviewing energy loans.

Mr. WORTLEY. I wonder if the president could comment.

Mr. BELLER. Yes, sir. I don't know where you came by that information. The energy department was not precluded in my knowledge, and I would add to that that the loan review function, after we were able to get it in place, started reviewing the loans, and we attacked those loans that had been classified by the Comptroller's Office first, and reviewed those loans and charged off the ones that were classified substandard, doubtful, et cetera. That was the place where obviously we reviewed them.

So as soon as we assembled the people to do it, that is what we attacked, and there was, to my knowledge, we were never precluded in any way from reviewing energy loans. It was just that we had not gotten to those reviews yet.

The CHAIRMAN. Mr. Barnard?

Mr. BARNARD. Thank you, Mr. Chairman.

Ladies and gentlemen, you have been most cooperative today, as well as patient and enduring, and for that reason I will make my questions as brief as possible.

Mr. Cook, did you know that the Penn Square Bank very frequently made venture capital loans for new oil ventures?

Mr. COOK. No, I didn't.

Mr. BARNARD. Let me rephrase it.

Do you have any knowledge that they made that type of loan?

Mr. COOK. No, I do not.

Mr. BARNARD. Mr. Haugland, as a banker, and in Muskogee, Okla., where I would imagine you would be confronted with the same opportunities for business as the Penn Square Bank, is it a

customary practice for banks to involve themselves in venture capital for new wells and new drills, new rigs.

Mr. HAUGLAND. Sir, we have very little oil activity in that part of Oklahoma. So our customer base is quite a bit different than the banks that you would look at here in Oklahoma City.

Mr. BARNARD. Is it not customary for those larger banks who have been in the oil business or energy business for many, many years to specialize not in venture capital loans but in collateral of wells and rigs and operations that are already in being and making a profit?

Mr. HAUGLAND. I guess in response to that, I would say that a venture capital oil loan would be like any other venture capital, that if there were additional collateral forthcoming to justify the credit advance, it would be done, but do you mean just by the venture itself?

Mr. BARNARD. Well, it was pretty widely known, at least suspected that Penn Square was making brandnew loans to brandnew people in the business, which was contrary to what I understand to be the practice in other banks who have had many, many years of experience in the oil-lending business. That story was written up rather at length in the American Banker of April 26, 1982, and somewhat corroborated by Mr. Jennings. When the gentleman writing the article asked him if he was actually providing venture capital, Mr. Jennings said he would like to be, noting that he was thinking about forming a venture capital subsidiary. It was reported that Penn Square was pretty much involved in new ventures, which I understand is somewhat contrary to normal banking practice.

Mr. HAUGLAND. If it was, sir, I was not aware of it.

Mr. BARNARD. Back in 1979, we passed a bill in Congress called FIRA, and in that particular law it required that insider loans, loans to members of the board of directors or to correspondents, had to be reported to the board of directors.

Was any such report ever made to you all about a schedule of loans made to your directors?

Mr. HAUGLAND. Yes, sir.

Mr. COOK. Yes, at every meeting.

Mr. ROSS. Yes, sir.

Mr. BARNARD. At every meeting that was done?

One of the things that interests me is that all of you seemed to be very, very surprised that the bank closed. You suspected that additional capital had to be raised and possibly according to some of you, \$4 million or \$5 million might be needed, and then all of a sudden \$40 million in loans were charged off.

Mr. RANDOLPH. Someone from your bench said that.

Mr. BARNARD. You had no forewarning, no indication at all from the Comptroller of the Currency that this requirement was going to be made on the bank?

Mr. RANDOLPH. No, sir, not until the last weekend.

Mr. BARNARD. Not until the last week, and yet you had had how many meetings with the Office of the Comptroller of the Currency?

Mr. RANDOLPH. We as a board did not meet with them at all during the last examination.

Mr. BARNARD. But you had been to Dallas twice, right?

Mr. RANDOLPH. Well, in 1980 and 1981.

Mr. BARNARD. But in those discussions, the ultimate results of what could happen if you did not turn the bank around was never discussed?

Mr. RANDOLPH. I don't understand what you mean.

Mr. BARNARD. Well, general, it is like talking tough to a recruit. They did not say something like if you do not turn that bank around we are going to close you up? Nothing like that was ever said?

Mr. RANDOLPH. They made those comments, but as we have told you over and over again that based upon their examinations in the fall of 1981 and their report to us in January 1982, that we were making progress to clear up those deficiencies that they were concerned about, further collaborated by the auditor's report to us in April.

Mr. BARNARD. So you felt comfortable?

Mr. RANDOLPH. Yes, sir, we did. We felt that the bank was in fact improving and the fact that they came in in April of this year and started an examination and we had no contact with any members of that examining group until the last week, on the first of July.

Mr. BARNARD. And they felt so comfortable about it in April that the just took a little vacation.

Mr. RANDOLPH. Well, I read the testimony that they found after 2 or 3 weeks that it was so horrible they ran to Washington with it, but we didn't have a chance to take a swing at the bat, so to speak.

Mr. BARNARD. Well, we are going to give them a swing at the bat when they come before us.

Mr. HAUGLAND, I believe that you have been very close to the Rooney family, if I am not mistaken.

Mr. HAUGLAND. Yes, sir.

Mr. BARNARD. And my information is you replaced Mr. Rooney on the board of Penn Square after his death in 1980.

I understand that there was a relationship between the Rooney family of Muskogee and the Rowsey family of the Mahan-Rowsey Co.

Do you know much about that relationship?

Mr. HAUGLAND. I know both families. Mr. Rooney, deceased, Larry Rooney, happens to live next door to the Rowsey-that-you-are-mentioning's father, but I don't think that outside of that, they serve on different bank boards.

Mr. BARNARD. Is Mr. Rooney on your board? Is there a Rooney on your board?

Mr. HAUGLAND. Yes, sir.

Mr. BARNARD. Which Rooney is it?

Mr. HAUGLAND. The son of Lawrence Rooney.

Mr. BARNARD. Can you tell us anything about the Mahan-Rowsey debt at Penn Square?

Mr. HAUGLAND. No, sir, I don't know anything about it except that we had an extremely large line of credit granted to them that was a participation of credit with either Chase or Continental.

Mr. BARNARD. All right. Thank you, sir.

Mr. Chairman, I have no further questions.

The CHAIRMAN. I am going to ask each and every one of you to answer this question. We have been trying to get to this, and perhaps we will try to twist the question around.

The Comptroller's Office was in Penn Square and indeed called the FDIC in, alerted Chase Manhattan and Continental, finally admitted to the Federal Reserve Board, after they asked about it, that there was trouble in the streets of Oklahoma City, particularly at Penn Square Bank.

There is a question about the fact that some customers of the institution withdrew substantial amounts of funds at the "advice of a mystical financial consultant."

You people are on the board, or were on the board of directors of the Penn Square Bank.

Did you, Mr. Smelser, can you state to this committee that the Comptroller's office and the representatives of the Comptroller's Office alerted you and apprised you of the severity of the situation at Penn Square Bank on Thursday and Friday of the week—that was the last 2 days, the Thursday and Friday that that bank was open?

Mr. SMELSER. Did they apprise us of the severity?

The CHAIRMAN. The severity of the situation and the impending doom that laid ahead.

Mr. SMELSER. Well, they apprised us of the severity, but I don't think they apprised us of the impending doom.

The CHAIRMAN. Well, let's put it this way. Did you feel as a result of those meetings that at the next board meeting with the management of Penn Square, that there was a whole lot that had to be done that had not been done to date, despite those glowing reports from Peat, Marwick & Mitchell and the Comptroller's Office in January of 1982?

Mr. SMELSER. Yes.

The CHAIRMAN. Yes what?

Mr. SMELSER. Yes, I did feel there was a lot to be done.

The CHAIRMAN. There was a lot to be done as a result of meetings on Thursday and Friday?

Mr. SMELSER. That's correct.

The CHAIRMAN. But prior to that you were not aware of it?

Mr. SMELSER. No, sir.

The CHAIRMAN. This was the first point at which you felt it was that serious?

Mr. SMELSER. The severity of it, yes, sir.

The CHAIRMAN. And Mr. Richardson, I believe you had some loans, rather substantial loans with Penn Square?

Mr. RICHARDSON. That's correct.

The CHAIRMAN. Would you pull the mike a little closer? That had to be renegotiated once Penn Square was closed, correct?

Mr. RICHARDSON. No, I just moved them out of the bank.

The CHAIRMAN. I am sorry, I used the wrong term. You had to go someplace else to get those loans.

Mr. RICHARDSON. That is right.

The CHAIRMAN. I ask you, did the Comptroller's Office in your opinion keep you properly apprised of the severity of the situation at Penn Square Bank?

Mr. RICHARDSON. I would say on Thursday they apprised us pretty heavily. They gave us 1 week to raise enough capital, until the 9th, to more or less stay in business.

The CHAIRMAN. OK. Prior to that.

Mr. RICHARDSON. No. That is the first meeting we had.

The CHAIRMAN. Was that the first inkling you got that things were that severe and that serious?

Mr. RICHARDSON. Yes, that is correct.

The CHAIRMAN. Mr. Ross?

Mr. ROSS. I was out of town on Thursday the 1st, and my first knowing of the problem was on July 2, on Friday when I returned back to town, but prior to that I had no knowledge or any expectations as has been testified here about its closing.

The CHAIRMAN. Well, I think you get the most—well, not the most, but certainly very glowing testimony and testimony very difficult to contradict that in view of the loss you sustained.

Mr. ROSS. Yes, sir.

The CHAIRMAN. So it is fair to say that until that Friday, because you could not be there Thursday, you were not aware of the fact that Penn Square was as severe as it was?

Mr. ROSS. That is correct.

The CHAIRMAN. So either the Comptroller held it from you or hid it from you, or the Comptroller did not know it either.

Mr. ROSS. Yes, sir, I would say that is fair.

The CHAIRMAN. Is that a fair conclusion?

Mr. ROSS. That is a fair statement.

The CHAIRMAN. Ms. Coe?

Ms. COE. Yes.

The CHAIRMAN. Do you agree?

Ms. COE. I did not know anything until I attended the July 1 meeting.

The CHAIRMAN. So either those facts were not made available to you—

Ms. COE. They were not.

The CHAIRMAN. Or/and were hidden from you, or the Comptroller's office did not know it either.

Is that a fair summation?

Ms. COE. I think that's fair.

The CHAIRMAN. Mr. Cook, do you agree with that summation?

Mr. COOK. I would concur with that.

The CHAIRMAN. Mr. Randolph?

Mr. RANDOLPH. Yes, sir, I knew nothing prior to the meeting. I did not attend the meeting because I was out of the country. I did learn about the need to raise capital in order to keep the bank open from talking to Mr. Smelser by phone on Thursday evening, and I later learned—I didn't learn the bank closed until the following Thursday. So I was somewhat out of touch.

The CHAIRMAN. But prior to the meetings of Thursday and Friday, July 1 and 2, you as a rather—as a businessman, again, whose I think business acumen is pretty good, were not aware of it. You were not appraised of it.

Mr. RANDOLPH. No.

The CHAIRMAN. So the conclusion is either the Comptroller hid it from you or the Comptroller did not know it either.

Mr. RANDOLPH. I guess I really don't know how to characterize the facts.

The CHAIRMAN. Now we get to our star here, Mr. Haugland, who is also not only a member of the board of directors but is also a member of the financial institutions industry, so to speak.

Were you aware of the severity of the situation prior to July 1 and 2?

Mr. HAUGLAND. Only to the extent that in our June regularly called board meeting that our management speculated from what he had been able to determine in his meetings with the representatives of the Comptroller's Office that our losses were going to be somewhere in the \$5 million to \$6 million area.

The CHAIRMAN. That was your management, right, your management telling you that?

Mr. HAUGLAND. Yes.

The CHAIRMAN. How about the Comptroller's Office?

Mr. HAUGLAND. Nothing. We knew they were in the bank and had been there since April 19, I believe.

The CHAIRMAN. You know, you were called to Dallas a few times, and here is what I want to know before we hear from the regulators, and I am going to be straight out with it.

You went to Dallas, and we got the impression from the Comptroller's briefing that by cracky, you people on the board should have known how bad things were because they laid it all out on the table for you.

Do you think that is an accurate picture of the meetings that you had in the Dallas office of the Comptroller on those two occasions? Did anyone feel as though it was all laid out for you and made clear to you that things were real bad?

Mr. RANDOLPH. I think with that meeting in Dallas they probably attempted to convey to us that there were some problems there, and they gave us the scenario of what they wanted us to do.

But I guess I don't really know.

The CHAIRMAN. Did you come away from that meeting say, by cracky, I am on this board of directors, I own stock.

Do you own stock or does your family own stock in the bank?

Mr. RANDOLPH. Yes, that is correct.

The CHAIRMAN. By cracky, I am going home to Oklahoma City and I am going to talk to my fellow board members, and by golly, we have got a lot of work to do to turn this thing around and we have got to do it rather expeditiously.

Did you have that feeling when you came home from that meeting?

Mr. RICHARDSON. I think that to some extent, yes, but then maybe that is wrong. However, from that day on in the board meetings we were constantly questioning the fact that we had this letter of agreement—and how we were getting along with it, and felt that things were getting done to work towards its solution.

Mr. SMELSER. Mr. Chairman, we speak of the severity of the situation, were we aware of it. The Comptroller classified Penn Square as a class 3 bank and not a 4 or 5 which makes a tremendous difference as to what the supposed severity of the situation is.

The CHAIRMAN. I just repeat that Mr. Richardson says he came back feeling things ought to be done. You know, on a scale of 1 to

10, how excited were you about the fact that you had to come back here, motivated, excited?

Mr. COOK. I remember talking to Eldon Beller and asking him how serious the problem was, and he said it was damned serious. He said the next step will be a cease and desist order—this was in the summer of 1981. He said the next step was clearly going to be a cease and desist order. But again, as I think all of us have said, that was 1981. Then we get the examination in late 1981 and we have got the Comptroller saying to us in January that we have gone a long way toward solving the various items that were in the compliance letter, No. 1, and No. 2, that there is a reasonable chance—and that is in our minutes—I believe there is a reasonable chance that we will get out from underneath that compliance letter at our next audit, that things are in that good a shape.

The CHAIRMAN. So at that point you were lulled into a sense of security?

Mr. COOK. I wouldn't say we were lulled because we still felt—I mean, after all, we didn't want to be a No. 3 bank. We wanted to be a No. 1 bank. So there was still a long way to go.

The CHAIRMAN. But a number three bank in reality and in truth is not all that bad.

Mr. COOK. At least it is not a four or a five. That is exactly right.

Mr. BARNARD. Mr. Chairman, I guess we cannot resolve until we talk to the Comptroller, how they moved from \$5 million or \$6 million in capital needs to \$40 million in capital needs overnight.

Maybe Mr. Beller could answer that.

Mr. BELLER. No, sir, I can't. But based upon the anticipated chargeoffs that we had concluded in-house that our chargeoffs would run in the neighborhood of \$3 million to \$4 million, we had identified that many problems ourselves. The first indication I had that it would be more than that was when I was advised by the examiners that they looked like it was \$6 million.

Mr. BARNARD. Now, you charged off \$4 million at the end of 1981, at your direction, I believe.

Mr. BELLER. At my direction, after I came to work for the bank.

Mr. BARNARD. But those were other than energy loans? Those were real estate loans?

Mr. BELLER. Yes, other than energy, and those were loans that we charged them off ourselves.

Mr. BARNARD. Did you feel that you had cleaned up the loan portfolio at that time?

Mr. BELLER. Inasmuch as I had been able to find within those few short weeks. The examination continued and the examiners continued to come up with larger numbers of chargeoffs until they finally got to \$12 million, \$20 million, and I understand it ended up somewhere in the \$40 millions. I have never seen the list of the chargeoffs yet.

Mr. BARNARD. Mr. Chairman, I would like to ask the board members, were you being lulled into the dream of this bank in the next 2 or 3 years becoming a billion dollar bank?

Mr. RANDOLPH. No. We were programming somewhere between 15 to 20 percent growth, which was in real terms probably 5 to 6 percent if you take account of inflation. We were basically basing

our growth on the ability to fund the capital needs from the earnings of the bank rather than the need for new capital infusions.

Mr. WEBER. Mr. Chairman?

The CHAIRMAN. Mr. Weber.

Mr. WEBER. It seems to me the situation is becoming a little more clear. Based upon the testimony of the board of directors and also Mr. Beller's testimony that apparently—and also the earlier testimony that we had from Mr. Conover and buttressed by the testimony that we will be getting from the regional Comptroller's office later today, corrective actions apparently were in place or were being put into place that were satisfactory to the OCC as of the September 30, 1981 examination.

The question then is how were those corrective actions evaded so easily between October of 1981 and the period or the time of the next examination of the bank that the OCC made in I believe it was April of 1982, completed—the preliminary I think was completed in early May of 1982, arousing their alarm.

I think the question is, What were the corrective actions that were taken and how were they so easily evaded during that period of time? And I do not know that any of you can answer that, but I think that is really the question.

The OCC is saying that the bank had the corrective, was in the process of taking corrective actions and did not follow through, and I do not know who could answer that question. Apparently you were placing your reliance on a management that did not make good on the corrections that they had agreed, the corrective actions that they had agreed to make, and I do not know if that was the president, the chief executive officer, or the senior loan officer in the department of energy?

The CHAIRMAN. You are a little young to remember this, Mr. Weber, but when I was young, every Saturday you would go to the movies to see Tom Mix or one of those old cowboys, but you always had to go the next Saturday to see the next issue in the serial, you know, what happens next week.

So we are going to get as much as we can from these witnesses, and hopefully, as we get to the next episode, we might learn a little more.

Now, at the June 15, 1982, meeting, Mr. Patterson noted his participation in what appeared to be a partnership. "Mr. Randolph then inquired about possible conflict of interest. The chairman, Mr. Jennings, stated the ethics committee reviews officer participations as well as details of the borrowing."

Could anyone on this panel tell the committee what members of the board sat on the ethics committee?

Did any of you sit on the ethics committee?

Mr. ROSS. No.

The CHAIRMAN. Do you know who the members of the ethics committee were?

Ms. COE. No.

The CHAIRMAN. Does anyone know who was on the ethics committee?

Mr. RANDOLPH. No, sir.

Mr. SMELSER. It is the first time we've heard of it.

The CHAIRMAN. Was it kept a secret from you?

Mr. RICHARDSON. That's the first time we knew of it.

The CHAIRMAN. They answered your question, Mr. Randolph, about a conflict by saying the ethics committee would take it up.

I was going to ask you what the procedures of the committee, of the ethics committee were in reviewing potential conflicts of interest, but none of you know anything about the ethics committee at Penn Square Bank?

Mr. RANDOLPH. I don't know anything.

Mr. ROSS. No, sir.

The CHAIRMAN. Mr. Beller, were you on the ethics committee?

Mr. BELLER. There was not a formal ethics committee, to my knowledge. There was a standards and conduct directive. All officers had—

The CHAIRMAN. Directive?

Mr. BELLER. Yes, sir, an outline that we gave them that would, if they were placed in any type of relationship that would give a conflict of interest at any time, that that should be reported in writing to the chairman of the board and president of the bank. That is the nearest thing to an ethics committee that existed to my knowledge.

The CHAIRMAN. But you are not aware of any ethics committee that met in formal meetings?

Mr. BELLER. No, sir.

The CHAIRMAN. And people wonder why Penn Square had problems.

Ladies and gentlemen, we want to thank you very kindly for your assistance.

There might be some written questions we might submit to you and if you think of anything else that might be helpful to the committee, please feel free to contact us or our staffs.

But on behalf of each and every member of the committee, we want to thank you for your assistance, your openness, your frankness, your willingness to assist, and the help you have given us this morning and this afternoon.

The committee will be in recess for 5 minutes in order to allow our official reporter to retool and relubricate.

This fellow is fantastic. We have had him around the country with us. We have had him all over the place. He is just outstanding.

Mr. BARNARD. Is that going in the record, Mr. Chairman?

The CHAIRMAN. Of course. That goes in the official record. We asked for him to come with us because of the fact that he gets the testimony accurately.

Ray, you have 5 minutes.

We will be back.

Our next panel will consist of, so that they know, Mr. Frank Murphy and Mr. Cravens, Mr. Kenworthy, Mr. Kimberling, Dr. Margo, Mr. Mead Norton, and Bill Stubbs, and we have already had Gene Smelser.

[A brief recess was taken.]

The CHAIRMAN. The committee will come to order.

The Chair at this point in time would like to submit for the record other documents that have been referred to in the questioning of the witnesses, and this would be the minutes of the meeting of the board of directors of Penn Square Bank from April 14, 1981,

through June 15, 1982, and without objection, these will be put into the record.

The CHAIRMAN. The Chair would also ask unanimous consent to place into the record a communication from the Comptroller of the Currency re Penn Square Bank from Mr. Conover, the Comptroller of the Currency, dated August 15, 1982, and this is a summary, a copy, rather, a formal agreement executed with the bank of September 1980, copies of the notice of charges of the order for cease-and-desist order June and July 1982, and a summary of each examination report from 1976 through 1982.

I would inform the press and everybody else not to get too excited because this is a summary of the examination reports with all kinds of names and I.D.'s deleted, and very frankly, I am afraid we are going to have to ask for much more than the summary.

[The material referred to, with an addendum, appears in the appendix section as appendix C.]

Mr. SPRADLING. I am Mr. Spradling, an attorney for Mr. Cravens.

With respect to the minutes first admitted, there is an error in the minutes of the Dallas meeting. Mr. Cravens was absent and Mr. Norton was present, and I think they have got it reversed.

The CHAIRMAN. They had it backwards.

Thank you.

At this time we have Mr. Frank Murphy, former president of Penn Square; J. C. Cravens, Mr. Kenworthy, Mr. Kimberling, Dr. Margo, H. Mead Norton, Mr. Stubbs, and Mr. Ron Burks.

If you gentlemen would be kind enough to rise with me.

[Witnesses sworn.]

The CHAIRMAN. The Chair would like to thank all of you again for your assistance and your appearance here, and the members of this particular panel have been with the institution since its inception, and it will be very helpful to get a real clear history of this.

And I think I would first like to ask Mr. Murphy, since he has been with the institution or connected with it for a long period of time, if you would be willing to tell us or give us a brief recap of the history of the bank from the time you joined I believe in the 1960's, a very brief one.

TESTIMONY OF FRANK MURPHY, FORMER PRESIDENT OF PENN SQUARE BANK; J. C. CRAVENS, KEN L. KENWORTHY, C. F. KIMBERLING, DR. MARVIN K. MARGO, H. MEAD NORTON, BILL STUBBS, AND RON BURKS

Mr. MURPHY. Yes, Mr. Chairman. I joined in January 1961 as assistant vice president. In September 1961 I went into commercial loans as vice president. In April 1964, the executive vice president; in January, I believe, 1965 until the present, then last year, as vice chairman.

The CHAIRMAN. Now, you became at any time between 1964 when Mr. Jennings left the bank and went to Fidelity and 1975 and 1976 when he regained control and returned, was the bank under any level of criticism from the Comptroller of the Currency's administrator, or from the Comptroller of the Currency?

Mr. MURPHY. No letter of administration, no, sir.

The CHAIRMAN. Any cease-and-desist orders?

Mr. MURPHY. No, sir.

The CHAIRMAN. In other words, the bank was functioning properly as far as the Comptroller's office was concerned? Your reports were relatively unexciting?

Mr. MURPHY. I would think operating above average, I would like to believe.

The CHAIRMAN. Now, could you tell the committee your impressions of what changes occurred at the bank subsequent to the return of Mr. Jennings and his assuming control?

Mr. MURPHY. The primary change was directing the bank into the energy field. That has been at the peak.

The CHAIRMAN. This was a rather substantial or dramatic change in direction, was it not?

Mr. MURPHY. Yes, it was.

The CHAIRMAN. Compared to what the bank had been doing previously.

Mr. MURPHY. Very much so.

The CHAIRMAN. What was your reaction to this right hand turn, so to speak, or 180 degree turn?

Mr. MURPHY. Well, I guess I am known as pretty conservative. I felt that with the proper direction and proper loans there would be nothing wrong with it, even though I am conservative.

The CHAIRMAN. When did you indeed leave the institution?

Mr. MURPHY. Sir?

The CHAIRMAN. When did you leave Penn Square?

Mr. MURPHY. When the FDIC—I was advised I was no longer on the payroll.

The CHAIRMAN. The minutes reflect considerable discussion of a former officer, Mr. Thomas Orr, and the problems he had caused prior to his resignation in 1981.

Could you tell us what was his function at Penn Square?

Mr. MURPHY. Mr. Orr was an executive vice president over commercial loans, excluding energy.

The CHAIRMAN. And do you know who brought him into Penn Square?

Mr. MURPHY. Yes, sir, Mr. Jennings.

The CHAIRMAN. We have heard references this morning to horse loans.

Was Mr. Orr involved in what is known, in these horse loans?

Mr. MURPHY. Well, we didn't think so, but apparently it has turned out that way, yes.

The CHAIRMAN. And were other members of the board or officers of the institution involved in these horse loans?

Mr. MURPHY. Not to my knowledge, sir.

The CHAIRMAN. Now, again, he seems to have had problems.

Is he the gentleman about whom letters went to the Comptroller in complaint?

Mr. MURPHY. Yes, sir.

The CHAIRMAN. Do you know what the sum and substance of those complaints were?

Mr. MURPHY. The sum and substance, no, sir, I do not.

The CHAIRMAN. You do not know what the allegations were?

Mr. MURPHY. Allegations, direct knowledge, I do not. Hearsay, yes, but direct knowledge I do not.

The CHAIRMAN. Maybe we can get that from the Comptroller's office.

Tell me, Mr. Murphy, would you be good enough to inform us as to how long you had been acquainted with Mrs. Evelyn Wood who I believe served as an assistant to Mr. Jennings?

Mr. MURPHY. I have been acquainted with her from the time she became a secretary originally to Mr. Jennings.

The CHAIRMAN. And when would that have been?

Mr. MURPHY. Four or five years ago maybe. Maybe longer.

The CHAIRMAN. Subsequent to his return to Penn Square in 1975?

Mr. MURPHY. Yes, sir.

The CHAIRMAN. And to the best of your knowledge she came on board and worked for Mr. Jennings throughout?

Mr. MURPHY. Yes, sir.

The CHAIRMAN. That period of time?

Mr. MURPHY. Yes, sir.

The CHAIRMAN. If the committee members will allow, I am just getting this in handwriting myself. I will go through with some of these members their involvement and then open up for the other members, and then that way maybe we will have a better handle.

Now, Mr. Stubbs, you have been a director since 1964?

Mr. STUBBS. Yes, sir.

The CHAIRMAN. And you, therefore, were with the bank since 1964 and 1974 prior to the change of direction?

Mr. STUBBS. Yes, sir.

The CHAIRMAN. And then you were on from 1975 until the demise, so to speak, on July 5 and 6?

Mr. STUBBS. Yes, sir.

The CHAIRMAN. Could you give us your impression of the direction the bank took, the difference between the manner in which it functioned prior to 1974 and subsequent to 1975—a very capsulized version?

Mr. STUBBS. I was on the board from 1964 to 1974. The bank was basically a real estate bank and I am in the real estate business, and that is the reason I was on the board. I offered to resign when Mr. Jennings and his group bought the bank and he requested that I stay on, and I did.

And it did take a complete change and go into the energy business, which was very foreign to me. And what I could see from sitting on the board, it seemed like it was a very profitable venture for the bank.

The CHAIRMAN. Let me ask you this, Mr. Stubbs. Were you present at the Dallas meeting in 1981?

Mr. STUBBS. Yes, sir.

The CHAIRMAN. With the Comptroller?

Mr. STUBBS. Yes, sir.

The CHAIRMAN. Did any of the directors at any time say to the Comptroller of the Currency—the people at that meeting—what is our authority as far as the control of management is concerned and do we have the power to remove management if we feel it is in the best interest of the institution?

Mr. STUBBS. Yes, sir. I think that was reflected in such minutes with Mr. Smelser, asking him, and he told us that if we did not feel—I am sorry; I have got laryngitis—

The CHAIRMAN. See if you can get a little closer.

Mr. STUBBS. That if he did not feel that we could move the people that we could resign from the board.

The CHAIRMAN. This is what the Comptroller told you?

Mr. STUBBS. I am afraid he said that, yes.

The CHAIRMAN. The Comptroller, when asked—

Mr. STUBBS. In the minutes.

The CHAIRMAN. In other words, when asked how you could reprove management if you felt that in some instances management was poor, the answer was well, one way would be to resign from the board?

Mr. STUBBS. Yes, sir. He said that.

The CHAIRMAN. That is a most unique way of solving the problem.

Now, Mr. Cravens and Mr. Norton, you were the two that we had a little dispute about. We again want to thank you for your appearance here. You two have been with the bank for a long period of time.

Let me ask, because you were there both before and after the original tenure of Mr. Jennings and then his return.

Mr. NORTON. Yes.

The CHAIRMAN. In your opinion, was the board of directors kept sufficiently informed about the affairs of the bank by management subsequent to 1975?

Mr. NORTON. You will have to talk a little bit louder. I am hard of hearing.

The CHAIRMAN. Do you feel as though you were sufficiently informed about the manner in which Penn Square Bank was being operated after 1975, when Mr. Jennings returned, until July of this year?

Mr. NORTON. Well, before Mr. Jennings came there it was pretty open, but after he got there, why it was not so open. In other words, he did not explain a lot of things to us.

The CHAIRMAN. Mr. Cravens?

Mr. CRAVENS. Well, I am one of the original directors of the bank and I am speaking more or less for Mead Norton and myself. We are just advisory directors. I have been a nonvoting director since inception, except I was a director until we sold out our interest in 1974, I believe it was, when we sold the majority interest to Jennings' group.

To my knowledge, and I guess I believe that of Mr. Norton, our greatest knowledge was of the early years of the bank, we do not know much about it after it became out of our control. I concur generally with General Randolph and Mr. Cook's comments. I will be happy to answer any questions that the committee may have to the best of my knowledge.

The CHAIRMAN. Dr. Margo, you have been on the board since 1965, is that correct?

Dr. MARGO. Yes, sir.

The CHAIRMAN. I tell you I must compliment you because prior to coming to Congress I did a lot of work with workman's comp

with orthopedic surgeons and I have to have orthopedic men because of a back condition and I know how busy you are and the fact that you were able to spend time on the board of this bank I compliment you.

Tell me, do you feel as though the documents and the information provided to you by management of the bank subsequent to 1975 allowed you or gave you sufficient knowledge so that you could in an intelligent and responsible manner carry out your duties as a member of the board of directors of that institution?

Dr. MARGO. Well, at the time I thought I was getting enough information, but all of the information we received was at the board meetings only. It was always recommended to us at the end of the meetings that we not take home any of this information and keep it there in our board manuals, and that seemed reasonable.

And so we very seldom, if ever, had any material to take home and peruse and study.

The CHAIRMAN. For instance, let me ask you this. Did you ever see the management letter from Peat Marwick and Mitchell that cited the fact that a great number of steps should be taken to further improve the institution that was in oh, perhaps mid-1982?

Dr. MARGO. I believe that was in the June meeting and I do not remember having that, no, sir.

The CHAIRMAN. The previous panel told us that it was mentioned in passing, that a synopsis or a summary—

Dr. MARGO. Yes.

The CHAIRMAN. But you never saw the actual letter?

Dr. MARGO. I don't remember seeing it, no, sir.

The CHAIRMAN. The recommendation of the Comptroller's office, you signed the letter of agreement in Dallas, correct?

Dr. MARGO. Yes.

The CHAIRMAN. Did you get a copy of that letter to take home with you—that agreement?

Dr. MARGO. No, sir.

The CHAIRMAN. Did you ask for a copy?

Dr. MARGO. No, sir.

The CHAIRMAN. Would it have been helpful to you to have a copy?

Dr. MARGO. Well, in hindsight it would have been.

The CHAIRMAN. Well, you tell me you never asked for a copy. Tell me why did you not ask for a copy? It is a rather lengthy agreement. Frankly, I have read it a few times and I have a good memory, but a half an hour after I read it I do not remember each and every point in that letter.

Dr. MARGO. I assumed again that it was something that we should not be taking out. It was not public information. Therefore, they did not want it to get out into the public hands.

The CHAIRMAN. Yet you remember the board, you have, you are looked upon as a responsible individual since you are elected to that board. Don't you feel as though you were trustworthy enough to take that material home, and particularly you as a doctor? Just think of the responsibility you have under your Hippocratic oath, right?

Dr. MARGO. Yes, sir. There was only one copy that I know of and to my knowledge none of the members got a copy.

The CHAIRMAN. That is most unfortunate.
Mr. Kimberling, you came on the board in 1981?

Mr. KIMBERLING. In 1963.

The CHAIRMAN. And at that time you were treasurer of the CMI Corp?

Mr. KENWORTHY. That is me.

The CHAIRMAN. Mr. Kenworthy, I am sorry.

So you came on board in August of 1981?

Mr. KENWORTHY. I came on board in September. I was elected in August.

The CHAIRMAN. Your first meeting was September?

Mr. KENWORTHY. That is correct.

The CHAIRMAN. And that was immediately after the July 1981 meeting at the Comptroller in Dallas. Were you told about the bank's problems prior to joining the board?

Mr. KENWORTHY. Yes. I was told that the bank was under a letter agreement and had 10 points and were making progress toward those.

The CHAIRMAN. Who gave you that information?

Mr. KENWORTHY. Eldon Beller.

The CHAIRMAN. By the way, who asked or who was it that invited you to join the board?

Mr. KENWORTHY. Eldon Beller.

The CHAIRMAN. But I have here information that during the board meeting August 11 when Mr. Jennings was recommending your election as director, the minutes state the following: "Jennings repeated Mr. Kenworthy's background. Mr. Beller noted Mr. Kenworthy's knowledge of financial matters would be of special benefit to the board and from the asset and liability side." So you had both of them recommending you, so to speak. You could not miss.

Now you, I think, except for two instances, attended every board meeting from there on, right?

Mr. KENWORTHY. To my knowledge, yes.

The CHAIRMAN. And there were extensive discussions about pass-through loans and overdrafts in those meetings?

Mr. KENWORTHY. Yes, there was.

The CHAIRMAN. The June board meeting—that is the next-to-the-last one before the bank was shut down—you raised questions about the sudden changes and increases in loan loss reserves.

Mr. KENWORTHY. Yes, sir.

The CHAIRMAN. Is that correct?

Mr. KENWORTHY. Yes.

The CHAIRMAN. Would you share with the committee your impressions of the board meetings and the adequacy of the information you received at these meetings?

Mr. KENWORTHY. They were—from the moment I began until the last June meeting the information increased. The directors appeared to discuss the information in greater depth at each board meeting. It was an improving information, to my knowledge.

The CHAIRMAN. You heard me ask Dr. Margo about whether or not that letter of agreement that had been signed—incidentally, it had been entered into even before you went on the board—but when you were told about it.

Mr. KENWORTHY. Yes, it was.

The CHAIRMAN. Did you ever see a copy of that actual letter?

Mr. KENWORTHY. No, sir.

The CHAIRMAN. Did you ever ask to see a copy?

Mr. KENWORTHY. No, sir.

The CHAIRMAN. Would it have been helpful to you to see a copy, or to have a copy, so that you knew which direction the institution was taking, whether they were complying with the requirements of the Comptroller?

Mr. KENWORTHY. It was my understanding that that was the blueprint for Mr. Beller to work against in the bank. It was also my understanding that they were making progress against that letter.

The CHAIRMAN. The minutes reflected both you and your company, CMI, were borrowers at the bank. Could you tell us the status of your loans? Were any of them participated out or did they stay with Penn Square?

Mr. KENWORTHY. Personal loans or CMI?

The CHAIRMAN. The CMI loans.

Mr. KENWORTHY. The CMI loans, they are both—both in the bank and participated out.

The CHAIRMAN. What committees of the board did you serve on?

Mr. KENWORTHY. I was elected to the audit committee this year in March.

The CHAIRMAN. How about the ethics committee? Were you ever on the ethics committee?

Mr. KENWORTHY. No, sir.

The CHAIRMAN. Was anybody on this panel ever on the ethics committee?

Mr. KENWORTHY. No, sir.

The CHAIRMAN. Did anybody on this panel—were they ever aware of the existence of an ethics committee?

Mr. KENWORTHY. Only as it was mentioned.

The CHAIRMAN. As it was mentioned earlier this morning?

Mr. KENWORTHY. Yes, sir.

The CHAIRMAN. Mr. Kimberling, you have been a director since 1963?

Mr. KIMBERLING. Yes.

The CHAIRMAN. And do you have stock holdings in either Penn Square Bank or the holding company, the parent holding company, First Penn?

Mr. KIMBERLING. Yes.

The CHAIRMAN. And would you describe those for us?

Mr. KIMBERLING. I have 450 shares of stock, I believe, in the holding company.

The CHAIRMAN. And in the bank itself?

Mr. KIMBERLING. None.

The CHAIRMAN. Are you involved in the partnership that is still in the Penn Bank Tower?

Mr. KIMBERLING. No, sir.

The CHAIRMAN. Do you have any relationship with Kimberling's Inc., a supermarket concern?

Mr. KIMBERLING. My son is the operator of those and I have some interest in them.

The CHAIRMAN. Do you have any personal loan from Penn Square Bank?

Mr. KIMBERLING. No, sir.

The CHAIRMAN. Do you know if Kimberling's Inc., the supermarket chain, does?

Mr. KIMBERLING. Yes. They have one loan.

The CHAIRMAN. Are there any loans to any partnerships that you are a part of or have an interest in with Penn Square Bank?

Mr. KIMBERLING. Only the supermarket loan.

The CHAIRMAN. Do you know what the status of that loan is?

Mr. KIMBERLING. It is current.

The CHAIRMAN. You have faith in your son?

Mr. KIMBERLING. Yes, sir.

The CHAIRMAN. OK. On June 15, 1982, meeting, however, the minutes state that you were not at this meeting. Mr. Murphy commented on Kimberling's loan, 15-0055, noting he expects its overdraft to be cleared in a week or 10 days. Do you have any familiarity with that?

Mr. KIMBERLING. Yes, sir. The reason it was an overdraft, we were in the process of selling a supermarket and it did not go as soon as we thought. And so we made some—paid some bills to shake the deal.

The CHAIRMAN. Selling anything at this point in our economy is difficult.

Lastly, Mr. Kimberling, did you or any company you are involved in make any large withdrawals in the last few weeks prior to the demise of this institution?

Mr. KIMBERLING. No, sir.

The CHAIRMAN. And lastly, Mr. Burks, would you be good enough to tell the committee a little bit about your background and business background?

Mr. BURKS. I went to Stanford University and graduated from Harvard Business School and have spent the major portion of my business career in real estate activities, primarily in regard to the financial aspects of the real estate practice.

The CHAIRMAN. Now when did you become a director of Penn Square?

Mr. BURKS. In February 1980.

The CHAIRMAN. February 1980?

Mr. BURKS. Yes.

The CHAIRMAN. And do you have any interest in any of the corporations or partnerships involved in the construction of the building that was to be named Penn Bank Tower?

Mr. BURKS. Yes, I did.

The CHAIRMAN. Could you describe that for us?

Mr. BURKS. I would be happy to. I am the general partner of a limited partnership which is entitled "Penn Bank Tower Investors." This partnership contributed some \$4.6 million toward the equity of the construction of the Penn Bank Tower Building.

The basic structure of the transaction was based on the \$4.6 million equity contributed by the limited partner and the general partners and some \$32 million of construction financing provided by Seattle First National Bank. The composition of the limited partnership was such that to the extent that a tenant in the build-

ing would occupy space in the building then he would have a right to participate to the extent of having to come up with his percentage of the equity required, his percentage of the loan guarantee that Seattle First and, of course, his lease in the building.

The CHAIRMAN. This is somewhat almost akin to a condo-type?

Mr. BURKS. It really is. That really was the kind of concept. For instance, if—I have precise numbers for you which I could give you, but just in terms of round numbers for simplification, one floor of the building approximated approximately 5 percent of the space of the building. The building was 22 stories, 300,000 square feet.

So that if an individual signed a lease for one floor, for 12,000 square feet, they would have had to come up with approximately 5 percent of the \$4.6 million in equity, which would have been approximately a quarter of a million dollars. They would have to have personally guaranteed 150 percent of their pro rata share of the construction loan.

So, let's say, here is this hypothetical tenant that is leasing a floor which approximates 5 percent of the building and he would have had to have guaranteed 7½ percent or 150 percent of his pro rata share. He would have had to have guaranteed 7½ percent of the \$32 million construction loan personally.

In addition, he would have had to have personally guaranteed the lease, which was a 10-year lease. All the leases in the building were the same, with the exception of the bank's. The bank's space was—the bank's lease was 20 years, and all other tenants were 10. So that individual who was signing the lease was on the hook for essentially— if a floor, using round numbers again, if a floor leased for \$20 a square foot and it comprised 12,000 square feet, that would a quarter of a million dollars a year in lease payments, and it was a 10-year lease with the rent escalating 5 percent a year.

But even if it did not, the individual would be responsible for some, in excess of \$2.5 million in lease payments over the term.

The CHAIRMAN. Let me ask you this and see if I understand this correctly. Who is the general partner?

Mr. BURKS. If I could, I am the general partner.

The CHAIRMAN. That means that no matter what happens with the Penn Square Bank, you are still on the line as the general partner.

Mr. BURKS. That is correct.

The CHAIRMAN. As I think most of us here understand what a general partner is and limited partners and the liabilities that accrue to the general as opposed to some of the limited partners, so that the failure of Penn Square Bank does not inure to or enhance your position as a general partner. In fact, I do not think I envy you very much.

Mr. BURKS. Well, I think on the basis of the number of telephone calls that I have received from people who want to buy the building, they seem to infer that I am in somewhat precarious position.

The CHAIRMAN. Well, I hope you get your price. [Laughter.]

Let me ask you this. You attended quite a few of the meetings.

Mr. BURKS. Yes.

The CHAIRMAN. And as a matter of fact you did attend the 1981 and 1982 meetings at the Comptroller's Office in Dallas.

Mr. BURKS. Yes, sir.

The CHAIRMAN. How about giving us, as a fellow New England student—I did not get to Harvard, but I got to Boston University.

Mr. BURKS. I understood you were in the neighborhood.

The CHAIRMAN. As a neighborhood boy who has done well, you, Mr. Burks, what is your impression? Do you feel you were getting adequate information from the Comptroller's Office and that you were kept fully informed by management of what was occurring at Penn Square Bank?

Mr. BURKS. That is two questions. Let me try and answer the first one. Let me start out by saying that prior to 1980 I had never served on a board of directors of a bank and so had no real standard of comparison with what kinds of information a person should get and should not get.

And I was obviously coming on the board in February 1980 and going down to Dallas that summer. Things were already in motion. To be honest, I never questioned the fact of the amount of information that the Comptroller should be providing the bank directors.

I did feel, frankly, that the summer meeting with the Comptroller, I reviewed my notes of that meeting. I took fairly specific notes at that meeting and time and again Mr. Poole reiterated that the real problem with Penn Square Bank was the growth of the bank and the capital and that in fact if it were not for the issue of adequate capital within the bank that the bank would not have been placed in the special projects area. And, as a matter of fact, my notes indicate Mr. Poole mentioned that three different times during the course of that meeting.

So I left the meeting very concerned about the direction of the bank and the situation in which we found ourselves and the high growth rate. Very frankly, the energy industry in Oklahoma and the economy in Oklahoma up until very recently has been going at a fairly rapid rate compared to other areas of the country and so while we were concerned about the level of growth, we felt like it was somewhat symptomatic of the economy in which we were operating.

And in the summer meeting of 1981 I would say really the only thing that I would disagree with in terms of any of the outside directors that made any comments prior to, in the group prior to us, was just one slight remark that was made as to the summer of 1981 meeting being very harsh. I understand that the minutes reflect that Mr. Poole was very harsh with the board.

But I came away from that meeting with a very good attitude and feeling about their confidence and knowledge of Mr. Beller and Mr. Preston, who they had known for some time. So I had a high degree of confidence.

In regard to the amount of management information that we received as directors, once again I really was not aware of what a bank director should be receiving. As several people have pointed out, I was—I really did not like the situation of not being able to—of always keeping the bank information at the bank. It is very difficult to have information presented to you and then taken away and you never see it again.

But I feel like and felt like that the reports that management provided, especially after Mr. Beller came, that there was a high

degree of confidence on the part of the board of directors that we relied on Mr. Beller's background and experience. We relied on his commitment to be tough and to be strong and to bring areas that had been uncontrolled to bring them under control. And there was a high degree of comfort.

The CHAIRMAN. Now were you aware of the fact that Mr. Beller was doing his utmost but that he had his hands tied behind his back? I do not know if you were here earlier today, were you, when he cited—

Mr. BURKS. That comment of Mr. Beller's came as great a shock to me as it did to the previous outside directors that were on this panel and, I would imagine, as it did to the people that sit at this table right now.

The CHAIRMAN. As a matter of fact, would it not be rather difficult to really do things in that institution when you are hamstrung in that manner and a major portion of that portfolio you are not allowed to touch, so to speak?

Mr. BURKS. It would be very difficult.

The CHAIRMAN. Very difficult.

Incidentally, I would point out to you that there is a booklet, and there are quite a few of them out there, an official booklet, some put out by the Federal Reserve Board, some by the regulatory agencies, this by a former Chairman of the FDIC, Mr. Robert Barnett—"Responsibilities and Liabilities of Bank Directors." It is a very tiny book, \$8.50. I will admit it is expensive. It was published in 1980 and I do not get a profit out of it. I am not trying to sell it.

But there are publications available from the regulatory agencies as well that perhaps you might get for nothing, but they do outline the responsibilities and liabilities of bank directors, and I think it would be very helpful and I wish that more—how many of you here are aware of the fact that these are available to you?

[A show of hands.]

The CHAIRMAN. All right, you are all aware of it? Swell. I am really not trying to sell this, really and truly.

Mr. Burks, are you involved in various other enterprises other than Penn Square or in partnerships or in companies in which you are a stockholder or director, where other officers of Penn Square or directors of Penn Square are also involved?

Mr. BURKS. I am involved in four different partnerships, of which the Penn Bank Towers is one partnership. There are three other partnerships of which I am the general partner and in which there are limited partners, of which there are Penn Square Bank directors and officers involved as limited partners.

The CHAIRMAN. Is Mr. Jennings involved in some of these?

Mr. BURKS. Yes, he is.

The CHAIRMAN. What type of businesses are those? You are talking about three other partnerships?

Mr. BURKS. Those businesses are three hotels with one partnership, also owning real estate and previously owned an office building that we sold a couple of years ago.

The CHAIRMAN. Mr. Leach.

Mr. LEACH. Thank you, Mr. Chairman.

Mr. Murphy, when you were president of the bank, did you also have authority as either chief executive officer or chief administra-

tive officer? Would you describe your functions the same way as Mr. Beller described his, or were they very different?

Mr. MURPHY. During which period, sir—the 1964 to 1965 or after 1975?

Mr. LEACH. Please begin with the first period.

Mr. MURPHY. I was the chief executive officer and chief administrative officer from, say, 1965 to 1975. After 1975 Mr. Jennings was chief executive officer. I was chief administrative officer. I saw that on a call report one day. I did not know I had been appointed that.

Mr. LEACH. Were you as surprised as the rest of the directors at the reading of the various duties of the president as compared to the head of the petroleum division and the chairman of the board?

Mr. MURPHY. I certainly was, yes.

Mr. LEACH. Have you ever known of a bank structured that way, where the president had such a limited role?

Mr. MURPHY. Well, I operated that way for a while, yes. I must say in other banks I do not know, sir.

Mr. LEACH. Mr. Burks, you stated that the chief problem of the bank was lack of capital and too much growth, but Mr. Conover, head of the Comptroller's Office, testified before us in Washington several weeks ago, that the bank was repeatedly warned of illegal banking activities. Was this board ever informed of the fact that illegal practices—by illegal I mean violations of the banking law—were occurring?

Mr. BURKS. We were informed that there were some violations of the law at the summer of 1980 meeting, and I was extremely shocked that a bank upon which I was a member of the board of directors had violated any law.

Mr. LEACH. It is one thing to say abstractly we are dealing with a problem of a lot of growth and not quite enough capital. Many good companies as well as good banks in America deal with that problem all the time. In fact, I cannot think of a company that says it has too much capital. But there is a distinction between a problem that is abstract, that is dealt with in the Harvard Business School case study method all the time and a corporation in which the U.S. Government tells the board of directors that violations of law are occurring. I am just wondering how seriously the board of directors took those descriptions.

Mr. BURKS. I took that comment very seriously and it disturbed me a great deal and I did not mean to minimize the violations of the law that Mr. Poole cited that day. I merely meant to indicate, which my notes reflect, that Mr. Poole said that the Penn Square Bank would not be under the administrative letter if it were not for the single issue of capital.

Mr. LEACH. I appreciate that and I do not want to stress it too much. Frankly, I think that in terms of the outside directors we are perhaps spending more time than we need to, Mr. Chairman. It is the inside directors who I think will provide the most interesting insights into this problem. I suspect many of you outside directors are going to be embarrassed as to your pocketbooks and some perhaps as to your judgment, but I doubt very much if many of you will suffer any embarrassment to your reputation.

I think it should be stressed that when something goes wrong, a lot of very good and very decent and very reasonable people get

tainted. In this case, it appears that the vast majority of people should suffer no damage to their reputations in a situation which frankly, has upset the Nation's whole banking system. While there is some suggestion of less than perfect ethical behavior on the part of some insiders, that certainly does not apply to the vast majority of those associated with this bank.

The CHAIRMAN. Mr. Annunzio?

Mr. ANNUNZIO. Thank you, Mr. Chairman.

I do not have any questions. I do not want to go over the same ground that we have been over. I look at the witness list and we are only about halfway, but just one comment.

I take it that after listening to the panel, the last group of directors—outside directors—and this panel, I just get this feeling that some of you or most of you think that the closing of the Penn Square Bank was a mistake by the Comptroller of the Currency, that things were really not as bad as the Comptroller pictured them to be, and that this is similar to an "Alice in Wonderland" story, despite the fact that millions and millions of dollars were lost and the Comptroller warned about the \$41 million and a couple of directors here that lost a couple of million dollars and hundreds of thousands of dollars and bad loans all around the country.

How many of you feel that the Comptroller made a mistake when he closed the bank?

Mr. MURPHY. Sir, with the information I had on July 1—I was out of town that week and was called back in—at the meeting on July 1, when the cease-and-desist order was issued, the requirement of \$30 million in capital given until July 9, the loan losses as shown at that time, which in my opinion some of them are not losses—that is a personal opinion—I, from that, what happened after that, I do not know. I left town again and came back in and heard it on the news—the 10 o'clock news July 5.

I was shocked, of course.

Mr. ANNUNZIO. That is why I detect this, Mr. Murphy. That is the reason I detect this feeling all morning that nobody knew what was going on.

Mr. MURPHY. Unless there is a lot of changes between the first and when the decision was made, which I am not aware of, it should not have been closed. The shareholders should have been given the opportunity to raise the capital and change management if they wanted to—fire Frank Murphy or some of the others. That would be fine.

But I do not think—to save the bank I do not think an effort was made to try to save it. That is my personal opinion, sir.

Mr. ANNUNZIO. Were there any other comments? Let's get this thing out in the open.

Mr. STUBBS. I think we definitely needed to have an effort to save the bank and I think there were commitments already made to cover the—cover \$40 million instead of \$30 million. I lost \$800,000 in that bank myself and I had all the faith that we could keep it going.

Mr. ANNUNZIO. How much worse would it have been, Mr. Stubbs, if you got rid of Mr. Patterson and Mr. Jennings and the bank had remained open? The Comptroller, after all, could have recommend-

ed that both of these gentlemen get out. How much worse could it have been?

Mr. STUBBS. It could not have been this bad. [Laughter.] [Applause.]

Mr. ANNUNZIO. Anybody else? Mr. Burks?

Mr. BURKS. One of the things that I still cannot understand is the reason why.

Mr. ANNUNZIO. Let's get it out. That is right.

Mr. BURKS. Why the Comptroller did not make some of the information available to management. I do not understand why the Comptroller did not have some conversations with the Federal Reserve before this took place.

I read in the testimony before your committee that it came as a surprise during the last week or so. Just 2 or 3 days before the bank was closed the Comptroller found out that there were 150 credit unions that had \$250 million in Penn Square Bank. I think the ramifications of the decision that the Comptroller of the Currency made, I think it would be very interesting to have those exposed to the light of day.

Mr. ANNUNZIO. You know, Mr. Burks, when he appeared before the committee I asked him if he knew of any banks that were going to close on the weekend, and our hearings were on, I think it was on a Thursday. So the weekend was coming. I said can you give me some advance information? Are you going to close any banks? And he did not know of any. But a few days later I read in the Wall Street Journal—that is how I got my information, and I am a senior member of the House Banking, Finance and Urban Affairs Committee—that he closed a bank in Abilene.

Mr. BARNARD. That was an aberration. [Laughter.]

Mr. ANNUNZIO. Right. But the point I wanted to make here was they pumped in a lot of money at Abilene and kept it open.

Mr. BURKS. We were prepared to do that here in Oklahoma City as well.

Mr. STUBBS. We were going to do it with private capital. They got the FDIC loan. We were going to do it with private capital.

Mr. ANNUNZIO. Thank you.

The CHAIRMAN. Mr. Weber.

Mr. WEBER. To the best of your recollection, was there ever an occurrence where the chairman or anyone else on the management team suggested that the board would voluntarily declare the bank insolvent?

Dr. MARGO. No.

Mr. KIMBERLING. No.

Mr. WEBER. There was never any discussion about that possibility?

Mr. KIMBERLING. No.

Dr. MARGO. No.

Mr. MURPHY. No.

Mr. BURKS. My memory escapes me exactly, but on the afternoon of the 4th, Mr. Jennings made a statement to the board that based on certain events that had taken place he had thought that the bank was technically—and I am not sure what the definition of “technically solvent” or “technically insolvent” is—but said that the law was such that it was his responsibility to notify the Comp-

troller of the Currency at such time that he thought that the bank was insolvent.

He advised certain people—and it was in a board room and some of the board had come and gone; it was not like the board was in session all day long. I happened to be at the bank that entire day and certain people had come and gone, but he came in and said it is my belief, based upon the information that we have because of all of the publicity in the newspapers and in the media, that there was a run, that there was in fact a run on the bank and that it was his opinion that the bank was probably technically insolvent and that it was his responsibility to notify the Comptroller.

Now I am just telling you what I heard. Mr. Jennings was gone for 30 or 45 minutes meeting with a representative of the Comptroller's office, and to the best of my knowledge came back to the room and said the Comptroller does not accept our position, that the bank is insolvent. It is the Comptroller's position that the bank is solvent and that the Federal Reserve is willing to lend up to \$27 million to protect a run on the bank, and that the bank will be open for business on Tuesday.

Mr. WEBER. What day was that? Do you have any idea?

Mr. BURKS. That was Friday.

Mr. WEBER. Which would have been July 2?

Mr. BURKS. Yes, sir.

Mr. WEBER. And was that an official meeting of the board of directors?

Mr. BURKS. I can't really tell you. There were certain of the directors that were around the bank. The meeting started at 8 in the morning, as I recall, and certain people came and left. As I recall, that was midafternoon or so.

I had a subsequent conversation later that afternoon with a gentleman who, I believe, was the chief lending officer of the Federal Reserve, who advised me that the Federal Reserve was in fact going to support Penn Square Bank and I walked him to his car as he was racing to the airport, and we shook hands and he said he would see me next week. And I said I look forward to seeing you, with the thought that Penn Square would open on Tuesday morning.

Mr. WEBER. I believe that the chronology is that on that same day the OCC sent a letter to the FDIC formally requesting assessment of the prospect for an FDIC-assisted transaction and merger or something of that kind. And then it was on July 5, 1982, that the Federal Reserve Bank of Kansas City indicated that it was not prepared to extend further credit, and that was the day that the insolvency was declared.

Mr. BURKS. I am not sure I understand the disagreement in fact.

Mr. WEBER. I am not saying I disagree with anything you are saying at all. I do not want to recount the statement that I made to the earlier panel, but it does seem to me that we have got a failure, a problem of trust, I guess—who trusts whom.

You are being charged as a board of directors with the failure to exercise your powers as directors who control the operations of this bank. You were relying upon the officers to get that job done. I believe probably the officers were a major part of the problem. You signed an agreement—and I guess most of you were signatories to

the formal agreement dated September 9, 1980. Are there any that were not on the board at that time?

Mr. KENWORTHY. I was not.

Mr. WEBER. Mr. Kenworthy, you were not a signatory, but were aware of it when you came on the board later.

One of the provisions of that agreement was not to grant additional loans unless current and satisfactory credit information was available and the loans were supported by appropriate collateral documentation.

One of the other points of that agreement was to revise the lending policy and establish procedures to monitor and enforce adherence and, very frankly, in October of 1981 the Comptroller of the Currency, as a result of its examinations, thought the bank was on the right road to correcting or to putting corrective procedures into practice. After having given the board great warnings—at two of the directors' meetings at least—they felt that you were on the right road.

I think the board felt it was on the right road to correcting the situation. You were relying on the officers, Mr. Beller and Mr. Jennings and Mr. Patterson. Mr. Beller tells us in effect this morning that he was relying upon Mr. Jennings and Mr. Patterson.

And I think that what needed to be done was to put into place some procedure for an independent review of the actions of the officers by a committee of the board of directors or agents that reported to the board of directors and had the power to review and control the actions of the officers specifically and could override the officers' actions in that way.

Apparently there was no such procedure. Am I correct that you had no independent group that was overriding the decisions of the officers? I guess I do not have any further questions.

The CHAIRMAN. Thank you.

Mr. Burks, since you were asked to bring certain documents with you today, are the documents that we requested available?

Mr. BURKS. Yes, sir, they are.

The CHAIRMAN. Would you be good enough to provide them to the committee at the conclusion of your testimony? Well, we will take them now. Thank you for your cooperation.

Prior to going to my colleagues, one question. The previous panel, we went back and forth on this. Now I am informed and I would like to ask this panel—I am informed that when a copy of the examiner's report was sent to the bank there is a signature sheet attached and it is the duty of each director to review the examination report and to sign the sheet attesting to his or her review. The examiners then check that signature sheet at the next exam.

Mr. Stubbs, have you signed the signature sheet on the examiner's report?

Mr. STUBBS. I think, if I recall correctly, that the examination would be reviewed at the board and passed around and everybody sign it.

The CHAIRMAN. And then everybody would sign the signature sheet to the effect that they had either reviewed or had reviewed for them?

Mr. STUBBS. It was reviewed for us.

The CHAIRMAN. By management?

Mr. STUBBS. By management and then passed around and we signed it.

The CHAIRMAN. In other words, management told you what they wanted you to know about the examiner's report? Let's be honest now, Mr. Stubbs.

Mr. STUBBS. I never ever read the report.

The CHAIRMAN. You were told what they wanted to tell you about it, right? I mean, you are a \$700,000 or \$800,000 loser in this situation.

Mr. STUBBS. More than that.

The CHAIRMAN. Do you think maybe you should have read those reports rather than have them just summarized for you?

Mr. STUBBS. Maybe I am easier to con than Continental is. I do not know. [Laughter.]

The CHAIRMAN. You have got some sense of humor, taking the bath that you took, if you can still laugh about it.

Mr. STUBBS. I would rather laugh than cry.

Mr. ANNUNZIO. You know, in Congress we have a procedure known as the signing of a conference report that is passed around for all the members of the conference; and 80 percent do not know what is in that conference report.

Mr. BARNARD. Frank, don't tell it all. [Laughter.]

Mr. ANNUNZIO. Don't feel so bad.

Mr. STUBBS. Thank you, sir.

The CHAIRMAN. I assure you that there are very few Members of Congress who have lost the kind of money you have lost for not reading a conference report.

Mr. Barnard.

Mr. BARNARD. Thank you, Mr. Chairman.

Mr. Cravens, you and Mr. Norton are indicated as advisory board members. Why is that so?

Mr. CRAVENS. Well, it is automatic when you are 70. That is in the bylaws.

Mr. BARNARD. You do not have the same function and responsibilities as the other directors?

Mr. CRAVENS. We have no vote, no.

The CHAIRMAN. They do not get paid, either.

Mr. BARNARD. I would doubt that, Mr. Chairman.

Mr. Cravens, I know you are speaking somewhat for Mr. Norton. Your membership on the board dates back to what date?

Mr. CRAVENS. I was one of the original organizers of the bank.

Mr. BARNARD. One of the original organizers. Then I think that you and Mr. Norton and Mr. Murphy, your membership is dated back to the early 1960's, right?

Mr. MURPHY. I joined the bank in January 1961, sir, and became a board member in 1964, I believe it was.

Mr. BARNARD. Mr. Stubbs, I believe you were an early member of the board.

Mr. STUBBS. Frank came on in 1963 and I came on in 1964.

Mr. BARNARD. Did it disturb you gentlemen that after the change in organization in 1975 there was a change in modus operandi of the bank?

Mr. CRAVENS. Well, I thought there was a very enthusiastic bunch in trying to do something.

Mr. BARNARD. You did not question at all the thrust of the new enthusiastic bunch?

Mr. CRAVENS. Well, I kind of figured I was a little old fashioned.

Mr. BARNARD. Do you still feel that way about it?

Mr. CRAVENS. That I was not keeping up with the modern times.

Mr. BARNARD. But you felt that it was worth a go, right?

Mr. CRAVENS. Well, I do not know. I lost about a half a million in it too.

Mr. BARNARD. That is hindsight, isn't it. What about you, Mr. Murphy? Did you express any dissent about the new thrust of the management?

Mr. MURPHY. I say dissent? No; I cannot say I dissented, sir. Previously I was more conservative.

Mr. BARNARD. Well, hadn't this modus operandi been considerably different than the previous operation of the bank?

Mr. MURPHY. More aggressive, yes, sir.

Mr. BARNARD. Well, did you consider the concentration of loans that was developed? Did you think that was healthy for the bank?

Mr. MURPHY. Concentration with proper loans I felt would be healthy.

Mr. BARNARD. What about the lack of diversity?

Mr. MURPHY. It depends upon which area you are in. When real estate is up, you should be in real estate, and I am not saying 100 percent.

Mr. BARNARD. Do you remember the experience that some great banks had in the country during the era of REIT's?

Mr. MURPHY. Yes, sir, I sure do.

Mr. BARNARD. Wasn't that a problem of concentration and not being aware of the marketplace?

Mr. MURPHY. Yes, it was.

Mr. BARNARD. Would you go so far as to say that it is an example of poor bank management to concentrate in one particular area of loans?

Mr. MURPHY. Well, I personally would not dwell on that. I never did. But I did accept the philosophy—Mr. Jennings being from Oil Patch and all—and I had confidence that he knew what he was doing, sir.

Mr. BARNARD. Mr. Stubbs, you and Mr. Kimberling, how did you feel about this change in direction of the bank?

Mr. STUBBS. I was not adverse to oil. I was strictly real estate and I did not feel qualified to express myself on it. The profits looked great and the interest rates were high and nobody could afford to pay the interest rates but the oilers anyhow. I thought we were dropping a little too much real estate myself.

Mr. BARNARD. Let me ask Mr. Burks, was the board brought up to date from time to time as to how active brokers were in finding deposits for the institution?

Mr. CRAVENS. No, sir.

Mr. BURKS. I was never aware that the bank utilized brokers.

Mr. CRAVENS. We never heard that.

Mr. BARNARD. And yet they were paying brokers 100 or 200 basis points for deposits brought into the bank. From time to time were

you able to see the makeup of deposits such as the concentration of credit union deposits in the bank?

Mr. BURKS. Absolutely not.

Mr. BARNARD. Did any of you on the board except Mr. Murphy—I presume you knew about the brokers' activities.

Mr. MURPHY. I knew that. Yes, sir.

Mr. BARNARD. Did any of the other members of the board understand how broker deposits functioned?

Mr. STUBBS. No.

Mr. BARNARD. They are very expensive, you know—very expensive deposits to bring in.

Mr. Chairman, I have no further questions.

The CHAIRMAN. Mr. Wortley.

Mr. WORTLEY. Thank you, Mr. Chairman.

Mr. Murphy, just for the record, what is the fee for a director's meeting?

Mr. MURPHY. \$400 a meeting if you attend.

Mr. WORTLEY. \$400 a meeting.

Mr. MURPHY. Yes, sir.

Mr. WORTLEY. That is about the same fee which prevails all over Oklahoma City area in other banks?

Mr. MURPHY. I have no idea, sir.

Mr. WORTLEY. Mr. Burks, I wonder if you could straighten me out on some information I have here. According to some annual reports you had a number of interests with Bill Jennings and Carl Swan—for instance, First Penn Corp. You owned about 5.9 percent and Jennings owned 26.7 percent and Swan 7.6 percent.

Peachtree Hospitalities—you seem to be equal partners, the three of you—Jennings, Swan, and yourself had one-third interest. The Chi-Chi property in Atlanta, at least at one time you owned about 11 percent and Mr. Jennings around 25 percent and Mr. Swan 21 percent.

What is this Skirvin Plaza Investors? You had a 1 percent interest and Mr. Jennings had about 16 percent; and Copeland Energy you owned about 5 percent and Mr. Swan about 23 percent; and Northwest Investors you owned around 23 percent-plus and Mr. Jennings about 15 percent.

Would these be reasonably close figures as to common endeavors that you shared with these other gentlemen?

Mr. BURKS. Yes, sir. Those are reasonably close percentages.

Mr. WORTLEY. I would imagine that those various business endeavors did some of their banking at least with Penn Square. Would it be safe to say?

Mr. BURKS. To the best of my knowledge, Mr. Wortley, the amount of business that was done with Penn Square was very, very minor and I would be happy to go down with you, if you would like, the list of each one of those entities and describe the financial relationships, if you would like.

But from the time I went on the board of directors it was a personal policy of mine to limit the amount of business that I did with Penn Square Bank to the absolute minimum and my major bank is another bank here in Oklahoma City.

The CHAIRMAN. Would the gentleman yield on that?

Mr. WORTLEY. Yes.

The CHAIRMAN. By investment are you talking about shares of stock in the bank or the holding company?

Mr. BURKS. Yes, sir.

The CHAIRMAN. Did you also have deposits in Penn Square at the time?

Mr. BURKS. Yes, sir.

The CHAIRMAN. How did you do?

Mr. BURKS. Well, I don't know whether it is good or bad, but I was not in the position to have lost the amount of money that some people did, but we had two different accounts which exceeded \$100,000.

The CHAIRMAN. All of those records are available to us. Did you or any of your—do you mind, George?

Mr. WORTLEY. Go right ahead, Mr. Chairman.

The CHAIRMAN. Did you or any of your businesses have any deposits in Penn Square that were removed within the last 4 or 5 days?

Mr. BURKS. No, sir.

The CHAIRMAN. You were not one of those lucky ones who had the benefit of the unnamed financial consultant?

Mr. BURKS. I personally deposited \$80,000 in Penn Square Bank on Wednesday or Thursday of the week before it closed.

The CHAIRMAN. Was that a brand new account?

Mr. BURKS. No, it was an account that I had maintained. While it was an account that—it was one of my company accounts—I did maintain a number of business accounts at Penn Square Bank. But, as I said, my borrowings at the bank were very, very modest.

The CHAIRMAN. But the point is that you lost too.

Mr. BURKS. A great deal.

The CHAIRMAN. That does not help the others who lost.

Mr. BURKS. Misery loves company, I guess.

Mr. WORTLEY. Thank you, Mr. Burks, for your very forthright answers.

Mr. BURKS. You are welcome.

Mr. ANNUNZIO. Mr. Chairman, could I ask each of the witnesses one question with a yes or no answer?

Mr. Stubbs, could the bank have been saved, yes or no?

Mr. STUBBS. Yes.

Mr. ANNUNZIO. Mr. Kimberling?

Mr. KIMBERLING. I believe so, yes.

Mr. ANNUNZIO. Dr. Margo?

Dr. MARGO. I am not sure. I was not there at the last two meetings.

Mr. ANNUNZIO. Mr. Murphy?

Mr. MURPHY. From the information I had, yes.

Mr. ANNUNZIO. Mr. Burks?

Mr. BURKS. I have no knowledge of the information that the Comptroller had at his fingertips in making the determination that the loan losses were \$50 million. I do know that that figure, as late as 2 or 3 days before the bank closed, was as low as \$22 and the number was bouncing around like a ping-pong ball.

Mr. ANNUNZIO. Mr. Kenworthy?

Mr. KENWORTHY. I have no knowledge.

Mr. ANNUNZIO. Just your opinion.

The CHAIRMAN. Is what you are saying that once you went on the board that rather than borrow from Penn Square, either yourself or the partnerships in which you are involved, you went to other institutions? You were better off avoiding any conflicts?

Mr. BURKS. Yes, sir.

The CHAIRMAN. Is it safe to assume that your involvement—because I had the same questions—that as far as borrowing from Penn Square are concerned they were de minimus? You provided us with volumes of documentation.

Mr. BURKS. I would be more than happy to provide you with detailed information, but it certainly is my position that my borrowings with Penn Square were very negligible.

Mr. WORTLEY. Your personal borrowings or the borrowings of these institutions I just recited?

Mr. BURKS. Both.

Mr. WORTLEY. In other words, are you also saying that those institutions never borrowed any money from Penn Square Bank?

Mr. BURKS. As I said before, I would be delighted to give you a detailed description. I would not want to say never, but I can tell you that it is very minimal and I will be happy to provide as detailed an information as this committee would like.

Mr. WORTLEY. Maybe just a bottom line item, if I could ask you. At the time Penn Square was closed, did any of these organizations I just mentioned owe any money to Penn Square Bank?

Mr. BURKS. One company, called Copeland Energy, of which I was a very small investor, I am not sure even what their borrowings were with the Penn Square Bank, so I would hate to make any—I do know that they borrowed from a correspondent. Northwest Investors had no borrowings, had their borrowings from Liberty National Bank. Skirvin Plaza Hotel had \$110,000 laundry lease with the Penn Square Bank, which was at a market rate and which I was asked to give—I have got \$10 million of financing on the Skirvin Plaza Hotel and \$110,000 at Penn Square Bank.

I have got \$10 million of financing at Northwest Investors and virtually none at Penn Square Bank.

So they are modest numbers.

Mr. WORTLEY. Do you think that business relationships that you may have enjoyed with Mr. Jennings and Mr. Swan in any way might have impaired your ability to exercise some independent judgment as an outside director of the Penn Square Bank?

Mr. BURKS. Well, let me speak to that question. You indicated two individuals and I would like to speak to the two individuals as opposed to just one question.

Mr. Swan has had a long relationship with Mr. Jennings and so anything that I was involved in with Mr. Swan was a result of his close and long-term friendship with Mr. Jennings, and any of my investments with Mr. Swan were extremely minor, as I think the information that I have provided you will show.

In regard to my ability to be an objective director of the Penn Square Bank, I think the record will show that I had more money invested in Penn Square Bank than Mr. Jennings had invested in any of my real estate projects of which he was a limited partner. I believe that I was able to indicate to him total objectivity.

Mr. KENWORTHY. I have no opinion.

Mr. ANNUNZIO. Mr. Cravens?

Mr. CRAVENS. I do not have an opinion.

Mr. ANNUNZIO. Mr. Norton?

Mr. NORTON. No opinion.

Mr. ANNUNZIO. Thank you, Mr. Chairman.

The CHAIRMAN. I want to thank all of you for assisting us here today. And for those who suffered such losses, it is not easy, and unfortunately it is part of the process. And your presence here and your assistance has been deeply appreciated. Thank you.

Now we will ask Jim Blanton, the managing partner, and Dean York, engagement partner of Peat Marwick and Mitchell, to please join us.

[Witnesses sworn.]

TESTIMONY OF JIM BLANTON, MANAGING PARTNER, AND DEAN YORK, ENGAGEMENT PARTNER, PEAT, MARWICK, MITCHELL & CO., OKLAHOMA CITY, OKLA.

The CHAIRMAN. Mr. Blanton and Mr. York, we want to thank you for your appearance here today. We would like to inform the committee or remind them of the fact that a friendly subpoena was issued to these gentlemen to appear. They have, however, indeed been most cooperative. They have submitted a statement that I would like to place in the record at this point. If there is no objection, we will put your entire statement in the record at this point.

[The statement submitted for the record follows:]

STATEMENT BY JAMES D. BLANTON, MANAGING PARTNER, PEAT, MARWICK, MITCHELL
& CO., OKLAHOMA CITY, OKLA., AUGUST 16, 1982

Mr. Chairman and Members of the Committee:

I am James Blanton, managing partner of the Oklahoma City office of Peat, Marwick, Mitchell & Co. I served as our firm's partner in overall charge of our relationship with First Penn Corporation and its subsidiaries, principal of which was Penn Square Bank. With me today is one of our partners, Dean York, who was in charge of our 1981 audit of First Penn Corporation and Penn Square.

With banks as with all clients, the code of ethics governing our profession dictates that we not discuss publicly confidential client matters. We are able, however, to discuss Penn Square with you today because we appear pursuant to your subpoena.

Your staff asked that we provide a chronology of our relationship with the Bank, a relationship which began ten months ago. This statement reviews that chronology in brief.

Penn Square Retention of Peat Marwick

During the Spring of 1981, the Bank hired several new senior executives. We were later to learn that recruitment of new management talent was a part of the Bank's response to the critical findings of the Office of the Comptroller of the Currency during prior examinations of the Bank.

Certain of the new senior officers who joined in 1981 -- including Mr. Eldon Beller, as President and Chief Administrative Officer -- came to Penn Square as experienced bank executives from other banks in the area which are clients of Peat Marwick. We knew Mr. Beller and many of his colleagues to be respected, professional bankers. They in turn knew our firm, our services, our people and our reputation. As you may know, Peat Marwick serves clients of all sizes in all industries around the world. We are particularly known, however, as a leader among accounting firms providing services to the banking industry.

In November 1981, Mr. Beller contacted us to discuss the possibility that Peat Marwick consider serving as independent auditors for the parent company and the Bank. Important aspects of the discussions included three matters:

(1) The Bank's Response to the Agreement Between the Board of Directors and the Comptroller

Mr. Beller advised us that the Bank was operating under an Administrative Agreement with the Comptroller requiring changes in various areas noted by the Comptroller's prior examinations. His mission, as he explained it, was to do what was necessary and appropriate to satisfy the regulators' concerns. Additionally, he wished to improve the Bank's policies, procedures and practices to sustain its continued growth and profitability consistent with sound banking practice. He indicated that the Bank's independent accounting firm would perform the annual audit and also be asked to provide professional services needed to assist management in establishing improved accounting procedures, controls, and information systems to better manage the Bank's growth.

(2) The Prior Auditors, Arthur Young & Company

During these discussions we obtained the prior audit reports and noted that while the 1979 report was unqualified, the 1980 report reflected a qualified opinion by Arthur Young. The Arthur Young report indicated that they were unable to satisfy themselves as to the adequacy of the reserve for possible loan losses at December 31, 1980 "due to the lack of supporting documentation of collateral values of certain loans."

As is customary, we contacted Arthur Young to discuss their relationship with the parent company and the Bank and to inquire of any disagreements or problems they might have had in serving this client. They indicated they had served this client for several years with a good professional relationship, free of significant problems. They cited the qualification in their 1980

report to be certain we were aware of it. They also indicated that in accordance with usual practices there would be no problem in our reviewing their working papers whenever we desired.

We have seen reports in the media which imply that Arthur Young was "fired" because they gave a qualified opinion in 1980. We have never had that impression. Based on everything we were told by that firm, and by Penn Square, they were not "fired" because of their qualified opinion. We believe we were engaged at a time when the new president and the new management team were doing their utmost to bring to bear all necessary resources, both within and outside the Bank, to remedy the past problems.

During our discussions, we advised Penn Square that if the conditions Arthur Young encountered had not been corrected, we would also qualify our report for 1981.

(3) Peat Marwick Independence

The requirements of our firm and profession specify that we must be independent of our clients before serving as auditors. In terms of client banks, this means, among other things, that our partners should not have unsecured loans with a client bank in excess of ten percent of individual net worth.

Since our office serves a number of banking clients, Penn Square was, until late 1981, one of the banks where our partners could borrow money with no independence concern. Hence, several of our partners had loans at Penn Square.

As is our usual practice, we asked our Executive Office in New York for advice on the steps to take to ensure our independence. After consultation with our Executive Office, we advised the Bank that the loans must be sold by the Bank to non-client banks to ensure that Penn Square would not be at risk of loss.

The Bank sold the partners' loans to non-client banks. During the audit, we satisfied ourselves that such loans were out of the Bank.

After thorough discussions of these and other matters we agreed to accept appointment as the independent auditors.

The 1981 Audit

Our audit of the financial statements was as of and for the year ended December 31, 1981. On the other hand, the Arthur Young audit was as of and for the year ended December 31, 1980. At no time did we have any quarrel with the qualified opinion on their 1980 audit and our report disclosed the existence of their 1980 opinion with its qualification.

Our audit of the 1981 financial statements was conducted in accordance with generally accepted auditing standards as promulgated by the American Institute of Certified Public Accountants. In accordance with these standards and based on our evaluation of internal controls, our audit procedures were principally substantive in nature. That is to say that we focused on account balances at or near year end and performed procedures, on a test basis, designed to verify such year-end balances. So, for example, we obtained written confirmations directly from selected borrowers and depositors as to their account balances.

As I am sure you know, Penn Square had sold many loans, without recourse, to other banks. Once sold, these loans were no longer assets of Penn Square but were assets of the purchasing bank. Accordingly, these loans were no longer in the financial statements of Penn Square. We did, however, check the accuracy of Penn Square memorandum records on loans sold to other banks by obtaining written confirmations from the purchasing banks of the amount of the loans they had purchased from Penn Square.

As part of the 1981 audit, we spent considerable time reviewing the adequacy of the Bank's "allowance for possible loan losses". We noted the Bank had established a loan review function as a part of the Credit Review Department. This Department was established in September 1981 to review all significant loans in the Bank. Its objective was to identify and evaluate all problem loans and use such information to assist management in correcting the problems where possible and to establish the "allowance for possible loan losses" at the proper level. This ongoing process was the basis of the Bank's "allowance" recorded as of December 31, 1981.

In our audit, we reviewed information, including financial and other data, on selected borrowers, principally those loans which were past due or had other indications of problems, to assess the risk of loss in the loan portfolio. Much like the Comptroller's examiners, we categorized such loans by our evaluation as to risk of loss. After summarizing this information, we satisfied ourselves that the "allowance for possible loan losses" at December 31, 1981 was a reasonable estimate by management of possible loan losses in the loan portfolio at that time.

From our review of the Arthur Young workpapers we ascertained that the "certain loans" which were the subject of their qualification in 1980 and to which they referred as lacking supporting documentation of collateral value aggregated approximately \$14,700,000 or about 7% of the total loans of the Bank at December 31, 1980.

Our audit work in 1981 disclosed that subsequently 12 of these loans totalling approximately \$3,000,000 were completely or substantially paid-off. Of these loans, \$800,000 were charged-off in 1981. Other of these loans had little, if any, documentation problems in 1981 due to follow-up by management to correct deficiencies. Those loans that still had documentation problems were considered in assessing the overall adequacy of the allowance for possible loan losses at December 31, 1981.

As part of its ongoing monitoring process, the Comptroller's office in October 1981 conducted an examination to follow up on progress made in correcting deficiencies noted by them in prior examinations. Their report indicated that although significant problems remained, improvement was reflected in all areas and commended the Directors for their efforts in recent months.

During the course of our audit, we also noted the improving picture with respect to the Bank's operations, procedures, policies, credit review, and loan administration. While a definite improvement had occurred, the Bank still had problems with much still to be done. Areas which we believed needed attention and further improvement were covered in our extensive 22 page management letter to the Bank's Board of Directors -- a document separate from the audited statements.

This management letter contained our specific recommendations with respect to the many problems of the Bank, including:

- o loan administration, and specifically loan review and documentation;
- o organization structure;
- o written policies and procedures and related employee training;
- o internal monitoring and reporting to the Board of Directors; and
- o increased internal auditor effectiveness.

While these were important areas to the Bank, they did not, in our view, significantly impact the Bank's financial statements at December 31, 1981 or our opinion that such statements were fairly presented.

The independent auditor's function is to determine whether the financial statements including the notes thereto, as prepared by management, fairly present the financial position and results of operations in accordance with generally accepted accounting principles for the reporting period. The facts disclosed in the Bank's 1981 financial statements include:

- o the provision for possible loan losses in 1981 was \$6,343,000 as compared with \$1,407,830 in 1980.
- o loans charged off in 1981 were \$4,835,557 as compared with \$617,401 in 1980.
- o the allowance for possible loan losses at December 31, 1981 was

\$4,141,447 as compared with \$2,004,587 at December 31, 1980.

After the audit work on the financial condition as of December 31, 1981, was completed in March 1982, 50 copies of the audit report were delivered to First Penn Corporation and the Bank, and our 22 page management letter to the Board was subsequently delivered.

The Bank, as you may know, produced and distributed an annual report for 1981. This report contained limited financial data but did not contain the full set of financial statements or our accountant's report or that of Arthur Young for 1980. As the Bank is not publicly held, it is not required to present this information in its printed annual report.

After the Audit

We had involvement with the Bank management following delivery of the report, principally on financial systems consulting and tax matters. Our contact with the Comptroller's examiners before they closed the Bank was limited and we have had no communication with them since then as to the problems they found.

We did have one meeting on July 1, 1982, with management of the Bank who informed us that one of our partner's loans, which had been sold to another bank, apparently had been repurchased by Penn Square Bank. This repurchase occurred without our knowledge and was completely contrary to our prior understanding with the Bank. Immediately after being made aware of this matter, our partner arranged to repay the Bank in full.

Neither the Comptroller nor the FDIC have indicated to us specifically why they concluded that the Bank had to be liquidated.

We appreciate this opportunity to provide a brief overview of our audit of Penn Square. I will be pleased to answer questions that you may have of us.

The CHAIRMAN. I think you are both aware of the fact that there are two primary areas that we would like to inquire into. And indeed, you have also been cooperative prior to today with staff in providing us information in these areas. And so I would at this point, with your statement in the record, just approach the loan relationship situation.

Mr. BLANTON. Mr. Chairman, may I read my statement into the record?

The CHAIRMAN. Well, it is in the record already. If you want to summarize it, I am just trying to get along with the situation. We have put the entire statement in as presented. It is one of our standard procedures. OK?

Mr. BLANTON. Yes, sir.

The CHAIRMAN. Now, you have provided us with memorandum relating to loans to Penn Square Bank with various individuals with Peat, Marwick, Mitchell & Co.; correct?

Mr. BLANTON. That is correct.

The CHAIRMAN. What were the origination dates on the loans discussed in your memos? By "memos" I mean the memo from Peat, Marwick, Mitchell & Co. in New York to you here in Oklahoma City, dated December 30, 1981.

Mr. BLANTON. There were, to my recollection, approximately six different loans. There were three loans to one partner in our firm. There was one loan to another partner in our firm. I don't know the exact dates, but I believe they were in 1979 and 1980. There were two additional loans that were made to a group of partners. One loan was a line of credit that I believe was in place about the latter part of August. The first draw was in September.

The CHAIRMAN. Of?

Mr. BLANTON. 1981.

The CHAIRMAN. Would that be Doral Associates?

Mr. BLANTON. Yes. Both of those are Doral Associates.

The second loan was committed to, I believe, in about September of 1981. It was a permanent financing loan, if you will, a mortgage on a project. And it was funded and closed in January of 1982.

The CHAIRMAN. Were these loans subsequently sold, the Doral loans?

Mr. BLANTON. Yes, they were.

The CHAIRMAN. Do you know when that occurred, the date of the sale?

Mr. BLANTON. I don't know the exact dates. I believe they were both sold. It is my understanding that the permanent loan, the mortgage, was actually sold when it was closed, that presumably it was never on the books of the bank. The first loan, the equity loan, was sold, I believe, in January.

The CHAIRMAN. Do you know to which institutions these were sold?

Mr. BLANTON. It is my understanding that—and both of those were Doral loans—that they were sold to Utica Bank, the Bank of New England, I believe, and Citizens Bank in Muskogee.

The CHAIRMAN. And were these loans sold in their entirety? And does Penn Square have any remaining interest?

Mr. BLANTON. Penn Square has no interest.

The CHAIRMAN. Were they nonrecourse sales?

Mr. BLANTON. Yes.

The CHAIRMAN. Has Penn Square Bank ever bought back any of these loans or taken back any of these loans whether they be the Doral loans or the other loans referred to in the memorandum?

Mr. BLANTON. It is my understanding that one of the loans that belonged to one of our partners did get returned to Penn Square for collection or renewal and was not reparticipated.

The CHAIRMAN. Do you know which one that was?

Mr. BLANTON. It was approximately, I believe, a \$300,000 loan.

The CHAIRMAN. And to whom was that one? I see \$50,000 to Dick Turner; \$600,000 to Marshall Snipes

Mr. BLANTON. It was one of the loans to Mr. Snipes.

The CHAIRMAN. And that was repurchased by Penn Square?

Mr. BLANTON. It was returned to Penn Square.

The CHAIRMAN. And where does it stand now?

Mr. BLANTON. It has been paid.

The CHAIRMAN. So there is no loan outstanding from Penn Square to any of the Peat, Marwick, Mitchell & Co. people?

Mr. BLANTON. That is correct.

The CHAIRMAN. The memo from your New York office dates December 30, 1981. And that memo describes what has to be done to assure independence. Do you know when your New York office was asked to provide the advice concerning this issue?

Mr. BLANTON. From my memory, I don't know the exact date. It was late November.

The CHAIRMAN. Then it would have been about the time that Arthur Young was terminated, November 20, 1981?

Mr. BLANTON. Yes. My recollection of the facts was that it was, in fact, before Arthur Young was terminated.

The CHAIRMAN. But as a matter of fact, the independence issue was resolved subsequent to Peat, Marwick, Mitchell & Co. having been retained by Penn Square? By that I mean the memorandum of independence.

Mr. BLANTON. The memorandum that you have there was dated after we were retained.

The CHAIRMAN. December 30, 1981?

Mr. BLANTON. Yes. But the independence issue, we believe, was resolved prior to our engagement as auditors.

The CHAIRMAN. Do you have your material? I think there is a typo here. We have a memorandum, and I would like to put these in the record, but before I do, I would like to correct this. There is the December 31, 1981, memo from Mr. Guinan to Mr. Blanton.

Mr. BLANTON. Correct.

The CHAIRMAN. And then there is a March 4, it says, 1981, but I think it should be 1982 memo to the file from C. D. York, the engaging partner.

Mr. BLANTON. If that is dated in 1981, you are correct.

The CHAIRMAN. That is a mistake, is that not correct, because it indeed tells us what you have just been telling us about the loans have been participated out, Doral to Utica, and to Idaho First National Bank of Boise?

Mr. BLANTON. Yes, that is correct.

The CHAIRMAN. And another one, a line of credit to Citizens National in Muskogee, Okla.

Mr. BLANTON. Yes.

The CHAIRMAN. So the record will show that there is a typo in that. And at this point I would ask unanimous consent that both those memoranda be put into the record.

[The material referred to follows:]



Peat, Marwick, Mitchell & Co

To: J. D. Blanton
Office: Oklahoma City

Date: December 30, 1981
Sieno: as

From: J. M. Guinan
Office: Executive

Enc:
cc: C. E. Graese - Executive
L. E. Levy - Executive
Independence Files

Subject: Independence - Borrowings from Financial
Institutions

Personal

This memorandum summarizes our discussions regarding certain loan arrangements that partners in your office have with Penn Square Bank, a new audit client. The loan arrangements have been grouped into three separate categories below for ease of discussion. All of the loans described herein were negotiated with the Bank prior to it becoming a client.

In connection with a real estate venture, a group of partners have a \$2.3 MM loan with the Bank. Eighty percent of the loan is secured by a first mortgage on the property; the remainder is guaranteed personally by the partners involved. The loan is material to the partners, but not to the Bank. Penn Square Bank currently has arranged to fully participate out the loans to nonclient financial institutions. It would service the loan for the nonclient. The Bank would bear no risk for default because the participation would be without recourse. The participation arrangement should be completed by December 31, 1981, the Bank's fiscal year-end. As we discussed, an independence problem would not arise if the above arrangement were completed as proposed.

A partner has a loan of approximately \$50,000 for a partnership investment which is secured by those partnership assets and which he personally has guaranteed. Under AICPA and Firm independence rules, this type of unsecured loan would not create an independence problem if the loan were not to exceed ten percent of the partner's net worth. It is my understanding that the loan amount is below the ten percent threshold; therefore, no independence problem exists with regard to the subject loan.

Another partner has three separate loans that total \$600,000. The loans relate to various investments and are secured either by investment assets or by the partner's personal guarantee. The loans are material to the partner's net worth. None of the investments involves participation with prohibited companies or persons. The partner intends to pay off the loans within six months. As we discussed, the appearance of independence would not be impaired if the partner were to pay off the loans prior to the year-end of the Bank. In no event, however, should the pay off period extend beyond the date of our initial accountants' report. If the partner were unable to pay off the loans within that time period, he would have to obtain a letter of credit from a nonclient bank to support the loans. If the client were to fully participate out the loans similar to the participation arrangement discussed above, the appearance of independence also would not be impaired.



Peat, Marwick, Mitchell & Co

CONFIDENTIAL

To: File
 Office:
 From: C. Dean York
 Office: Engagement Partner

Date: March 4, 1981
 Steno: jk
 Enc:
 cc:

Subject: Independence re: Penn Square Bank

In response to the instructions from John Guinan in his memo dated December 30, 1981, regarding the Firm's independence with Penn Square Bank, a new client, I am satisfied the following has occurred:

- (1) The Doral Associates related loans in which the partners of the office equally participate amount to the following with the related actions taken by the Bank:
 - o The interim first mortgage loan which approximates \$1.6 million on a real estate project in Oklahoma City has been fully participated to Utica National Bank & Trust Co. in Tulsa. Plans are to make the permanent loan with the Idaho First National Bank in Boise, Idaho.
 - o The line of credit of \$1. million to Doral Associates has been participated to Citizens National Bank of Muskogee.
- (2) A \$50,000 loan made by Dick Turner for an oil and gas personal investment is not considered to be material to Mr. Turner's net worth.
- (3) The loans to Marshall Snipes, which approximates \$600,000 to his interest, to the extent material to his net worth, have been participated out of the bank on a nonrecourse to non-client banks.

All of the above was reviewed with Mr. Rick Dunn, Executive Vice President, on this date. I am satisfied the above arrangements conform to the spirit of Mr. Guinan's memo and that the Firm is independent of Penn Square Bank and its related entities.

C. Dean York

The CHAIRMAN. Mr. Leach.

Mr. LEACH. With reference to the Arthur Young audit statement, which they qualified, how unusual is it to have a qualified statement on a bank audit?

Mr. BLANTON. My reaction is that it probably would not be that unusual.

Dean, would you feel differently?

Mr. YORK. Well, I would only say that a qualified opinion, while it is unusual, it certainly does occur.

Mr. LEACH. When I look at the Arthur Young contract dated January 6, 1981, it makes specific mention that they would be looking at the possibility that illegal acts might have occurred. When you audited the bank, did you find that any illegal acts had occurred?

Mr. BLANTON. No, we did not.

Mr. LEACH. Were you aware that the Comptroller's Office had repeatedly warned the bank about violations of the banking laws of the United States?

Mr. BLANTON. Yes.

Mr. LEACH. Would you call a violation of the law an illegal act?

Mr. BLANTON. I think the way that we would interpret that—and let me say that we were, as we said, aware that those were technical violations as opposed to someone knowingly or willingly violating the law.

Mr. LEACH. The Comptroller of the United States has talked about repeated violations of the banking laws of the United States. As a banking committee, we write legislation in the banking area, and we have a high respect for what we do. Repeated violations of law are something that one raises one's eyebrows about. And I think that this would be particularly the case from an auditor's perspective.

None of us knows how this situation is going to unfold, but certainly there are widespread rumors that activities have occurred here that go beyond the realm of bad judgment into the realm of conflict of interest and, very possibly, if not probably, violation of the law. Did you find any indication of this at any time during your audit?

Mr. BLANTON. No, we did not.

Mr. LEACH. When you prepared a second audit that explained your major audit, it indicated some negative things at the bank. Did you consider including part of this in the public audit?

Mr. BLANTON. We only conducted one audit and rendered our opinion on the financial statements. The management letter, which I presume you are referring to, was a byproduct of that one audit.

Mr. LEACH. You probably heard mentioned by a number of public directors of the bank that they had a good deal of confidence in how the bank was doing based upon your audit of the bank. Do you think they had reason, based upon your discussions with them, to be concerned otherwise? In particular, one director asked at a board meeting whether there was anything that should be brought to the attention of the board of directors, and he indicates that you said no. Do you recall that question being asked, and do you recall your response?

Mr. BLANTON. I don't specifically recall that question being asked. Obviously, there were many things in our management letter that were of importance to the board and areas that they needed to direct their attention to. But I think it would be fair for the board to say that when we met with them to briefly discuss the results of the audit, that we gave them the impression of an improving picture. And I presume that maybe that is what he is referring to.

Mr. LEACH. But you do not think that any member of the board has the right to feel somewhat misled by a failure on the part of the auditors to stipulate that things were not perhaps as good as they might have been?

Mr. BLANTON. I believe that we—well, as I said, we advised the board of an improving situation which is what we believed.

Mr. LEACH. Sometimes improving situations mask troubles. One can say that some parts of the situation were improving and new people were brought in to handle certain things. But in terms of bank assets being leveraged, in terms of loans being made with perhaps less than adequate documentation, one might argue that the problem was not improving but worsening. Even if it were improving, things could still have been very, very bad.

Mr. BLANTON. Yes, that is correct. Let me clarify what I mean by "an improving situation." Not that the bank's financial condition was improving, because we looked at it only at one date, but that they were addressing those areas that the Comptroller had criticized bank management for and that they were making improvement.

Mr. LEACH. Perhaps I am confusing roles here. You are responsible for the figures, and the Comptroller is responsible for the structural things like whether or not there are enough people in place. Are you saying that there was no improvement in the figures but that with respect to what the Comptroller was concerned about there might have been improvement in some areas?

Mr. BLANTON. I am not quite certain how to answer that. Let me try. The context of the Comptroller's report, as I recall it, was that the bank had numerous administrative problems. It is also my recollection of that report that although the Comptroller did have classified loans, that they were not of such a magnitude that we were concerned. Our own evaluation of the loans on December 31, and the Comptroller, his review was either September 30 or October 31, was that we had classified loans in excess of what the Comptroller had.

Mr. LEACH. How many banks does your office audit?

Mr. BLANTON. We provide auditing, tax, and consulting services to approximately 50 banks.

Mr. LEACH. Of the 50 banks, how many have loans with inadequate documentation in the same proportion as Penn Square? Would you say that Penn Square was average in terms of its documentation problems, or substantially worse than average?

Mr. BLANTON. Worse than average.

Mr. LEACH. Out of the 50 banks, would you place it 20th from the bottom or at the bottom?

Mr. BLANTON. I am not sure that I know the answer to that. Certainly, it was worse than average.

Mr. LEACH. Just barely worse than average?

Mr. BLANTON. It was substantially worse than average.

Mr. LEACH. Do you know of any bank that is worse?

Mr. BLANTON. I don't have the basis for knowing the details of the other banks. I personally do not audit the banking clients.

Mr. LEACH. Have you ever personally audited a worse bank in terms of documentation?

Mr. BLANTON. I personally have never audited any bank, including Penn Square.

Mr. LEACH. Why are you before us?

Mr. BLANTON. Well, I was hoping to read my statement, or at least portions of it, to somewhat explain my role. I am managing partner of the office.

Mr. LEACH. Has your office ever audited a bank with worse documentation?

Mr. BLANTON. I don't know the answer to that, but I suspect we have audited, perhaps not banks, but companies whose records were as bad or worse.

Mr. LEACH. But no bank? You cannot think of a bank?

Mr. YORK, can you?

Mr. YORK. I can say, yes, that I have.

Mr. LEACH. How many? How many have you audited?

Mr. YORK. Because I am speaking from personal knowledge, I can think of one.

Mr. LEACH. Out of 5 or out of 50?

Mr. YORK. Out of the client base that is in our office.

Mr. LEACH. Do you compete with other auditing firms to get clients?

Mr. BLANTON. Yes, we do.

Mr. LEACH. When you take on a firm that has had a qualified audit report and you give an unqualified audit report, you bear an extra burden of responsibility, particularly when you take over for one of the reputable firms—and yours is one of the reputable firms—in America. Do you agree that you bear an extra burden?

Mr. BLANTON. No, sir, I think that our responsibility lies with our opinion. In other words, we have responsibility for our opinion regardless of what the previous auditors did.

Mr. LEACH. Was there any in-house dissent? Did anyone in your firm say that this ought to be a qualified audit or that there might be something going on beneath the surface that appeared to be a violation of the law?

Mr. BLANTON. No, sir.

Mr. LEACH. There was no dissent? This was a unanimous opinion?

Mr. BLANTON. Yes, sir.

Mr. LEACH. I have no further questions.

The CHAIRMAN. No one on your examining team saw anything at Penn Square that they felt was a violation of the regulations or the statutes that apply?

Mr. BLANTON. I did not. Are you asking about my answer to Mr. Leach's question? Was it the same question?

The CHAIRMAN. I changed the question slightly. Would you answer the question?

Mr. YORK. When you speak of violations of the law, one that is commonly referred to by the Comptroller is in the area of legal lending limit violations. And, yes, those did occur in the bank, we did observe them, and we did comment on them in our letter to the board.

The CHAIRMAN. Were you aware of the participations that were indeed supposedly nonrecourse and yet it now appears as though they were recourse participations?

Mr. YORK. Yes, we were aware of one of them.

The CHAIRMAN. You do not think that there is anything illegal about that to label them nonrecourse, whereas in reality they were recourse?

Mr. BLANTON. We were not aware of any participations with any understandings that they were not nonrecourse. It was our understanding that all participations were nonrecourse.

The CHAIRMAN. Did your people observe the fact that there were a number of nonrecourse loans that had been repurchased by Penn Square from the upstream banks?

Mr. YORK. I was not aware of a number of them. As I can recall, I can think of one loan that did come back to the bank that we reviewed.

The CHAIRMAN. Just one?

Mr. YORK. Just one that I can think of.

The CHAIRMAN. Mr. Annunzio.

Mr. ANNUNZIO. I have no questions, Mr. Chairman.

The CHAIRMAN. Mr. Weber.

Mr. WEBER. Thank you, Mr. Chairman.

Did you have any discussions of your yearend audit report with the Comptroller of the Currency's office, with the OCC?

Mr. BLANTON. No, we did not.

Mr. WEBER. Were you aware that they made an examination of this bank on March 1 of 1982 and that in their findings they report that the external audit was unacceptable to the examiner?

Mr. BLANTON. I am not aware of that. That is the first that I have heard that.

Mr. WEBER. You are not aware whether they were referring to the external audit of Peat Marwick or not?

Mr. BLANTON. I don't know what they're talking about. We have had virtually no communication with the Comptroller or the FDIC.

Mr. WEBER. You know, I was looking at, on May 4, 1982, a confidential report to the board of directors of the bank from Peat Marwick. It is quite a few pages long, 20 pages or so, giving recommendations on management procedures that should be improved and so forth.

And there is a statement on page 5 that it says, in summary, virtually every significant area of the bank has been reviewed and changes have either been made or in process.

And on page 20 of the report, the bank has made great strides in correcting or improving practically all of the areas addressed in this agreement of September or the administrative agreement that had been entered into between the board and the Comptroller of the Currency.

You know, it was at that very same time that the Comptroller of the Currency was engaged in another examination of a bank that

was leading, in their own words, to uncovering serious problems with the bank.

What that says to me is that the board of directors was receiving very, very mixed signals here. On the one hand they were being told by people, their own officers and Peat Marwick, that everything was coming along just fine. And on the other hand there were these things going on with the Office of the Comptroller of the Currency that indicated things were quite different.

Specifically, did you know the president had no control over the lending functions of the department of energy or the energy department, the energy lending, and that was being carried out by Mr. Jennings and Mr. Patterson?

Mr. BLANTON. It may be necessary to ask Mr. Beller. But as I interpreted Mr. Beller's comments was that Mr. Jennings had the authority to override him on lending decisions. I did not interpret, nor was it our observation, that Mr. Beller did not have authority over the operations of the Energy Department.

Mr. WEBER. So you, in fact, did not know the differentiation of responsibilities between the president and the chairman?

Mr. BLANTON. Well, I think that it has been represented that 80 percent of the banks lending activity was devoted to energy and Mr. Beller had no involvement over that 80 percent. That was not our understanding or observation. That is not my understanding of his comment.

It was my understanding that if Mr. Jennings could override Mr. Beller on making an energy loan; that was my understanding of the comment. If he is here, perhaps we need to ask him.

The CHAIRMAN. Would the gentleman yield?

Mr. WEBER. Yes, I would.

The CHAIRMAN. I think the gentleman and I both heard Mr. Beller read his instructions from the CEO and the chairman of the board. Were you here when he read those?

Mr. BLANTON. Yes, I was.

Mr. WEBER. My recollection, Mr. Chairman, was very clearly that Mr. Patterson reported to Mr. Jennings and Mr. Beller reported to Mr. Jennings.

The CHAIRMAN. And Mr. Beller was told that as far as energy loans are concerned, don't you worry about them, we are taking care of them.

Mr. WEBER. I want to get back to the differences between the Arthur Young report on the 1980 audit and your findings. In the 1981 audit, Arthur Young qualified their report on the basis that it was the adequacy of the reserves for possible loan losses due to the lack of submitting documentation and collateral values of certain loans. That was the reason why they qualified their report.

You have, in turn, in your report found, I quote, "that the bank formed a loan review function and adopted a formalized approach to the evaluation and documentation of credit risks within the loan portfolio," and went on to say that this satisfied your judgment.

That was not satisfactory to the Office of the Comptroller of the Currency. But can you explain what improvement there had been in the evaluation of the loan reserves as the result of what you call the formalization of that systematic analysis and so forth? How did that actually work to the benefit of the bank, or did it work at all?

Mr. YORK. In our judgment, it was in place and working, acknowledging the fact that the people who came to the bank to establish that review function came basically in September of 1981.

They had in place people with the background in credit review and evaluation. They had established their own internal procedures as to how they would classify loans internally, how they would relate those classifications to the reserve for loan losses, and help management and the board establish the necessary reserves.

We certainly noted that. And very frankly, Arthur Young, the previous auditors, did not have that to review.

Mr. WEBER. I would yield back, Mr. Chairman.

The CHAIRMAN. Mr. Barnard.

Mr. BARNARD. Thank you, Mr. Chairman.

Mr. York, I presume you had the largest part to play in the report to the board after your initial examination. Is that true?

Mr. YORK. Yes. I signed the firm's reports.

Mr. BARNARD. Have you had any second thoughts about that since this time? Do you think that you should have probably been stronger in your recommendations of some of the things that you found in the examination of the bank?

Mr. YORK. Well, certainly, when you read the newspapers now, you might surmise that. The problem that I am still dealing with, and I think a lot of people are dealing with, is factually why the bank was closed. We understand that the Comptroller classified \$40 million or whatever the number is in loans, which caused the bank to become insolvent.

Mr. BARNARD. Well, at the time of that examination, you did know, of course, about the administrative agreement?

Mr. YORK. Absolutely.

Mr. BARNARD. What is the general approach of Peat Marwick and Mitchell when writing an audit report about revealing administrative agreements?

Mr. YORK. To my knowledge, there are banks that are under other administrative agreements. It is my understanding generally. I have never seen those disclosures made, for some good reasons. If you make those kind of disclosures in financial statements, since public confidence is such that that type of disclosure, in essence, could trigger some kind of run on the bank.

Mr. BARNARD. Well, would you kindly interpret this to me? As I understand it, this is a footnote that is on the audit reports. It is in the work papers.

Mr. YORK. This was a memorandum written by the manager on engagement regarding the letter of agreement. Since that agreement did exist and we were aware of it, in one of my review notes, as I recall, I felt like that it needed to be addressed as a matter of import as far as the audit goes, but not from the standpoint that the administrative agreement would require disclosure.

In footnotes to financial statements, that is not a typical disclosure.

Mr. BARNARD. But what you wrote—and I would like for you to read it into the record—it seems to be pretty substantial to me as far as your opinion of the operation of this bank. Could you read it into the record for us, please?

Mr. YORK. I will try. This copy is not real clear. I believe it says something to the effect—may I take just a moment and look at this to make sure I am reading the same thing?

The directorate of the bank signed an administrative agreement with the Comptroller. Until Mr. Beller became president of the bank in 1981, the bank remained in total noncompliance with the agreement. Presently, the bank is in substantial compliance with the agreement and expects to be released from it during the next ongoing examination.

Due to the fact that the new management has worked so vigorously towards correcting the situation that led to the issuance of the agreement and the fact that they expect to be released from it shortly, it is not necessary to disclose the agreement in the footnotes to our report.

Reading on:

In order to ensure that substantial compliance existed, PMM examined all areas of agreement either through review and observation or inquiry of personnel. All areas appear to be satisfactory with the exception of occasional lending limit violations and a substantial number of loan document exceptions which the bank is working on vigorously to correct.

Mr. BARNARD. Mr. York, in the fourth line of that, is it not true that the word "total" was originally in that, and it was struck out and the word "substantial" written over it?

Mr. YORK. That is correct.

Mr. BARNARD. In other words, originally it read "Until Mr. Beller became president of the bank in May of 1981, the bank remained in total noncompliance with your agreement. At present, the bank is in total," and then that "total" was scratched out and "substantial compliance" with the agreement? Right?

Mr. YORK. That is correct.

Mr. BARNARD. But the question I asked you originally was, you did not feel that this was important enough to be in the report itself?

Mr. YORK. No. And I am not sure it would ever normally be, merely because of the existence of an administrative agreement.

Mr. BARNARD. Well, what happened to these poor institutions that put money in there, relying upon your report? You think that they would have had the same attitude about this bank if they had seen that the auditors had said that they were in even substantial noncompliance?

Mr. YORK. I don't how they might interpret that.

The CHAIRMAN. Would the gentleman yield?

Mr. BARNARD. Yes.

The CHAIRMAN. Does Peat Marwick and Mitchell audit any credit unions?

Mr. BLANTON. We do not audit any credit unions in Oklahoma City out of the Oklahoma City office.

The CHAIRMAN. I mean in the United States of America.

Mr. BLANTON. I am very sure we do.

The CHAIRMAN. Do you audit any savings and loans?

Mr. BLANTON. Yes, we do.

The CHAIRMAN. Do you think it is possible that some of those you audit, that your firm audits, may have had funds in excess of \$100,000 at Penn Square Bank?

Mr. BLANTON. It's possible.

The CHAIRMAN. I thank the gentleman for yielding. I would not be too happy if I were they.

Mr. BARNARD. Mr. York, another question I would like to ask you about your report. On page 8 of the management letter it says, "after reviewing the new organizational chart which is currently in the process of implementation" and I emphasize this "there is only one recommendation that we wish to make" and I will read on very hurriedly:

The oil and gas division is quite large and has several key personnel reporting to the senior vice president in charge of the department. Because of the relatively large span of control which now exists and the variety of tasks performed within the department and particular talents of the department head, we recommend that the organization of this key department continue to be reviewed.

The review should be made from the standpoint of continuing to improve the administration of the day-to-day activities of the department and yet capitalize on the strengths of the department head and his relationship with key loan customers and upstream correspondents. For him to maintain these relationships and effectively administer the department may be unrealistic as the bank continues to grow.

Do you think possibly on reflection you might want to make that a little bit stronger? I presume we are talking about Mr. Patterson in that statement; is that correct?

Mr. YORK. That is correct.

Mr. BARNARD. Would you care to answer that?

Mr. YORK. Well, I feel like our recommendation is still good today because of the span of control that he did have and all of the things that Mr. Patterson was doing.

Mr. BARNARD. On another subject, let us talk about the adequacy of loan loss reserves. In a memo written during March, Mr. York, I believe that you discussed the adequacy of Penn Square's loan loss reserves. The memo states that:

In connection with our review of the loan charge-offs for 1981 and our review made to determine the adequacy of the reserve for 1981 there was nothing specifically noted that would indicate the 1980 reserve was materially inadequate at that point in time.

One could surmise because of the large charge-offs which occurred in 1981 that perhaps the 1980 reserve was inadequate at that point in time. However, on review of what happened during 1981, this would not necessarily be the conclusion that one would draw.

So I ask the question, was it your opinion today that the 1980 reserve was understated, according to Peat, Marwick, Mitchell & Co.'s formula?

[The memorandum referred to follows:]

Client: First Penn Corporation and Penn
Square Bank, N.A.

From : C.D. York, Engagement Partner

Subject: 1981 Accountants' Report

Because 1981 was our first year to audit the Company and its related entities, principally, Penn Square Bank, it was necessary for us to refer to the prior auditor's report which was qualified. Arthur Young's qualification was quite unusual due to the fact they qualified their opinion on the basis of a scope restriction because they were unable to satisfy themselves as to the adequacy of the reserve for loan losses due to certain collateral information being insufficient for their purposes. Naturally it was necessary on our part to consider their qualification in relation to our opinion on the 1981 financial statements.

After much review of the professional literature regarding auditors reports and qualified opinions, I was unable to find an example of the particular problem that we have. In considering our opinion for 1981, first I determined that we are satisfied that the 1981 balance sheet is fairly stated. I am satisfied we will give a clean opinion on the 1981 financial position without any problem. The next question is, due to Arthur Young's qualification, should it have any impact on our opinion on the 1981 results of operations. In analyzing this particular problem the following was considered:

1. AY's qualification did not indicate they were satisfied or dissatisfied with the reserve for loan losses. Their qualification only indicated they could not make a determination as to the adequacy or inadequacy and accordingly resulted in their "except for" opinion.
2. Management of the Company and the Bank maintain that, in their opinion, the 1980 reserve for loan losses was sufficient. This is borne out by a number of statements made by management in their offering document for the sale of stock in November 1981.
3. In connection with our review of the loan chargeoffs for 1981 and our review made to determine the adequacy of the reserve for 1981, there was nothing specifically noted that would indicate the 1980 reserve was materially inadequate at that point in time. One could surmise, because of the large chargeoffs which occurred in 1981, that perhaps the 1980 reserve was inadequate; however, on review of what happened during 1981, this would not necessarily be the conclusion that one would draw. Several things were noted in our review of 1981 such as:
 - o The Bank's senior management changed considerably with the addition of a new president, a new executive vice president in charge of credit and collection and a new executive vice president in charge

- of finance.
- o The establishment of a loan review department.
- o A formalization of their approach as to how the reserve for loan losses should be reviewed and adjusted periodically.

Also, in reviewing what happened in 1981, we noted that the federal examiners' report had a number of classified loans in their examination of early 1981. However, such classifications, insofar as losses and doubtful loans, was not in excess of the reserve which was established at the end of 1980. It was also noted that when Mr. Beller, the new bank president, came on board he took a very conservative view of the loans they had reviewed internally. If loans were determined to be anywhere near doubtful in collection, he placed them on a nonaccrual status and gave them a very conservative classification which in turn caused an upward adjustment in the reserve for loan losses. Also, if in their view, a loan could not be recovered in the very near term, the loan was charged-off and litigation was immediately instituted against the borrower; even though they knew, and subsequently, it has occurred there were significant recoveries to be had on such loans. In reviewing the prospectus that the Bank prepared as of September 30, 1981, it was noted that the reserve for loan losses was about \$2,600,000. Subsequently, due to a softening in the local economy, and particularly the energy industry, the Bank believed it was necessary to increase the reserve for potential problems that appear to exist in the loan portfolio.

So, in reviewing what happened in 1981 with respect to the reserve for loan losses, it appears to me that the Bank's new management is taking a much stronger stance in it's estimation of the reserve and has adjusted the reserve upward to recognize potential losses in the loan portfolio which are more visible due to the change in the economy in the latter part of 1981 as compared to what the picture was at the end of 1980.

Consequently, my conclusion is that the change in the reserve is just a natural progression of the estimating process which management must continually undertake. Although, I do recognize that the attitude of senior management now is probably different than it was in 1980; however, this is still a part of the estimating process.

In summary, it is my opinion that what we have is a situation where management has certainly improved its documentation of their rationale for maintaining the reserve for loan losses at a certain level. It was also obvious to me and our staff, during the course of the audit, that the Bank's system of loan review and documentation of credit and collateral has certainly improved over the prior year. In the course of our review and evaluation of the loans, we were able to have at our disposal documentation and information with which to make a review of the individual loans. Management also uses such information

to help determine the necessary adjustments to the reserve on a quarterly basis.

In view of the foregoing, it's my opinion that the 1981 adjustments made to the reserve for loan losses are part of the normal estimating process. Management's opinion as to the adequacy of the reserve at the end of 1980 further confirms that whatever happened in 1981 is again reflective of the estimating process and the actual occurrences during 1981. As a result of our review and tests of the reserve including the above information, I believe that we can give an opinion on the 1981 results of operations.

In order to help bridge the gap between AY's qualified opinion for 1980 and our clean opinion for 1981, I felt that it was necessary to have language in our opinion drawing the reader's attention to footnote 4 of the financial statements which discusses improvements made in 1981 in the formalization of their approach to evaluating the reserve and related documentation. Such language was added immediately following our reference to AY's qualified opinion. The location of the reference, I believe, should be there as opposed to a middle paragraph in order to immediately draw the reader's attention to the fact that something has changed in 1981 as ~~it~~ compared to 1980. While professional literature speaks to middle paragraphs where an emphasis of a matter is concerned, I believe, in this case, the notation of that reference is best shown immediately following our reference to AY's qualification as opposed to a middle paragraph.

Due to the unusual nature of these reporting problems, I consulted with various of my audit partners as to what they thought about the problems encountered and my recommendations as to how to handle them. I spoke with Hugh Hyde, bank partner in the Houston office, Mr. Jack Noftsgger, our audit PIC and Mr. Jim Blanton, the managing partner. After discussing the various points mentioned herein with them, they all indicated that my assessment of these problems and the resulting resolutions were acceptable.

Mr. YORK. Do I believe that the 1980 reserve was understated?

Mr. BARNARD. Right.

Mr. YORK. Not necessarily, no.

Mr. BARNARD. What about the 1981 reserve?

Mr. YORK. I am aware of no information to this date as to why that reserve would be inadequate.

Mr. BARNARD. According to the information that we have, Penn Square in each instance, did not reserve nearly the percentage that most banks did against its substandard loans or the next classification, doubtful loans. It did reserve 100 percent of its loss loans. But the percentages of substandard and doubtful were far less than what the normal average was.

Do you know any reason why that was done?

Mr. YORK. No, I don't. The whole area of loan review, as you can appreciate, is a highly judgmental area, and there are different rules of thumb that are used.

Mr. BARNARD. Mr. Chairman, I have no further questions.

The CHAIRMAN. Mr. Wortley.

Mr. WORTLEY. Thank you, Mr. Chairman.

In the scope of your audit of a client, what portion of the loan portfolio do you verify?

Mr. BLANTON. We took the total loan portfolio of the Penn Square Bank. We performed tests of that portfolio in total, but they were only tests. In other words, we did not verify every loan. The total population was the portfolio of Penn Square Bank.

Mr. WORTLEY. How much of the loan, how much of the Energy Department, since that was about 80 percent of the portfolio?

Mr. BLANTON. It was in the total population, so the entire energy portfolio had an opportunity to be tested.

Mr. WORTLEY. And you did not find any deficiencies in it, and you were satisfied with what you saw that these loans were in good shape that were on the books and were verified?

Mr. BLANTON. Our review of those loans was to form an opinion on the financial statements as a whole, which we did; not to describe the energy portfolio in particular, some of the energy loans were classified in our examination.

Mr. WORTLEY. In view of the fact that the Comptroller of the Currency was critical of the Penn Square Bank, do you feel that the internal controls of Penn Square were adequate?

Mr. BLANTON. No, sir. We don't believe that they were adequate.

Mr. WORTLEY. Well, did you criticize them in the public statement?

Mr. BLANTON. No, sir.

Mr. WORTLEY. You only criticized them in the management letter?

Mr. BLANTON. That is correct.

Mr. WORTLEY. Do you think that is fair to the public? And is that a custom of the profession?

Mr. BLANTON. I am not sure that I can determine what is fair or unfair to the public. I can say that it is a normal procedure to issue a management letter, and that we do not address in the financial statements or in footnotes all of the problems of a client.

Mr. WORTLEY. Well, do you not feel that you have a responsibility to someone other than your client, in this case Penn Square? Is

the whole purpose of an audit not to make certain that things are verified and the public is adequately informed of it, and shareholders and investors and depositors?

Mr. BLANTON. Penn Square Bank was a privately held bank. We were engaged by and to report to the board of directors. We did not report to depositors. We did not report to the public. We reported only to the directors of Penn Square Bank.

Mr. WORTLEY. But was not your audit report, in turn, passed on to depositors?

Mr. BLANTON. To my knowledge, our audit report was not passed on to depositors.

Mr. WORTLEY. What was the distribution of the report then? Who would get it?

Mr. BLANTON. We delivered 50 copies of our report to the board of directors. We would assume that that report was for the use of the directors, and we would presume that the report would probably be requested by the upstream banks. The bank itself, as far as putting information to whomever, they produced their own slick, if you will, annual report, with pictures. It did not include a complete set of financial statements. It did not include our opinion, nor did it include Arthur Young's opinion.

[The documents referred to will be found in the appendix section as follows: Appendix D, Penn Square Bank, N.A., Annual Report, 1981; appendix E, Penn Square Bank, N.A., Annual Report, 1982; appendix F, filings of First Penn Corp. with the Federal Reserve Bank, received in Records Section, June 4, 1982, which includes amendments to organizational documents, First Penn Corp. minutes of special shareholders' meeting, Tuesday, June 14, 1981, and consolidated and parent holding company financial statements with Peat, Marwick, Mitchell & Co. report thereon.]

Mr. WORTLEY. It did not include your statement at all?

Mr. BLANTON. That is correct.

Mr. WORTLEY. Is that the custom for most banks?

Mr. BLANTON. If a bank is publicly held, then it is required to produce an annual report in accordance with the rules of the SEC. Penn Square, not being publicly held, was not required to do that. In other words, a publicly held bank would include a complete set of financial statements, the auditor's report, and other management information that are required to discuss the operations of the bank. And those are SEC rules. Where you have a private company or bank, they generally don't publish anything. But in an instance like this, I can't recall any specific examples, but, yes, this is done. It is not that unusual.

Mr. WORTLEY. Well, in other words, your audit is only for their personal gratification? It went nowhere else?

Mr. BLANTON. Our audit was for the board of directors, and that is who we reported to. If I might distinguish, we were not a part of any offering document. So from our viewpoint, well, if we were part of an offering document, then we would, in fact, know that investors were going to rely on it. That was not the case here.

Mr. WORTLEY. I yield back the balance of my time. I am finished, Mr. Chairman.

The CHAIRMAN. If it were indeed going to be part of an offering document, what would you have put in there that you did not put in?

Mr. BLANTON. If it were——

The CHAIRMAN. Say, you were auditing Chase Manhattan, and that is publicly held; right?

Mr. BLANTON. If it were an offering document, it would have financial statements in it, as we have reported. But it would also contain other disclosures by management.

The CHAIRMAN. I am talking about Peat, Marwick, Mitchell & Co.

Mr. BLANTON. If it were an offering document?

The CHAIRMAN. If your report was going to be part of an offering document, tell me what you would have done.

Mr. BLANTON. If our report were going to be part of an offering document, it would be the same set of financial statements, assuming that it met regulatory requirements. From time to time there are differences. For example, the SEC wants certain information, or perhaps the Federal home loan bank wants certain information.

Basically, our product, or our opinion on the financial statements would be the same, with one exception, and that is that they would require our consent to the use of our opinion. To obtain our consent for the use of our opinion, we would presumably have insisted that other disclosures be placed in there by management, something so that an investor would be aware of all events up to the date of his investment.

The CHAIRMAN. Would that include the letter of agreement with the Comptroller of the Currency?

Mr. BLANTON. I don't know.

Mr. LEACH. Would the gentleman yield?

The CHAIRMAN. I would yield to the gentleman.

Mr. LEACH. The chairman asked a question earlier as to whether you audited any credit unions that might be involved. Are you responsible for auditing any activity of Seattle First, of Chase Manhattan, or of Continental Illinois?

Mr. BLANTON. Our firm is the auditor for Chase Manhattan.

Mr. LEACH. In this instance, did you have any contact with your firm regarding the audit of Chase Manhattan, and would you have given any information to Chase Manhattan that might have been relevant to them?

Mr. BLANTON. To my knowledge, we gave no information to our firm regarding that.

Mr. LEACH. If you knew what we presume is new knowledge in comparison with 6 months ago, what are your obligations as an auditor? Would that information be immediately given to your firm in New York as relevant to Chase Manhattan's audit?

Mr. BLANTON. My response would be no, that we would not give information. I have never encountered that. So in a real-life situation——

The CHAIRMAN. You have never encountered it. You encountered it right here. You have it right here. Are you wearing blinders?

Mr. BLANTON. While we were doing the audit of the Penn Square Bank, we didn't share anything.

The CHAIRMAN. You were not aware of the fact that there were numerous classified energy loans in Penn Square Bank?

Mr. BLANTON. Are you asking did we notify our New York office after conducting our examination?

The CHAIRMAN. Excuse me. I am asking you if you were aware of the fact that there were numerous classified energy loans at Penn Square Bank.

Mr. BLANTON. As of what date?

The CHAIRMAN. During your audit.

Mr. BLANTON. I don't believe that there were numerous classified energy loans as of the date of our audit.

The CHAIRMAN. Were you aware of the fact that Penn Square was paying the interest on behalf of borrowers on participation loans that had been sold upstream to Chase Manhattan and to Continental?

Mr. BLANTON. Yes, we were aware of that. We discussed it in our management letter.

The CHAIRMAN. You were aware of that?

Mr. BLANTON. Yes, we were.

The CHAIRMAN. You do not and did not feel an obligation, therefore, as an auditing firm to inform Chase Manhattan of the fact that this bank in Oklahoma City was pulling the wool over their eyes on some of those participation loans that they purchased from Penn Square?

Mr. BLANTON. I don't believe that you can conclude that if they were advancing interest on these participations that they were pulling the wool over anyone's eyes without knowing why the advance was made.

The CHAIRMAN. Mr. Blanton, Mr. Blanton, please, please. This is one of the problem areas. Mr. Beller stated earlier that as a result of the December 8 memorandum that has been placed in the record that there was over \$2 million of interest that was paid to upstream banks on loans that were nonperforming loans, and some of these moneys were going to your other client, Chase Manhattan.

And there is only one reason to do something like that, and that is so Mr. Patterson and his colleagues could continue selling participations to upstream banks. Otherwise, if too many of the loans were found to be nonperforming, they could not continue their sales around the Nation, could they?

So to say that that was not improper, that they were not pulling the wool over Chase Manhattan's eyes, you are maybe hoping they were not. But I think perhaps you should think twice about that one.

You have two clients, and I think maybe you think you did not have an obligation to the borrowers or rather to the depositors who put sums in excess of \$100,000 into Penn Square. But it seems to me that since your firm was collecting fees from both Chase and Penn Square, that you might have had some kind of obligation there.

[Witnesses conferred.]

Mr. BLANTON. I think Mr. York can add to that. Some of those advances were investigated, the information available to us indicated the practice was decreasing and there were some reasons for those instances where it was continuing.

Mr. YORK. Yes. We also read the memo that you had presented this morning to you. We looked at that area as well. We inquired and reviewed what management was doing, and still felt that it was the type of thing that should still be a subject matter in our management letter, which we covered.

The CHAIRMAN. What do you mean, a subject matter? What is that? Absolution? I mean you say you are forgiven for your sin, we will make it a subject matter rather than a sin?

Mr. YORK. No.

The CHAIRMAN. Well, what do you mean by "a subject matter"? I mean something is either right or it is wrong.

Mr. YORK. And it was wrong from a viewpoint of good business practice.

The CHAIRMAN. OK. Well, why call it a subject matter? Why not just say it is wrong? I mean this obfuscation and semantics and all of that, let us talk English that the people in Oklahoma and the people in Rhode Island and Georgia and Iowa can understand rather than some gobblydegook?

Now, Mr. Blanton, you know those 50 copies you say you delivered to the board of directors because it is a privately held bank; is that correct?

Mr. BLANTON. Yes, sir.

The CHAIRMAN. You are not aware of the fact that the people at Penn Square dealing with brokers gave your reports as well as those of Arthur Young of those money brokers who, in turn, cited those, your reports, to people, credit unions, S&L's around this Nation who put enormous sums of money into this institution based on your audit reports, since that was all that was available to them?

Do you mean to tell me you are not aware of the fact that your reports are used by brokers for that purpose and by the people at Penn Square Bank who were attempting to get large deposits into that institution?

Mr. BLANTON. I have read newspaper reports that money brokers had copies of our financial statements.

The CHAIRMAN. And this is the first time it ever occurred to you in your career with Peat Marwick and Mitchell that your reports of Peat, Marwick, Mitchell & Co. were used in this manner by financial institutions, whether it be Penn Square or any other institution that you do auditing for? Did this come as a complete and total surprise to you, like the fact that when you get to be 10 years old you find out there is no Santa Claus?

Mr. BLANTON. Because there were two sets of financial statements that we discussed, I do not know whether the credit unions had the financial statements that we issued or the financial statements that the bank issued. Obviously, I do not know what the bank did with those financial statements.

The CHAIRMAN. You have heard of Xerox machines?

Mr. BLANTON. Yes, sir.

The CHAIRMAN. I have a letter here that was handed to me.

Mr. LEACH. Will the gentleman yield to me?

The CHAIRMAN. Yes.

Mr. LEACH. At any time, whether directly after the audit or up through late June, did you talk to your office in New York with an

understanding that they might talk to Chase Manhattan about difficulties at this bank?

Mr. BLANTON. To my knowledge, we never initiated any calls to our New York office concerning Penn Square Bank.

Mr. LEACH. How about vice versa?

Mr. BLANTON. It is my understanding that our New York office did call us and ask that we perform certain procedures with respect to their participations that were being serviced by Penn Square.

Mr. LEACH. At what time was this?

Mr. BLANTON. In March.

Mr. LEACH. In other words, by virtue of the fact that Peat, Marwick worked as an auditor for both banks, Chase came to have earlier knowledge of this particular bank's situation?

Mr. BLANTON. Not to my knowledge. To my knowledge, no one in our office involved with Penn Square Bank ever initiated any calls to Chase or to New York.

Mr. LEACH. But you indicated a moment ago that your office in New York initiated a call to your office here.

Mr. BLANTON. They asked us to perform certain procedures.

The CHAIRMAN. I feel as though now we are in General Hospital. [Laughter.]

The CHAIRMAN. What do you mean by a certain procedure—I mean, is this a blood transfusion or a transplant or a bypass? Could you be more specific?

Mr. BLANTON. When we audited Penn Square Bank we were looking at Penn Square's portfolio, not the participations. They asked us to perform similar types of procedures with respect to participations.

The CHAIRMAN. Your New York office, on behalf of Chase Manhattan?

Mr. BLANTON. That is correct.

Mr. LEACH. Earlier you indicated that if you came upon problems, you would not feel it your obligation to inform Peat, Marwick in New York and to inform Chase. Is that your position? Do you think that intra-company obligation is something that the auditing community is going to have to look at very carefully in terms of its future procedures?

Mr. BLANTON. Mr. Leach, as the chairman pointed out, yes, that did happen in this instance where Penn Square was closed, but we had no advance notice to give our New York office that it was coming.

All I am saying is that that never became an issue, and to my knowledge, I don't ever recall that being an issue on any client. So I guess what I am saying—my response would be I think that we probably would not notify, but I have never encountered it.

Mr. LEACH. I understand exactly what you are saying. I suspect that this might become a problem in your intracompany discussions. It poses a very serious philosophical dilemma for the company as well as for the auditing profession.

Mr. WEBER. Would the gentleman yield?

Mr. LEACH. I would be happy to.

Mr. WEBER. It seems to me you could do us a favor if you would restate, as best you understand it, what are the rules of ethical

conduct that pertain to the accounting profession so far as the confidentiality of client information is concerned.

I assume that you keep all confidences of the client just that, confidential, between you and the client only. Is that correct?

Mr. BLANTON. That is correct.

Mr. WEBER. And the thing that clouds the issue here is that we may be dealing in an area of civil fraud or actual illegality, and the question is at that point, do you maintain the confidentiality of those potential violations of law from other people who may be affected by that information, I assume. Is that the way you read that question also, or that problem?

[Pause.]

Mr. WEBER. Can you answer?

Mr. BLANTON. I am thinking. I really do not know the answer to that question. It obviously has been the subject of much debate among accountants.

Mr. WEBER. You are in a situation of a conflict of interest. You are representing two clients who have conflicting interests. The interest of the one client is to keep the information totally confidential. The interest of the other client, of course, is to be informed.

Mr. BLANTON. I think that I can safely say that it is our firm policy that we do not ever discuss the condition of one client with another client. And I do not think that that was the question being asked.

The CHAIRMAN. Let me rephrase the question for you. No. 1, I do not think that accountants are in the stead of attorneys or doctors.

Mr. BLANTON. That is correct.

The CHAIRMAN. You do perhaps have a code of conduct within a profession.

Mr. BLANTON. That is correct.

The CHAIRMAN. But you do not have an immunity, say, where if you were brought into a courtroom.

Mr. BLANTON. That is correct.

The CHAIRMAN. Don't you really face the dilemma, in this instance, when indeed, that which is happening at Penn Square has a very direct relationship, as we found out, on Chase Manhattan? Both of whom are your clients. I would suspect that the fee for auditing Penn Square doesn't begin to compare with the fee Peat, Marwick, Mitchell & Co. gets for auditing Chase Manhattan.

Now, it is not as though Chase Manhattan says, We want to know about the internal workings of this competitor institution. What you are faced with here is a situation where they are dealing with each other; there is an interaction, a business relationship, and the health of one affects the health of the other.

Don't you really have a compounding of your dilemma because gee, if the people at Chase Manhattan say to themselves, Why didn't that Oklahoma City group of Peat, Marwick, Mitchell & Co. let us know what was happening or what was going on at Penn Square, when they knew that this would affect our losses at Chase Manhattan, also being audited by Peat, Marwick.

Mr. BLANTON. Mr. Chairman, you are assuming that we knew what was going on at Penn Square.

The CHAIRMAN. I think that is because I am told you are an excellent firm.

Mr. BLANTON. You are assuming that we have knowledge of what the Comptroller found during his examination.

The CHAIRMAN. Mr. York said he was aware of the memo of December 8 about what was happening on those participations. That is not an assumption. I am not assuming, sir.

Mr. BARNARD. Mr. Chairman, would you yield for a minute?

The CHAIRMAN. I would be happy to.

Mr. BARNARD. Mr. Blanton, what was the substance of the inquiry from the Chase Manhattan Bank? Was it about a specific participation, or was it about general participation policy? Can you tell us what that inquiry was?

Mr. BLANTON. Mr. Barnard, I would like to decline to answer your question, only because we are getting now out of the discussion of Penn Square and into a discussion of Chase Manhattan. And I am not free to discuss Chase Manhattan.

Mr. BARNARD. Well, may I just differ slightly in saying that we are really talking about what information is privy to Chase Manhattan and not privy to other people who also stand to lose.

The CHAIRMAN. And excuse me, we are talking—the question is directed to the situation at Penn Square, not Chase Manhattan. What was that procedure?

Mr. BARNARD. In other words, we were talking here about an inquiry that the Peat, Marwick, & Mitchell Co., office in New York made to the Oklahoma City office as a result of a Chase Manhattan inquiry. Was that about a specific participation loan or was it about a general participation policy? You don't think you could tell us that?

Mr. BLANTON. I do not believe I could tell you that.

Mr. LEACH. If you would yield, Mr. Barnard.

Mr. BARNARD. Yes.

Mr. LEACH. Was this request based upon a standard audit of Chase Manhattan, or was it a request based upon some concerns reflected by Peat, Marwick, Mitchell & Co.?

Mr. BLANTON. I do not know the answer. If I did know the answer, I do not think I could say.

The CHAIRMAN. Do you want to state that question again for me, Jim?

Mr. LEACH. The question was whether this was a standard operating procedure stemming from a normal audit of Chase, or whether it was a special request growing out of a nonstandard audit procedure.

The CHAIRMAN. If the gentleman would yield, I would like to rephrase his question. Actually, the question was propounded by Mr. Barnard, and the question was, you were asked as you stated, "to perform a procedure" at Penn Square relative to participation loans. Is that not correct?

Mr. BLANTON. That is correct.

The CHAIRMAN. I think I am quoting you. Is that correct?

Mr. BLANTON. That is correct.

The CHAIRMAN. We are now asking you to tell us whether that procedure had to do with participations in general, whether it related to the December 8 memo about prepayment of interest, whether it was on a particular participation. You now tell us you don't feel you can answer, but the Chair at this point would state

to you, sir, that this committee is investigating the failure of Penn Square Bank, a matter of which we have jurisdiction and, indeed, the responsibility to look into to see if any changes in legislation or bank regulatory procedures or processes are necessary.

Your answer to the question would help this committee, and would be invaluable to this committee and necessary to this committee to carry out its duties. The Chair rules that the question is pertinent and directed to the situation at hand. I would respectfully request on behalf of this committee that you, indeed, answer the question.

[Witness conferring with counsel.]

Mr. BLANTON. Mr. Chairman, my counsel has advised me that we would be pleased to discuss any information concerning Chase only if we can obtain Chase's permission first.

Mr. BARNARD. Mr. Chairman, I don't believe we are asking anything about Chase.

The CHAIRMAN. Excuse me. Let me ask you this question. The inquiry to perform a procedure, did it come from Chase Manhattan or from Peat, Marwick, Mitchell & Co. in New York?

Mr. BLANTON. I do not know the answer.

The CHAIRMAN. Mr. York? I assume Mr. York is the gentleman who performed the procedure.

Mr. YORK. It is my understanding that the request came from Chase.

The CHAIRMAN. Directly or through Peat, Marwick, Mitchell & Co.?

Mr. YORK. Through Peat, Marwick, Mitchell & Co.

Mr. LEACH. Mr. Chairman?

The CHAIRMAN. Mr. Leach.

Mr. LEACH. This is a very interesting area of concern and of philosophical import. Since we are going to be holding additional hearings, however, and given the position of the gentlemen present and their counsel's advice, I would suggest that we postpone further consideration of this issue. To press the point at this time could be unnecessarily embarrassing both to the witnesses and their company, which is one of the great American auditing firms. With the understanding that this matter will be pursued further, I recommend that we not pursue it at this time.

The CHAIRMAN. Well, if we don't pursue it, Mr. Leach, I think that by the same token, it leaves unanswered from this moment forward the fact that Chase Manhattan asked that certain procedures be performed in March of this past year.

We were told by the Comptroller in a briefing by the Comptroller and the FDIC that they informed—the Comptroller didn't inform their office; that they, in turn, informed Continental Illinois and Chase Manhattan and the others until 6 or 7 days before July 5, the date the D-Day here.

We are finding out that it appears as though Chase Manhattan, through some ESP—which in this instance I don't criticize; I think it is great of Chase Manhattan—that they had some inklings about the fact that maybe procedures ought to be performed here at Penn Square to try to learn a little more about these participations.

It appears that Chase Manhattan may have been privy to something through the Peat, Marwick, Mitchell & Co. route back in March of this year. If we want to leave that hanging—and certainly I want to assure Mr. Blanton and Mr. York that we will not leave it hanging for ad infinitum, because this committee does pursue these things. If you want to leave it hanging and you make a conscious decision that you are better off letting it hang out there unanswered than to face up to it now, perhaps then we will allow you to leave it hanging.

[Witness conferring with counsel.]

Mr. BLANTON. Mr. Chairman, let me just make this statement. To the best of my knowledge, no one in Peat, Marwick, Mitchell & Co. in Oklahoma City had any conversations with any individual from Chase Manhattan specifically concerning Penn Square. To my knowledge, no one in Peat, Marwick, Mitchell & Co. in Oklahoma City initiated any discussions with anyone in our New York office to discuss specifically Penn Square Bank.

I would be pleased to—

The CHAIRMAN. But you are leaving one—let's go this way. To your knowledge, did anyone at Peat, Marwick, Mitchell & Co. in New York City initiate any discussions with personnel in Peat, Marwick, Mitchell & Co. in Oklahoma City relative to performing a procedure in Oklahoma City? That is one you did not include.

Mr. BLANTON. As I stated earlier, we would be pleased to discuss that matter, but we feel that we need the consent of Chase Manhattan.

Mr. LEACH. Mr. Chairman?

The CHAIRMAN. Just let me get an answer to this. He told me to his knowledge, no one from Chase contacted Peat, Marwick, Mitchell & Co. in Oklahoma; no one from Oklahoma contacted either Peat, Marwick, Mitchell & Co. or Chase. Now I am saying did anyone from Peat, Marwick, Mitchell & Co. New York contact somebody at Peat, Marwick, Oklahoma City relative to performing a procedure at Penn Square on participations?

Mr. BLANTON. I have already answered that question, that yes, we were contacted by New York.

Mr. LEACH. Mr. Chairman?

The CHAIRMAN. Yes?

Mr. LEACH. I certainly understand the dilemma you gentlemen face in wanting to discuss this with your client. It would be my suggestion at this point, given the potential for contempt citations, that the representatives of Peat, Marwick, Mitchell & Co. relating to Chase Manhattan be invited to testify at a future hearing to resolve all of this.

The CHAIRMAN. May the Chair just state that I wanted to get it clear on the record, because of his last reply, that there was communication. I didn't want to leave it hanging that there was not. I am satisfied that we will have—certainly, there are going to be further hearings on this, and not only for the benefit of Peat, Marwick, Mitchell & Co., but for many others who are happy to testify, or who were unhappy to testify today or didn't want to testify today.

I want to make it very clear that we are going to be chatting with them in the months ahead, and maybe the years ahead. There

is too much of this case that has to be cleared up that we are not going to forget about it.

Mr. BARNARD, do you have any further questions?

Mr. BARNARD. No, Mr. Chairman.

The CHAIRMAN. Does anyone else have any questions of these witnesses?

[No response.]

Let me ask you this, Mr. Blanton and Mr. York. You have heard the panel preceding who testified that in their opinion, Penn Square should not have been shut down on July 5. You were here, weren't you?

Mr. BLANTON. Yes.

Mr. YORK. Yes.

The CHAIRMAN. Now, you are the auditing firm. Do you agree or disagree with that panel? Do you feel that Penn Square should have been shut down and this unusual procedure entered into by establishing the special deposit insurance bank? Or should that have been triggered, or do you think other means should have been taken?

Mr. BLANTON. Because we do not have the facts that caused the Comptroller to reach his decision as of that date, let me say this. If the Comptroller had closed Penn Square Bank on December 31, 1981, then I believe that would have been done in error.

The CHAIRMAN. Thank you, gentlemen. At this time, I would ask unanimous consent to have placed in the record the two documents from Peat, Marwick, Mitchell & Co; one dated June 14, 1982, addressed to Mr. James Gunter, executive vice president, Penn Square Bank; and the other dated May 4, 1982, board of directors, Penn Square Bank in Oklahoma. Without objection, so ordered.

[The documents referred to follow:]



Peat, Marwick, Mitchell & Co.

Certified Public Accountants

First Oklahoma Tower
Oklahoma City, Oklahoma 73102

June 14, 1982

CONFIDENTIAL

Mr. James J. Gunter, Executive Vice-President
Penn Square Bank, N.A.
Oklahoma City, Oklahoma

Dear Mr. Gunter:

In connection with our examination of the financial statements of Penn Square Bank, N.A. as of December 31, 1981, we noted certain matters relating to the Bank's system of internal accounting control and accounting procedures that we wish to call to your attention. In your consideration of the items mentioned in the following paragraphs, please understand that our recommendations are intended to assist you in the presentation of and accountability for the Bank's assets, liabilities, income and expense accounts. An effective system of internal accounting control and operating procedures should help guard against any irregularities that our test work may not disclose. The efficiency and effectiveness of Bank personnel are determined by adequate managerial policies and periodic reviews of such policies and employee performance.

As you read this letter, please bear in mind that its purpose is to supplement our letter which was issued to the Bank's Board of Directors on May 4, 1982. Also, please consider that we have not reviewed the Bank's internal accounting controls since March 19, 1982, the date of completion of our field-work in the Bank, and therefore, we may not be aware of changes subsequent to that date.

GENERAL

As noted in our previous letter, the Bank's growth rate over the last few years has been phenomenal. This type of rapid expansion normally increases processing requirements and tends to stretch existing personnel. This in turn increases the opportunity for errors to occur, processing short cuts and the circumventing of existing internal controls. The remainder of this letter will speak to individual areas of the Bank which we believe merit your attention; however, we urge you to continually be aware of and make improvements in other areas of the Bank where controls may have been weakened during this period of rapid growth.

OPERATIONS

Efficient workflows are essential to any organization to ensure and maintain excellent customer satisfaction. The following items are intended to enhance the Bank's ability to process items orderly and efficiently.

- o Require all departments to release work immediately to the Proof Department. This will assist the department in meeting important deadlines and reduce the late afternoon volume;
- o Clean checks of all staples, rubber bands, paper clips and other fasteners prior to delivery to the Proof Department to avoid rehandling the items and to reduce the number of rejected items;
- o Encode account numbers on unencoded deposit and withdrawal tickets at the funds receiving areas to assist in assuring that the encoded number is correct and to encourage the use of pre-encoded customer deposit slips;

- o Establish procedures in all funds receiving areas to prepare items for MICR encoding by arranging items in proper sequence before sending them to Proof;
- o Prepare a notice of missing documents for inclusion with the customer's monthly statement when an item or items are missing from the statement. The notice should explain that an item is missing but to prevent delay, the statement is being mailed. The notice should continue with a statement indicating that should the customer need a copy for tax purposes, to circle the needed item, return the statement to the Bank and a copy will be forwarded as soon as possible. This procedure will reduce the amount of time necessary for research and filmwork;
- o Review the types of manually prepared reports to the reports produced by the data processing system. When the same or similar information is available from the system, the manual reports should be deleted;
- o Close select departments to outside calls (bookkeeping, proof, tellers, etc.) except during posted operating hours. This allows individual departments to prepare and process the bulk of their work without disruptions;
- o Encourage customers to properly endorse all checks with name and account number. This procedure reduces bookkeeping research time for deposited items returned;
- o Request a program change in order to automatically assess insufficient check charges through the data processing system. This method decreases the amount of time required to manually handle the items and decreases the number of paper items in the system. In addition, it requires positive officer response to waive insufficient charges, improving controls over excess waivers;
- o Revise the overall Bank policy regarding NSF items. We realize that the Bank will not collect 100% of the income generated and that special arrangements have been made for zero balance type accounts or customers who maintain substantial balances in other accounts;
- o Establish a cut-off time in which loans may be brought to the note area for same day processing. This will assist the note departments in forwarding their work to proof in a timely manner;

- o Discontinue manually posting payment activity on the reverse side of commercial notes. This is time consuming and unnecessary. Department personnel indicated that an account history can be requested from the processor's automated system and received the following day; and
- o Relocate operational departments (bookkeeping, proof, transit, data processing, etc.) within close proximity of each other. At the present time, these departments are located in separate sections of the Bank, creating disruptions in the efficient flow of work. This recommendation is currently being reviewed by the senior operations officer.

CASH MANAGEMENT

The realization of any bank's earning potential is dependent upon the effective management of its earning assets. An overall goal for employing Bank assets effectively is to maintain an average of 90% of total assets in an earning capacity.

- o Due From Bank Accounts - The Bank continually monitors the activity of its primary correspondent banks in order to maintain balances to compensate for services performed. At the same time, it was indicated that "due from" accounts with little or no activity were reviewed periodically. We recommend the Bank review these relationships and eliminate or reduce balances where possible;
- o Clearinghouse Cash Letter - At the present time the Bank does not make a cash letter send to the 10:00 A.M. clearinghouse exchange. The Bank's check volumes may be significant enough, due to holdovers and early morning mail, to indicate an opportunity may exist to reduce float by making an additional send to the clearinghouse exchange. We understand this option is currently being evaluated;
- o Large Item Procedures - The Bank should ensure that large item procedures are clearly defined and understood for all funds receiving areas, by documenting the procedures and reviewing them periodically with the staff who processes these items. Additionally, the money manager should monitor areas where large items are normally received to ensure that all large items are identified, pulled and processed in time to meet key deadlines.

LOANS

The following represent opportunities for possible improvements in the area of loans (commercial and installment):

- o As of December 31, 1981, the Bank was approximately two months behind on preparing its daily commercial loan reconciliations. We recommend that the loans and their related interest be reconciled on a daily basis without exception and that an officer scrutinize and approve each reconciliation. Subsequent to year end, the Bank corrected, in varying degrees, many of the problems that plagued this process; however, we urge the Bank to devote a great deal of attention to this area until the reconciliation process is operating smoothly.
- o A formalized daily reconciliation of installment loans (principal and interest) is not being consistently prepared. Personnel within the department should be required to prepare daily a formalized reconciliation on a standardized form. Once this reconciliation is complete, a subsequent review and approval by a supervisor in the department should be performed.
- o On certain participated loans, we noted that the Bank had maturity dates on certain of the notes and corresponding participation certificates which did not correspond. The Bank should consider improving procedures in this area to ensure such dates are the same on future participated loans.

DEPOSITOR ACCOUNTS

During our examination, we noted the following with respect to depositor accounts:

- o There was no supervisory review and approval of the demand and savings accounts reconciliations. Such a review would encourage a more timely recognition of errors or unusual reconciling items.
- o Although all depositor account reconciliations are being performed timely, they only reconcile dollar amounts. The Bank should consider instituting a requirement in the reconciliation process that a reconciliation of the number of accounts be performed in addition to reconciliations of dollar amounts. This procedure will ensure that accounts are not inadvertently or purposely dropped from the system and the dollars transferred to another account.

OTHER

The following represent other areas of the Bank where improvements can occur:

- o The Bank sometimes releases loan collateral without requiring proper authorization and documentation of the released items.
- o The Bank does not always prepare reconciliations of all "due from bank" accounts on a timely basis. Procedures should be implemented to require that such accounts be reconciled on a current basis.
- o The control logs for travelers checks in both the main bank and drive-in bank were not posted up-to-date on the day of our surprise count. Also, it was noted the log had only a grand total with no denominational break down. We recommend a review of policies in this area for possible improvement.

* * * * *

Jim, we trust these operational comments will be of benefit as you continue to improve the Bank's financial controls and procedures.

Very truly yours,


C. Dean York, Martner

cc. Mr. Bill Jennings
Mr. Eldon Beller
Board of Directors



Peat, Marwick, Mitchell & Co.

Certified Public Accountants

First Oklahoma Tower
Oklahoma City, Oklahoma 73102
(405) 239-6411

May 4, 1982

CONFIDENTIAL

The Board of Directors
Penn Square Bank, N.A.
Oklahoma City, Oklahoma

Gentlemen:

Recently, we completed our examination of Penn Square Bank, N.A.'s financial statements for the year ended December 31, 1981 along with the consolidated financial statements of First Penn Corporation (collectively referred to herein as the Bank).

Because this was the first year for us to be associated with the Bank, we spent considerable time reviewing such areas as the Bank's organization, policies, procedures, information systems, internal reporting, income tax strategies, data processing, internal accounting controls, etc. The topics as outlined herein are the result of such review.

Our recommendations are designed to address the broader issues which confront management that have been brought about by the Bank's phenomenal growth over the past five years. These recommendations, if adopted, will enhance the Bank's security over its assets and depositor accounts and increase overall profitability and control of the organization as a whole. Matters which relate directly to accounting procedures and internal controls of an operational nature are covered in a separate letter to Mr. James J. Gunter, Executive Vice President of Finance. A copy of such letter will be made available to you.

After reviewing the letter, we recommend that you ask Bank management to respond to the various recommendations and indicate in writing which recommendations will be implemented and the reasons for those which are rejected, if any. Also, a time frame should be established for implementation of the recommended procedures. Periodic progress reports should be made to the Board and/or Audit Committee as to the progress the Bank is making with its implementation schedule. However, as new controls and procedures are considered, please bear in mind that organizational changes and effective systems of internal control evolve over a period of time and the cost-benefit of such changes must be evaluated by management and the Board prior to implementation.

Gentlemen, you have the overall responsibility for the financial health of the Bank and protection of its assets. We trust the recommendations herein and our involvement with your organization will be beneficial as each of you fulfill your duties as directors.

OVERVIEW

Presently the Bank is the fourth largest bank in Oklahoma City with assets in excess of \$400 million. Three years ago, assets were only \$100 million which indicates the Bank's remarkable growth in such a short time.

Typically when an institution experiences rapid growth of this magnitude, tremendous stress is placed on virtually every aspect of the Bank to keep pace, but in particular, it is difficult on personnel and support systems. Penn Square has been no different in feeling the stress of its rapid growth.

The positive results of growth are generally obvious and occur almost immediately with accelerating growth in assets, deposits and increased profits. However, there are usually negative aspects to growth if the growth is not carefully controlled. Such negative aspects are not so obvious and take longer to surface. The negative aspects to the Bank's virtually uncontrolled growth culminated in 1980 and early 1981 with a qualified audit report for 1980 and a critical bank examiners' report from the Comptroller's office in early 1981.

The more significant problem areas within the Bank which caused these reports were:

- o Inadequate asset, liability management;
- o Poor liquidity;
- o No monitoring of credit and collection;
- o Large number of loan collateral documentation deficiencies and technical violations;
- o Rising loan losses;
- o Inadequate financial management information;
- o Support systems in the commercial and energy lending area could not keep pace with the loan volume. As a result, the details of commercial loans along with accrued interest were very difficult to reconcile to the general ledger control accounts;
- o Numerous extensions of loans for both principal and interest were made with no cash payments required of the customer;
- o Many of the Bank's best loans were participated upstream to large correspondent banks which often left the lesser quality loans on the Bank's books. The Bank's loan volume at year end was between \$1.5 billion and \$2 billion, most of which had been participated with other banks;

- o Inadequate information with respect to customer balances, profitability and his total relationship with the Bank;
- o Numerous lending limit violations;
- o Large overdrafts on which fees were often waived;
- o Insufficient level of equity capital to support the Bank's growth; and
- o Inadequate internal monitoring through committees of the Board and management to set policy, follow-up and measure results.

These and other problems were only symptoms of the larger problem. Due to the Bank's unparalleled growth, there were insufficient numbers of personnel to cope with the growth and a corresponding lack of experienced senior management to direct the efforts of departmental personnel.

During the second quarter of 1981, the Bank's senior management responded to these problems by making a commitment to do whatever was necessary to correct the problems and bring the Bank's growth under control. Some of the steps taken which have been quite visible to us were:

- o Hiring of a new president who had experience in a large bank.
- o Hiring of additional senior management all with large bank experience to support the president in the areas of:
 - Loan administration, credit and collection
 - Finance
 - General legal counsel
- o Hiring of additional supervisory personnel and staff to support the new senior management as well as additional personnel to adequately support existing departments within the bank. This meant the hiring of personnel ranging from senior loan officers to file clerks.

- o The Bank's number of personnel more than doubled in a nine month period from a level of approximately 160 to a level of almost 325 by December 31, 1981.
- o Internal committees of the Board and senior management have been formed to set policy and monitor performance.
- o Some of the Bank's policies have been formalized in writing while others are in the process of being formalized.
- o Procedures manuals are in the process of being written.
- o A credit department has been established to review and evaluate loan collection and documentation.
- o Controls have been placed on the making of new loans and the extension of existing loans.
- o A process has been established for determining the necessary level of the loan loss reserve and the related monthly provision.
- o Controls over letters of credit have been established.
- o Criteria has been established for the charge off of loans and the placement of loans on a noninterest accrual status.
- o An asset, liability program has been established with the related review of liquidity.
- o Financial controls have been improved and the accounting department significantly strengthened.
- o The Bank's current and long-term financial management information needs are currently being reviewed with an action plan to make the necessary changes in a cost-effective orderly fashion.
- o The Bank's entire organization structure has been reviewed from top to bottom with consequent changes made which are in the process of being implemented.

In summary, virtually every significant area of the Bank has been reviewed and changes have either been made or are in process.

During the course of our audit of the Bank for 1981, we had an opportunity to work with virtually all of the Bank's new senior management and many of the new supervisory personnel. Without exception we have been highly impressed with their professional banking knowledge and ability to bring about change in their area of responsibility. It appears to us that the Bank has put together, in a very short time, an outstanding management team which has the skills to bring the Bank's growth under control. But more importantly, they have the talent to take advantage of the growth the Bank has achieved to date by strengthening the existing asset base and use it to develop a long-term program of controlled growth and profits. The positive changes which have occurred in less than one year have been truly remarkable and impressive.

As mentioned in the first part of this letter our remaining comments and recommendations are designed to help the Bank bring about further change and/or to encourage the changes which are already underway. Such comments and recommendations should also help the Bank further formalize and structure its program for changes and improvement in the Bank's operations and performance.

These comments have been reviewed with senior management to ensure that factual content is correct. In the process of such review, it was gratifying to note there were few comments which we had that management had not previously considered or was in the process of reviewing. In short, there were no surprises of significance.

PLANNING FOR CONTROLLED GROWTH AND PROFITSGoal Setting and Long Range Planning

One of the characteristics of a high performance bank is having clearly defined goals and objectives for growth and profits with the necessary short and long range plans for achievement of such goals.

As the Bank considers a variety of changes throughout the organization, we recommend that the Board of Directors and senior management consider the need to formalize the Bank's goals and objectives with the related short and long range plans for achievement. Also, in conjunction with such strategies, the Bank should consider establishing budgetary controls over all general ledger accounts and cost centers for certain departments of the Bank.

Establishment of a formal planning process and budgetary controls will provide the Bank with multiple benefits and allow the following to occur:

- o Penetrating questions are asked by both members of the Board and senior management as to what the organization is now and where would they like for it to be in the future.
- o Careful analysis is made of the organization's strengths and weaknesses.
- o Realistic and measurable goals and objectives are set with a plan for periodic monitoring and reporting to the Board on the Bank's progress.
- o Management develops a short and long range strategy for the achievement of its goals.
- o Reward systems are reviewed and often revised to encourage the achievement of established individual and departmental goals.

There is no question that organizations perform better when they have a clear understanding as to where they are going and a well developed plan to get there as opposed to organizations which just operate from day-to-day and let the future take its course.

While we recognize the Bank has begun to address the area of long range planning and budgetary control, we urge you to continue the progress on perhaps a more formalized basis. By doing so, we believe it will be easier to treat longer range organizational problems on an overall basis rather than by the traditional piecemeal approach.

Organizational Structure

Recently, the Bank's organizational structure was revised for the effect of new additions of senior and intermediate levels of management personnel which was mentioned earlier. As a result, new positions and even new departments have been created.

While the organizational changes are still in an evolutionary state, we urge that senior management and the Board continue to review the organizational structure and personnel positions and ask yourselves "is it right now and for the future, or does it need revision?"

After reviewing the new organization chart which is currently in the process of implementation, there is only one recommendation we wish to make.

The Oil and Gas Division is quite large and has several key personnel reporting to the Senior Executive Vice President in charge of the department. Because of the relatively large span of control which now exists, the variety of tasks performed within the department and the particular talents of the department head, we recommend that the organization of this key department continue to be reviewed. The review should be made from the standpoint of continuing to improve the administration of the day-to-day activities of the department and yet capitalize on the strengths of the department head and his relationships with key loan customers and upstream correspondents. For him to maintain these relationships and effectively administer the department may be unrealistic as the Bank continues to grow.

Policies and Procedures

Guidelines for the operation of a bank or any organization are generally set through policies established by the board of directors and senior management. Specific procedures are then designed by management and staff to implement the various policies. In some organizations, policies and procedures are informal and most often communicated orally or through internal memos. However, as an organization grows in terms of volume of business and number of personnel, such informal means of communicating important operational matters becomes less and less efficient and effective.

The above described method has been the way in which the Bank has operated with respect to the setting of policies and implementation of related procedures. However, with the Bank's rapid growth, principally in the past three years, it is becoming more necessary to formalize old policies and establish new ones along with the necessary procedures to carry out the various policies.

At the present time, the Bank has under its employment a systems group which is responsible for reducing to writing all policies and procedures which govern operations in various areas of the Bank. This is, indeed, a positive effort, for approximately a year ago the Bank had practically no manuals in any areas. As the Bank continues to complete the various manuals for each area of the Bank, we urge you to consider the following:

- o As the systems personnel go into an area to formalize the policies and procedures in writing, an officer from that area should be assigned to work closely with this group. This will allow individual areas of the Bank to lend valuable input to the systems group during the formulation of that area's policies and procedures.
- o When the policies and procedures have been written in a certain area, management should consider having the internal audit department perform a detailed review of the policies and procedures of that area before presentation to the Board for their approval. This will help ensure that the policies and procedures provide for proper controls in each area.
- o As procedures are being developed, management should strive to design them to be functionally oriented rather than written for an individual's duties. This approach will provide more flexibility as the Bank continues to grow.

Completion of the policies and procedures manuals in each area of the Bank and required compliance with them by all bank personnel will allow the Bank's operations to flow more smoothly and provide the Bank with stronger controls in each

Profitability

In the past, the Bank has not established formalized performance goals such as:

- o return on average assets,
- o return on equity capital,
- o ratio of capital to assets,
- o earning assets as a percentage of total assets,
- o ratio of loans to deposits,
- o interest spread,
- o liquidity ratio,
- o etc.

With today's volatile interest rates and inflationary pressures which the Bank must operate within, the establishment of such measurable performance goals becomes a necessity in order to monitor and control the Bank's growth.

When establishing these goals, management must recognize that profitability levels of the Bank should be higher than most banks of similar asset size primarily due to the large loan portfolio which the Bank is currently servicing for correspondent banks and the related fee income generated therefrom.

Although the Bank has performed work in some of these areas, we encourage further development of matters such as the following:

- o Review the pricing of all products and services.
- o Determine the actual profitability of the Bank's large customer relationships.
- o Consider revising Bank policy with respect to service charges for overdrafts and NSF items. It appears to us that some customers have taken advantage of the Bank in this area.

- o Determine the direction of the Bank's trust department. Our limited analysis indicates that it will continue to be a loss center for some time.
- o Establish an overall goal of maintaining an average of a percentage of total assets (say 90%) in earning assets. This is especially important since the realization of the Bank's earning potential is dependent upon the effective management of its assets.
- o As the Bank considers improved operational efficiencies throughout the Bank, there are a number of ways in which improved workflow and controls can be achieved in the processing of items. Specific suggestions have been made in our letter to Mr. Gunter.

REPORTING AND MONITORING SYSTEMS

Internal Monitoring Reports

As described in the diagram at Appendix A, the "control environment" of the Bank in its simplest form consists of the Board and senior management setting policies, goals and objectives for the organization with the related monitoring and reporting systems established to monitor adherence to policies and measurement of performance.

Naturally, for proper monitoring to occur, the Bank must have a good information system to meet the needs of the various levels of management and a well organized and managed internal audit department to review and test adherence to policies and procedures and report exceptions noted to the Board and senior management.

At the present time the Bank, aided by the consulting division of our firm, is determining whether it is receiving the necessary reports to adequately monitor the operations of the Bank. This is a vital question facing the Bank, which should receive a high priority until the management information needs of the Bank have been determined and an action plan agreed upon as to how such needs will be met.

Completion of this project will allow the Bank to determine the following:

- o Determine what information is necessary which will allow management to properly monitor bank operations.
- o Once this is determined and cost estimates are developed, the Bank can decide whether it needs to establish a data processing function within the Bank, leave it at Fidelity Bank as a service bureau operation or a combination of the two.
- o The Bank will then be able to formulate alternatives and ultimately establish the necessary system along with related data processing equipment which will benefit the Bank in the short and long run on a cost-effective basis.

Reports to the Board of Directors

Although you as Board members are receiving various financial reports at the monthly meetings, we believe that the presentation of additional financial information would be beneficial. We recommend the following as improvements in this area:

- o The Board has been seeing financial information for only the Bank. We recommend that the Board also receive consolidated financial statements of First Penn Corporation. Such information represents the true financial picture of your financial institution as a whole and presents the only meaningful financial results from a stockholder point of view.

- o A presentation of asset yield and cost of money trends over a period of time should be presented to help you monitor the actual "spread" made by the Bank on its interest margin. A proper management of this spread has a direct impact on the Bank's profit objectives.
- o After management establishes a budgetary system, they will be able to present to you a comparison of actual financial results compared with the corresponding budgeted data on a monthly basis. Such a report should also contain explanations of material variances between budgeted and actual information.
- o The loan administration area of the Bank presently prepares an excellent "problem loan list" and a related calculation of the necessary loan loss reserve. We believe this information will be an excellent addition to your board reports and should be presented to you on at least a quarterly basis. Because the level of the Bank's reserve for loan losses has a direct impact on earnings, you should be familiar with the rationale as to how the level of the reserve is determined at any point in time.
- o Many times the presentation of financial information in the form of illustrated graphs is beneficial to the readers of such information. This provides the preparer of information an opportunity to provide the reader a view of asset, income and expense, yields and cost of money trends over an extended period of time in a clearer but much less detailed presentation. Virtually all the measurement goals which the Board establishes can be reported effectively through the use of various types of charts and graphs. We encourage the use of such presentation due to the trends which are highlighted and the time savings achieved when having to present and read a large variety of financial data.

Increasing Internal Audit Effectiveness

The Internal Audit Department is an important and integral part of the monitoring process. They serve as your "eyes and ears" to determine how well the rest of the Bank is following established policies and procedures.

For any internal audit function to be effective, it must have direct and visible support from the Board in order for them to have the proper stature within the organization. Their reports to the Board should receive due consideration and significant exceptions reported should be appropriately dealt with in a decisive and timely manner. The audit department also requires input and direction of the Board with respect to their annual audit program, areas which require emphasis or special projects in areas where the Board requires more information. At the same time, the audit department should be accountable to the Board for their budget of time and money to operate the department versus amounts actually spent.

The Bank has an active internal audit department of six persons. To improve their effectiveness, we recommend the following:

- o The development of a complete internal audit program which spans the entire year and is approved annually by the Board's audit committee. Such a program should relate audit risk to time spent and be comprehensive enough to cover all significant areas of the Bank. Presently, we are making arrangements with personnel of this department to assist in the development of such a program.
- o The stature and authority of the department within the Bank is unclear among some of the Bank's officers and staff. The Board should consider instructing its senior management to convey to all personnel the importance of the internal audit function within the Bank and the cooperation they are expected to receive.
- o Development of an adequate working knowledge of EDP functions, especially if processing is established "in house", could prove to be extremely beneficial to the department. The use of audit software programs will allow the auditors to be more efficient and effective in the work they perform.

LOAN ADMINISTRATIONLoan Review Function

In 1981, the Bank established a much needed loan review function which consists of a grading system for all loans to be used to determine the necessary reserve for loan losses at the end of each quarter. A controlled expansion of this function will allow the Bank to challenge its reserve for adequacy on a regular basis, which is an admirable trait of any bank. This is an extremely positive step for the Bank, and we urge you to take full advantage of your capable staff in this area.

Loan Documentation

As was pointed out in recent regulatory examinations of the Bank, documentation of loans and their related collateral has been less than adequate in the past. During the latter part of 1981, the Bank showed a marked improvement with respect to loan documentation and will apparently continue to improve due primarily to the perseverance of senior management to correct existing problems and reduce future errors through the hiring of an excellent staff to monitor this area. This is a critical area for any bank but especially your bank, due to the expanding nature of your loan operations. Therefore, we believe it merits your utmost attention until all problems are corrected.

Correspondent Banking

During 1981, the Bank was involved in certain practices with respect to loans participated upstream to other banks which we consider questionable. The most significant of these involves the practice of making periodic payments of both principal and interest to the correspondent banks without first receiving payments from the borrowers. The Bank is not required to do this according to the written participation agreements, but apparently the Correspondent Banking division has orally agreed to do this with some banks.

This practice is not desirable for the following reasons:

- o It causes a continual increase in the Bank's accrued interest receivable (a non-earning asset) which reduces the potential earnings of the Bank.
- o It also causes an unplanned strain on the Bank's liquidity since cash is paid out before cash is received from the borrowers.
- o When these transactions occur, an extension of credit has been made to the borrower without official approval.

In our opinion, discontinuance of this practice is imperative to the Bank. If it remains necessary to continue on certain occasions, it should require documented approval by the credit policy committee or executive management.

Other

During our examination, we observed other practices in the area of loans which we believe merit your attention and possible improvement:

- o As of December 31, 1981, the Bank was approximately two months behind on preparing its daily loan reconciliations. We recommend that the loans and their related interest be reconciled on a daily basis without exception and that an officer scrutinize and approve each reconciliation. Subsequent to year end, the Bank corrected, in varying degrees, many of the problems that plagued this process; however, we urge the Bank to devote a great deal of attention to this area until the reconciliation process is operating smoothly.

- o We noted instances where loan officers have extended loans, some as many as 15 times, without requiring a principal reduction and many times without requiring the payment of the accrued interest. In addition, we noted several cases when interest is not paid, the accrued interest is not added to the principal of the new loan. As a result, interest income is being lost when these situations occur. Additionally, the effects of this practice resulted in a situation at December 31, 1981 where there was approximately five months of interest income for the year which had not been collected compared to three months at December 31, 1980. The effect on the Bank is a strain on cash flow and an increase in non-earning assets. We recommend the Bank establish a policy of requiring interest to be paid when due and exceptions to this policy only approved by the Bank's chairman, president or Board. If the interest payment is extended, it should be added to the principal of the note.

- o Subsequent to December 31, 1981, we observed a continual increase in customer overdrafts. Some of the overdrafts resulted in the Bank violating its legal lending limit to certain of these customers. We believe the Bank should make concentrated efforts to not allow these violations to occur in the future. Also, management should consider working with customers in an effort to reduce the amounts involved in these overdrafts, especially since customers are often not charged for their overdrafts. To also ease the problem in the overdraft area, we recommend that the Bank's loan officers not make loans until funds are available for such loans.

- o It came to our attention during our examination that loan officers occasionally instruct their secretaries to prepare and sign official documents such as official checks and loan instruments in their absence. In most cases, such persons have no authority to perform such a task. We recommend, if the loan officers are unable to be in the Bank, they should arrange for other officers to perform these tasks in their absence.

TRAINING

As discussed earlier herein, the Bank's number of personnel have more than doubled in the past year. Such an increase was necessary to adequately staff the Bank in order to handle its growth to date as well as future growth and changes which will occur. When the Bank assimilates such a large number of personnel in such a short time, little time is available to properly train new personnel in the Bank's policies, procedures, practices and philosophy of operation.

Presently, the Bank has slowed its hiring to a more normal pace. Now is a good time to review the Bank's need to establish a formal internal training program. Establishment of such a program will allow the following to happen:

- o All personnel can be instructed in an orderly manner regarding recent changes which have taken place with respect to policies, procedures and organizational changes. An excellent training program can serve to communicate the Board's and senior management's views on a variety of matters.
- o The Bank will have a vehicle whereby once an employee is hired, he can be taken through a new-employee orientation program and adequately trained to perform his job early in his employment, thereby helping to avoid unnecessary and costly errors.
- o The Bank can also begin a program of cross-training for all positions in the Bank. This will provide adequate backup to ensure that during periods of vacation or illness, an employee's daily tasks and routines are adequately performed by another employee in the Bank.

OTHER MATTERSAdministrative Agreement

As you are well aware, the Bank has been operating under an administrative agreement with the Comptroller of the Currency throughout most of 1981. Primarily, during the later part of 1981, management of the Bank has made great strides in correcting or improving practically all of the areas addressed in this agreement. Management is to be commended for their efforts and progress to correct a serious situation in such a short period of time.

Centralized Purchasing

During this period of rapid growth, the Bank has lacked control over its purchasing function. It appears that several departments have purchased fixed assets, such as minicomputers, cars, artwork, etc. without approval of the purchasing officer.

Recently, controls in the purchasing area have been significantly strengthened. The Bank now requires that all purchasing be performed or approved by the purchasing department. These new controls are a must before previously mentioned budgetary controls can be effective.

IMPLEMENTATION OF RECOMMENDATIONS

As you consider the comments and recommendations made herein, please remember that responsibility for having effective internal controls and sound operating procedures within the Bank ultimately rests with each of you as Directors. In preparing to implement some or all of the recommendations, the following should be considered:

- o Preparation of a formal response to this letter for the Board by management of the Bank;
- o Preparation of a plan for implementation on a priority basis with definite timetables established;
- o Identification of matters which can be performed by the Bank and those which will require outside assistance;
- o Reporting periodically to the Board the progress made regarding the implementation schedule; and
- o Consideration of the concept of cost versus benefit as decisions are made regarding controls and procedures to be installed.

* * * * *

Our examination of the Bank's financial statements is based on tests of data supporting financial transactions and as such, you will appreciate that our examination will not necessarily disclose the existence of irregularities, if any. The ultimate assurance as to the safeguarding of assets and reliability of the financial records and information is dependent upon an effective system of internal controls, good management and the application of proper accounting principles and procedures. We trust that the recommendations made herein will serve to strengthen and enhance such controls in your efforts to meet your underlying managerial responsibilities.

Normally, the transition to a new accounting firm can be quite time consuming and sometimes rather frustrating for certain of the Bank's personnel. However, we trust that the benefits of our first audit will outweigh any of the negative aspects and that on the whole, you will find it to have been a worthwhile experience. We have certainly enjoyed this first year in working with you and Bank management and look forward to a lasting relationship in serving Penn Square Bank and its related entities.

Should you have any questions concerning the matters discussed in this letter, we shall be pleased to discuss them with you at your convenience.

Very truly yours,

Rest, Marwick, Mitchell & Co.



Peat, Marwick, Mitchell & Co.

Certified Public Accountants

345 Park Avenue
New York, New York 10154
(212) 758-9700

Office of General Counsel

October 8, 1982

The Hon. Fernand J. St Germain
Chairman
Committee on Banking, Finance and
Urban Affairs
U.S. House of Representatives
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

Peat, Marwick, Mitchell & Co. ("PMM&Co.") submits this letter to clarify and to amplify its testimony during the hearing on Penn Square Bank, N.A. ("Penn Square") before your Committee on August 16. On behalf of the Firm, I request the permission of the Committee to supplement the record of that hearing.

During the hearing on August 16, PMM&Co.'s witnesses respectfully declined to discuss, on the grounds of client confidentiality, the services performed by PMM&Co.'s Oklahoma City office for The Chase Manhattan Bank, N.A. ("Chase") with respect to loan participations Chase purchased from Penn Square. The witnesses faced a dilemma. They had appeared pursuant to a subpoena which, in PMM&Co.'s view, extended to services performed for Penn Square, but not to services performed for any other client of the Firm. With respect to services performed independently for and at the request of another client, i.e., Chase, PMM&Co. was bound by a professional code of ethics not to disclose the services or the resulting communications.

PMM&Co.'s predicament, of course, could be resolved by Chase's consent. As Mr. Blanton then stated, PMM&Co. would be pleased to provide this information to the Committee under such circumstances. Subsequently PMM&Co. requested and received permission from Chase for PMM&Co. to set forth its views as to the request it received, the services performed and the resulting communications with Chase.

As you, Mr. Chairman, noted during the hearing, the assertion of client confidentiality could result, and did result, in false accusations and misinformation being circulated in the media. We believe the disclosure, with the client's permission, of the facts relating to the services performed for Chase amply demonstrates the propriety of PMM&Co.'s conduct.

PMM&Co.'s New York office, for many years, has served as Chase's independent certified public accountants. In late October, before Penn Square had approached PMM&Co. to accept the engagement as Penn Square's auditors, Chase requested advice from our New York office on procedures Chase might employ with respect to its loan participations from Penn Square. PMM&Co.'s New York office recommended that Chase engage Penn Square's auditors, with Penn Square's permission, to conduct the anticipated procedures. Arthur Young & Company had been, and was then assumed to be continuing as, Penn Square's auditors. Such a recommendation and course of action is not uncommon in the case of loan participations.

Later, when Chase determined to proceed, Penn Square had engaged PMM&Co.'s Oklahoma City office to conduct its audit examination as of and for the year ended December 31, 1981. Thus, in early February 1982, Chase's request was made to PMM&Co. personnel in New York who in turn discussed it with PMM&Co.'s Oklahoma City office. Attached as Exhibit A is a copy of a memorandum dated February 10, 1982 outlining Chase's request. As expressly set forth in the memorandum, Chase was to forward a letter of understanding to Penn Square once the scope of the assignment was determined.

PMM&Co. personnel in New York and Oklahoma City discussed the work to be undertaken and then PMM&Co. New York personnel reviewed the scope of the assignment with Chase. Once PMM&Co. and Chase agreed upon the specific procedures, Chase on April 8, 1982 wrote to Mr. Bill P. Jennings, Chairman and Chief Executive Officer of Penn Square, requesting Penn Square's approval. Following the approval of Penn Square senior management -- confirmed orally to PMM&Co. by Eldon Beller, President and Chief Administrative Officer and James Gunter, Chief Financial Officer -- PMM&Co. began its work.

By letter dated May 21, 1982, PMM&Co.'s Oklahoma City office forwarded a draft of the expected report, dated May 5, 1982, to PMM&Co.'s New York office. PMM&Co.'s New York office

subsequently provided a draft to Chase for purposes of review and discussion, and determination as to whether further procedures were appropriate. The letter and draft report appear as Exhibit B hereto. With the press of other matters, the report was never completed nor any additional procedures performed.

As is evident, there was nothing improper in these procedures. It is not uncommon for one financial institution to approve the conduct of special procedures by its auditors for a second institution when the first is servicing loans for the other. Moreover, as the draft report indicates, these limited, special procedures did not disclose significant discrepancies or weaknesses. The proposed findings of the draft report were not inconsistent with the information available at the time of the PMM&Co. report on Penn Square's financial statements.

We believe this information will clarify the testimony presented on August 16 and will resolve the questions raised concerning the services Peat, Marwick, Mitchell & Co. performed for Chase with respect to the Penn Square loan participations.

Respectfully yours,



Edwin D. Scott
Assistant General Counsel

EDS:bw
Attachments



Peat, Marwick, Mitchell & Co

To: Mr. C. D. York
 Office: Oklahoma City

From: J. S. Zwaik
 Office: New York

Date: February 10, 1982
 Steno: rms

Enc:
 cc:

Subject: Performance of Agreed-upon Procedures at Request of Chase
 Manhattan Bank

Pursuant to our telephone conversation of February 9, the purpose of this memorandum is to outline certain procedures which you are being asked to perform on behalf of The Chase Manhattan Bank. These procedures pertain to certain commercial loans (primarily production payment loans) in which Chase is participating with Penn Square (generally 90%-99% Chase share). These loans were originated by Penn Square, who continues to service them. Currently, Chase has approximately 150 such loans totaling approximately \$230 million.

Based upon discussions I have held with Chase personnel, they are requesting the following procedures to be performed:

- o review of Penn Square's credit granting policies and procedures
- o review of Penn Square's credit monitoring (subsequent to credit extension) policies and procedures
- o review of Penn Square's procedures for the servicing of loans (including, but not limited to, collection of payments from borrowers and forwarding appropriate amounts to Chase)
- o confirmation of 25% of the number of loans Chase is participating with Penn Square (confirmation with both borrowers and any other participants). Selection to be on a random basis.
- o review of credit files for all Chase participation loans over \$5 million, plus 15 such loans under \$5 million, randomly selected.

EXHIBIT A

Based upon the above, could you please prepare and forward to me the following:

- o proposed draft report
- o detail procedures to be performed
- o fee estimate

Based on the procedures, etc., Chase personnel will prepare a letter of understanding to be sent to Penn Square.

In addition, as we discussed, since Chase says that they will pay for these procedures (Chase will address the question of passing the cost to Penn Square with them at a later date), you should charge your time and expenses to New York contract #176-07545-77.

I appreciate very much your cooperation in this matter. If you have any questions, please call me at (212) 552-2873 (or 2874).



Peat, Marwick, Mitchell & Co.

First Oklahoma Tower
Oklahoma City, Oklahoma 73102
(405) 239-4411

May 21, 1982

Joseph Chu
Peat, Marwick, Mitchell & Co.
345 Park Avenue
New York, NY 10154

Dear Mr. Chu:

Enclosed is a draft of our special report performed for Chase Manhattan Bank on Penn Square Bank, N.A. Please note any changes you wish to make and provide me with the proper heading of our report and return to me as soon as possible.

Sincerely,

PEAT, MARWICK, MITCHELL & CO.

Kim W. Shoemaker, Supervising Senior

KWS/dlh

EXHIBIT B

CREDIT GRANTING PROCEDURES

Robert L. Denner, Vice-President
Chase Manhattan Bank, N.A.
One Chase Manhattan Plaza
New York, New York 10015

Dear Mr. Denner:

As you requested, we have performed certain agreed procedures on behalf of Chase Manhattan Bank (Chase) on certain loans and records of Penn Square Bank, N.A. (Penn Square). These procedures are in accordance with our audit program (Exhibit B) which was attached to the authorization letter from Chase to Mr. Bill P. Jennings, Chairman of the Board, Penn Square Bank, N.A. Our resulting findings were as follows:

Credit Granting

We discussed credit granting policies with Mr. John Baldwin, Senior Vice President, who informed us at the present time any lending officer in the Bank has authority to make a loan, if such loan does not cause the borrower's total indebtedness to exceed \$50,000. If such a loan does cause total indebtedness to exceed \$50,000, the loan is then approved by either the Bank's credit policy committee, or the Bank's president or Chairman. We performed an inspection of the loan documents on a test basis to determine whether all new notes which caused total indebtedness to exceed \$50,000 were so approved and discovered no discrepancies from this policy. The Bank has plans in the near future to establish individual lending limits for each officer rather than the \$50,000 limit for all officers.

Credit Monitoring

During 1981 the Bank established a strong loan review function. It is presently a joint responsibility of the loan review department and each individual loan officer to monitor the financial condition of their customers. The loan review department performs this task by reviewing past due reports and overdraft lists, performing periodic collectibility reviews and maintaining a problem loan list. We performed various tests and reviews to ensure the completeness of this work and discovered no discrepancies. In addition, the loan review department reviews all new loans within 90 days of the issuance date to ensure performance as agreed on in the loan documents. The individual loan officers are responsible for maintaining contact with each customer in an effort to determine their business needs and possibly detect potential problems with a loan when they first occur.

Loan Servicing

We discussed with Bank officials the policies regarding servicing of the loans participated with Chase and learned there are two types of payments to Chase. The first type is simply when a customer makes a payment and Penn Square wires Chase its pro-rata share. The Bank has adequate controls over this function. The second type of payment to Chase occurs when Penn Square wires Chase money from its own funds to meet the requirements of the note even though the borrower has failed to meet these requirements. This procedure occurred quite frequently in 1981, due to the lack of a policy to govern it. In 1982 a new policy was established which requires the approval of Penn Square's credit policy committee and therefore, due to these stringent controls, this situation is occurring less frequently.

Confirmations

We randomly selected 25% of the total number of loans in which Chase is participating with Penn Square for direct confirmation with the borrower as of March 31, 1982. This resulted in 38 confirmations mailed and 36 being returned to us with no exceptions. We performed alternative procedures to ensure validity of the notes on those borrowers not responding.

Loan Document Inspection and Payment History

We randomly selected 25 loans participated to Chase and inspected the loan files for the following required documentation:

- o executed loan document
- o signed note
- o collateral properly perfected
- o appraisals when appropriate
- o engineering reports, including a documented review by Penn Square's engineers, when appropriate
- o insurance coverage with Penn Square named as loss payee, when appropriate
- o current financial information
- o properly executed extensions, when applicable

We discovered three minor exceptions which the Bank is in the process of correcting.

Also, on these 25 loans we performed a payment history test which consisted of:

- o Determining whether loan payments are made when due.
- o Determining whether a loan is current or past due and that such status is reflected in Penn Square's internal reports.

- o Determining the number of times, if any, the loan has been extended.
- o Determining the borrower is making his required payments or if Penn Square is making them on behalf of the borrower to Chase (see information under loan servicing).

We discovered no significant exceptions in this area.

Collectibility Review

We performed a credit file review for collectibility on all loans in which the portion Chase owned, equaled or exceeded \$5,000,000. Also, we performed such a review on 15 additional loans selected at random in which Chase participated in an amount less than \$5,000,000. See Exhibit A for a detail list of loans reviewed and their related classification.

* * * * *

Because these procedures do not constitute an examination in accordance with generally accepted auditing standards, we express no opinion on the financial statements of Penn Square. In connection with the procedures referred to above, no significant discrepancies or weaknesses were discovered. Had we performed additional procedures or had we made an examination of the financial statements in accordance with generally accepted auditing standards, other matters might have come to our attention that would have been reported to you. It is understood that this report is for the exclusive information of Chase Manhattan Bank and is not to be distributed to others for any purpose.

May 5, 1982

Exhibit AName of BorrowerClassification

NAMES OF INDIVIDUAL
 BORROWERS DELETED FROM
 THIS COPY.

Good
 Good
 Good
 OLEM
 Good
 Good
 Good
 OLEM
 OLEM
 Good
 OLEM
 OLEM
 Substandard
 Substandard
 Good
 Doubtful
 Substandard
 OLEM
 Good
 OLEM
 OLEM
 Substandard

DRAFT FOR FRASER USE ONLY

PMWACD.

Examination of Agreed on Procedures for Chase Manhattan BankCompany Penn Square Bank, N.A.Period ended 1-31-82

Item No.	Auditing Procedure	Period and Extent	Done By
	<p>Objectives:</p> <p>The objective of the following audit tests is to determine whether or not that Penn Square Bank is following its own policies and those of prudent banking with respect to the loans they have participated to Chase Manhattan Bank of New York. A special report in accordance with SAS #14 will be prepared which covers our finding after applying the below agreed upon procedures.</p> <ol style="list-style-type: none"> 1. Review existing policies and procedures regarding Penn Square Bank's credit granting policies. Discuss all pertinent data with appropriate personnel and prepare a memo documenting our findings. 2. Perform the same procedures as mentioned in #1 regarding credit monitoring. 3. Prepare a memo regarding the servicing of Penn Square Bank's loans which are participated to Chase Manhattan Bank. 4. Randomly select 25 loans participated to Chase and perform the following: <ol style="list-style-type: none"> (A) Review and analyze loan document file to determine if such documents are complete with data such as: <ul style="list-style-type: none"> o Executed loan document o Currently signed notes o Collateral properly perfected o Appraisals obtained where appropriate o Engineering reports obtained and reviewed by the Bank's engineers where appropriate. o Insurance coverage obtained with the Bank named as loss payable payee where appropriate o Current financial statements o If loan extensions for principal and/or interest exist, determine they have been properly executed. (B) In reviewing the loan documentation, compliance test the Bank's adherence to the policies noted in steps 1, 2 and 3 above. (C) On the loans selected, perform a payment history test of the loan or credit line tracking such information as: <ul style="list-style-type: none"> o Are payments made when due for principal and interest? o Determine if loan is current or past due and that such status is reflected on the Bank's internal reports. o Determine number of times the loan has been extended for principal and/or interest. o Determine if customer is making the principal and interest payments or if the Bank is making them in the customer's behalf to Chase. (D) If significant exceptions are found in this test, call Jan Dwaik in New York for guidance as to how we should proceed. 		

PMM&CO.

Elimination of Agreed on Procedures for Chase Manhattan Bank
 Company Penn Square Bank, N.A. Period ended 3-31-82

Item No.	Auditing Procedure	Period and Extent	Done By
5.	On a random basis as of a random date, select 25% of the total number of loans in which Chase is participating with Penn Square and confirm directly with borrowers via positive confirmations. Such loans were previously confirmed as of December 31, 1981 and all exceptions were cleared to our satisfaction. The loans selected in (4) above should be included in the test.		
6.	Send second requests as necessary.		
7.	Clear all exceptions to our satisfaction.		
8.	Review for collectibility all loans which Chase has a participation equal to or greater than \$5,000,000 plus fifteen other loans less than \$5,000,000 selected at random. Include all loans classified other than "good" in the report to Chase.		
9.	Draft the report noting all procedures performed and any errors or weaknesses noted during our work. Such report will be prepared in conformity with SAS #14.		

The CHAIRMAN. At this time, the Chair would call Mr. Harold Russell, managing partner of Arthur Young & Co.

Mr. BARNARD. Mr. Chairman, might I ask a procedural question? Because of the essence of time, might it not be possible to question some of the witnesses whose testimony would be a lot more pertinent today?

The CHAIRMAN. I assure the gentlemen we will complete the witness list today.

Mr. BARNARD. We are going to complete it today?

The CHAIRMAN. Yes, sir.

Mr. BARNARD. Thank you. You are not going to complete it today; you might complete it tonight or in the morning.

The CHAIRMAN. As the gentleman knows, we from Rhode Island feel that all hours are daytime hours. The way you enjoy life, it is a wonderful thing, and being in Oklahoma City is such a wonderful pleasure—

Mr. BARNARD. You are enjoying this? [Laughter.]

The CHAIRMAN. I enjoy being with these wonderful people and with you and Jim, and the rest. [Laughter.] [Witness sworn.]

TESTIMONY OF HAROLD RUSSELL, ARTHUR YOUNG & CO.

The CHAIRMAN. Mr. Russell, you are the gentleman with Arthur Young & Co. who was the predecessor firm to Peat, Marwick, Mitchell & Co., doing the auditing at Penn Square Bank?

Mr. RUSSELL. Yes, I am.

The CHAIRMAN. For how long a period of time were you auditing Penn Square?

Mr. RUSSELL. We began to audit the bank in 1976. We examined the balance sheets for 3 years, and then on the formation of the holding company in 1979. We reported on the holding company in 1979 and 1980.

The CHAIRMAN. In addition to the bank—

Mr. RUSSELL. We reported only on the holding company in 1979.

The CHAIRMAN. Would you be good enough to describe for us the reasons given to you by the people at Penn Square when they informed you that they had no further need for your services?

Mr. RUSSELL. We really weren't given a reason; we simply were sent a letter saying that—I think the term was executive management had decided to make a change.

The CHAIRMAN. Were you here this morning when the question was asked of Mr. Beller as to this change, and among the reasons were that he could not get any return phone calls from the people at Arthur Young & Co.?

Mr. RUSSELL. I think he said Mr. Gunter complained of that. Yes, I was here. There was a period for about a week when the individual who was responsible for the day-to-day work was ill, and there was some difficulty in getting a hold of him.

The CHAIRMAN. Were the people at Penn Square informed of the fact that that gentleman was ill?

Mr. RUSSELL. It was a woman, but yes, they were. And in fact, I think she called them from home.

The CHAIRMAN. Now, your 1980 audit, I think everybody is aware of the fact, at this point had a qualifying statement. Do you feel as

though this necessarily placed doubt on the adequacy of the loan loss reserves?

Mr. RUSSELL. In the 1980 accounts?

The CHAIRMAN. Yes.

Mr. RUSSELL. Yes. With respect to 1980. Of course, that is exactly what we were qualifying for, and we said that we had a scope qualification which is a highly unusual thing, particularly in a financial institution. And particularly, when it goes to the reserve to loan losses, as ours does.

We simply indicated that the supporting documentation which was inadequate was so inadequate that we could not make the determination as to whether it was adequate or not adequate.

The CHAIRMAN. In 1979, you performed an extensive examination of the oil and gas loans of Penn Square.

Mr. RUSSELL. Yes.

The CHAIRMAN. And my information is that you found that they were in pretty good condition?

Mr. RUSSELL. In 1979, they were in excellent condition.

The CHAIRMAN. In 1980, you analyzed the loans that were criticized by the Comptroller's examiners. Did you find the Comptroller's people to be evenly balanced in their approach, or in your opinion, what was the attitude of the bank officials about those classifications?

Mr. RUSSELL. That is two questions. Yes, certainly in 1980, at the end of the year, the Comptroller really had what I would call their A team examining the bank.

The CHAIRMAN. Their best?

Mr. RUSSELL. Some of the best people that they had because they brought in people from the Dallas office, the Houston office and other offices. So I think in answer to that question, they had excellent people reviewing the accounts of the bank at the end of 1980. And I have forgotten your second question.

The CHAIRMAN. As you know, that team did, indeed, classify a number of those loans energy loans.

Mr. RUSSELL. Yes, they did.

The CHAIRMAN. Do you think that the people—that the A team was overly harsh in their classifications of those loans?

Mr. RUSSELL. Well, the bank suggested to officials that they were overly harsh. We reviewed those classifications and we agreed with the classifications of the Comptroller, or those examiners.

The CHAIRMAN. Mr. Leach?

Mr. LEACH. Let me say that in retrospect, it is quite clear that seldom has a caveat served an auditing company so well. [Laughter.]

Mr. RUSSELL. But it is not simply a caveat.

Mr. LEACH. I asked the gentleman from Peat, Marwick how common a practice it was to have a qualification in a bank audit, and he said it was not highly unusual. You have just stated that it is highly unusual to have a scope qualification. Could you elaborate on that?

Mr. RUSSELL. Well, I don't know how I could elaborate other than expressing my opinion that when you have a scope qualification that says there is inadequate documentation that goes to the re-

serve loan losses. I doubt very much if you will find very many of those kinds of qualifications in a bank or any financial institution.

Mr. LEACH. Out of 1,000 banks that are audited by principal auditing companies in America, how many will have scope of qualifications?

Mr. RUSSELL. That run to the loan loss reserve? I would guess—and these are hypothetical type questions—but I would guess, I would be surprised if it exceeded five.

Mr. LEACH. Five out of 1,000 would qualify as a highly unusual condition.

I was intrigued to read your letter of contract with the bank dated January 6, 1981, in which you stated, and I will just quote, "In conducting our examination, we became aware of the possibility that illegal acts may have occurred that may have a material effect on the financial statements." Is that standard contractual language?

Mr. RUSSELL. That is standard.

Mr. LEACH. That is not an unusual aspect?

Mr. RUSSELL. No.

Mr. LEACH. In your judgment, were there illegal acts that occurred?

Mr. RUSSELL. Almost in any bank situation there will be some violation, some technical violations, which would be characterized as illegal acts.

Mr. LEACH. Were you saying that your scope qualification indicated that the possibility of illegal acts was high or low?

Mr. RUSSELL. No. Our scope qualification goes to the inadequacy of the documentation of the loan loss ratios. We are saying that the loan files themselves were inadequate, the documentation, so we could not make a decision.

Mr. LEACH. I appreciate that and would yield briefly to the chairman.

The CHAIRMAN. I thank the gentleman for yielding. Now, you said that paragraph on illegal acts is standard, and in many institutions you will find some violations, and we are aware of that. But let's talk about Penn Square.

You just told us that in about 5 out of 1,000 cases you would have a scope qualification such as was contained in your report?

Mr. RUSSELL. Yes, I would be surprised.

The CHAIRMAN. As to illegal procedures at Penn Square, were they within the ordinary realm, or would you say that they were a little higher than ordinary?

Mr. RUSSELL. Well, I don't think I can make that comparison. There were a number of illegal acts which were identified both by the examiners and ourselves, and I really couldn't compare it to other banks. I don't think I could add anything to that.

The CHAIRMAN. Except for the fact that—well, you perhaps do not think you could add anything, but I think you could because I am told that you have written a few manuals on bank procedures and are very, very knowledgeable in the area, and this is why I asked my colleague to yield for a moment.

Mr. RUSSELL. Well, I was as far as writing technically when I was chairman of the Subcommittee for the American Institute which

was writing the Bank Audit Guide for the Institute. That is my involvement with that.

With respect to Penn Square at the end of 1980, I would have to say that I think that the technical violations were probably, as far as number, more than you would normally incur or see in a bank. Yes. But I think they were well documented in the examiner's report.

I think—as I say, I really think they did a fine job, and they sent in excellent people to do that. So I think they did document that.

The CHAIRMAN. I thank the gentleman for yielding.

Mr. LEACH. In your judgment, do you feel the fact that you made a qualifying statement in your audit was a factor in your not being required to perform the audit the following year?

Mr. RUSSELL. I have no way of knowing. I have listened to the testimony that you have heard today, and I would have to assume that Mr. Beller would feel more comfortable with Peat, Marwick. But beyond that, I have no knowledge.

Mr. LEACH. Firms can only make money when they have clients. To make an audit finding that is less than perfect and will reflect poorly on that company takes a degree of courage. I would like to tip my hat both to you, sir, and to your firm. And I appreciate your willingness to appear before us today.

Mr. RUSSELL. Thank you. It is, indeed, an easy thing to do as a practical matter.

The CHAIRMAN. Mr. Barnard?

Mr. BARNARD. As far as procedure is concerned, when an auditing firm such as yours finds the need to make a qualifying disclosure, where is it normally found?

Mr. RUSSELL. Well, I think you are speaking about the specific situation.

Mr. BARNARD. Yes.

Mr. RUSSELL. Do you mean where the report is found or where the qualifying statement is?

Mr. BARNARD. Where the qualifying statement is found.

Mr. RUSSELL. The qualifying statement, when it goes to a scope qualification, is normally found in the auditor's opinion letter.

Mr. BARNARD. And in your particular statement, it was found in paragraph 2, I believe.

Mr. RUSSELL. That is right.

Mr. BARNARD. Paragraph 2 of your letter?

Mr. RUSSELL. That is correct. It is actually in paragraph 1, which refers you to paragraph 2. It is an "except for" letter.

Mr. BARNARD. Is that a generally accepted procedure among all creditable—

Mr. RUSSELL. As far as the way it is presented, yes, that would be the way; what we would call the statement of auditing standards were presented, yes, sir.

Mr. BARNARD. That is the general modus operandi?

Mr. RUSSELL. Yes.

Mr. BARNARD. The acceptable modus operandi?

Mr. RUSSELL. Yes, sir.

Mr. BARNARD. So in other words, if it was on the four last pages of a document that had at least 20 or 25 pages, you would find that that might be a little unusual, right?

Mr. RUSSELL. Well, that would be unusual because you would have to have a four-page opinion letter to do that. When you have a scope qualification it must be in the opinion letter. It cannot be in the financial statement.

Mr. BARNARD. Would you consider, then, a statement such as this as being a scope qualification:

It should be understood that future loan losses involved an exercise of judgment. It is the judgment of management that the allowance is adequate at both December 31, 1981 and 1980.

Is that an explanation?

Mr. RUSSELL. I think you must be reading from the Peat, Marwick report.

Mr. BARNARD. Yes, I am.

Mr. RUSSELL. No, that would normally—let me think about how I might answer you. Well, it would not be a scope qualification. It is more—it would be a representation of management in the financial statements. I think you would have to characterize it as a representation of management.

Mr. BARNARD. It is a representation of management?

Mr. RUSSELL. Yes.

Mr. BARNARD. But it is a statement from the auditors to whom? The board of directors?

Mr. RUSSELL. Well, the auditors, ourselves, or anyone else really only render an opinion letter. The financial statements themselves are supposed to be the representation of management. They have the primary responsibility for that. So the auditors would be responsible for their opinion letter.

Mr. BARNARD. I have no further questions.

The CHAIRMAN. Mr. Russell, when you prepared that report that had the qualification, were you aware of the fact that it would be reviewed not only by the board of directors of Penn Square or the parent holding, but by many, many people around the country who might be giving thought to investing funds in Penn Square?

Mr. RUSSELL. Well, the answer is that we were aware that it would become public information, but it would not necessarily become public information to the general public in that it was included in a filing with the Federal Reserve, which is required of a bank holding company, and in a document entitled FRY-6 report. So we were aware of that.

And obviously, we have been quite cognizant of the fact that our report would be the only public information available—even though it is on the holding company itself—for an investor who understood those reports to understand our qualification went to the subsidiary bank.

The CHAIRMAN. And so, a sophisticated money broker who was attempting to make a determination as to whether or not advise clients to invest funds in a particular institution would know enough to look at that report, would they not?

Mr. RUSSELL. Well, I don't know whether they would know or not. It would depend upon the broker.

The CHAIRMAN. Would it surprise you to be told that quite a few of the money brokers have told us that yes, indeed, they reviewed your report and that of Peat, Marwick, Mitchell & Co.?

Mr. RUSSELL. I would think that brokers were sophisticated would know where the information was, and would make sure they had access to it, yes, sir.

The CHAIRMAN. So it would not surprise you to learn that your report was being reviewed by those people?

Mr. RUSSELL. No, I would expect it to be.

The CHAIRMAN. Thank you. Mr. Weber?

Mr. WEBER. Thank you, Mr. Chairman. Mr. Russell, your 1980 financial statement is qualified for the reason that there was a lack of supporting documentation of collateral values of certain loans. Your 1979 report was not so qualified. Was there some change in documentation between 1979 and 1980 that caused you to qualify the 1980 report but not the 1979?

Mr. RUSSELL. Yes, there was. In 1979, the bank did a very good job in obtaining engineering reports from very reputable engineering firms like Keplinger and Lawson and others, and did that quite well and quite thoroughly, and they were very current.

In 1980, that deteriorated and there were not current engineering reports. In some cases, there were engineering reports which did not include an opinion of the engineer, or did not include the assumption that the engineer used or the nature of the reserves that he had estimated; volumetric versus historical data.

Mr. WEBER. Do you know any reason why that was permitted to deteriorate in that fashion?

Mr. RUSSELL. No, I do not.

Mr. WEBER. When did you first bring to management's attention the fact that you were giving consideration to qualifying the report in this fashion?

Mr. RUSSELL. Well, we would normally begin really doing our audit, the bulk of it, being able to look at loan reserves, after the end of the year. So it would have been sometime prior to the issuing of the report obviously, but sometime in latter February or the first part of March.

Mr. WEBER. I assume that you did discuss this with management; the fact that you would include this type of statement?

Mr. RUSSELL. Yes, we did.

Mr. WEBER. Who specifically did you speak to?

Mr. RUSSELL. Bill Jennings.

Mr. WEBER. What was his reaction?

Mr. RUSSELL. Obviously, he was not pleased with that, but the meeting concluded on, I think, you have to do what you think you have to do.

Mr. WEBER. Did he make any statement about future employment?

Mr. RUSSELL. No, he did not.

Mr. WEBER. Did he make any other threat or recommendation or pleading or arm twisting of any kind?

Mr. RUSSELL. No other threat.

Mr. WEBER. Did you perform any further services after March 13, 1981, for the bank?

Mr. RUSSELL. Yes, we did some various little, what we would call management services activities. One was to help them look for a new financial vice president. There was another, dealing with some review of or actually just helping establish and supervising or help-

ing direct internal auditors in a study of commitment fees. And one was to look at some of the financial accounting and tax ramifications of some of the fringe benefits of the package.

Mr. WEBER. Did you give them any assistance in instituting procedures to remedy your qualification?

Mr. RUSSELL. They did not request that.

Mr. WEBER. Are you familiar at all with the procedures which were instituted?

Mr. RUSSELL. Only as they have been. I, of course, knew that Beller had been hired, or Mr. Beller had been hired, and that some others had been hired, but nothing beyond that.

Mr. WEBER. Do you have sufficient knowledge of those new procedures to have an opinion as to whether or not they would have satisfied you, had you been the ones to prepare the 1980 or 81 statement?

Mr. RUSSELL. No, I wouldn't have an opinion.

Mr. WEBER. And did you have anything to do with instituting further corrective procedures to bring the bank into compliance with the administrative agreement which had been executed between the board of directors and the OCC?

Mr. RUSSELL. We were not requested to do so, no, sir.

Mr. WEBER. Thank you very much, Mr. Russell.

The CHAIRMAN. Mr. Wortley?

Mr. WORTLEY. I have no questions, Mr. Chairman.

The CHAIRMAN. Mr. Leach, did you have anything further?

Mr. LEACH. No, sir.

The CHAIRMAN. Mr. Russell, there is another question I am tempted to ask but I am not going to ask. Again, we want to thank you for your patience in staying with us, and for your assistance and willingness to cooperate.

[Subsequent to the August 16 hearing, Arthur Young & Co. issued this statement in regard to the Lytel letter:]

PENN SQUARE

During the Congressional hearings on Monday, the Committee introduced a copy of a letter from John Lytel of Continental Bank to William Patterson. This letter, which we obtained in the course of our audit, related only to loans which Michigan National had acquired. It did not indicate that any other bank had a right to resell loan participations to Penn Square. And, in fact, the letter suggests that it was Continental and not Penn Square which had agreed to reacquire the loans.

In the course of our audit of First Penn Corp., we confirmed well in excess of 90 percent of the participation loans with the banks who purchased participations from Penn Square. With the exception of the Michigan National loans covered by this letter, none of the confirmations disclosed any repurchase arrangements.

With respect to the Michigan National participation loans identified in the letter, those loans were in fact disclosed in the footnotes to the financial statements.

The CHAIRMAN. At this point, I would like to put in the record the following: First, the February 11, 1980 auditor's letter from Arthur Young & Co. regarding First Penn Corp.'s yearend 1979 consolidated statements; second, the February 18, 1980, Arthur Young "Management Letter"; third, the January 6, 1981, letter from Arthur Young & Co. re: scope of yearend 1980 audit; fourth, March 13, 1981 "qualified" audit letter; fifth, Arthur Young "Management Letter" dated May 20, 1981; sixth, filings of First Penn Corp. with the Federal Reserve Bank, received in records section,

June 22, 1981; seventh, letter dated November 20, 1981 from Bill P. Jennings to Harold L. Russell, Arthur Young & Co., informing them that Peat, Marwick, Mitchell & Co. will do yearend 1981 audit.

[The material follows:]

ARTHUR YOUNG & COMPANY

1900 LIBERTY TOWER
OKLAHOMA CITY, OKLAHOMA 73102

The Board of Directors
First Penn Corporation

We have examined the accompanying balance sheets (company and consolidated) of First Penn Corporation at December 31, 1979 and the related statements (company and consolidated) of income, stockholders' equity and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements mentioned above present fairly the financial position (company and consolidated) of First Penn Corporation at December 31, 1979 and the results of operations (company and consolidated) and the changes in financial position (company and consolidated) for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Arthur Young & Company

February 11, 1980

ARTHUR YOUNG & COMPANY

1900 LIBERTY TOWER
OKLAHOMA CITY, OKLAHOMA 73102

Mr. Bill P. Jennings, Chairman of
the Board
First Penn Corporation and Penn
Square Bank N.A.
Dr. Marvin K. Margo, Chairman,
Examining Committee, Penn Square
Bank, N.A.
1919 Penn Square
Oklahoma City, Oklahoma 73118

Dear Mr. Jennings and Dr. Margo:

We have examined the consolidated financial statements of First Penn Corporation for the year ended December 31, 1979, and have issued our report thereon dated February 11, 1980. As part of our examination, we studied and tested the Company's system of internal accounting control to the extent we considered necessary under generally accepted auditing standards. This was done to establish a basis for relying on such system in determining the nature, timing and extent of the other auditing procedures necessary to enable us to express an opinion on the Company's consolidated financial statements and otherwise to assist us in planning and performing our examination of the financial statements.

Our examination of the Company's consolidated financial statements, including our study and evaluation of its system of internal accounting control, would not necessarily have disclosed all conditions requiring attention in the system of internal accounting control because both the audit and the study employed, as is customary, selected tests of accounting records and related data. However, our examination disclosed the following conditions relating to Penn Square Bank, N.A. as to which we believe corrective action should be taken or documentation (including cost/benefit considerations) should be prepared as to the reasons why corrective action was not considered necessary in the circumstances. (In general, corrective action need not be taken when the cost of installing or improving a control procedure would exceed the benefit expected to be derived. Since precise measurement of costs and benefits usually is not possible, any evaluation of such relationship requires estimates and judgments by management.)

The following conditions captioned, "Conditions Requiring Attention" were considered, to the extent necessary in determining the nature, timing and extent of our audit tests applied in our examination of the Company's consolidated financial statements.

CONDITIONS REQUIRING ATTENTION

Reconciliations

The following were noted in our review of the reconciliations of various general ledger accounts at December 31, 1979.

1. Eleven official checks totaling \$1,372,337 issued at year end by the Bank were either unrecorded or recorded in the wrong account at the time loan disbursements were made.
2. Accrued interest receivable on investment securities according to the general ledger exceeded the amount per the investment portfolio EDP printout by \$19,446. It was also noted that during the year two unexplained journal entries had been made, apparently in an attempt to balance the general ledger to the investment portfolio EDP printout. In addition, the pledging status of six securities as listed on the investment portfolio EDP printout did not agree with confirmation responses of the various state and political subdivisions for which the securities were pledged.
3. The accrued interest related to the single pay notes carried on the instalment loan EDP printout was not reconciled to the general ledger.
4. Company personnel were unable to locate 46 shares of the Bank's stock which is supposed to be in custody of First Penn Corporation.
5. The detail EDP printout of participation loans sold included numerous classification errors and some unrecorded transactions (see further comments immediately following under transactions not recorded timely).

Transactions not recorded timely

Due to banks reconciliations - Our review of reconciling items on the Healdton Bank account reconciliation at December 31, 1979 disclosed that two checks had been issued by Healdton to

purchase loans under participation agreements; however, the Bank had not recorded these particular loans as being sold. We were told by the Loan Department personnel that the Loan Officer had not notified the Credit and Collateral Department of the transaction. The transaction was subsequently recorded by the Bank on January 9, 1980.

Charged-off loans - Control ledgers and individual loan subledgers are maintained by the Accounting Department for all past and current year charge-offs and related recoveries. However, these subledger cards are not balanced on a regular basis. On loans charged-off and subsequent payments, the subledgers should be reconciled to the control ledgers on a monthly basis.

Charged-off loan customers - At our request, the Bank's internal auditor made an investigation of an official check payable to the Bank not clearing in a reasonable time period which disclosed a series of events resulting in two commercial loans, one on an unsecured basis, being made in 1980 to a borrower. This borrower had three instalment loans which were charged-off in 1979 by the Bank. The internal auditor submitted a report setting out the details of the transaction to the Bank's president in February 1980.

Trust department income - During our review of the Trust Department, it was noted that 1979 income from the purchases and sales of gold certificates had not been recorded by the Bank at December 31, 1979.

While the amounts proved to be immaterial in 1979, all transactions should be recorded timely. The failure to do so frequently leads to a breakdown in discipline which leads to other accounts not being recorded.

Loans

Documentation - While loan file documentation has improved since our last examination, we noted several technical deficiencies in documentation during our loan file review. The technical deficiencies noted are listed in Exhibit I. Among the more significant deficiencies noted were:

1. We noted four oil and gas loans on which the collateral mortgages had not been filed.
2. In several instances current financial statements, engineering reports and appraisals were not in the files but had been received by bank personnel. To maintain up-to-date credit information in loan files, the responsible individuals should route all documents to the Credit and Collection Department in a timely manner.

Loan policies - As mentioned in our 1977 and 1978 management letters, we believe a formal loan policy statement should be adopted by the Board of Directors. In 1978, we were informed that a draft loan policy was being prepared; however, the minutes of the Board of Directors do not indicate that such a policy has been adopted. We continue to believe strongly that a definitive loan policy should be formalized and adopted by the Board.

With the Bank's continued activity in the oil and gas area, the loan policies for this type of loan should include detail standards for documentation, nature of oil and gas reserves on which loans will be made, methods of reserve estimation and discount factors which will be acceptable and the maximum amount to be loaned as a percent of discounted values for each method of reserve estimation.

Letters of credit - It appears that the various loan officers may extend a letter of credit to a customer without approval or review from a second loan officer or the Loan Discount Committee. In response to one of our inquiries, we were informed there are no reconciliation procedures in effect for balancing the individual letters of credit to the total letter of credit liability ledger. Due to the increased volume of letters of credit during 1979, we suggest that the individual letters of credit be balanced to the liability control ledger at least monthly and that approval policies for letters of credit be instituted.

Loans in excess of legal lending limitations - At December 31, 1979, our review of loan concentrations (obligations direct or indirect of the same or affiliated interests) revealed one line in excess of the Bank's legal lending limitation under the Comptroller of the Currency's regulations by approximately \$250,000. Loan concentrations must be constantly monitored to insure that lines of credit do not exceed lending limits. The members of the Board of Directors are personally liable for loans in excess of lending limits.

COMMENTS ON OTHER MATTERSInterest income on municipal securities

The Bank maintains two separate general ledger accounts for interest income on municipal securities, municipal - other and municipal - Oklahoma. The EDP printout received from R. J. Edwards, Inc. does not segregate the Oklahoma municipal interest from other municipal securities. During the year arbitrary percentages were applied to record monthly accrued income. The misstatement of income between the two accounts was approximately \$30,000. At year end we made adjustments to classify the interest properly. Since the income tax treatment for state return purposes is different for Oklahoma and other municipal interest, we recommend that a detail analysis be manually prepared each month and income recorded to the proper account.

Travel and entertainment expenditures

A review of selected travel and entertainment expenditures and the related documentation disclosed that employee expenses were not always properly supported or documented. To comply with Internal Revenue Service Regulations, proper documentation and support should accompany each travel and entertainment report. Bank management has notified bank personnel of the documentation requirements and new expense report formats were implemented in January 1980.

Overdrawn accounts

When a customer's overdrawn balance is charged-off, the "fees on checking" income general ledger account is charged for the total balance. To improve the accounting for losses incurred from overdrawn accounts and properly reflect fees on checking income, we recommend the loss be recorded to a specified expense account and the "fees on checking" income account be reduced only by the portion of charges to the customer's account.

Prepaid expenses

No detail schedule of prepaid expenses and the related monthly amortization to expense is maintained. Our review of the prepaid balance at December 31, 1979 disclosed certain expenses amounting to \$14,696 which should have been fully expensed. A schedule should be maintained of prepaid expenses to support the monthly amortization to expense. This schedule should be reviewed for propriety at least quarterly by the controller. We also noted that some relatively minor amounts were recorded as prepaid expenses to be amortized. To facilitate monitoring prepaid expenses, a policy should be established setting out the type and a minimum dollar amount of prepaid expenses which would be deferred. Expenditures not meeting these criteria should be expensed.

Safekeeping of investment securities

We noted in our verification of securities held in safekeeping by Liberty National Bank that the listing contained the Bank's securities, securities held for the Bank's customers, and securities purchased by the Bank's Trust Department. To facilitate reconciliations of Bank-owned securities, including the related pledging of certain securities, we suggest Bank personnel request Liberty's safekeeping department to segregate the various securities held by type.

Expense checks

We noted several instances where invoices were marked "paid" but no indication of the expense check number or date paid was made.

Paid invoices should be stamped paid and the related check number, date paid and account distribution also should be indicated on the invoice. In addition, we recommend the establishment of a combination check register and expense distribution journal. This record facilitates accounting for all checks issued and serves as a source for verifying all paid expenses were charged to the proper account.

Signature cards on demand deposit accounts

Our review of selected demand deposit accounts revealed two instances where unsigned temporary signature cards were on file for over a year. We recommend that check file clerks prepare, on a monthly basis, detail lists of accounts with temporary signature cards which are over 30 days old. This customer list should be submitted to the head bookkeeper and reviewed by the internal auditor periodically.

General ledger

The Bank still does not have a chart of accounts. To facilitate general ledger postings and location of cards, each account should be assigned a number and cards numbered sequentially by account number when more than one card required for account activity. The debit and credit slips prepared should include account name and number which would facilitate postings to the proper general ledger account.

Electronic data processing

Processing of accounting and operational information of the Bank is dependent upon the data processing services provided by Fidelity Computer Services. As a result of our review of Fidelity's EDP Service Center, we developed the following comments which we believe the Bank's management should discuss with Fidelity management:

Disaster plan - We were told by Fidelity personnel that, with the proposed move of the processing facilities, arrangements for alternative processing will be formulated. However, at the time of our review Fidelity had no alternative processing arrangements for emergency processing in the event of disaster or prolonged loss of use of EDP equipment.

We believe that a EDP Service Center such as Fidelity's should develop a comprehensive plan directed towards providing alternative manual and mechanical means for continued processing in the event the computer systems are destroyed or become inoperative for an extended period of time.

The contents of such a plan should include:

- Location and description of alternative processing sites.
- Production schedules and priorities.
- Data conversion methods.
- Procedures for establishing updated data and program files.

After a disaster plan has been developed, the Bank should be notified that it has been tested under simulated emergency conditions. During the test the disaster plan should be evaluated for its effectiveness, and modifications, if necessary, should then be incorporated in the plan.

Standards manual - No formalized standards manual exists for program development. Such a manual is a valuable aid in understanding the role of various EDP techniques utilized in processing data. The development of a standards manual documenting programming and system development methodology is an important factor in continuity of data processing functions. Such a manual should be developed which details the approach utilized in the following:

- Systems analysis and design activities.
- Program development and testing procedures.
- Program interface techniques to accessing data base.
- User coordination and acceptance procedures.
- Documentation efforts concerning:
 - System specification.
 - Individual program narratives, flowcharts.
 - Operations and control instructions.
 - User processing and control instructions.

Production control - Production efforts are scheduled and controlled by a manual production control system. In an EDP service center the size of Fidelity Computer Service, enhanced service can be provided by utilizing an automated production control system. Such a system lessens the possibility of incomplete or misrouted output of the user bank's data. We were told Fidelity has plans to implement an automated system.

Automated tape library system - Currently, all backup of master files is managed by the production personnel in a manual fashion. Files are stored offsite on tape and rotated according to a predetermined schedule. Due to the large number of tapes handled, the possibility exists for failure to create and retain necessary backup copies of critical files. We recommend that an automated tape librarian system be implemented to provide greater assurance that proper backup is created for user banks.

* * * * *

This letter is issued solely for the information of the Company's board of directors, management and counsel; it should not be presented or quoted to anyone outside the Company because of the possibility of misunderstanding by other persons who may not be aware of the objectives and limitations of internal controls and of our study and evaluation thereof.

We would like to express our appreciation for the cooperation and assistance received from your personnel during the course of the audit.

We would be pleased to discuss the matters reported or to answer any questions you may have at your convenience.

Very truly yours,

Arthur Young & Company

Oklahoma City, Oklahoma
February 18, 1980

<u>Borrower</u>	<u>Bank's portion at 12-31-79</u>	<u>Loan file deficiency</u>
Roger Casida	\$ 3500	Note not made payable to Penn Square Bank
ASA Energy Corp.	36,232	No financial statements
James J. Cook	150,000	No financial statements
Eagle Drilling	-0-	No financial statements
Equity Drilling	280,000	No financial statements
Lambdin-Dawson	34,285	No financial statements or appraisal in file
George C. Martin	225,000	No financial statements
Paramount Drilling	86,887	Insurance expired 1-1-79 on airplane collateral
Steele Construction	31,000	No financial statements
Bill Stubbs Co.	97,162	No financial statements
Thomas Oil Co.	19,258	No financial statements
Robert Daughterty	86,225	Financial statements (3-77) and appraisal (1965) old
Century Oil & Gas Co.	145,356	Engineering report (2-77) and financial statements (5-78) old
Dahlgren Contracting, Inc.	100,087	Financial statements (1-78) old
C. Hubert Gragg	125,000	Appraisal (1-77) and financial statements (12-77) old
Publishing Industries, Inc.	394,449	Financial statements (9-77) old

<u>Borrower</u>	<u>Bank's portion at 12-31-79</u>	<u>Loan file deficiency</u>
Ivan Thompson	\$200,000	No appraisal on horse collateral and collateral title not in Borrower's name
A Perm-O-Green Lawn	35,709	No appraisals of collateral and financial statements (3-78) old
Rick Mason	40,000	Oil and gas mortgage filed on one of two leases
E. M. McDowell Sr. & Jr.	-0-	No financial statements
Delhi Pacific Mines Ltd.	500,000	Oil and gas mortgages had not been signed or filed. Title opinions and engineering reports not in borrower's name
J. D. Helms	403,000	Engineering reports and title opinions not obtained on all leases
David Hostelly	700,000	Engineering report does not segregate information individual for lease mortgaged.
David Kennedy	51,260	No assignment of oil and gas mortgages in Borrower's name
L & T Oil & Gas Inc.	50,000	Oil and gas mortgages had not been filed
Stanmark Petroleum	400,000	Oil and gas mortgages had not been filed on all leases
Copeland Energy Corp.	296,429	Title opinions not obtained on all leases
Bob Carroll and Peter Massion	290,000	Title opinions not in borrower's name and no assignments in file

ARTHUR YOUNG & COMPANY

1900 LIBERTY TOWER
OKLAHOMA CITY, OKLAHOMA 73102

January 6, 1981

Mr. Bill P. Jennings,
Chairman of the Board
First Penn Corporation
Dr. Marvin K. Margo,
Chairman, Audit Committee
Penn Square Bank, N.A.
1919 Penn Square
Oklahoma City, Oklahoma 73118

Gentlemen:

The purpose of this letter is to confirm our existing relationship as certified public accountants for First Penn Corporation and to provide an understanding of the scope of services to be performed by our firm.

Our examination of your annual consolidated and parent company financial statements will be made in accordance with generally accepted auditing standards and accordingly will include such tests as we consider necessary in the circumstances. Unless unusual conditions not now foreseen make it impracticable for us to do so, we will submit a report on our examination of these financial statements which will express an opinion as to the fairness of their presentation in conformity with generally accepted accounting principles.

Under generally accepted auditing standards, the independent auditor has the responsibility, within the inherent limitations of the auditing process, to plan the examination to search for errors or irregularities (as defined in authoritative professional literature) that would have a material effect on the financial statements. Our search for material errors or irregularities ordinarily is accomplished by performing those auditing procedures that in our judgment are appropriate in the circumstances to form an opinion on the financial statements as a whole. Our examination, which is based on the concept of selective testing of the data being examined, is subject to the inherent risk that material errors or irregularities, if they exist, will not be detected.

In conducting our examination, we will be aware of the possibility that illegal acts (as defined in authoritative professional literature) may have occurred that may have a material effect on the financial statements. Examinations conducted in accordance with generally accepted auditing standards are of limited effectiveness in discovering possible illegal acts and cannot be expected to provide assurance that illegal acts will be detected, although procedures that are performed primarily for the purpose of forming an opinion on the financial statements as a whole may also bring possible illegal acts to the auditor's attention.

During the course of our examination, we may observe opportunities for economies in or improved controls over your operations. It is our practice to bring such opportunities to the attention of an executive at the appropriate level of management, either orally or in writing. Should you desire any further information concerning our responsibilities and functions as an independent auditor in making the examination, we shall be pleased to furnish information to you upon request.

We will also prepare the Company's annual United States Federal and Oklahoma consolidated income tax returns.

In addition to the preparation of the returns, upon your request, we are also prepared to advise you generally on tax problems and tax planning. In this connection, in order to be of greatest assistance in minimizing the Company's tax burdens, we should be advised in advance of any major transactions the Company proposes to undertake.

Should the Company be selected for examination by the Internal Revenue Service or by other tax authorities, we will also be pleased to represent the Company or to assist you in discussions with these authorities and in preparing any refund claims or protests that may be necessary to obtain a final determination of the Company's tax liability.

We would like to caution you that tax rules change constantly. For this reason, any opinion expressed in connection with a transaction at one time may not apply to a similar transaction at a later date. Therefore, to be most helpful, we should be able to take a fresh look each time a transaction of a material nature is proposed.

Our fees for the annual examination and other accounting and auditing services (as requested) will be based on hours worked by the various grades of personnel, at our standard rates applicable to each, plus out-of-pocket expenses.

We anticipate reducing the fees at our standard rates by a discount of 23% for 1980. Other work, including preparation of the Federal and Oklahoma income tax returns and specific tax planning related projects upon special request, will be billed separately at our standard rates, plus out-of-pocket expenses.

Our report and accompanying financial statements will be in the format required for the Company's filing of the FR Y-6 with the Federal Reserve Board.

If this letter meets with your approval, please sign one copy and return it to us.

Yours very truly,

Arthur Young & Company

The arrangements described above are acceptable to us.

FIRST PENN CORPORATION:

By *Bill P. Jennings*
Bill P. Jennings,
Chairman of the Board

Date *January 30 1980*

PENN SQUARE BANK, N.A.:

By *Marvin K. Margo*
Marvin K. Margo, M.D.,
Chairman, Audit Committee

Date *January 30 1980*

ARTHUR YOUNG

ARTHUR YOUNG & COMPANY
1900 LIBERTY TOWER
OKLAHOMA CITY, OKLAHOMA 73102

The Board of Directors
First Penn Corporation

We have examined the accompanying balance sheets (company and consolidated) of First Penn Corporation at December 31, 1980 and 1979 and the related statements (company and consolidated) of income, stockholders' equity and changes in financial position for the years then ended. Except as stated in the following paragraph, our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

We were unable to satisfy ourselves as to the adequacy of the reserve for possible loan losses at December 31, 1980 due to the lack of supporting documentation of collateral values of certain loans.

In our opinion, except for the effects of such adjustments, if any, on the 1980 financial statements (company and consolidated) as might have been determined to be necessary had we been able to satisfy ourselves as to the adequacy of the reserve for possible loan losses, the statements mentioned above present fairly the financial position (company and consolidated) of First Penn Corporation at December 31, 1980 and 1979 and the results of operations (company and consolidated) and the changes in financial position (company and consolidated) for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

Arthur Young + Company

March 13, 1981

ARTHUR YOUNG

ARTHUR YOUNG & COMPANY
1900 LIBERTY TOWER
OKLAHOMA CITY, OKLAHOMA 73102

May 20, 1981

Examining Committee, Penn
Square Bank, N.A.
Mr. Bill P. Jennings,
Chairman of the Board
First Penn Corporation and
Penn Square Bank
1919 Penn Square
Oklahoma City, Oklahoma 73118

Gentlemen:

We have examined the parent company and consolidated financial statements of First Penn Corporation for the year ended December 31, 1980, and have issued our report thereon dated March 13, 1981. As part of our examination, we made a study and evaluation of the Company's system of internal accounting control to establish the level of our reliance on such system in determining the nature, timing, and extent of other auditing procedures necessary to enable us to express an opinion on the Company's financial statements.

Our study and evaluation was more limited than would be necessary to express an opinion on the system of internal accounting control of First Penn Corporation, taken as a whole. Accordingly, we do not express such an opinion. Because of its limited nature, our study and evaluation would not necessarily disclose all material weaknesses or other conditions requiring attention in the system of internal accounting control.

Our study and evaluation disclosed the following conditions that we believe results in more than a relatively low risk that errors or irregularities in amounts that would be material in relation to the Company and consolidated financial statements of First Penn Corporation may occur and not be detected within a timely period.

Our report on the financial statements of First Penn Corporation at December 31, 1980 was qualified since we were unable

to satisfy ourselves as to the adequacy of the reserve for loan losses due to the lack of supporting documentation of collateral values of certain loans. With the significant growth of Penn Square Bank's loan portfolio implementing sound loan policies and procedures is a critical factor in both the decision process in making loans and monitoring the portfolio.

Loan file documentation

Both our review and that of the national bank examiners disclosed documentation deficiencies in the loan files, the most significant of which related to information supporting collateral values. It is critical that the Bank correct the loan file documentation deficiencies and implement procedures to obtain all applicable information from new borrowers prior to loan approval and to monitor existing loan files for complete and current information.

Loan policies

Although the Bank has adopted a loan policy, we believe that a more definitive loan policy specifically tailored for the Bank's portfolio should be formalized and adopted by the Board. The policy should include provisions which define by type of loan (real estate, construction, oil and gas) criteria for: (a) acceptance of loan, (b) review of applications, (c) acceptable appraisal or valuation techniques, (d) required documentation and (e) procedures for monitoring the loan.

With the Bank's continued activity in the oil and gas area, the loan policies for this type of loan should include detail standards for documentation, nature of oil and gas reserves on which loans will be made, methods of reserve estimation and discount factors which will be acceptable and the maximum amount to be loaned as a percent of discounted values for each method of reserve estimation.

Reserve for loan losses

Currently, the Bank's reserve for loan losses is based on a percent of outstanding loans, which, in the opinion of management, is adequate to absorb potential losses in the loan portfolio. To properly monitor the loan portfolio and related reserve for loan losses, we believe a more definitive policy should be implemented to provide for review of individual loans or lines of credit. The policy should include procedures for review of the adequacy of the reserve at least quarterly with

documentation of the loans reviewed and conclusions reached. The policy should also include criteria for actual charge-off of loans and subsequent monitoring of the charge-offs.

OTHER CONDITIONS REQUIRING ATTENTION:

The following conditions also came to our attention as to which we believe corrective action should be taken or documentation (including cost/benefit considerations) should be prepared as to the reasons why corrective action was not considered necessary in the circumstances.

Participation loans

At December 31, 1980, there were approximately \$23 million of participation loans effected by the Bank which had participation maturity dates prior to that of the loan. Subsequent to year end the terms of the majority of such participation loans were amended to conform with that of the underlying loan. In addition approximately \$2 million of participation loans were not reflected in the Bank's subsidiary records due to a direct transfer by the participating bank of the funds advanced.

The Bank has had increasing activity in the participation loan area. Accordingly, establishing specific procedures related to processing of such loans is critical. Such procedures should include a review by a responsible employee of the terms of any agreements, the amounts involved and proper recording in the accounting and subsidiary records.

In addition, our confirmation procedures related to participation loans disclosed some differences in interest rates and loan balances. All differences were reconciled by the Bank's internal audit department and reviewed by us. We believe a periodic confirmation program of participation loan balances and terms by the internal audit department should be established. This procedures should identify any differences on a timely basis.

Letters of credit

As mentioned in our 1979 management letter, there are no standard procedures in effect regarding the issuance of letters of credit including approval by a second loan office or the

loan discount committee. A policy should be established defining dollar limits for each officer and related approval for letters of credit in excess of such limits. In addition, policies should be implemented to define (1) acceptable customers, (2) documentation, and (3) method of determining and monitoring collateral value. The letters of credit should be reconciled to the subsidiary records at least monthly.

Payroll and payroll tax reports

Our review of the payroll tax reports for 1980 disclosed differences between the amounts reported on the payroll tax reports for total compensation and that recorded in the general ledger. The Bank's internal audit department is reviewing these differences and determined that a portion of the difference appears to relate the Saturday pay to employees.

Quarterly payroll tax reports should be reconciled to the general ledger compensation expense prior to filing. Consideration should be given to making payments for Saturday work in the normal payroll process rather than the cash payments.

* * * * *

These conditions were considered in determining the nature, timing, and extent of audit tests applied in our examination of the Company's parent company and consolidated financial statements and this report does not affect our report on those financial statements dated March 13, 1981.

COMMENTS ON OTHER MATTERS:

Commercial paper

The Company began issuing commercial paper during 1980. We noted a trend toward a negative interest factor due to the short-term of the paper being issued not allowing for an offsetting investment of funds in revenue producing investments. We understand that subsequent to year end, the controller of the Bank who was responsible for commercial paper transactions has terminated her employment.

Due to the highly regulated nature of commercial paper and an indicated trend of negative cash flow, we suggest a qualified employee be placed in charge of commercial paper transactions.

General ledger postings

The Bank still does not have a chart of accounts with assigned account numbers. We also noted some general ledger tickets which lacked adequate information documenting the purpose of the entry. To facilitate postings to the proper general ledger account, we suggest assigning each an account number and including this number on the general ledger ticket. Additionally, the tickets should include a brief description of the purpose of the entry and bear the approval of a supervisor. An additional control which would facilitate subsequent review of the entries would be to indicate the offsetting debit or credit on the general ledger ticket.

Wire transfers

At the time of our review, the Bank had no formal procedures relating to wire transfers. Due to the nature and volume of transactions, a system with good controls is imperative. We noted a lack of segregation of duties. In addition, there were no formal limits or criteria for persons, both in the bank and customers who were authorized to initiate transactions. We suggest an evaluation of the existing system be prepared and control features be determined and implemented. Reference is made to the national bank examiners' comments on wire transfers under internal control deficiencies for a summary of areas which should be considered.

Accounts payable

At December 31, 1980, the liability for operating expenses incurred at year end but not paid was accrued. As payments were made subsequent to year end, the liability was reduced. In the past, the Bank has not accrued such expenses as management did not feel they were significant.

We understand there has been no procedure adopted regarding the handling of such expenses in 1981 and that expenses will be recorded as paid. For January 1981, expenses will be understated by the amount of expense incurred at January 1981 but paid subsequently as payment of expenses in January will have been offset against the liability set up at year end. To properly reflect monthly and year-to-date expenses, accounts payable for accrued liabilities should be set up monthly. This could be accomplished by setting up a voucher system whereby liabilities are recorded as incurred. Subsequent payment should then be offset against the liability.

An alternative would be to record an estimate of such accrued liabilities and adjust this payable to actual at year end. For monthly and year to date information to be as accurate as possible the estimate should be compared to actual on at least a quarterly basis and infrequent or unusual items should be accrued for separately.

Dual controls

Internal controls are strengthened by dual control. Areas we noted for which such controls could be implemented are as follows:

- Receipt and preparation of currency shipments.
- Mail deposits.
- Verification of night deposits.
- Access to automated teller machine.

* * * * *

The management of First Penn Corporation and its subsidiary, Penn Square Bank, N.A. is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

This report is intended solely for the use of management and should not be used for any other purpose.

We would be pleased to discuss the matters reported or to respond to any questions, at your convenience.

Very truly yours,

Arthur Young & Company

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JUN 27 1981

APR 27 1981

1. Consolidated and Parent Holding Company Financial Statements.

The required financial statements, at year ended December 31, 1980 are provided, attached as Exhibit I, hereto.

2. Annual Reports to Stockholders and to the Securities and Exchange Commission (SEC).

a. The registrant does not prepare an annual stockholder report; attached as Exhibit I please find the consolidated financial statements of First Penn Corporation.

b. Neither the registrant nor its subsidiary files annual reports with the SEC.

3. Information on Subsidiaries

Information on the registrant's subsidiary is provided in Schedule A.

4. Non-Bank Subsidiary Financial Statements

Information on the registrant's non-bank subsidiary is provided on Schedule A. Financial statements are not submitted on this non-bank subsidiary, since it is a subsidiary of the bank that is fully consolidated on a line-by-line basis in the registrant's consolidated report of condition.

5. Information on Organizations Other Than Subsidiaries

The registrant has no direct or indirect interest in any organization other than its wholly owned subsidiary, Penn Square Bank, N.A.

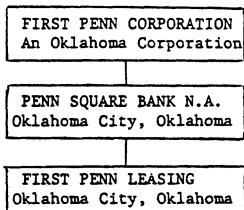
6. Activities of the Parent Bank Holding Company

Registrant engages in the activity of owning or controlling its wholly owned subsidiary bank as set forth in the completed Schedule C attached hereto and as a distributor of commercial paper.

7. Terminations

No organization has ceased being a part of the bank holding company organization during the registrant's fiscal year.

DIVISION OF BANKING
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8. Organization Chart - December 31, 19809. Amendments to Organizational Documents

The registrant has not amended the documents under which it was organized and operates.

10. Shareholders

The following shareholders of registrant, all of whom are either United States citizens or corporations, own, control or hold, with the power to vote 5% or more of the outstanding voting shares of registrant:

a. Mr. Bill P. Jennings, of Oklahoma City, Oklahoma, owns beneficially and of record 56,049 shares of registrant's common stock.

b. The Rooney Corporation, located in Tulsa, Oklahoma, owns beneficially and of record 15,080 shares of registrant's common stock.

11. Directors and Officers

Information concerning the directors and principal officers of registrant is as follows:

a. Mr. Bill P. Jennings of Oklahoma City, Oklahoma, owns 56,049 shares of registrant's common stock and serves as President and a Director of registrant, and Chairman of registrant's subsidiary bank, which constitutes his principal occupation. In addition, Mr. Jennings serves as Vice Chairman and a Director of the Bank of Healdton, Healdton, Oklahoma, and exercises voting control over 19.7% of the shares of that bank as a result of shares individually owned and shares voted as a trustee. Mr. Jennings also serves as President and a Director of First Healdton Corporation, in which he controls the same percentage of shares as he controls in the bank. Mr. Jennings serves as Director of Community Bank & Trust Company and

Community Corporation in Enid, Oklahoma, and has a 13% ownership in each entity. In addition, Mr. Jennings, has the following business interests:

Penn Northwestern Land Development Co.	25% Stock Limited Partnership
Petro Building Limited	25% Stock Limited Partnership
J-Mc Aircraft Corporation	50% Stock Ownership Interest
TSJ, Inc.	25% Stock Ownership Interest
Chi-Chi's of Atlanta, Inc.	30% Stock Ownership Interest
Trans-Central Airlines, Inc.	20% Stock Ownership Interest
American Gypsum Company	10% Stock Ownership Interest
Northwest Investors, Ltd.	15% Limited Partnership Interest
Skirvin Plaza Investors	16.6% Limited Partnership Interest
JJS, A Partnership	33.3% Limited Partnership Interest

b. Mr. Frank L. Murphy of Oklahoma City, Oklahoma, owns 225 shares of registrant's common stock and serves as Secretary/Treasurer of registrant and as President of registrant's subsidiary bank, which is his principal occupation. In addition, Mr. Murphy serves as Secretary and a Director of Edgewater Heights Development Corporation in which he has a 50% ownership interest.

c. Mr. John E. Rooney of Tulsa, Oklahoma, owns 1,960 shares of registrant's common stock and serves as a Director of registrant. Mr. Rooney's principal occupation is as President of the Rooney Corporation in which he has a 50% ownership. The following entities are subsidiaries of Rooney Corporation or a subsidiary of the subsidiaries which Mr. Rooney has a 50% ownership:

- East Side Development Company
- Fleet Finance Company
- Lake Country Beverage
- Leland Equipment Company
- Leland-Manhattan Joint Venture
- Penn Square, Inc.
- Manhattan Construction Company
- The Rooney Company

In addition, Mr. Rooney serves as Secretary and a Director of Hope Lumber and Supply Company, in which he owns 140 shares. He also owns 14% of the outstanding shares of Citizens National Bank of Muskogee, Oklahoma. He is an operating partner in the Rooney Oil Company in which he has a 1/3 interest.

d. Mr. W. A. Ross of Oklahoma City, Oklahoma, owns 2,944 shares of registrant's common stock and serves as a Director of registrant. Mr. Ross's principal occupation is as President and owner of Dub Ross Company, in which he has a 100% ownership. In addition, Mr. Ross has the following interest:

Northwest Investors, Inc.	10% Limited Partnership Interest
Colcord Association Ltd.	Limited Partnership Interest
Skirvin Plaza Investors	20% Limited Partnership Interest

e. Mr. Carl W. Swan of Oklahoma City, Oklahoma, owns 9,819 shares of registrant's common stock and serves as a Director of the registrant. Mr. Swan's principal occupation is as an independent oil producer. Mr. Swan has the following interests:

Copeland Energy	23% Stock Ownership Interest
Swan Aviation Director & President	100% Stock Ownership Interest
World of Travel Director	80% Stock Ownership Interest
Longhorn Oil & Gas Co. Director	50% Stock Ownership Interest
Swan Coal Company Director & President	100% Stock Ownership Interest
American Gypsum Co. Director	16.66% Stock Ownership Interest
Intrepid Drilling Corp. Director	15% Stock Ownership Interest
Continental Drilling Corp. Director	40% Stock Ownership Interest
Swan Petroleum Director & President	100% Stock Ownership Interest
Haymaker Farms	11% Stock Ownership Interest
Midwest National Bank	20% Stock Ownership Interest
Texas Oilfield Supply	15% Stock Ownership Interest
Olympic Expl	40% Stock Ownership Interest
High Plains Drilling	40% Stock Ownership Interest

f. Mr. Ronald H. Burks of Oklahoma City, Oklahoma, owns 7,500 shares of registrant's common stock and serves as a Director of registrant's subsidiary bank and of registrant. Mr. Burks' principal occupation is as President of Ronald Burks Investments, Inc. in which he has 100% ownership. In addition, Mr. Burks has the following interests:

Chi-Chi's of Atlanta	11.1% Land & Building Interest
Chi-Chi's of Sunrise, Florida	11.1% Land & Building Interest
Peachtree Hospitalities	33% Stock Ownership Interest
Northwest Investors	25% Stock Ownership Interest

12. Insider Loans

The bank holding company organization has made no loans to any insider, or his interests, aggregating more than 10% of the equity capital accounts of the registrant.

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JUN 22 1981

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FIRST PENN CORPORATION
FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 1980 AND 1979
with
REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

ARTHUR YOUNG

FOR FILES
Cherie Sues

ARTHUR YOUNG

ARTHUR YOUNG & COMPANY
1900 LIBERTY TOWER
OKLAHOMA CITY, OKLAHOMA 73102

The Board of Directors
First Penn Corporation

We have examined the accompanying balance sheets (company and consolidated) of First Penn Corporation at December 31, 1980 and 1979 and the related statements (company and consolidated) of income, stockholders' equity and changes in financial position for the years then ended. Except as stated in the following paragraph, our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

We were unable to satisfy ourselves as to the adequacy of the reserve for possible loan losses at December 31, 1980 due to the lack of supporting documentation of collateral values of certain loans.

In our opinion, except for the effects of such adjustments, if any, on the 1980 financial statements (company and consolidated) as might have been determined to be necessary had we been able to satisfy ourselves as to the adequacy of the reserve for possible loan losses, the statements mentioned above present fairly the financial position (company and consolidated) of First Penn Corporation at December 31, 1980 and 1979 and the results of operations (company and consolidated) and the changes in financial position (company and consolidated) for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

Arthur Young + Company

March 13, 1981

FIRST PENN CORPORATION
 CONSOLIDATED BALANCE SHEETS
 December 31, 1980 and 1979

<u>ASSETS</u>	<u>1980</u>	<u>1979</u>
Cash and due from banks	\$ 59,625,519	\$ 25,671,661
Investment securities (Note 3)	42,627,346	22,982,819
Loans, less reserve for possible loan losses of \$2,004,587 (\$1,002,097 in 1979) (Notes 4, 5 and 12)	199,894,664	106,484,882
Federal funds sold	16,000,000	1,100,000
Premises and equipment (Notes 6 and 8)	3,724,388	1,936,348
Accrued interest receivable	7,372,553	2,495,276
Other assets (Note 2)	<u>1,213,248</u>	<u>1,033,114</u>
Total assets	<u>\$330,457,718</u>	<u>\$161,704,100</u>
 <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Deposits:		
Demand	\$135,029,063	\$ 79,701,722
Savings	13,341,126	13,261,028
Time	<u>136,522,794</u>	<u>56,717,078</u>
Total deposits	284,892,983	149,679,828
Federal funds purchased	650,000	400,000
Other liabilities (Note 7)	4,636,579	1,975,341
Notes payable (Note 8)	8,606,800	3,160,001
Commercial paper	14,640,252	-
Loans sold under agreement to repurchase	<u>2,795,561</u>	<u>-</u>
Total liabilities	316,222,175	155,215,170
Stockholders' equity (Note 10):		
6.5% cumulative preferred stock, \$60 par value; 5,000 shares authorized, 4,225 shares issued	253,500	253,500
Common stock, \$1 par value; 250,000 shares authorized, 162,466 shares issued (108,311 shares in 1979)	162,466	108,311
Surplus	7,420,753	3,142,508
Retained earnings	<u>6,398,824</u>	<u>2,984,611</u>
Total stockholders' equity	<u>14,235,543</u>	<u>6,488,930</u>
Total liabilities and stockholders' equity	<u>\$330,457,718</u>	<u>\$161,704,100</u>

See accompanying notes.

FIRST PENN CORPORATION
 CONSOLIDATED STATEMENTS OF INCOME
 Years ended December 31, 1980 and 1979

	<u>1980</u>	<u>1979</u>
Interest income:		
Interest and fees on loans	\$24,665,544	\$11,038,809
Interest on investment securities:		
Taxable	299,778	277,397
Tax exempt	<u>1,308,326</u>	<u>908,630</u>
Total interest on investment securities	1,608,104	1,186,027
Interest on federal funds sold	<u>282,715</u>	<u>14,933</u>
Total interest income	26,556,363	12,239,769
Interest expense:		
Interest on deposits:		
Savings	715,844	734,974
Time	11,834,081	4,360,560
Other	<u>2,745</u>	<u>56,650</u>
Total interest on deposits	12,552,670	5,152,184
Interest on commercial paper	1,055,686	-
Interest on federal funds purchased	871,220	710,847
Interest on notes payable	791,024	189,450
Interest on subordinated notes	<u>-</u>	<u>59,656</u>
Total interest expense	<u>15,270,600</u>	<u>6,112,137</u>
Net interest earnings	11,285,763	6,127,632
Provision for possible loan losses	<u>1,407,830</u>	<u>615,000</u>
Net interest earnings after provision for possible loan losses	9,877,933	5,512,632
Other income:		
Service charges on deposit accounts	366,920	108,212
Other service charges and fee income	431,738	279,050
Other	<u>89,312</u>	<u>61,536</u>
Total other income	887,970	448,798

(Continued on following page)

FIRST PENN CORPORATION
 CONSOLIDATED STATEMENTS OF INCOME
 (CONTINUED)

Years ended December 31, 1980 and 1979

	<u>1980</u>	<u>1979</u>
Other expense:		
Salaries	\$ 1,997,560	\$ 1,243,156
Employee benefits	341,656	237,381
Occupancy and equipment expense	618,828	390,363
Other	<u>2,410,459</u>	<u>1,208,478</u>
Total other expense	<u>5,368,503</u>	<u>3,079,378</u>
Income before income taxes, minority interest and securities losses	5,397,400	2,882,052
Provision for income taxes (Note 9)	<u>1,966,710</u>	<u>969,675</u>
Income before minority interest and securities losses	3,430,690	1,912,377
Minority interest	<u>-</u>	<u>232,112</u>
Income before securities losses	3,430,690	1,680,265
Securities losses, net of related income taxes and minority interest	<u>-</u>	<u>7,111</u>
Net income	<u>\$ 3,430,690</u>	<u>\$ 1,673,154</u>

See accompanying notes.

FIRST PENN CORPORATION
 (consolidated and parent company)
 STATEMENTS OF STOCKHOLDERS' EQUITY
 Years ended December 31, 1980 and 1979

	<u>Preferred stock</u>	<u>Common stock</u>	<u>Surplus</u>	<u>Retained earnings</u>
Balance at December 31, 1978	\$ -	\$ 64,552	\$1,387,918	\$1,311,457
Net income	-	-	-	1,673,154
Exchange of stock for stock of subsidiary bank (Note 2)	253,500	18,759	779,590	-
Exchange of stock for subordinated notes of subsidiary bank (Note 2)	<u>-</u>	<u>25,000</u>	<u>975,000</u>	<u>-</u>
Balance at December 31, 1979	253,500	108,311	3,142,508	2,984,611
Net income	-	-	-	3,430,690
Common stock issued	-	54,155	4,278,245	-
Preferred stock dividends	<u>-</u>	<u>-</u>	<u>-</u>	<u>(16,477)</u>
Balance at December 31, 1980	<u>\$253,500</u>	<u>\$162,466</u>	<u>\$7,420,753</u>	<u>\$6,398,824</u>

See accompanying notes.

FIRST PENN CORPORATION
 CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

Years ended December 31, 1980 and 1979

	<u>1980</u>	<u>1979</u>
Source:		
Net income	\$ 3,430,690	\$ 1,673,154
Charges against (credits to) income not involving funds in the current period:		
Depreciation and amortization	307,887	187,858
Excess of provision for possible loan losses over net loan charge-offs	1,002,490	374,606
Amortization of premiums on securities	129,209	57,303
Accretion of discounts on securities	(36,625)	(16,890)
Deferred federal income taxes	76,710	(26,000)
Amortization of cost in excess of net assets of subsidiary bank	21,348	21,314
Net book value of property dispositions	<u>12,562</u>	<u>-</u>
Funds provided from operations	4,944,271	2,271,345
Decrease in federal funds sold	-	2,900,000
Proceeds of borrowings	5,606,800	1,000,000
Increase in deposits	135,213,155	59,033,185
Increase in federal funds purchased	250,000	400,000
Increase in other liabilities	2,584,528	-
Increase in commercial paper	14,640,252	-
Loans sold under agreement to repurchase	2,795,561	-
Common stock issued in exchange for subordinated notes of subsidiary bank (Note 2)	-	1,000,000
Common stock issued in exchange for subordinated notes of subsidiary bank (Note 2)	-	786,226
Preferred stock issued in exchange for stock of subsidiary bank (Note 2)	-	265,623
Proceeds from the sale of common stock	<u>4,332,400</u>	<u>-</u>
	<u>\$170,366,967</u>	<u>\$67,656,379</u>

(Continued on following page)

FIRST PENN CORPORATION
 CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION
 (Continued)

Years ended December 31, 1980 and 1979

	<u>1980</u>	<u>1979</u>
Application:		
Increase in cash and due from banks	\$ 33,953,858	\$15,075,152
Increase in securities	19,737,111	5,351,876
Increase in loans	94,412,272	43,252,807
Increase in federal funds sold	14,900,000	-
Additions to premises and equipment	2,106,886	236,838
Increase in accrued interest receivable	4,877,277	1,238,279
Increase in other assets	203,085	11,141
Decrease in other liabilities	-	1,390,286
Payments on notes payable	160,001	100,000
Cancellation of indebtedness of subordinated notes of subsidiary bank (Note 2)	-	1,000,000
Preferred stock dividends	16,477	-
	<u>\$170,366,967</u>	<u>\$67,656,379</u>

See accompanying notes.

FIRST PENN CORPORATION
(parent company only)

BALANCE SHEETS

December 31, 1980 and 1979

<u>ASSETS</u>	<u>1980</u>	<u>1979</u>
Cash on deposit with subsidiary bank	\$ 7,595,651	\$ 7,442
Certificate of deposit of subsidiary bank	8,300,000	-
Receivable from subsidiary bank	873,083	701,500
Investment in stock of subsidiary (Note 2):		
Equity in net assets	20,422,403	8,936,511
Cost in excess of net assets acquired	<u>747,180</u>	<u>767,322</u>
	21,169,583	9,703,833
Land (Note 8)	1,242,721	-
Other assets	<u>48,046</u>	<u>18,782</u>
Total assets	<u>\$39,229,084</u>	<u>\$10,431,557</u>
 <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Liabilities:		
Other liabilities:		
Income taxes payable	\$ 977,535	\$ 766,490
Interest payable	752,089	1,271
Other	<u>16,865</u>	<u>14,865</u>
	1,746,489	782,626
Commercial paper	14,640,252	-
Notes payable (Note 8)	<u>8,606,800</u>	<u>3,160,001</u>
Total liabilities	24,993,541	3,942,627
Stockholders' equity (Note 10):		
6.5% cumulative preferred stock, \$60 par value; 5,000 shares authorized, 4,225 shares issued	253,500	253,500
Common stock, \$1 par value; 250,000 shares authorized, 162,466 shares issued (108,311 shares in 1979)	162,466	108,311
Surplus	7,420,753	3,142,508
Retained earnings	<u>6,398,824</u>	<u>2,984,611</u>
Total stockholders' equity	<u>14,235,543</u>	<u>6,488,930</u>
Total liabilities and stockholders' equity	<u>\$39,229,084</u>	<u>\$10,431,557</u>

See accompanying notes.

FIRST PENN CORPORATION
(parent company only)

STATEMENTS OF INCOME

Years ended December 31, 1980 and 1979

	<u>1980</u>	<u>1979</u>
Income from subsidiary bank:		
Dividends	\$ 300,000	\$ 233,125
Interest on subordinated notes	-	7,533
Interest on certificates of deposit	<u>270,375</u>	<u>-</u>
Total income from subsidiary bank	570,375	240,658
Expenses:		
Interest	1,846,710	189,450
Amortization	22,951	22,946
Other expenses	<u>4,305</u>	<u>13,959</u>
Total expenses	<u>1,873,966</u>	<u>226,355</u>
Income (loss) before income tax benefit, equity in undistributed earnings of subsidiary and securities losses	(1,303,591)	14,303
Income tax benefit (Note 9)	<u>749,183</u>	<u>95,225</u>
Income (loss) before undistributed earnings of subsidiary and securities losses	(554,408)	109,528
Equity in undistributed earnings of subsidiary before securities losses	<u>3,985,098</u>	<u>1,570,737</u>
Income before securities losses	3,430,690	1,680,265
Equity in securities losses of subsidiary, net of related income taxes	<u>-</u>	<u>7,111</u>
Net income	<u>\$3,430,690</u>	<u>\$1,673,154</u>

See accompanying notes.

FIRST PENN CORPORATION
(parent company only)

STATEMENTS OF CHANGES IN FINANCIAL POSITION

Years ended December 31, 1980 and 1979

	<u>1980</u>	<u>1979</u>
Source:		
Net income	\$ 3,430,690	\$1,673,154
Charges against (credit to) income not involving funds in the current period:		
Equity in undistributed earnings of subsidiary	(3,985,098)	(1,563,626)
Amortization of organization costs	1,603	1,632
Amortization of cost in excess of net assets of subsidiary bank	<u>21,348</u>	<u>21,314</u>
Funds provided from (absorbed by) operations	(531,457)	132,474
Proceeds of borrowings	5,606,800	1,000,000
Increase in taxes payable	211,045	600,413
Increase in accrued interest payable	750,818	1,270
Increase in commercial paper	14,640,252	-
Increase in other liabilities	2,000	14,000
Common stock issued in exchange for subordinated notes of subsidiary bank (Note 2)	-	1,000,000
Common stock issued in exchange for stock of subsidiary bank (Note 2)	-	786,226
Preferred stock issued in exchange for stock of subsidiary bank (Note 2)	-	265,623
Proceeds from sale of common stock	<u>4,332,400</u>	<u>-</u>
	<u>\$25,011,858</u>	<u>\$3,800,006</u>
Application:		
Increase in cash	\$ 7,588,209	\$ 7,021
Increase in certificates of deposit	8,300,000	-
Increase in receivable from subsidiary	171,583	623,956
Purchase of land	1,242,721	-
Increase in other assets	30,867	17,180
Additional equity investment in subsidiary bank through (Note 2):		
Capital contribution	7,500,000	1,000,000
Cancellation of indebtedness of subordinated notes of subsidiary bank	-	1,000,000

(Continued on following page)

FIRST PENN CORPORATION
(parent company only)

STATEMENTS OF CHANGES IN FINANCIAL POSITION
(CONTINUED)

Years ended December 31, 1980 and 1979

	<u>1980</u>	<u>1979</u>
Acquisition of subsidiary bank stock	\$ 2,000	\$1,051,849
Payment on notes payable	160,001	100,000
Preferred stock dividends	<u>16,477</u>	<u>-</u>
	<u>\$25,011,858</u>	<u>\$3,800,006</u>

See accompanying notes.

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

December 31, 1980 and 1979

1. Summary of significant accounting policies

Principles of consolidation - The consolidated financial statements include the accounts of First Penn Corporation ("the Company") and its subsidiary, Penn Square Bank N.A. ("the Bank"). All significant intercompany transactions and accounts have been eliminated.

Investment securities - Investment securities are stated at cost adjusted for amortization of premiums and accretion of discounts on the straight-line method to maturity. Gains and losses on sales of investment securities are computed on the specific cost identification method.

Interest on loans - Interest on commercial and real estate loans is accrued based on the principal amount outstanding. Interest on instalment loans is recognized as revenue based on the sum-of-the-months-digits method.

Reserve for possible loan losses - The reserve for possible loan losses is a valuation reserve which has been provided from charges to earnings in the form of provisions for possible loan losses. The provision charged to earnings is the amount which, in the opinion of management, is considered necessary to maintain the balance in the reserve for possible loan losses at a level adequate to absorb potential losses in the loan portfolio. The provision is based on loans specifically identified as probable losses and other factors which, in management's judgment, deserve recognition in estimating possible loan losses.

Premises and equipment - Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line and declining balance basis over the estimated useful lives of the individual assets.

Retirement plan - The Bank has a noncontributory retirement plan covering substantially all full-time employees. The Bank's policy is to fund costs accrued, including amortization of prior service costs.

Income taxes - The Company and its subsidiary bank file a consolidated income tax return. Income tax charges are allocated to the Bank on the basis of its taxable income included in the consolidated financial statements.

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

December 31, 1980 and 1979

1. Summary of significant accounting policies (continued)

Deferred income taxes are provided on all significant timing differences. These differences relate primarily to (1) the difference between the provision for possible loan losses reported for income tax purposes and that reported for financial statement purposes and (2) amortization over a ten-year period of the effect of the change for income tax purposes in 1978 from the cash basis to the accrual basis of reporting certain revenues and expenses.

Investment tax credits are accounted for on the flow-through method.

2. Investment in subsidiary

During 1976 and 1977, the Company acquired 83,259 shares of the 100,000 outstanding shares of the Bank. This acquisition was accounted for as a purchase and the excess of cost over fair market value of the net assets acquired of \$851,792 is being amortized on a straight-line basis over a period of forty years. The unamortized balances of \$747,180 and \$767,322 at December 31, 1980 and 1979, respectively, are included in other assets in the consolidated balance sheet.

During 1979, the Company offered to issue to the minority shareholders of the Bank for each share of the Bank's common stock owned either (1) one and one-half shares of the Company's \$1 par value common stock or (2) one share of the Company's preferred stock.

In September 1979 the following exchanges were effected:

Number of shares of bank stock exchanged	Number of shares of company stock issued	
	Common	Preferred
16,731	18,759	4,225

The additional investment acquired in the Bank was recorded at net book value of the Bank stock which in management's opinion approximated fair market value of the net assets acquired.

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

December 31, 1980 and 1979

2. Investment in subsidiary (continued)

In addition, the Company offered to exchange one share of its common stock for each \$40 of principal face value of the Bank's \$1,000,000 subordinated notes. All note holders exercised their options in exchange for 25,000 shares of the Company's common stock. In October, the Company canceled the Bank's liability on these notes resulting in an additional \$1,000,000 investment in the subsidiary bank. In addition, a cash capital contribution of \$1,000,000 was made by the Company to its subsidiary bank in 1979.

In January, 1980, the Company purchased the remaining 10 outstanding shares of the Bank at a cost of \$200 per share. The excess of cost over fair market value of the shares acquired was \$1206. This amount is included in the unamortized excess cost at December 31, 1980. A cash capital contribution of \$7,500,000 was made by the Company to its subsidiary bank in 1980.

3. Investment securities

The carrying values and estimated market values of investment securities at December 31, 1980 and 1979 are as follows:

	Consolidated	
	<u>1980</u>	
	Carrying value	Market value
United States Treasury securities	\$10,992,420	\$10,643,000
Obligations of states and political subdivisions	31,334,926	26,546,000
Other	300,000	300,000
	<u>\$42,627,346</u>	<u>\$37,489,000</u>
	<u>1979</u>	
United States Treasury securities	\$ 3,181,184	\$ 2,816,000
Obligations of states and political subdivisions	19,741,635	18,013,000
Other	60,000	60,000
	<u>\$22,982,819</u>	<u>\$20,889,000</u>

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

December 31, 1980 and 1979

3. Investment securities (continued)

At December 31, 1980 and 1979 investment securities with book values aggregating \$18,549,000 and \$9,460,000, respectively, were pledged to secure public funds.

4. Loans

Loans are stated at face value less unearned income. The amount of unearned income at December 31, 1980 and 1979 was \$1,537,889 and \$1,903,264, respectively. Loans at December 31, 1980 and 1979 are as follows:

	Consolidated	
	1980	1979
Commercial	\$155,798,134	\$ 83,424,493
Real estate	26,763,002	10,532,265
Instalment	16,356,789	13,263,098
Other	2,981,326	267,123
	201,899,251	107,486,979
Reserve for possible loan losses	(2,004,587)	(1,002,097)
	<u>\$199,894,664</u>	<u>\$106,484,882</u>

Included in outstanding loans at December 31, 1980 were loans totaling \$3,846,129 to officers and directors, or their affiliates. Also during 1980 the Bank purchased loans from and sold loans to two banks in which an officer-director of the Company held an equity interest. At December 31, 1980 outstanding transactions with these banks consisted of:

Loan participations purchased	\$1,737,484
Loan participations sold	\$6,767,646

Management believes all such loans are made in the ordinary course of business.

5. Reserve for possible loan losses

Changes in the reserve for possible loan losses during 1980 and 1979 were as follows:

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

December 31, 1980 and 1979

5. Reserve for possible loan losses (continued)

	Consolidated	
	1980	1979
Balance at beginning of year	\$1,002,097	\$ 627,491
Provision charged to operating expense	1,407,830	615,000
Recoveries of loans previously charged off	212,061	19,038
Losses charged off	(617,401)	(259,432)
Balance at end of year	\$2,004,587	\$1,002,097

6. Premises and equipment

An analysis of premises and equipment follows:

	Consolidated	
	1980	1979
Land	\$1,712,146	\$ 469,426
Building	1,607,244	1,461,562
Furniture and equipment	1,158,227	845,699
Other	459,455	74,259
	4,937,072	2,850,946
Less accumulated depreciation	1,212,684	914,598
	\$3,724,388	\$1,936,348

The land account is composed of land on which the drive-in facility is located and unimproved land.

7. Other liabilities

Other liabilities consist of the following:

	Consolidated	
	1980	1979
Accrued interest payable	\$3,186,239	\$1,012,187
Income taxes payable	1,032,859	821,789

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

December 31, 1980 and 1979

7. Other liabilities (continued)

	Consolidated	
	1980	1979
Deferred federal income taxes	\$ 176,710	\$ 75,000
Other	240,771	66,365
	\$4,636,579	\$1,975,341

8. Notes payable

Notes payable consist of the following obligations of the parent company:

	Parent Company and consolidated	
	1980	1979
Demand notes payable secured by 98,354 shares of the Bank's stock:		
Due February 26, 1981 at Chicago floating prime interest rate	\$7,500,000	\$ -
Due February 26, 1980 at New York prime interest rate not to exceed 8%	-	2,160,001
Due December 28, 1980 at New York prime interest rate	-	1,000,000
Demand note payable, due February 27, 1981 at Dallas prime interest rate, secured by land held by the parent company at cost of \$1,242,721	1,106,800	-
	\$8,606,800	\$3,160,001

Subsequent to year end, the \$7,500,000 demand note was extended to February 26, 1982 and the \$1,106,800 demand note was extended to May 29, 1981. It is the intention of management to seek to renew the debt upon maturity of the demand notes.

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

December 31, 1980 and 1979

9. Income taxes

Consolidated income tax expense, including the tax effects of securities losses, consists of the following components:

	<u>1980</u>	<u>1979</u>
Current tax:		
Federal	\$1,710,000	\$888,400
State	<u>180,000</u>	<u>100,000</u>
	1,890,000	988,400
Deferred	<u>76,710</u>	<u>(26,000)</u>
	<u>\$1,966,710</u>	<u>\$962,400</u>

A reconciliation of the amount computed by applying the federal statutory rate of 46% and the effective income rate follows:

	<u>1980</u>	<u>1979</u>
Income tax at statutory rate	\$2,482,804	\$1,318,468
Tax exempt interest	(585,059)	(392,375)
Investment tax credit	(42,955)	(12,200)
State taxes, net of federal benefit	97,200	54,000
Other	<u>14,720</u>	<u>(5,493)</u>
	<u>\$1,966,710</u>	<u>\$ 962,400</u>

An analysis of the provision (credit) for deferred income taxes follows:

Provision for possible loan losses for income tax purposes in excess of financial provision	\$72,400	\$ 15,400
Amortization of effect of the change for income tax purposes in 1978 from the cash basis to the accrual basis of reporting certain revenues and expenses	(10,800)	(10,800)
Provision for state income taxes for financial purposes in excess of tax provision	-	(32,000)
Other	<u>15,110</u>	<u>1,400</u>
	<u>\$76,710</u>	<u>\$(26,000)</u>

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

December 31, 1980 and 1979

9. Income taxes (continued)

The income tax benefit for the parent company represents the excess of amounts payable by its subsidiary in lieu of paying federal income taxes on a separate return basis over the taxes payable on the consolidated return.

10. Common and preferred stock

On September 6, 1979, the stockholders approved an amendment to the Articles of Incorporation increasing the number of \$1 par value common stock authorized to 250,000 shares from the previously authorized 100,000 shares. The stockholders also approved the authorization of 5,000 non-voting preferred shares with a par value of \$60 and with dividends cumulative at the annual rate of 6.5%. Each preferred share is convertible into one share of the common stock of the Company at any time at the option of the holder and is subject to redemption at the option of the Company upon payment of the par value plus accrued dividends at any time following January 1, 1989. No cash dividends may be paid on common stock if the dividends on the preferred stock is in arrears.

11. Commitments

The Bank has lease agreements for (1) the land under the main bank, which expire in 2029, and (2) office facilities one of which expires in 1985 with renewal options for three five-year terms, one of which expires in 1981, and two which expire in 1984 both with renewal options for three one-year terms. Minimum annual rentals under these leases are as follows:

1981	\$118,353
1982-1983	122,752
1984	21,119
1985	7,980
1986-1989	7,200
1990-2029	3,000

In addition to the minimum rental for one of the office facility leases, the Bank also pays additional rental based on a percent of average total deposits as defined for each lease year. The lease covering the land provides for rental payments to be adjusted every 10 years based on a cost of living index. Total rental expense for 1980 amounted to approximately \$99,000.

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

December 31, 1980 and 1979

12. Participation loans

At December 31, 1980, there were participation agreements in effect with maturity dates prior to that of the underlying loans. Subsequent to December 31, 1980, the majority of the agreements totaling \$18,651,497 were amended to reflect terms that coincide with the terms of the note.

Accordingly, the participation agreements amounting to \$20,969,203 at December 31, 1980 have not been reflected in the accompanying balance sheet as loans outstanding. However, the National Bank Examiners required that certain of these loans be reflected as loans outstanding in reports submitted to their office. After renegotiation of the terms of agreements subsequent to December 31, 1980, these amounts will not be included in such reporting.

13. Subsequent event

Subsequent to December 31, 1980 the Company acquired, from certain officer-stockholders, all of the outstanding stock of a company involved in a real estate development project for approximately \$1,250,000. The acquired company's principal asset is the uncompleted development project which is subject to debt of approximately \$3,000,000. Approximately \$400,000 of this debt, at December 31, 1980, was payable to the Bank. The lead lending bank has filed foreclosure proceedings on the project. In addition, certain suppliers of the project have filed third party claims against the Bank for materials supplied the project and punitive damages. Management is of the opinion that no significant loss will be incurred in connection with this transaction.

DOMESTIC BANK HOLDING COMPANY

JUN 23 1981

ANNUAL REPORT F. R. Y - 6

OFFICIAL RECORD COPY

YEAR ENDING 1980/12/31

SUPPLEMENT

NAME OF BANK HOLDING COMPANY: FIRST PENN CORPORATION

MAILING ADDRESS

STREET: 1919 PENN SQUAKE

P.O. BOX 26208

CITY: OKLAHOMA CITY

STATE: OKLAHOMA

ZIP CODE: 73126

LOCATION OF PRINCIPAL OFFICE:

CITY: OKLAHOMA CITY

COUNTY: OKLAHOMA

STATE: OKLAHOMA

ZIP CODE: 73126

I (NAME) JENNINGS, BILL P

(TITLE) PRESIDENT

AN AUTHORIZED OFFICER OF THE HOLDING COMPANY NAMED ABOVE, HEREBY CERTIFY ON THE ... DAY OF ... 19... THAT THIS REPORT HAS BEEN EXAMINED BY ME AND IS TRUE AND COMPLETE TO THE BEST OF MY KNOWLEDGE AND BELIEF.

SIGNATURE

NAME, TITLE, AND PHONE NUMBER OF PERSON TO WHOM INQUIRES MAY BE DIRECTED:

NAME: TRUESWELL, PATTI

TITLE: ACCT SUPERVISOR

TELEPHONE NUMBER: (405) 842-7441 (AREA CODE)-NUMBER

THIS REPORT IS REQUIRED BY SECTION 5(C) OF THE BANK HOLDING COMPANY ACT (12U.S.C 1844) AND SECTION 225.5(B) OF REGULATION Y (12C.F.R. 255.5(b)).

SCHEDULE A

PAGE 1 OF 3

 INFORMATION ON SUBSIDIARIES<1>
 SEE F.R. Y-6, REPORT ITEM 3.

TO BE COMPLETED FOR EACH BANK AND NONBANK, DIRECT AND INDIRECT, FOREIGN AND DOMESTIC SUBSIDIARY OF THE BANK HOLDING COMPANY.

NAME: FIRST PENN LEASING CORPORATION
 CITY: OKLAHOMA CITY
 STATE: OKLAHOMA
 COUNTY: OKLAHOMA
 ZIP CODE: 73120
 DATE OF SUBSIDIARY'S FISCAL YEAR END: 1966/12/31

1. IF THIS SUBSIDIARY BECAME PART OF THE BHC ORGANIZATION DURING THE LAST FISCAL YEAR, ENTER THE DATE AND NATURE OF CONSIDERATION PAID IF OTHER THAN MONETARY: (WHICH SHOULD BE REPORTED IN ITEM 13 ON PAGE 3 OF THIS SCHEDULE)

DATE(YMMDD):
CONSIDERATION:

FOR ITEMS 2 AND 3, PLACE THE APPROPRIATE NUMBER IN THE BOX PROVIDED.

2. THIS SUBSIDIARY IS:

- | | | |
|--|-----|---|
| A. (1) A BANK (AS DEFINED IN THE ACT) | /2/ | / |
| (2) A NONBANK ORGANIZATION<2> | | |
| B. (1) A JOINT VENTURE | /2/ | / |
| (2) NOT A JOINT VENTURE | | |
| C. (1) A CORPORATION | /1/ | / |
| (2) A PARTNERSHIP | | |
| (3) NOT A CORPORATION OR PARTNERSHIP
(SPECIFY TYPE:) | | |
| D. (1) ACTIVE | /1/ | / |
| (2) INACTIVE | | |
| E. (1) DOMESTIC<3> | /1/ | / |
| (2) FOREIGN<4> | | |

3. IF THIS IS A SUBSIDIARY OF A BANK, IS IT FULLY CONSOLIDATED WITH THE BANK?

- (1) YES (NAME OF BANK) PENN SQUARE BANK, N. A. /1/
 (2) NO /
 (3) NOT APPLICABLE (NOT A SUBSIDIARY OF A BANK) /

<1> REFER TO DEFINITIONS 5 AND 7 IN GENERAL INSTRUCTIONS FOR SUBSIDIARY DEFNS.
 <2> QUESTIONS 2A2: A NONBANK IS ANY ORGANIZATION THAT IS NOT A BANK, AS DEFINED IN THE BHC ACT.
 <3> QUESTION 2E: A BANK (AS DEFINED IN THE BHC ACT) IS CONSIDERED DOMESTIC.
 <4> REFER TO DEFINITIONS 6 AND 7 IN THE GENERAL INSTRUCTIONS FOR FOREIGN ORGANIZATIONS.

INFORMATION ON SUBSIDIARIES

4. LIST EACH ORGANIZATION WITHIN THE BANK HOLDING COMPANY ORGANIZATION THAT DIRECTLY OWNS OR CONTROLS VOTING SECURITIES OF THIS SUBSIDIARY, AND INDICATE THE TYPE(S) OR CLASS(ES) OF SHARES OWNED OR CONTROLLED AND PERCENTAGE (TO THE NEAREST TENTH OF ONE PERCENT) OF OUTSTANDING SHARES OF EACH TYPE OR CLASS OWNED OR CONTROLLED.

DIRECT PARENT	CLASS OF SHARES	PER CENT OWNED
PENN SQUARE BANK, N. A.	COMMON STOCK-VOTING	100.00
/	/	/
/	/	/
/	/	/
/	/	/
/	/	/

5. SPECIFY THE EXEMPTIVE PROVISION AND REGULATION OR BOARD ORDER (INDICATE DATE) RELIED UPON FOR RETENTION OF THIS SUBSIDIARY. <1>

SECTION 4(C) 5
 /
 SECTION 4(C) 5
 /
 /
 /

6. LIST CURRENT ACTIVITIES CONDUCTED BY THIS SUBSIDIARY IN ORDER OF IMPORTANCE.

ACTIVITY CODE<2>	CONDUCTED IN U.S. (1=YES, 2=NO)
06AA /	1 /
06AC /	1 /
/	/
/	/
/	/

7. LIST ACTIVITIES COMMENCED BY THIS SUBSIDIARY THIS YEAR.

ACTIVITY CODE<2>	CONDUCTED IN U.S. (1=YES, 2=NO)	EFFECTIVE DATE (YYMMDD)
06AA /	1 /	79/01/01 /
06AC /	1 /	79/01/01 /
/	/	/

8. LIST ACTIVITIES TERMINATED BY THIS SUBSIDIARY DURING THE FISCAL YEAR.

ACTIVITY CODE<2>	EFFECTIVE DATE (YYMMDD)
0140 /	79/01/01 /
/	/
/	/

9. LIST ACTIVITIES NOT CURRENTLY CONDUCTED BY THIS SUBSIDIARY BUT FOR WHICH APPROVAL EXISTS.

ACTIVITY CODE<2>
 /
 /
 /

<1> QUESTION 5: REFER TO DEFINITIONS 9 AND 10 IN THE GENERAL INSTRUCTIONS.
 <2> QUESTIONS 6, 7, 8, 9: REFER TO THE OMC ACTIVITY MANUAL FOR CODES, USE THE + DIGIT ALPHANUMERIC CODES WHENEVER POSSIBLE.

INFORMATION ON SUBSIDIARIES

10. IF THIS SUBSIDIARY'S HEAD OFFICE IS LOCATED IN THE UNITED STATES, FURNISH THE FOLLOWING INFORMATION: <1>

- A. NUMBER OF EXISTING OFFICES 1 /
- B. NUMBER OF OFFICES ESTABLISHED DURING FISCAL YEAR /
- C. NUMBER OF OFFICES TERMINATED DURING FISCAL YEAR /
- D. NUMBER OF OFFICES APPROVED BUT UNOPENED /

11. IF THIS SUBSIDIARY'S HEAD OFFICE IS LOCATED IN A FOREIGN COUNTRY, FURNISH THE FOLLOWING INFORMATION:

COUNTRY OF HEAD OFFICE NUMBER OF OFFICES

/ /
COUNTRY OF OTHER OFFICES NUMBER OF OFFICES

AMOUNTS IN THOUSANDS OF U.S. DOLLARS

- 12. TOTAL AMOUNT AT WHICH THIS SUBSIDIARY IS CARRIED ON THE BOOKS OF ITS OWNER(S) WITHIN THE BANK HOLDING COMPANY ORGANIZATION. 226 /
- 13. TOTAL HISTORIC COST OF THIS SUBSIDIARY 100 /
- 14. BANK HOLDING COMPANY'S (PARENT ONLY) INCOME FROM THIS SUBSIDIARY DURING THE PARENT'S FISCAL YEAR: <2>
 - A. DIVIDENDS DECLARED (PAID OR PAYABLE DIRECTLY TO THE PARENT). /
 - B. OTHER (INTEREST, MANAGEMENT, AND SERVICE FEES, ETC.) EXCLUDING THE PARENT'S EQUITY IN UNJUSTIFIED EARNINGS OF THIS SUBSIDIARY. /
- 15. OUTSTANDING LOANS AND ADVANCES TO THIS SUBSIDIARY AS OF THE END OF THE BANK HOLDING COMPANY'S (PARENT ONLY) FISCAL YEAR: <2>
 - A. FROM THE BANK HOLDING COMPANY (PARENT ONLY) /
 - B. FROM SUBSIDIARY BANKS OF THE HOLDING COMPANY /
 - C. FROM OTHER SUBSIDIARIES OF THE BANK HOLDING COMPANY /
- 16. LOANS AND LEASES, NET OF UNEARNED INCOME AND RESERVE FOR POSSIBLE LOAN LOSSES: <3> /
- 17. TOTAL ASSETS: <3> /
- 18. STOCKHOLDERS' EQUITY: <3> /
- 19. TOTAL OPERATING REVENUE: <3> /
- 20. TOTAL OPERATING EXPENSES: <3> /
- 21. NET INCOME: <3> /
- 22. DO THE AMOUNTS FOR THIS SUBSIDIARY IN ITEMS 16 THROUGH 21 CONSOLIDATE ON A LINE BY LINE BASIS THE ACCOUNTS OF ANY OF ITS SUBSIDIARIES? ENTER "1" FOR YES, "2" FOR NO, "3" FOR INAPPLICABLE. 3 /
- 23. IF THE FINANCIAL STATEMENTS OF THIS SUBSIDIARY HAVE NOT BEEN SUBMITTED IN REPORT ITEM 4 BECAUSE ITS ACCOUNTS HAVE BEEN CONSOLIDATED ON A LINE-BY-LINE BASIS WITH ANOTHER SUBSIDIARY FOR WHICH STATEMENTS HAVE BEEN SUBMITTED, INDICATE THE NAME OF THAT SUBSIDIARY. <3>

 <1> QUESTION 10: NEED NOT BE COMPLETED FOR ANY BANKS (AS DEFINED IN THE BHC ACT)
 <2> QUESTION 14, 15: NEED NOT BE COMPLETED FOR COMPANIES THAT FILE FR 2314 OR FR 2860b.
 <3> QUESTIONS 16-21: NEED NOT BE COMPLETED FOR A BANK, A SUB OF A BANK CONSOLIDATED IN ITS PARENT'S CONSOLIDATED REPORT OF CONDITION, OR ANY SUBSIDIARY FILING AN FR 2314 OR FR 2860b: REFER TO REPORT ITEM 3 INSTRUCTIONS.

SCHEDULE A

PAGE 1 OF 3

INFORMATION ON SUBSIDIARIES<1>
SEE F.R. Y-6, REPORT ITEM 3.

TO BE COMPLETED FOR EACH BANK AND NONBANK, DIRECT AND INDIRECT, FOREIGN AND DOMESTIC SUBSIDIARY OF THE BANK HOLDING COMPANY.

NAME: PENN SQUARE BANK, N. A.
/ _____ /CITY: OKLAHOMA CITY
/ _____ /STATE: OKLAHOMA
/ _____ /COUNTY: OKLAHOMA
/ _____ /ZIP CODE: 73118
/ _____ /

DATE OF SUBSIDIARY'S FISCAL YEAR END: 1980/12/31 / _____ /

1. IF THIS SUBSIDIARY BECAME PART OF THE BHC ORGANIZATION DURING THE LAST FISCAL YEAR, ENTER THE DATE AND NATURE OF CONSIDERATION PAID IF OTHER THAN MONETARY: (WHICH SHOULD BE REPORTED IN ITEM 13 ON PAGE 3 OF THIS SCHEDULE)

DATE (YYMMDD): / _____ /
CONSIDERATION: / _____ /

FOR ITEMS 2 AND 3, PLACE THE APPROPRIATE NUMBER IN THE BOX PROVIDED.

2. THIS SUBSIDIARY IS:
- | | | |
|---------------------------------------|-----|------|
| A. (1) A BANK (AS DEFINED IN THE ACT) | /1/ | /__/ |
| (2) A NONBANK ORGANIZATION<2> | | |
| E. (1) A JOINT VENTURE | /2/ | /__/ |
| (2) NOT A JOINT VENTURE | | |
| C. (1) A CORPORATION | /1/ | /__/ |
| (2) A PARTNERSHIP | | |
| (3) NOT A CORPORATION OR PARTNERSHIP | | |
| (SPECIFY TYPE:) | | |
| D. (1) ACTIVE | /1/ | /__/ |
| (2) INACTIVE | | |
| E. (1) DOMESTIC<3> | /1/ | /__/ |
| (2) FOREIGN<4> | | |

3. IF THIS IS A SUBSIDIARY OF A BANK, IS IT FULLY CONSOLIDATED WITH THE BANK?
- (1) YES (NAME OF BANK) /3/ _____ /__/
- (2) NO
- (3) NOT APPLICABLE (NOT A SUBSIDIARY OF A BANK)

<1> REFER TO DEFINITIONS 5 AND 7 IN GENERAL INSTRUCTIONS FOR SUBSIDIARY DEFS.
 <2> QUESTIONS 2A2: A NONBANK IS ANY ORGANIZATION THAT IS NOT A BANK, AS DEFINED IN THE BHC ACT.
 <3> QUESTION 2E: A BANK (AS DEFINED IN THE BHC ACT) IS CONSIDERED DOMESTIC.
 <4> REFER TO DEFINITIONS 6 AND 7 IN THE GENERAL INSTRUCTIONS FOR FOREIGN ORGANIZATIONS.

INFORMATION ON SUBSIDIARIES

4. LIST EACH ORGANIZATION WITHIN THE BANK HOLDING COMPANY ORGANIZATION THAT DIRECTLY OWNS OR CONTROLS VOTING SECURITIES OF THIS SUBSIDIARY, AND INDICATE THE TYPE(S) OR CLASS(ES) OF SHARES OWNED OR CONTROLLED AND PERCENTAGE (TO THE NEAREST TENTH OF ONE PERCENT) OF OUTSTANDING SHARES OF EACH TYPE OR CLASS OWNED OR CONTROLLED.

DIRECT PARENT	CLASS OF SHARES	PER CENT OWNED
FIRST PENN CORPORATION	COMMON STOCK-VOTING	100.00
/	/	/
/	/	/
/	/	/
/	/	/
/	/	/

5. SPECIFY THE EXEMPTIVE PROVISION AND REGULATION OR BOARD ORDER (INDICATE DATE) RELIED UPON FOR RETENTION OF THIS SUBSIDIARY. <1> SECTION 3(A) (1)

/

/

/

/

6. LIST CURRENT ACTIVITIES CONDUCTED BY THIS SUBSIDIARY IN ORDER OF IMPORTANCE. ACTIVITY CODE<2> CONDUCTED IN U.S. (1=YES, 2=NO)

6025	/	1	/
/	/	/	/
/	/	/	/
/	/	/	/

7. LIST ACTIVITIES COMMENCED BY THIS SUBSIDIARY THIS YEAR.

ACTIVITY CODE<2>	CONDUCTED IN U.S. (1=YES, 2=NO)	EFFECTIVE DATE (YYMMDD)
/	/	/ / /
/	/	/ / /
/	/	/ / /

8. LIST ACTIVITIES TERMINATED BY THIS SUBSIDIARY DURING THE FISCAL YEAR.

ACTIVITY CODE<2>	EFFECTIVE DATE (YYMMDD)
/	/ / /
/	/ / /
/	/ / /

9. LIST ACTIVITIES NOT CURRENTLY CONDUCTED BY THIS SUBSIDIARY BUT FOR WHICH APPROVAL EXISTS.

ACTIVITY CODE<2>
/
/
/

<1> QUESTION 5: REFER TO DEFINITIONS 9 AND 10 IN THE GENERAL INSTRUCTIONS.
 <2> QUESTIONS 6, 7, 8, 9: REFER TO THE BHC ACTIVITY MANUAL FOR CODES, USE THE * DIGIT ALPHANUMERIC CODES WHENEVER POSSIBLE.

INFORMATION ON SUBSIDIARIES

10. IF THIS SUBSIDIARY'S HEAD OFFICE IS LOCATED IN THE UNITED STATES, FURNISH THE FOLLOWING INFORMATION:<1>

- A. NUMBER OF EXISTING OFFICES 1 /
- B. NUMBER OF OFFICES ESTABLISHED DURING FISCAL YEAR /
- C. NUMBER OF OFFICES TERMINATED DURING FISCAL YEAR /
- D. NUMBER OF OFFICES APPROVED BUT UNOPENED /

11. IF THIS SUBSIDIARY'S HEAD OFFICE IS LOCATED IN A FOREIGN COUNTRY, FURNISH THE FOLLOWING INFORMATION:

COUNTRY OF HEAD OFFICE NUMBER OF OFFICES

COUNTRY OF OTHER OFFICES NUMBER OF OFFICES

AMOUNTS IN THOUSANDS OF U.S. DOLLARS

- 12. TOTAL AMOUNT AT WHICH THIS SUBSIDIARY IS CARRIED ON THE BOOKS OF ITS OWNER(S) WITHIN THE BANK HOLDING COMPANY ORGANIZATION. 21,170 /
- 13. TOTAL HISTORIC COST OF THIS SUBSIDIARY 7,134 /
- 14. BANK HOLDING COMPANY'S (PARENT ONLY) INCOME FROM THIS SUBSIDIARY DURING THE PARENT'S FISCAL YEAR:<2>

 - A. DIVIDENDS DECLARED (PAID OR PAYABLE DIRECTLY TO THE PARENT). 300 /
 - B. OTHER (INTEREST, MANAGEMENT, AND SERVICE FEES, ETC.) EXCLUDING THE PARENT'S EQUITY IN UNDISTRIBUTED EARNINGS OF THIS SUBSIDIARY. /

- 15. OUTSTANDING LOANS AND ADVANCES TO THIS SUBSIDIARY AS OF THE END OF THE BANK HOLDING COMPANY'S (PARENT ONLY) FISCAL YEAR:<2>

 - A. FROM THE BANK HOLDING COMPANY (PARENT ONLY) /
 - B. FROM SUBSIDIARY BANKS OF THE HOLDING COMPANY /
 - C. FROM OTHER SUBSIDIARIES OF THE BANK HOLDING COMPANY /

- 16. LOANS AND LEASES, NET OF UNEARNED INCOME AND RESERVE FOR POSSIBLE LOAN LOSSES<3> /
- 17. TOTAL ASSETS<3> /
- 18. STOCKHOLDERS' EQUITY<3> /
- 19. TOTAL OPERATING REVENUE<3> /
- 20. TOTAL OPERATING EXPENSES<3> /
- 21. NET INCOME<3> /
- 22. DO THE AMOUNTS FOR THIS SUBSIDIARY IN ITEMS 16 THROUGH 21 CONSOLIDATE ON A LINE BY LINE BASIS THE ACCOUNTS OF ANY OF ITS SUBSIDIARIES? ENTER "1" FOR YES, "2" FOR NO, "3" FOR INAPPLICABLE. 2 /
- 23. IF THE FINANCIAL STATEMENTS OF THIS SUBSIDIARY HAVE NOT BEEN SUBMITTED IN REPORT ITEM 4 BECAUSE ITS ACCOUNTS HAVE BEEN CONSOLIDATED ON A LINE-BY-LINE BASIS WITH ANOTHER SUBSIDIARY FOR WHICH STATEMENTS HAVE BEEN SUBMITTED, INDICATE THE NAME OF THAT SUBSIDIARY.<3>

<1> QUESTION 10: NEED NOT BE COMPLETED FOR ANY BANKS (AS DEFINED IN THE EHC ACT)

<2> QUESTION 14, 15: NEED NOT BE COMPLETED FOR COMPANIES THAT FILE FR 2314 OR FR 2866B.

<3> QUESTIONS 16-21: NEED NOT BE COMPLETED FOR A BANK, A SUB OF A BANK CONSOLIDATED IN ITS PARENT'S CONSOLIDATED REPORT OF CONDITION, OR ANY SUBSIDIARY FILING AN FR 2314 OR FR 2866B: REFER TO REPORT ITEM 3 INSTRUCTIONS.

ACTIVITIES OF PARENT BHC

NAME: FIRST PENN CORPORATION

CITY: OKLAHOMA CITY _____

STATE: OKLAHOMA _____

COUNTY: OKLAHOMA _____

ZIP CODE: 73126 _____

1. LIST CURRENT ACTIVITIES CONDUCTED BY PARENT IN ORDER OF IMPORTANCE:
 ACTIVITY CODE<1> CONDUCTED IN US(1=YES,2=NO)
 UGAA / / 1 / /
 / / / /
 / / / /
 / / / /
 / / / /
2. LIST ACTIVITIES COMMENCED BY THE PARENT THIS FISCAL YEAR:
 ACTIVITY CODE<1> CONDUCTED IN US(1=YES,2=NO) EFFECTIVE DATE(YMMMDD)
 / / / / / / / /
 / / / / / / / /
 / / / / / / / /
3. LIST ACTIVITIES TERMINATED BY PARENT THIS FISCAL YEAR:
 ACTIVITY CODE<1> EFFECTIVE DATE
 / / / / / / / /
 / / / / / / / /
 / / / / / / / /
4. LIST ACTIVITIES NOT CURRENTLY CONDUCTED BY PARENT FOR WHICH A VALID APPROVAL
 BY AUTHORITIES IS IN EFFECT.
 ACTIVITY CODE<1>
 / / / /
 / / / /
 / / / /
5. NUMBER OF OFFICES OF THE PARENT COMPANY:
 A. NUMBER OF EXISTING OFFICES(INCLUDING HEAD OFFICE). 1 / /
 B. NUMBER OF OFFICES ESTABLISHED DURING FISCAL YEAR. / /
 C. NUMBER OF OFFICES TERMINATED DURING FISCAL YEAR. / /
 D. NUMBER OF OFFICES APPROVED BUT UNOPENED. / /
 6. DOLS COMPANY FILE WITH SEC? (1=YES,2=NO) 2 / /
 7. SPECIFY THE EXEMPTIVE PROVISIONS AND REGULATION OR BOARD ORDER(INDICATE DATE)
 RELIED UPON FOR AUTHORITY TO CONTINUE TO ENGAGE IN THE BUSINESS ACTIVITIES
 LISTED IN ITEM 1 ABOVE.<2>

"NOT APPLICABLE OR NONE"

<1> QUESTIONS 1,2,3,4: REFER TO BHC MANUAL FOR ACTIVITY CODES,USE THE 4 DIGIT ALPHANUMERIC CODES WHENEVER POSSIBLE.
 <2> QUESTION 7: REFER TO DEFINITION 11 IN THE GENERAL INSTRUCTIONS.

SCHEDULE D

4423
PAGE 1 OF 1

TERMINATIONS

PROVIDE THE FOLLOWING INFORMATION FOR ANY ORGANIZATION (SUBSIDIARY AND ORGANIZATION OTHER THAN A SUBSIDIARY, BANK AND NONBANK, DOMESTIC AND FOREIGN) THAT CEASED BEING PART OF THE BANK HOLDING COMPANY ORGANIZATION DURING THE BANK HOLDING COMPANY'S FISCAL YEAR. INCLUDE ALL ORGANIZATIONS THAT WERE LIQUIDATED, DIVESTED, OR MERGED OUT OF EXISTENCE. IF MORE SPACE IS NEEDED, ATTACH A SEPARATE PAGE SUPPLYING THE INFORMATION IN THE SAME FORMAT.

IF THE ORGANIZATION WAS DISPOSED OF: DESCRIBE THE MANNER AND TERMS OF DISPOSITION; INDICATE THE AMOUNT OF CREDIT EXTENDED TO THE PURCHASER BY THE BANK HOLDING COMPANY ORGANIZATION, IF ANY; AND INDICATE WHETHER THE PURCHASER HAS ONE OR MORE OFFICERS, DIRECTORS, TRUSTEES, OR BENEFICIARIES IN COMMON WITH, OR SUBJECT TO CONTROL BY, THE BANK HOLDING COMPANY ORGANIZATION.

COL A. NAME AND ADDRESS OF EACH ORGANIZATION TERMINATED.

NAME: _____
 CITY: _____ STATE: _____
 COUNTY: _____ ZIP CODE: _____

COL B. NAME AND ADDRESS OF EACH ORGANIZATION THAT ABSORBED A MERGED ORGANIZATION.

NAME: _____
 CITY: _____ STATE: _____
 COUNTY: _____ ZIP CODE: _____

COL C. EFFECTIVE DATE OF TERMINATION 19 / / _____

COL D. ENTER (1=LIQUIDATED, 2=DIVESTED, 3=MERGER, 4=OTHER) _____

COL A. NAME AND ADDRESS OF EACH ORGANIZATION TERMINATED.

NAME: _____
 CITY: _____ STATE: _____
 COUNTY: _____ ZIP CODE: _____

COL B. NAME AND ADDRESS OF EACH ORGANIZATION THAT ABSORBED A MERGED ORGANIZATION.

NAME: _____
 CITY: _____ STATE: _____
 COUNTY: _____ ZIP CODE: _____

COL C. EFFECTIVE DATE OF TERMINATION 19 / / _____

COL D. ENTER (1=LIQUIDATED, 2=DIVESTED, 3=MERGER, 4=OTHER) _____

TELEPHONE MESSAGES

REC'D IN RECORDS SECTION
JUN 23 1981

CONTACT <i>Cathy Truendell</i>	PHONE NUMBER (Area Code & Number) <i>(405) - 842 - 7441</i>	BANK HOLDING COMPANY NUMBER <i>2883</i>
BANK HOLDING COMPANY NAME <i>Frost Perm</i>	DATE OF PHONE CALL <i>5/5/81</i>	
<input checked="" type="checkbox"/> ANNUAL REPORT <i>AMENDMENTS TO Y.A.</i>	<input type="checkbox"/> REGISTRATION STATEMENT	
REMARKS <i>P.2. SEC. A FOR "LOANS": # 5 from N.A. to 4161(2) # 6 from 646 to 02AP & 06AR</i>		
<i>P.3 SEC. A FOR "BANK": # 10 to N.A.</i>		
<i>SEC. C : # 1 from 02AP & 01CE to 02AP</i>		
<i># 2 from 01CB to nothing</i>		
<i>Also: amended Sec to read: "All + income subject in future"</i>		
ASSISTANT EXAMINER: <i>John F. Moore</i>		

BSS 16 (10)

OFFICIAL RECORD COPY

CLERK

SUPPLEMENT

2



0520

Approved by the Federal Reserve Board
November 29, 1978
Approval expires January 1, 1981

ORIGINAL RECORD COPY

REC'D IN RECORDS SECTION
2285
MAR 03 1981

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
Washington, D.C. 20551

BANK HOLDING COMPANY FINANCIAL SUPPLEMENT

Division of Banking
SUPERVISORY OFFICE
FEB 27 PM 9 55
CLEVELAND, OHIO
Report 1981

Reporting period (fill in appropriate line below)
For the fiscal year period ending on December 31, 1980
For the 6-month period ending on _____, 19____

Name of bank holding company: First Penn Corporation

Mailing address: P. O. Box 26208
Street
Oklahoma City Oklahoma 73126
City State Zip Code

Location of principal office: Oklahoma City Oklahoma
City State
Oklahoma 73126
City County Zip Code
State Zip Code

I, Bill P. Jennings President
Name Title

an authorized officer of the bank holding company named above, hereby declare that this report has been examined by me and is true and complete to the best of my knowledge and belief.

Bill P. Jennings February 12, 1981
Signature Date

Name, title, and phone number of person to whom inquiries may be directed:
Sheryl A. Walker Controller
Name Title

405 842-7441 Ext. 274
Area Code Number

General Instructions

Who must report: This report is to be filed by domestic bank holding companies that have \$50 million or more in total consolidated assets. The following companies are not required to file the report: (a) a bank holding company that is a subsidiary of another domestic bank holding company; (b) a bank holding company that has been granted an exemption under Section 4(d) of the Act; and (c) a bank holding company that is organized under the laws of a foreign country, and more than half of whose consolidated assets are located, or half of whose consolidated revenues are derived, outside the United States. The Federal Reserve Bank may require this report from bank holding companies that are not required to file this report under the above criteria.

Full year reporting: Bank holding companies that have \$50 million or more in total consolidated assets must file this report once a year for the 12-month period covering their fiscal year.

Midyear reporting: In addition to full-year reporting, bank holding companies that have \$300 million or more in consoli-

dated assets must file this report for the 6-month period covering the first half of their fiscal year.

Time and place of filing: The report must be filed within 45 days after the end of the reporting period. Submit the original and three copies of the report to the Federal Reserve Bank of the district in which the bank holding company is registered.

Confidentiality: The report will be made publicly available after the bank holding company has released its financial statements to the public or 90 days after the end of the reporting period, whichever comes first. In the interim period, the information contained in this report will be regarded as confidential by the Federal Reserve System. If it should be determined that any information contained in this report must be released during this period, respondents will be notified.

Detailed instructions: Please refer to the instructions manual for the Bank Holding Company Financial Supplement.

FOR FILES
GUESS

This report is required by Section 5(c) of the Bank Holding Company Act (12 U.S.C. 1844) and Section 225.5(b) of Regulation Y (12 CFR 225.5(b)).

Consolidated Balance Sheet^{1/}
(Including foreign and domestic subsidiaries)

As of the close of business on 12-31, 1980

FR BANK USE ONLY

Year		Dist.	
1	Y 9 1 8 2 1	9	
BHC No.		Yr.	Mo.
11		23	25 27 30

		Dollar amounts		
		Bil	Mil	
ASSETS				
1. Cash and due from depository institutions:				
a. Interest-bearing balances	01		0	1a
b. Other			59 626	2
2. U.S. Treasury securities			10 992	3
3. Obligations of other U.S. Government agencies and corporations			0	4
4. Obligations of States and political subdivisions in the United States			31 335	5
5. Other bonds, notes, and debentures			0	6
6. Federal Reserve stock and corporate stock	02		300	7
7. Trading account securities			0	8
8. Federal funds sold and securities purchased under agreements to resell in domestic offices including those of Edge and Agreement subsidiaries			16 000	9a
9. Loans:				
a. Loans made at domestic offices:				
(1) Real estate loans			29 433	9a1
(2) Loans to financial institutions			0	9a2
(3) Commercial and industrial loans			144 099	9a3
(4) Loans to individuals for household, family, and other personal expenditures	03		13 375	9a4
(5) All other loans			13 490	9a5
b. Loans made at foreign offices and at Edge and Agreement subsidiaries			0	9b
c. Less: Unearned income on loans reflected in items above ^{2/}			1 467	9c
d. Less: Allowance for possible loan losses ^{2/}			2 005	9d
e. Loans, net			196 925	9e
10. Lease financing receivables	04		0	10
11. Company premises, furniture, fixtures, and other assets representing company premises			3 688	11
12. Real estate owned other than company premises			0	12
13. Investments in unconsolidated subsidiaries and associated companies			0	13
14. Intangible assets			747	14
15. Other assets			8 196	15
16. TOTAL ASSETS	05		327 809	16

^{1/} Bank holding companies with less than \$100 million in total consolidated assets need not complete the consolidated balance sheet and income statement (parts A and B of this report).
^{2/} Do not enclose amount in parentheses.

Remarks:

Consolidated Balance Sheet - continued

FR BANK USE ONLY

Year										Dist		
1	Y	9	8	2	1	1	9					
BHC No.										Yr.	Mo.	Day
11											3	
											30	

LIABILITIES AND STOCKHOLDERS' EQUITY

		Dollar amounts			
		Bil	Mil	Thou	
17. DEPOSITS:					
a. Deposits in domestic offices:					
(1) Demand deposits	06	135	029		17a1
(2) Time deposits:					
(a) Time deposits of \$100,000 or more		103	243		17a2a
(b) Other time deposits		31	780		17a2c
(3) Savings deposits:					
(a) Corporations and other profit organizations		1	593		17a3a
(b) Other savings deposits		11	748		17a3c
b. Deposits in foreign offices and in Edge and Agreement subsidiaries			0		17b
c. TOTAL DEPOSITS	07	284	893		17c
18. Federal funds purchased and securities sold under agreements to repurchase in domestic offices including those of Edge and Agreement subsidiaries			650		18
19. Commercial paper			14	640	19
20. Other borrowings with an original maturity of one year or less			8	607	20
21. Other borrowings with an original maturity of more than one year (excluding mortgage indebtedness and subordinated debt)				0	21
22. Mortgage indebtedness and liability for capitalized leases				0	22
23. Subordinated notes and debentures	08			0	23
24. Other liabilities			4	772	24
25. TOTAL LIABILITIES		313	562		25
26. Minority interest in consolidated subsidiaries				0	26
27. STOCKHOLDERS' EQUITY			14	247	27
28. TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY			327	809	28
MEMORANDA					
29. Amount of debt reported above in Items 21, 22, and 23 that is scheduled to mature within 0-2 year	09		8	607	29
30. Standby letters of credit outstanding			27	774	30
31. Deferred taxes (included in Item 24, "Other liabilities"):					
a. IRS bad debt reserve				0	31a
b. Other				108	31b
32. State the amount of intangible assets reported in Item 14 that is subject to amortization				747	32

Remarks:

Line 20 & 29 . It is the intention of management to seek to renew the debt upon maturity of the demand note.

FR BANK USE ONLY

Year			Dist		
Y	1	9	J	8	2
1	3		9		
BHC No.		Yr.	Mo.	Day	
11		23	25	27	30

Consolidated Report of Income^{1/}
(Including foreign and domestic subsidiaries)

Reporting period (fill in appropriate line below)
For the fiscal year ending on 12-31, 19 80
For the 6-month period ending on _____, 19____

	10	Year-to-date			1a
		Dollar amounts			
		Bil	Mil	Thou	
1. OPERATING INCOME:					
a. Interest and fees on loans			24	650	
b. Interest on balances with depository institutions				0	1b
c. Income on Federal funds sold and securities purchased under agreements to resell in domestic offices including those of Edge and Agreement subsidiaries				283	1c
d. Interest on U.S. Treasury securities				314	1d
e. Interest on obligations of other U.S. Government agencies and corporations				0	1e
f. Interest on obligations of States and political subdivisions in the United States			1	294	1f
g. Interest on other bonds, notes, and debentures	11			0	1g
h. Dividends on stock				10	1h
i. Trading account income, net (including commissions and fees)				0	1i
j. Income from lease financing				19	1j
k. Income from fiduciary activities				700	1k
l. Service charges, commissions, and fees				121	1l
m. Other operating income ^{2/}	12			58	1m
n. TOTAL OPERATING INCOME (sum of Items 1a through 1m)			27	649	1n
2. OPERATING EXPENSE:					
a. Salaries and employee benefits			2	336	2a
b. Interest on deposits			12	550	2b
c. Expense of Federal funds purchased and securities sold under agreements to repurchase in domestic offices including those of Edge and Agreement subsidiaries				739	2c
d. Interest on borrowed funds (excluding subordinated notes and debentures)			1	982	2d
e. Interest on subordinated notes and debentures	13			0	2e
f. Net occupancy expense, and furniture and equipment expense				652	2f
g. Provision for possible loan losses			1	408	2g
h. Other operating expenses			2	380	2h
i. TOTAL OPERATING EXPENSE (sum of Items 2a through 2h)			22	047	2i
3. INCOME (LOSS) BEFORE TAXES AND APPROPRIATE ITEMS BELOW (Item 1n minus Item 2i)				5	3
4. Applicable income taxes (foreign and domestic)	14			1	4
5. Minority interest (required to be reported here only if material) ^{2/}				3	5
6. INCOME (LOSS) BEFORE SECURITIES GAINS OR LOSSES AND EXTRAORDINARY ITEMS				0	6
7. Securities gains (losses), net of applicable taxes and minority interest				0	7
8. Extraordinary items, net of applicable taxes and minority interest				0	8
9. NET INCOME (LOSS)				3	9
MEMORANDA					
10. Total operating income on a fully taxable equivalent basis (Item 1n, adjusted)	15		29	84.5	10
11. Allowance for possible loan losses:					
a. Balance at end of previous year			1	002	11a
b. Recoveries credited to allowance				212	11b
c. Changes incident to mergers and absorptions, net				0	11c
d. Provisions for possible loan losses			1	408	11d
e. Less: Losses charged to allowance ^{3/}				61	11e
f. Foreign currency translation adjustments	16			0	11f
g. Balance at end of period (must equal Item 9d of Page 2.)			2	005	11g

3442

^{1/} Bank holding companies with less than \$100 million in total consolidated assets need not complete the consolidated balance sheet and income statement (Items A and B of this report).
^{2/} Minority interest may be reported in Item 1m if it is not material (see detailed instructions).
^{3/} Do not enclose amount in parentheses.

Parent Company Only: Balance Sheet

As of the close of business on Dec. 31, 1980

FR BANK USE ONLY

Year						Dist.		
1	2	3	4	5	6	7	8	9
	Y	9	8	2	1			
BHC No.			Yr.	Mo.	Day			
11			23	25	27	30	5	

		Dollar amounts			
		Bill	Mill	Thou	
ASSETS					
1. Cash and cash items	17	7	596		1
2. Securities ^{1/}		8	300		2
3. Loans, net			0		3
4. Lease financing receivables			0		4
5. Investments in and receivables due from subsidiaries and associated companies (sum of Items 15a(1) through 16b(2) below)		21	877		5
6. Premises, furniture, fixtures, and equipment		1	243		6
7. Other assets	18		56		7
8. TOTAL ASSETS		39	072		8
LIABILITIES AND STOCKHOLDERS' EQUITY					
9. Borrowings with an original maturity of one year or less:					
a. Commercial paper		14	640		9a
b. Other		8	607		9b
10. Other borrowed funds			0		10
11. Subordinated notes and debentures			0		11
12. Other liabilities	19	1	578		12
13. Stockholders' equity:					
a. Preferred stock (par value)			254		13a
b. Common stock (par value)			162		13b
c. Capital surplus		7	421		13c
d. Retained earnings		6	410		13d
e. Less: Treasury stock ^{2/}			0		13e
f. TOTAL STOCKHOLDERS' EQUITY	20	14	247		13f
14. TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY		39	072		14
MEMORANDA					
15. a. Equity investments in <i>bank</i> subsidiaries and associated banks: ^{3/}					
(1) Common and preferred stock (net of amount reported in Item 15a(2))		20	422		15a1
(2) Excess of cost over fair value of net assets acquired, net of amortization			74		15a2
b. Nonequity investments in and receivables due from <i>bank</i> subsidiaries and associated banks:					
(1) Loans, advances, notes, bonds, and debentures			0		15b1
(2) Other receivables			708		15b2
16. a. Equity investments in <i>nonbank</i> subsidiaries and associated nonbank companies: ^{3/}					
(1) Common and preferred stock (net of amount reported in Item 16a(2))	21		0		16a1
(2) Excess of cost over fair value of net assets acquired, net of amortization			0		16a2
b. Nonequity investments in and receivables due from <i>nonbank</i> subsidiaries and associated nonbank companies:					
(1) Loans, advances, notes, bonds, and debentures			0		16b1
(2) Other receivables			0		16b2
17. Loans and advances from subsidiaries and associated companies (included in Items 9, 10, and 11):					
a. Bank			0		17a
b. Nonbank			0		17b
18. Amount of borrowings included in Items 10 and 11 that is scheduled to mature within one year	22		0		18
19. Does the amount reported in Item 13f equal that reported in Item 27 of page 3 of this report? Enter "1" for Yes; "2" for No; and "3" if Page 3 was not reported. If the amounts are not equal, attach a statement of reconciliation.				1	19

^{1/} Exclude investments in subsidiaries and "associated companies." See Item 5.
^{2/} Do not enclose amount in parentheses.
^{3/} The sum of Items 15a(1) through 16b(2) must equal the amount reported in Item 5.

Parent Company Only: Income Statement

FR BANK USE ONLY

Year				Dist			
1	2	3	4	5	6	7	8
	Y	9	1	8	2	1	
BHC No.				Yr.	Mo.	Day	
11				23	25	27	30
							6

Reporting period (fill in appropriate line below)
 For the fiscal year ending on Dec. 31, 19 80
 For the 6-month period ending on _____, 19 _____

		Year-to-date			
		Dollar amounts			
		Bill	Mill	Thou	
1. OPERATING INCOME:					
a. Income from <i>bank</i> subsidiaries and associated banks excluding equity in undistributed income:					
(1) Dividends	23			300	1a1
(2) Interest				270	1a2
(3) Management and service fees				0	1a3
(4) Other				0	1a4
(5) Total of Items 1a(1) through 1a(4)				570	1a5
b. Income from <i>nonbank</i> subsidiaries and associated nonbank companies excluding equity in undistributed income:					
(1) Dividends				0	1b1
(2) Interest	24			0	1b2
(3) Management and service fees				0	1b3
(4) Other				0	1b4
(5) Total of Items 1b(1) through 1b(4)				0	1b5
c. All other operating income				0	1c
d. TOTAL OPERATING INCOME (Sum of Items 1a(5), 1b(5), and 1c)				570	1d
2. OPERATING EXPENSE:					
a. Salaries and employee benefits	25			0	2a
b. Interest expense			1	847	2b
c. Provision for possible loan losses				0	2c
d. All other expenses				0	2d
e. TOTAL OPERATING EXPENSE				847	2e
3. INCOME (LOSS) BEFORE TAXES AND APPROPRIATE ITEMS BELOW (Item 1 d minus Item 2e)				1	3
4. Applicable income taxes	26			304	4
5. Extraordinary items, net of tax effect				161	5
6. INCOME (LOSS) BEFORE UNDISTRIBUTED INCOME OF SUBSIDIARIES AND ASSOCIATED COMPANIES				543	6
7. Equity in undistributed income (losses) of subsidiaries and associated companies:					
a. Bank			3	985	7a
b. Nonbank				0	7b
8. NET INCOME (LOSS)				3	8
MEMORANDA					
9. Cash dividends declared:					
a. Common	27			0	9a
b. Preferred				16	9b

Remarks:

27
197.
(131
(76
0

*Penn Square**R*BILL P. JENNINGS
Chairman of the Board
Chief Executive Officer**Penn Square Bank**

November 20, 1981

Mr. Harold L. Russell
 Arthur Young & Company
 1900 Liberty Tower
 Oklahoma city, Oklahoma 73102

Dear Harold:

At a recent meeting of our Bank's executive management, a decision was made to change accounting firms. This was not an easy decision, considering your firm's years of service to us and was only made after thoughtful consideration. Please be assured that we have the highest regard for your firm, and have been most pleased with the high professional standard evidenced by your associates.

We have asked that Peat, Marwick, Mitchell & Co., become our accounting firm for all professional accounting services beginning for the year ending December 31, 1981. We hope the timing of our decision will not place your firm in a difficult situation with respect to year end scheduling and personnel staffing.

I know certain communication has to take place between predecessor and successor accounting firms and ask that your firm cooperate with Peat, Marwick, Mitchell & Co. in making the transition as smooth as possible. Messrs. Jim Blanton or Dean York, Partners with Peat, Marwick, Mitchell, & Co., will be in touch with you to make arrangements to review prior year working papers, tax files, etc.

Should you have any questions please contact me.

Sincerely,

Bill Jennings

Bill P. Jennings
 Chairman of the Board



The CHAIRMAN. Now, the moment we have all been waiting for. That is, we will call upon Mr. Clifton Poole, the Regional Administrator of the Comptroller's office, Mr. James Barton, Regional Surveillance Chief, and Stephen Plunk, National Bank Examiner. And if my colleagues on the committee would like to join me in the swearing in of these gentlemen, you could look upon this as a seventh inning stretch.

[Witnesses sworn.]

The CHAIRMAN. If all of you would like to stand for a few seconds, why don't we just stand and let the blood circulate a little bit? I tell you, you Oklahoma City attorneys, you didn't know how we northern attorneys operate, did you?

[Laughter.]

[Pause.]

The CHAIRMAN. We have with us now Mr. Poole, Mr. Barton and Mr. Plunk. I see another individual whom I understand is counsel to these people, and so I would repeat my caution to the effect that we will hear from the witnesses, and they may want to consult counsel if possible. But your appearance, Mr. Serino, is a distinct surprise to us. We thought that these gentlemen could handle it.

Mr. SERINO. I am sure they can, Mr. Chairman.

The CHAIRMAN. Mr. Poole, I understand you have a very brief statement. If you would like to enunciate it, you may proceed.

TESTIMONY OF CLIFTON A. POOLE, JR., REGIONAL ADMINISTRATOR, OFFICE OF THE COMPTROLLER; JIMMY FRANK BARTON, REGIONAL DIRECTOR FOR SPECIAL SURVEILLANCE; AND STEPHEN PLUNK, NATIONAL BANK EXAMINER

Mr. POOLE. I have some brief remarks I would like to make with regard to the statement that I have submitted. As you indicated Mr. Serino is also counsel for the Comptroller and is head of our Division of Enforcement and Compliance in Washington.

The CHAIRMAN. We have seen him before.

Mr. POOLE. What I would like to do is just very briefly cover the series of events that found our office involved with Penn Square, beginning in early 1980 and concluding with July 5, 1982 with the closure of the bank and its declaration of insolvency.

As you have indicated and as you requested, I brought Mr. Jimmy Barton and Mr. Plunk with me. Mr. Barton, also as you indicated, is the Regional Director for Special Surveillance in the regional office and is in charge of our problem banks in that capacity.

Mr. Barton is an examiner with some 12 years of experience with the Comptroller's office. Mr. Plunk is an examiner with 10 years of experience. He is currently examiner in charge of the Oklahoma City subregion, and was the examiner in charge of the last examination of Penn Square National Bank.

I have been with the Comptroller's office myself for 26 years; 19 of those years were spent in the field as an examiner, and the last 7 years as the Regional Administrator; three of them in the fifth region in Richmond, Va.; one of them in Memphis, Tennessee, and then three years in Dallas, Tex.

The Dallas region encompasses the States of Texas and Oklahoma where we supervise the activities of some 900 national banks. As I indicated, I will begin with the examination of April 1980, and most of what I will say will pretty well follow the pattern of the comments made by the directors of the bank and by the other individuals testifying here today.

We did conduct an examination completed in April of 1980. That examination rated the bank as a 3 bank. We found a wide variety of deficiencies in the bank, and I might add, however, that the quantitative deficiencies that normally would cause us to rate a bank 3 and put it in our special projects program and use administrative action were not present to a degree that we normally see in a problem bank.

Such things as classified asset totals and other such data were not of sufficient magnitude to cause us to have any great alarm, but there were other factors that did cause us considerable concern; namely, the bank's lack of liquidity and difficulty in the funds management area; its lack of capitalization and the rapid growth of the institution, as many people have pointed out, and in the face of that rapid growth, the understaffing of the institution.

As a result of that examination and based upon the information that we drew up a formal from that examination, we gathered into or drew up a formal agreement on the bank, and as I have indicated before, that formal agreement was a close call because the factors that tipped us over the edge in using the formal agreement were the somewhat subjective judgments which we made regarding capital adequacy, and primarily the weaknesses in the funds management area of the bank, and as I said, rapid growth of the institution.

We decided to have, as is our procedure in region 11, a meeting of the board in the regional office. It is our procedure, as I indicated, to do this. We feel that by bringing the board of directors to the regional office it impresses them with the seriousness of the situation, and we have found it to be a procedure that works well.

We held a board meeting on August 27, 1980, at which time we presented the formal agreement to the board. We discussed the deficiencies that we found in our examination and went over the formal agreement in detail.

At that board meeting, Mr. Jennings was resistive, openly resistive, to our efforts. He was concerned that our efforts and the use of an administrative agreement would thwart the bank's progress, and I might point out that to that point and continuing after that, the bank was making money. It was very profitable. The bank was growing rapidly, and as I indicated previously, we did not have an inordinately high percentage of classified or problem loans, as identified by our examination.

He was, as I recall, concerned that our administrative action and our actions in the bank would displace management's discretion. In spite of the objections, the board did sign the administrative agreement and returned it to the regional office. They also indicated at that point that they were already doing much of what was called for by the agreement.

We subsequently conducted a visitation of the bank on September 9, 1980, and we noted some improvement, but were still noting

problems in funds management, and growth was continuing and also, the understaffing conditions remained.

Because of these continuing concerns we conducted an examination as of December 31, 1980, which was concluded on February 27, 1981. As several have indicated, I personally handpicked the crew that conducted that examination. I was personally concerned regarding the funds management area of the bank and its lack of determination to address the problems in that area and the exposure that this was presenting to the bank.

The individuals who conducted that examination were some of our best people from the regional office, from the Oklahoma subregions, and other subregions around the region. That examination showed a significant deterioration in the condition of the bank; classified assets had increased, the loan documentation was very poor, the bank continued to experience rapid growth in the face of the continuing condition of being understaffed, capital growth was not keeping pace with the overall asset growth of the bank, and the bank had substantially failed to comply with the formal agreement which we had placed on the bank at the previous full examination.

After reviewing the report, the Washington and regional offices were faced with what steps to take to correct the situation. Basically, we had two choices; we could either go with a cease-and-desist order which was a more formal type of administrative action, or we could stick with our administration agreement, which was also a formal document.

Arguing for the use of a cease-and-desist order were our concerns regarding the attitude of the board of directors of the bank, as exhibited by their failure to comply with the agreement that we had in place, and by their apparent inability or unwillingness to correct the deficiencies that we had identified at previous examinations.

The CHAIRMAN. Excuse me, Mr. Poole, have you been here today during the day?

Mr. POOLE. Yes, sir.

The CHAIRMAN. Did you hear the two panels of the outside directors testify?

Mr. POOLE. Yes, sir.

The CHAIRMAN. What you just said does not square with what they told us. They impressed us that they were very concerned individuals and perhaps were not given enough guidance as to what they should do.

Now, one of the individuals said when he complained, he was told well, why don't you get off the board. He said that came from the Comptroller's Office. How do you square that with what you are saying to us.

Mr. POOLE. I am not sure I understand.

The CHAIRMAN. What do you mean, you don't understand. I will repeat my question.

Mr. POOLE. All right, sir.

The CHAIRMAN. You have been here today. Forget the statement. We will put it all in the record for you. It is all in the record, by unanimous consent, OK?

You state just now in your statement that the board of directors either were not that concerned or did not know how to go about making changes. Isn't that what you just said?

Mr. POOLE. Yes, sir.

The CHAIRMAN. I repeat. We have listened to the board, the outside directors. It seems to me they were very concerned. If anything, perhaps they did not have enough guidance given to them.

Mr. POOLE. I would have to disagree with that because the administrative agreement was a detailed document which, if followed, would have, in my opinion and I think everyone else's in the office, have corrected the deficiencies in the bank.

The CHAIRMAN. But that was ignored, was it not?

Mr. POOLE. It had been ignored substantially up to that point.

The CHAIRMAN. Now, what did you do about it? Did you recommend to Washington the removal of a few people like maybe Mr. Patterson or Mr. Jennings or what have you?

Mr. POOLE. There were no grounds for the removal of those gentlemen.

The CHAIRMAN. There weren't?

Mr. POOLE. No, sir.

The CHAIRMAN. Did you read the exchange between Mr. Homan and myself in Washington on that?

Mr. POOLE. I am not certain.

The CHAIRMAN. You are not certain. Well, we did have an exchange.

Mr. POOLE. In my opinion, sir, there were no grounds for the dismissal of any officer of the bank at that point in time.

The CHAIRMAN. OK. Let me ask you this: Were you quoted correctly when you were quoted as saying to the board of directors at one point in time, "There are those who wanted a cease-and-desist order, but I argued against that, and we have gone into this letter of agreement instead."

Mr. POOLE. What I believe what I said in the board meeting—well, prior to the board meeting, the Washington office and our office discussed the appropriate type of administrative action to take, and we decided that what we would do would be to go to the board meeting with the idea of telling the board that if they did not give us the impression that they were going to correct, or did not convince us that they were going to correct the deficiencies that we had found, we would use a cease-and-desist order. But what I would like to point out is that the level of deficiencies, in my estimation, would not have at that time fully supported the use of a cease-and-desist order. If we had used it, it would have been a very marginal situation.

The CHAIRMAN. Let me see if I can help you here, because I think this is the way I read you when I read this last night.

You were using a little psychology here that said, "Hey, listen, you have this management letter, this compliance thing, and there were those who wanted a cease-and-desist. Now, if you shape up here, if you make the necessary corrections and changes, then you don't end up with a cease-and-desist. But unless you do,"—is that what basically you felt they should read between the lines?

Mr. POOLE. Yes, sir. There was some use of psychology, as you put it, in my statement.

The CHAIRMAN. I have no quarrel with that. I commend you for it.

Mr. POOLE. However, there was basis in the fact that there were people in Washington, during our discussions, and also in the region who felt that we should use it, and sometimes I felt that we should have used a cease-and-desist order.

The CHAIRMAN. Let me ask you this for the benefit of the committee. In the face of a cease-and-desist, what would the classification have been? Would it still have remained a 3?

Mr. POOLE. We have used cease-and-desist orders in some cases on banks rated 3, but the majority of them I would say would probably be—well, I don't have any statistics, but many of them would be 4's and in some cases 3.

The CHAIRMAN. We are told that you are very experienced and that is why we are asking for your opinions in this matter.

Mr. POOLE. Yes, sir.

The CHAIRMAN. So you don't have to qualify your answers. It is just your best judgment and we accept it.

Mr. POOLE. I would say really I don't remember. I don't recall what number of banks that we have dealt with that were 3's or 4's with cease-and-desist orders, or in which, you know, ones.

The CHAIRMAN. Well, let me put the question to you this way: There would be more likelihood of a bank being classified 4 if it were under a cease-and-desist than if it were just under this letter agreement?

Mr. POOLE. Yes, sir, probably.

The CHAIRMAN. OK. Do you want to proceed with your statement?

Mr. POOLE. Yes, sir.

In any case, you viewed that we had the two choices and, as you put it, one of the reasons for the statement I made in the meeting was to use psychology to some degree. But it was a statement of fact, and we told the board that if we did not see significant improvement in compliance we would indeed convert the formal agreement to a cease-and-desist order.

And I would also like to point out that the contents of the cease-and-desist order, had we drawn it up, would have been virtually, probably virtually the same as the formal agreement, the document would have covered the same areas.

We did decide to use the agreement, or at least proceed in the manner which I indicated, to go into the meeting with an open mind and then determine by our assessment of the attitude of the board as to which action we would take. We did feel, however, that the administrative agreement in both content and detail covered all of the problems in the bank. And as I indicated before, I felt that if they were to respond and comply with that agreement it would solve the bank's problems and bring it to a recuperative position.

At the board meeting, as in previous board meetings and in all of our board meetings, we presented the condition of the bank as detailed in the examination report. We detailed the areas of noncompliance with the agreement. We told the bank of the extremely serious situation of any bank which does not comply with an agreement which they have signed. We told them of the basis for our decision.

Throughout the meeting, in stark contrast to the previous meeting, Mr. Jennings was completely silent until the very end, and at the end of the meeting he acknowledged that we had been—had done an accurate job of examining the bank. He agreed with our conclusions and our findings and he promised and committed himself to the correction of all of these deficiencies to bring the bank into full compliance.

Also at that meeting was Mr. Beller and several other members of the new senior staff of the bank. As indicated previously in testimony today, these individuals were known to the Comptroller's Office, they were known to our examiners in Oklahoma City, who had known them in their previous capacity with a large, conservative, well-managed institution in Oklahoma City.

We felt that they represented, as they were presented to us, a meaningful addition to the staff of the bank. Because of this we determined, as the record shows, that we would stay with the administrative agreement.

And I would like to point out that at the end of that board meeting almost to a person every director came up to me personally, shook my hand and thanked me for our attention and pledged themselves individually to correct the deficiencies in the bank and to bring the bank into full compliance with our wishes.

Following that examination, we conducted our visitation as of September 30, 1981, and I would like to point out that, while there are several comments this morning I think by members of the board regarding comments made to them at the board meeting in December, I believe it was, or January, the examination actually was as of September 30, 1981. So our representation was as of the picture of the bank in September.

That visitation found—well, first of all, that visitation was conducted by an examiner who had been in Mr. Barton's position as Regional Director of Special Surveillance throughout our dealings with Penn Square up to that point in time, and that examiner had been present at both board meetings and had recently been appointed as examiner in charge of the Oklahoma City subregion. And I felt that he was, and still do feel that at that time he was, the examiner best suited to conduct that examination.

As a result of that examination, we found that the bank had made in our opinion significant progress in beginning the correction of the systems, installing the systems and correcting the deficiencies that they had to correct to bring the bank back into compliance.

As several people have indicated and I will also support, the bank was not anywhere near a position where we would be willing to take it out of special projects or rate it other than a three at that time. But we had—we did find that the directors appeared to be following through on their promise to us at the earlier board meeting, as most of them have stated today.

In keeping with our policies, thereafter we conducted our examination, beginning on April 19, 1982. On May 13, Examiner Plunk telephoned me to report that he was finding significant deterioration of the condition of the bank. He indicated it was far too soon for him to accurately identify exactly how bad the situation would be, but he did say that he felt the situation had certainly worsened

since our last examination and could be truly significantly increased in severity.

On May 21 I was in contact with Mr. Roy Jackson, Regional Director with the FDIC in Dallas, on another matter and indicated Mr. Plunk's phone call to him at the end of that conversation. On June 23 I spoke further with Mr. Jackson regarding the status of our examination.

I might also point out that the FDIC also gets copies of all of our examination reports and numerous other forms that attest to the condition of our banks, and we normally have ongoing telephone conversations between various levels of staff and Mr. Barton and his counterpart there on an ongoing basis with regard to all of our problem banks.

I think it bears repeating briefly the degree of deterioration that took place between September 30, 1981, and July 5, 1982: As has been indicated previously, \$45.7 million in loans that were classified as loss in our last examination. Approximately \$30 million were booked by the bank after September 30, 1981. There was an increase in the loan portfolio in that same period of \$161 million and an increase of \$1 billion in the participations sold over that same period. This represents an increase in the loan portfolio of 63 percent and an almost doubling of the participations sold by the bank during that period.

In hindsight, I think there were two major causes for the bank's problems. One was the failure of the board to follow through on the corrective action which they promised to the Comptroller's Office at the board meeting in the regional office that they would make at that meeting on July 29, 1981, and the corrective action which our examination of September 30, 1981, showed to have been underway.

The second major cause was the downturn or the slump in the oil and gas industry. It was unprecedented and it was unpredicted, and that slump in the oil and gas industry, to which the bank had a large concentration of loans, with the absence of controls in the bank, left the bank in an extremely vulnerable position, a vulnerable position which led to its failure.

There has—I might say that in conclusion I'm fully satisfied that our supervision of Penn Square was completely consistent with the OCC guidelines and procedures, and I think it was totally appropriate to the condition of the bank as revealed to us by our supervisory efforts.

There has been some discussion by a number of people regarding the appropriateness of the action of examiners in charging off the loans that they did, which totaled I think \$49 million in total assets charged off. I can tell you that in my estimation these loans were dead losses. This does not mean that there could not be some recovery, and I have no idea what that could be. But these are losses in the truest sense of losses as classified by bank regulatory agencies.

They were, the examiners in the bank, were the best examiners we had in the region and some of the best we have in the country. We strengthened the examination force in the bank on several occasions during the examination, and I am fully confident that the losses that we classified are definitely losses.

The bank had roughly \$37 million in capital, and with losses of nearly \$50 million in my estimation the Comptrollers Office had no choice but to declare the bank insolvent. When a bank has a book insolvency, you cannot allow it to stay open, especially if the Fed will not continue to fund the liquidity needs of the bank, which were materializing at the latter days of this bank's existence.

I just might add that in my own personal experience I would have to say that the Penn Square Bank as we found it as a result of our April examination was in the worst condition that I have ever seen a bank in my 26 years of experience as a national bank examiner and a regional administrator. It doesn't even have any close rivals in that condition.

And the only reason I say that is to get my feelings on the record as to the reasoning behind the Comptroller's Office's decision to close the bank.

In essence, I feel we did our job in an exemplary fashion in notifying the board again and again as to the condition of the bank. We examined the bank a number of times. The condition of the bank, as the question has been raised, it was rated a 3 up and through our examination of September 1981 and it was ultimately closed 8 to 9 months later.

In my personal estimation, based upon my experience and based upon the examinations, the bank was simply a 3 bank through the series of examinations that we conducted, and we could not and should not have taken actions any different from those that we took in view of the condition of the bank as revealed to us through our examinations.

The CHAIRMAN. Let me ask you this. After 26 years, you say this is the most horrible thing that you've ever approached. How could they do it so quickly? September 30, not too bad, things are improving. October, November, December, January, February, March. April Mr. Plunk goes in with his team, right? You started in April?

Mr. PLUNK. Right.

The CHAIRMAN. Seven months, and you go from a 3 classification to the worst example you have seen in 26 years.

Mr. POOLE. Yes, sir.

The CHAIRMAN. Now, the economy certainly—aren't there other banks around this area of the country with a lot of energy loans, a lot of oil and gas and drilling and so forth?

Mr. POOLE. Yes, sir.

The CHAIRMAN. Aren't there other banks that also are pretty heavily involved in this type of lending?

Mr. POOLE. Yes, sir.

The CHAIRMAN. And the slump in energy would have affected them as well, didn't it?

Mr. POOLE. I've seen no more Penn Squares.

The CHAIRMAN. But did that slump—you gave two reasons, the failure of the board of directors to comply with your letter of agreement and the slump in the economy as far as energy is concerned. I'm reading from your statement. Right?

Mr. POOLE. Yes, sir, the interaction of the two.

The CHAIRMAN. And you agree that there are other banks heavily committed to energy loans. So that all we are left with, therefore, is the failure of the board of directors to comply. And yet, Sep-

tember of 1981 you conclude that the board is doing a pretty good job, they are moving forward, they've got Mr. Beller onboard and a new general counsel, et cetera, et cetera, right?

What happened?

Mr. POOLE. The comments we made regarding the job being done by the board as of September did in no way indicate that the job had been done. It was that it had been started.

The CHAIRMAN. That's the same comment Mr. Conover made in Washington.

Mr. POOLE. I think Mr. Beller, his comments this morning, indicated that the loan review process, which is an essential process in any bank, an independent loan review function where the bank assesses the quality of its own loans, had only begun the function and had not at that time gotten into the oil and energy credits, which, as you pointed out, were the great bulk.

The CHAIRMAN. Mr. Poole, that is inaccurate.

Mr. POOLE. Had not gotten into.

The CHAIRMAN. Had not gotten into? You have understated it.

Were you aware of the agreement or the memoranda or what have you, the directive to Mr. Beller: Hands off energy loans, Patterson and I, Mr. Jennings, are going to handle the energy loans and your loan review committee is not to get involved with energy loans?

Mr. POOLE. No, sir. We were under the impression of—we had information to the contrary, that Mr. Beller was indeed—and I remember your comments this morning, your questions to Mr. Beller, or some others, regarding his lack of background in the oil and energy area.

We knew that he did not have a background in oil and energy credits directly. But we felt that what the bank needed was good loan administration.

The CHAIRMAN. OK, a loan review committee, a good loan review committee.

Mr. POOLE. Right.

The CHAIRMAN. Were you aware of the fact that the loan review committee was not allowed to look at the energy loans?

Mr. POOLE. We were not aware of that.

The CHAIRMAN. When did you find this out?

Mr. POOLE. I would have to say that we found it out at the April examination.

Mr. LEACH. Would the gentleman yield?

The CHAIRMAN. Sure.

Mr. LEACH. Were you aware of the job descriptions?

Mr. POOLE. No, sir.

Mr. LEACH. As part of your examination process don't you look at job description?

Mr. POOLE. I don't know the extent to which the examiners did in this case. In some cases we would look at job descriptions, but in this particular case I don't believe—I think the job description, and I'm operating from memory—indicated that Mr. Beller and Mr. Patterson both reported to Mr. Jennings, that Mr. Beller was not over—

Mr. LEACH. Excuse me. You said you didn't read the job descriptions and now you remember the job descriptions?

Mr. POOLE. I remember the discussion this morning, the testimony.

Mr. LEACH. I see.

Mr. POOLE. But I do not believe that that in any way conflicted with Mr. Beller's responsibility as head of loan administration to oversee the lending function and to have control of and commit to us that he was going to install a loan review function at the bank.

The CHAIRMAN. Mr. Poole, you were here. Mr. Beller read his job description to us, and it wasn't one he made up himself. That is the one that he was handed and said, here, you are going to be paid x number of dollars per year plus bonuses, you've got a 5-year contract, and this, man, is what you're going to do: You're going to keep hands off energy loans.

Mr. Plunk, you were in there. You were in Penn Square. Did you see those job descriptions?

Mr. PLUNK. No, sir, I did not.

The CHAIRMAN. Were you in there in September of 1981?

Mr. PLUNK. No, sir.

The CHAIRMAN. Who was there? Who did the examining that time?

Mr. BARTON. The bank was examined by Jerry Lanier, who is no longer with our Office.

The CHAIRMAN. He left the Comptroller totally?

Mr. BARTON. Yes, sir.

The CHAIRMAN. At that time did he make any mention of the restrictions placed on Mr. Beller?

Mr. BARTON. No, sir, not that I'm aware of.

The CHAIRMAN. Mr. Plunk, in May of this year, May 13, you called Mr. Poole and you told him how bad things were.

Mr. PLUNK. I told him that I suspected the bank could be in a serious condition.

The CHAIRMAN. Right. Now, subsequently—how many examiners did you have with you?

Mr. PLUNK. I had somewhere around 15 examiners.

The CHAIRMAN. Subsequently, subsequent to that May 13 phone call, did you indeed leave the bank for a period of time, for a week?

Mr. PLUNK. We had a mandatory training session, yes, sir, that involved, among other things, equal employment and so forth. That is mandated pretty much by the Treasury Department.

The CHAIRMAN. How often are those held?

Mr. PLUNK. That's the first meeting in I believe 3 years.

Mr. POOLE. We had a combination staff conference, the first time in 3 years, and a training session which covered, as Mr. Plunk indicated, EEO, personnel evaluations, and several other areas.

The CHAIRMAN. Where was that held, by the way?

Mr. POOLE. It was held in Austin, Tex.

The CHAIRMAN. For the Dallas region?

Mr. POOLE. For the whole Dallas region.

It was my decision to pull the examiners out of Penn Square at that point in time, for two reasons: One, I wanted them to attend the conference. There were a significant number of our people there. And I also felt that the pulling them out for 1 week would not, in my opinion, and did not detrimentally affect the examination.

And as a matter of fact, there was an indication that we needed to give the bank some time to gather records for us regarding certain large credits which we were accumulating at that time, and we felt that with the benefits of the training, plus the time given the bank to pull together records, it would be as a total package beneficial.

The CHAIRMAN. Even though Mr. Plunk said, hey, Mr. Poole, things are very bad, very bad?

Mr. POOLE. Yes, sir.

The CHAIRMAN. The worst you've seen in 26 years.

Mr. POOLE. Not at that time.

The CHAIRMAN. Oh, you mean they got bad after the seminar? What were the dates of the seminar?

Mr. POOLE. It was in May. I don't remember the exact date.

The CHAIRMAN. Do you remember the dates, Mr. Plunk?

Mr. PLUNK. It was May 24.

The CHAIRMAN. May 24 through 31?

Mr. POOLE. It was the week after he called me.

It was not the worst bank I had ever seen at that point. It was a judgment call.

Mr. BARNARD. Will the gentleman yield for a question?

The CHAIRMAN. Mr. Barnard.

Mr. BARNARD. Mr. Poole, who scheduled the examination in April of 1982?

Mr. BARTON. I would have set up the schedule for that examination.

Mr. BARNARD. Mr. Barton, how far in advance was it scheduled?

Mr. BARTON. How far in advance? We have a scheduling process which looks forward two quarters. So we would have set up the schedule for the second quarter of 1982 in the fourth quarter of 1981.

Mr. BARNARD. It's very interesting that on April 26, 1982, a very exhaustive article appeared in "The American Banker," one of the best I've ever read about a financial institution, and you went in there on April 28. This article didn't prompt you to make that examination so hurriedly, did it?

Mr. BARTON. No, sir, it did not.

Mr. BARNARD. If I would have been you, I would have—

Mr. POOLE. That was purely coincidental. As a matter of fact, I didn't read the article until after the examination commenced.

Mr. BARNARD. Well, it was an excellent article. And as a matter of fact, the fellow who wrote the article ought to be a bank examiner.

Thank you, Mr. Chairman.

[The article referred to follows:]

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Oklahoma's Penn Square Bank, Maverick Oil Patch Lender: Some Say It's Bet Too Heavily on Energy

By PHILIP L. ZWEIG

OKLAHOMA CITY — They call it Continental Illinois' Oklahoma City loan production office. Its real name is Penn Square Bank NA, the principal subsidiary of Penn Square Corp. But judging from the pace at which the \$400 million-asset institution sells oil and gas loans to its friends in Chicago, the distinction may be more nominal than real.

What was just six years ago a sleepy, \$30 million-asset suburban retail bank is today a mammoth loan brokerage operation that is originating and participating out energy loans at a rate that gives some veteran energy lenders and correspondent bankers the shivers.

Here in oil and gas country, energy-related credits have for years constituted a large portion — as much as

30% or more — of the portfolios of most large banks. In contrast, 80% of Penn Square's portfolio is made up of these loans.

Lately, however, declining oil and gas prices, the surge in idle rigs, and the well-publicized cash flow squeeze of some large independent oil and gas producers have given rise to concern among some bankers and analysts that the bank may have bet too heavily on the energy business.

Having sold more than \$2 billion in participations — almost seven times the \$300 million in loans the bank now has on its own books — Penn Square may well have originated more loans relative to its own portfolio than any other bank in the nation. The volume of participations relative to loans varies con-

siderably from bank to bank, but it is certainly unusual for outstanding participations to exceed net loans.

Energy lending and correspondent banking are so tightly knit at the bank that the five-man correspondent department is actually melded into the oil and gas division.

Of the \$2 billion in participations, most have been sold upstream to four banks: Continental Illinois (which Penn Square says holds close to half of the total), Chase Manhattan, Seafirst, and Northern Trust. About \$125 million (6%-7% of the total) have been sold to some 30 or so smaller correspondents, mainly loan-hungry Oklahoma country banks.

This volume of energy deals is

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particularly awesome when one considers that the energy loan portfolios of Manufacturers Hanover Trust and Chase Manhattan Bank at yearend 1981 were approximately \$4 billion and \$3.5 billion, respectively.

Object of Some Sharp Criticism

In recent months, the bank's huge volume of participations, rapid growth, highly aggressive lending practices, some acknowledged snafus in loan documentation, and a dramatic rise in chargeoffs in 1981 have made it the object of some sharp criticism in Oklahoma banking circles.

The bank's flamboyant 58-year-old chairman and largest stockholder, Bill P. Jennings, and a large coterie of admirers in the energy business attribute this criticism to jealousy over Penn Square's phenomenal growth and

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profitability. "When you've grown as fast as we have," says the feisty, white-haired banker, "people tend to shoot at you."

To be sure, merchant banking has so far paid off handsomely for Penn Square. In 1980, the bank earned \$4.2 million on average assets of \$358 million, a return of almost 2.1%, far above the average for its peer group. Return on average equity was a phenomenal 33%. These results reflect primarily an abundance of fee income as well as relatively low noninterest expenses.

But traditional lenders question whether the bank can sustain these results over the longer term, particularly if energy prices continue to deteriorate. Indeed, 1981 was a year of reckoning in which the operational and administrative strains of originating billions in loans took their toll. Acknowledges one director, "The bank has had to run to keep up."

Big Hike in Loan Loss Provision

Although net operating earnings rose last year to \$4.7 million, the increase was due mainly to a lower income tax provision, since pretax operating revenues essentially remained flat. Non-interest expense doubled, while the provision for loan losses was boosted five fold, from \$1.4 million to \$6.3 million. Loan chargeoffs rose from a comfortable \$405,000 in 1980 (0.27% of net loans) to more than \$4.2 million in 1981 (1.8% of net loans).

In 1980, average net chargeoffs for banks in Penn Square's regional peer group were 0.36% of net loans, according to Cates Consulting Analysts, Inc. Comparisons for 1981 were not yet available. Consequently, return on average assets and average equity slipped to 1.3% and 18.6%, respectively.

Rather than pay dividends to its wealthy stockholders, Penn Square has ploughed earnings back into capital, creating a capital base that amounted to \$30.4 million by yearend 1981. That resulted in an equity-to-assets ratio of 7.7%, about the norm for banks of this size.

Many of the bank's customers are also stockholders. A closely held institution, Penn Square has 120 shareholders, 10 of whom own 80% of the bank.

The personal wealth of the bank's stockholders and directors is said to be one of the bank's key strengths. As one observer put it, "The board has very deep pockets" that could probably see the bank through a downturn in the energy picture.

The bulk of the energy portfolio consists of reserve loans and letters of credit made to independent producers operating in Oklahoma, according to the bank. The remainder — about 10% — consists of rig and equipment loans and loans to energy service firms. The bank says it is involved in virtually no national or major oil company credits.

Deep Anadarko Basin

Many of Penn Square's customer base of some 200 independents are active in the Deep Anadarko Basin, a vast natural gas pool in the western part of the state.

These customers include some of the most illustrious figures in the Oklahoma oil and gas business, such as Robert L. Hefner 3d, head of CHK Corp., a pioneer in exploration and development of the Anadarko Basin; An-Son Corp.'s Carl Andersen Jr., and Carl W. Swan, co-chairman of Continental Drilling Co. and a director of the bank.

But there are also some lesser names believed to be experiencing serious cash-flow difficulties. Several other Oklahoma banks have lately become so concerned about the outlook for small independent operators that they have established lists of firms requiring special monitoring.

According to Mr. Jennings, almost all its loans are secured, floating-rate credits priced at about 1/4 to 2% above the prime rates of its upstream correspondents. Typically, Penn Square, whose legal lending limit is \$3.5 million, will sell off about 80% of a loan — and sometimes even the entire loan — receiving an origination fee of 1/4 to 1%. So on a \$5 million loan, \$4 million of which is sold, Penn Square would receive an origination fee of \$20,000 to \$40,000.

Penn Square and the upstream correspondent will usually charge 1/4 to 2% on the unused portion, though Mr. Jennings says this is rare "because our customers use their money." Individual participations average \$1 million; though some have exceeded \$30 million, according to Mr. Jennings.

But he says there is no "typical" deal, because rates, balances, and fees are juggled differently on every credit.

Penn Square's portfolio is funded with a liability mix that consists of about 40% demand deposits and 60% time, savings, and NOW accounts.

Although Penn Square is where many banks say they'd like to be — specializing in a particular market and earning plenty of fee income by originating rather than holding assets — the older, downtown Oklahoma City banks say they are uneasy with the degree to which Penn Square has embraced this practice, and they disclaim any intention of imitating it.

Violating Taboos

According to conversations with senior officials of some of Penn Square's competitors and downstream correspondents, the upstart bank appears to have violated some of the taboos of energy lending and correspondent

banking. They believe it has based its reserve lending on an overly optimistic view of oil prices and interest rates, that it lends on brand-new properties and to inexperienced oil and gas operators — criticisms dismissed as "sour grapes" by Penn Square officials.

Correspondent bankers say that the Penn Square's volume of participations exceeds their own "comfort level" because of what they called the customary "moral obligation" of a loan originator to buy back loans that go

bad, particularly loans sold downstream. They point out that most of their own downstream participations are not made as overlines but rather as accommodations to their country banker customers.

But one local banker concedes that "about 50% of the criticism is sour grapes and the other 50% is deserved."

At least some of the snickering stems from the fact that Penn Square has built its oil and gas division by pirating energy lending officers, an increasingly scarce commodity, from its competitors, namely First National Bank and Trust of Oklahoma City, Fidelity, and Liberty National Bank and Trust. For example, Penn Square's new president, Eldon L. Beller, was recruited last year from First National, where he had been an executive vice president.

Even More Painful

What pains them even more is that Penn Square has snared some of their most valued customers. For example, First National Bank of Oklahoma City, the cornerstone of the Vose family's Oklahoma banking empire, is said to be smarting over the loss to Penn Square a few months ago of Mr. Andersen's An-Son Corp.

Whatever reservations bankers have about Penn Square, oilmen admire its hustling, entrepreneurial style and fast response to big loan requests. Pointing toward the high-rise tower of a well-established Oklahoma City bank from his downtown office window, one leading independent, who also happens to be a Penn Square stockholder, says, "They may be good for a few million without much difficulty. But if you need \$50 million, they want to tell you how to run your business." Adds James G. Randolph, president of Kerr McGee Coal Corp. and a Penn Square director, "They're a bunch of good old boys who understand the language of oil and gas. And Bill Jennings is a good salesman and promoter."

What is indisputable is that since 1975, when it was acquired by a group of investors headed by Mr. Jennings, Penn Square has been transformed from an undistinguished shopping center bank to a go-go institution that is one of the major originators of energy loans in the Southwest.

Returned to Buy It

Known to his friends as "Billy Pull" or "Beep," Mr. Jennings first joined the bank as executive vice president when it was founded as a consumer bank in 1960, then quit in 1964 to work for Fidelity in the same capacity. After 10 years with Fidelity, he returned to Penn Square to buy it.

Penn Square maintains correspondent relationships with Fidelity, the First National Bank, and Liberty National, among others. Fidelity, for example, handles the transaction processing of Penn Square's commercial and instalment loans and checking and savings accounts.

Located in the sprawling Penn Square shopping mall in the northwest quadrant of this city, the bank's whitewashed, three-story headquarter building, drive-in facility, and a

instalment loan office are today little more than vestiges of an earlier era. Only a small fraction of its business is now consumer related.

Having outgrown these facilities, the bank expects to move into a new 22-story office tower in mid-1983. The \$36 million building is being financed as an off-balance sheet joint venture involving several Penn Square customers.

'Continental's Local LPO'

Having his bank called Continental Illinois' local LPO doesn't seem to bother Mr. Jennings, an old-school entrepreneur who also owns a large share of the fledgling Trans-Central Airlines ("more of it than I'd like," he quips), dabbles in real estate as a partner in three local hotels, and is said to have sizable oil and gas holdings of his own.

Indeed, he relishes the association with banks that he regards as the top names in the oil and gas business, and protests with mock scorn that if Penn Square is an LPO for Continental, it is also an LPO for Chase, Seafirst, and Northern Trust.

However, he bristles at what he calls the "street talk" about his institution being stretched too thin in the energy business. Taking a short puff on his ever-present cigar, Mr. Jennings asserts that his institution has been a boon to the expansion of the capital-intensive oil and gas industry in Oklahoma, a state he describes as relatively cash-poor despite its robust energy economy.

The loan origination concept, he says, is particularly well suited to Oklahoma, a unit banking state where the capital needs of bank customers are often greater than the ability of individual banks "to meet them." Moreover, *Oklahoma's banking laws make it difficult for an out-of-state bank to operate there*, which explains the absence of money-center-bank loan production offices in the state.

Growing Up with Oil and Banks

In a lengthy and candid interview, Mr. Jennings and his top associates sought to dispel the bank's high-flying image, stressing that contrary to all the rumors, Penn Square lends money in much the same way as its downtown competitors, using credit criteria that are "standard in the industry."

"Our growth," he says, "appears so dramatic because we started with such a small base. By moving into an active posture early, and concentrating efforts on independent producers, perhaps when other banks were not, we established an original base of producers who are our very best salesmen. Word gets out pretty quickly that Penn Square is interested in the oilman."

Mr. Jennings himself grew up around oil and banks. His 85-year-old mother still runs the Bank of Hieldton in Hieldton, Okla. (pop. 3,380), a small southern Oklahoma town located in one of the state's original, Depression-era oil patches. "I've seen rigs stacked for years," the affable Oklahoman recalls. "I've seen boom and bust. I have a great attraction and feeling for the oil and gas business."

No one questions Mr. Jennings' interest in the oilman. But some criticize his interest in operators just going into business for themselves — precisely the reason Mr. Jennings offers for the success of Penn Square. He says that while some of his customers may not have been in business for themselves for very long, most of them have extensive experience in the oil and gas industry, having been employed as engineers, geologists, and "even mud salesmen." Mud is any fluid used to remove dirt, rock, and other "cuttings" produced while drilling for oil and gas.

► Penn Square: Page 16

Penn Square . . .

Continued from page 15

"Most of our customers were not customers of other banks," he says. "We recognized the potential of independent producers just getting started. These were producers who did not have substantial net worth but who had experience, integrity, and a willingness to work."

A Practice Frowned Upon

Asked if Penn Square was actually supplying venture capital, Mr. Jennings replied, "We'd like to be," noting that he was thinking about forming a venture capital subsidiary.

According to a lender who says he has turned away loan requests later approved by Penn Square, the bank is also willing to lend on "brand-new" properties, a practice frowned upon by most energy lenders. Generally, the performance of one or more wells is used as collateral for loans to finance additional drilling, whereas investor capital is used to fund the first wells on new properties. Mr. Jennings acknowledges that Penn Square lends on new properties, but only when "supplemented by seasoned properties or other assets."

Penn Square's chairman insists that the \$4.2 million in 1981 chargeoffs represented a one-time writeoff of bad real estate loans, not energy credits, much of which he says he expects to recover. At the same time, he acknowledges that nonaccruals also rose "substantially" in 1981.

Moreover, he says that the decision to take the chargeoffs in one lump was the bank's, not the Comptroller of the Currency's, as some sources have suggested.

Mr. Beller, regarded by some observers as a force for discipline in the bank, responded with a terse "yes" when asked if the move to charge off the bad loans reflected his influence.

No Acceleration of Chargeoffs

Despite the weakening of oil and gas prices, Mr. Jennings says that he does not expect chargeoffs of energy loans to increase dramatically in 1982, adding that there are a variety of mitigating factors that would cushion his institution even if oil dropped to \$20 a barrel.

For one thing, he says, most of his customers are diversified into natural gas as well as oil, often deriving as much as 70% of their revenues from deep gas production. Prices for deep gas — reserves found below 15,000 feet — are unregulated and lately have ranged between \$8.50 and \$10 per cubic thousand feet.

Second, he says that because of the margin of safety built into his reserve loans, a drop in prices would simply require the stretching out of the loan, and the loans still would be repaid before reserves run out.

Three Years Becomes Four Years

Even if oil hits \$20 a barrel, a three-year loan would become a four-year loan," Mr. Beller says. Experts agree that because of the windfall profits tax on oil selling for more than \$25 a barrel, a substantial drop in prices must occur before oilmen incur a dollar-for-dollar loss. This is because higher priced oil is more heavily taxed than lower priced oil under the extremely complex windfall profits tax formula.

Banks generally lend about half of the discounted net cash flow from oil and gas production for three to four years. Before the oil glut really took hold, many banks were discounting cash flows at about 12% and escalating prices about 8% per year on a base of \$32 per barrel.

A survey taken by Fidelity Bank of

major energy lenders indicated that many were revising these assumptions to reflect lower prices and the higher cost of funds. Penn Square says that for the last two months it has figured on oil prices holding at \$30 a barrel for two years, then rising at 8% per year. It is now discounting reserves at 15%.

"It's realistic," Mr. Jennings says, "to assume that for a year or more oil will hold at \$30-\$32, and possibly decline to \$28 or \$25. But we don't look for oil to go below \$25. Any prudent oil and gas lender will have a substantial cushion," he adds. "There is adequate coverage for reduction in the price of product."

The spot market for OPEC oil has recently ranged from \$28.50 to \$32 per barrel, depending on the grade, according to the New York-based Petroleum Intelligence Weekly.

A Number of Shakeouts

Energy lenders at other institutions agree that most loans could simply be extended if oil prices continue to drop, but only if the engineering estimates of reserves prove to be accurate. But one prominent energy lender says that "in the past, rising oil prices covered up a lot of mistakes" that would be accentuated by declining prices. As a result, there will be a number of "shakeouts" of energy operators, large and small, in 1982, he says.

The market for used drilling equipment has fallen off 50% in the last six months, he adds, "so if you've got a bad rig loan, you've really got a problem."

As for rig loans, Mr. Jennings says that they make up a small portion of the total energy portfolio and are generally secured with long-term contracts. However, one knowledgeable source contends that these loans are more often secured by one-year contracts.

In the week ending April 18, there were 3,422 active rotary rigs in the U.S., a drop of almost 10% from the same time last year, according to the Hughes Tool Co. of Houston, which maintains a running count of working units. The 827 active rigs in Oklahoma represented a significant rise over last year, but the number has been declining fairly steadily since last January.

Upsurge in Problems

There has also been what one Oklahoma City energy lender called a "tremendous upsurge" in problems — including lawsuits alleging misrepresentation — with drilling fund loans backed by standby letters of credit. Because the oil revenues in many of these deals have not been forthcoming, Oklahoma City banks are drawing on the letters of credit at an increasing rate.

Often, bankers say, letters of credit for drilling funds have been bought by limited partners and issued by a bank without the expectation that they would ultimately have to be funded.

Another criticism that has been leveled at the bank is that its lending staff is not large or experienced enough to service a portfolio of this size. Indeed, the bank's growth has been achieved with a commercial lending staff of fewer than 20 officers, most of



Penn Square Bank N.A.

them young lenders recently hired away from First National Bank, Liberty, Fidelity, as well as Continental and several New York institutions. The oil and gas division also includes four full-time petroleum engineers, according to Mr. Jennings.

"In this business," says one energy lender, "it pays to have a few grey hairs and to have lived through boom and bust."

A few of the bank's downstream correspondents are known to have rejected or sold participations back to Penn Square because of what one termed "sloppy documentation." An officer at a major southwestern bank said it had refused to buy Penn Square participations because "they weren't up to our standards." He would not elaborate.

One of the bank's upstream institutions, which also asked not to be identified, concedes that "there was a time when they were really stretched," but it adds that "now they've got that behind them." Says Mr. Jennings, "We have problems with documentation and so do other banks. It's a constant problem."

Understaffed, Overstaffed

Mr. Jennings acknowledges that "two years ago, we were understaffed. Today," he says, "I think we're overstaffed. Our staff is more than adequate when coupled with assistance we receive from participating banks. The state banking department and the national examiners have been helpful, in many instances, in making recommendations on procedures and documentation."

Mr. Jennings emphasizes that "our credit criteria are the credit criteria of the upstream banks" and that Penn Square is under no obligation, moral or contractual, to buy back loans. "Their engineers get together with our engineers before a commitment is made," insists Bill G. Patterson, senior executive vice president in charge of the oil and gas division.

Mr. Jennings explains that while his engineers occasionally differ with their counterparts at the upstream banks, those differences are inevitably "resolved in favor of the upstream banks." And Mr. Patterson declares, "No correspondent has ever lost a penny on a Penn Square loan."

However, one source says that Penn Square has avoided letting its correspondents take losses by arranging, in several instances, for stronger customers to buy out weaker clients whose loans were on the verge of going bad.

Some Decline to Comment

Responding to the controversy surrounding Penn Square, a spokesman for Chase Manhattan said, "Penn Square is a strong and competent bank, but our future relationship would depend on what they bring to us." John R. Boyd, senior vice president for energy lending at Seafirst, said, "They have been a strong and close correspondent of ours for the last five years and we feel they

are well managed. They have a strong board and excellent acceptance in their community." Continental and Northern Trust declined to comment.

One leading correspondent banker said he "took comfort" in knowing that Continental, one of the nation's leading oil and gas lenders, would certainly have scrutinized a Penn Square-originated credit as thoroughly as it would one of its own.

While Mr. Jennings and his colleagues do not seem to be rattled by criticism from their fellow bankers ("We don't care what bankers and analysts think, we only care what our customers think," he says), they do acknowledge that their future growth will be less dramatic and more diversified than it has been.

Mr. Jennings says he expects assets to rise by about 25% a year to about \$1 billion within five years, substantially less than the frenzied pace of the last few years. Earnings for 1982 should increase to about \$6.0 million, a gain of about 28%, he says. "Future growth won't be allowed to be as fast as in the past," adds Mr. Beller.

Branching Out

Asked if a more formal affiliation with Continental Illinois or another upstream correspondent might occur when and if the banking laws permit it, Mr. Jennings said, "That is a potential that exists for us or any other bank in the state." Then, he adds, he is not worried that the upstream banks may attempt to steal his customers because of their "strong loyalty to the bank that helped them get started."

Meanwhile, "We'll probably do more in real estate and construction lending, industrial financing and leasing, and mortgage servicing," he says. To that end, Penn Square has recently joined with four other institutions — which he refuses to name — in creating a financial and estate planning firm — Thompson, Tuckman, and Andersen — based in Palo Alto, Calif. The firm will soon open offices in Oklahoma City and other cities, according to Mr. Jennings.

Although he admits to being concerned about the sensitivity of his institution to the vagaries of the energy market, he says with a touch of smugness, "I'm awfully grateful we're not diversified into apartment houses, car loans, cattle ranching, and wheat farming."

The CHAIRMAN. At page 5 of your statement you say that:

We are still not at a level at which you would normally find us using a formal letter of agreement, let alone a formal cease and desist. Also, although we see the bank's funds tend to be very risky, those activities are extremely profitable. On the one hand, the classified assets totals and other quantifiable measures of the bank's lending were not at a level which would by themselves normally find us using a formal agreement, let alone a formal cease and desist order.

For how long a period of time had they been making these energy loans when you reached this conclusion? In other words, how old were these loans? Relatively new, weren't they? You know, looking at the charts, these charts of the Comptroller's Office, total loan growth rates for 1979, 1980, 1978, 1979, and 1980, the big push was in 1980, was it not?

Mr. POOLE. I believe so.

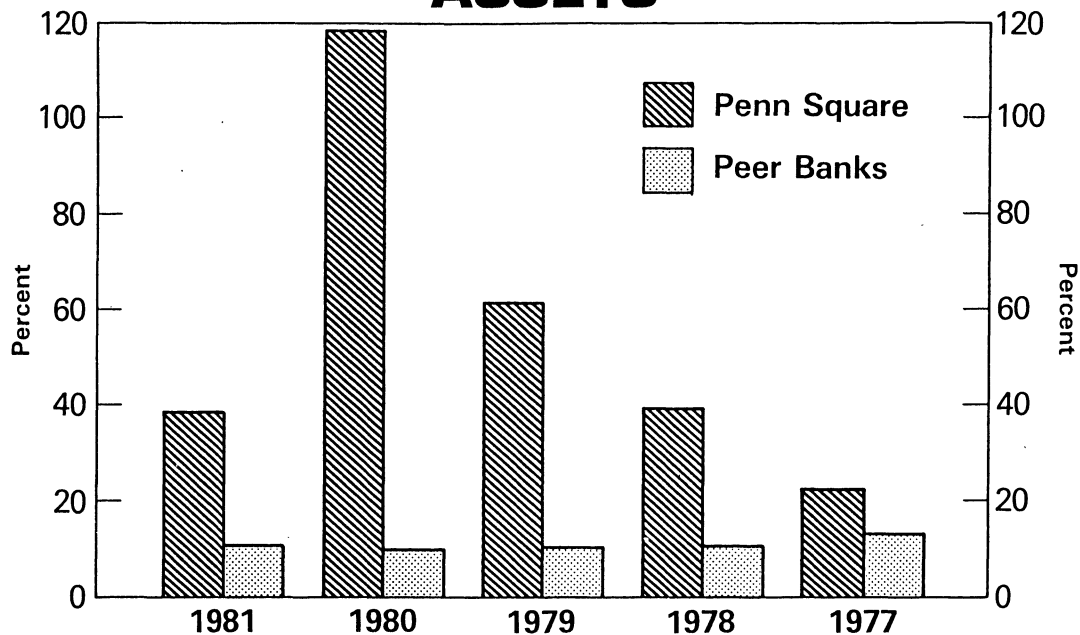
The CHAIRMAN. That compares to the chart---

Mr. POOLE. I can't see the chart.

The CHAIRMAN. Well, we will have them brought up a little closer.

[The charts referred to follow:]

GROWTH RATE Penn Square Bank, N.A. Compared with Peer Group Banks ASSETS



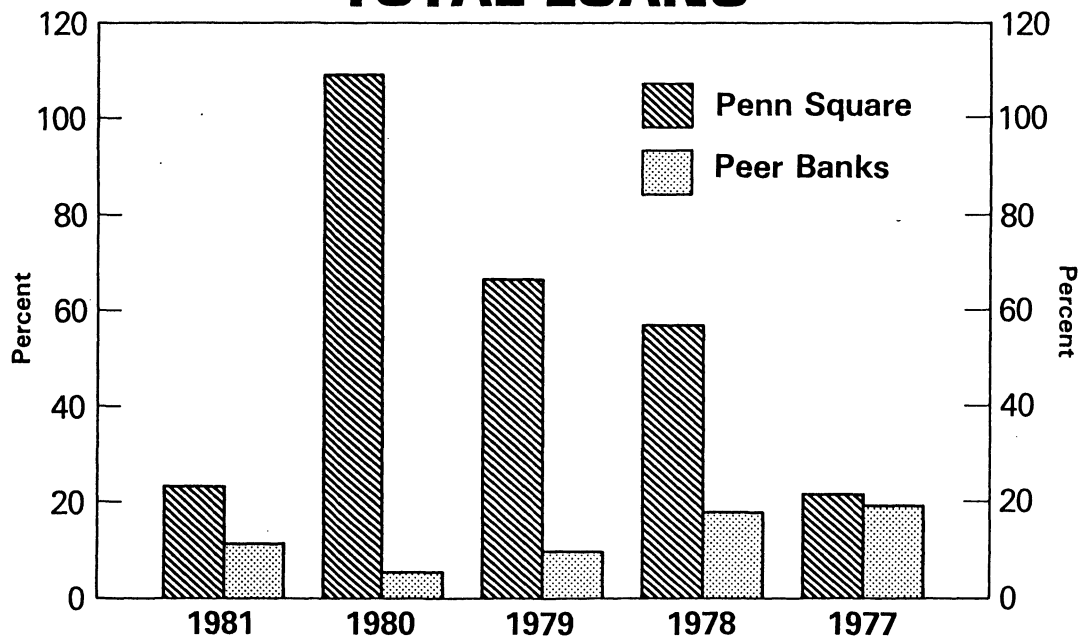
DATA Source: Comptroller of the Currency

GRAPH PREPARED BY STAFF OF THE BANKING, FINANCE
AND URBAN AFFAIRS COMMITTEE

GROWTH RATE

Penn Square Bank, N.A. Compared with Peer Group Banks

TOTAL LOANS

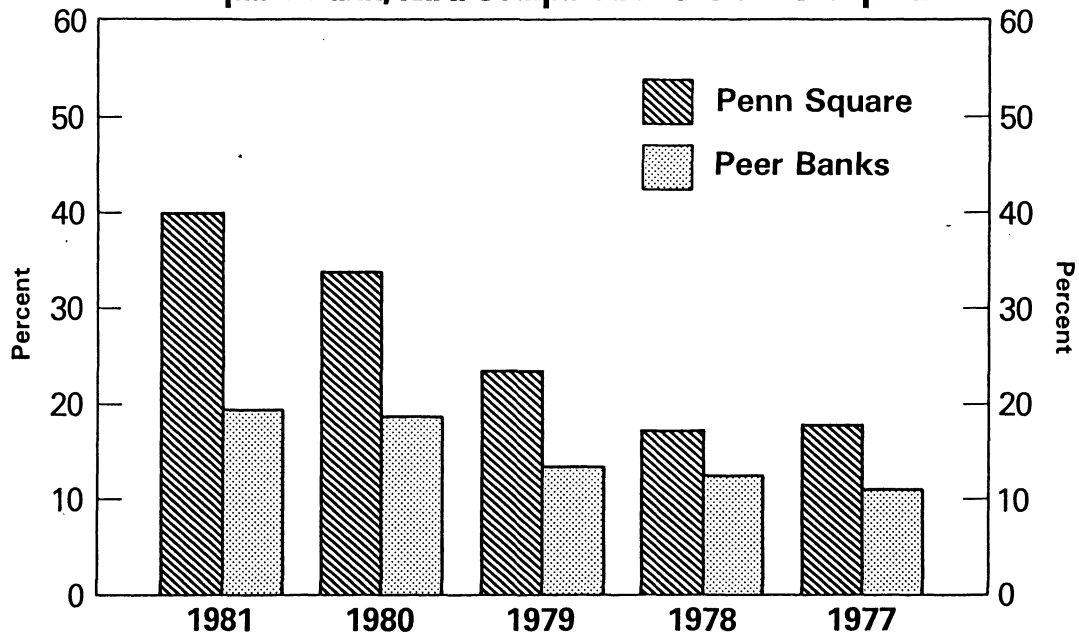


DATA Source: Comptroller of the Currency

GRAPH PREPARED BY STAFF OF THE BANKING, FINANCE
AND URBAN AFFAIRS COMMITTEE

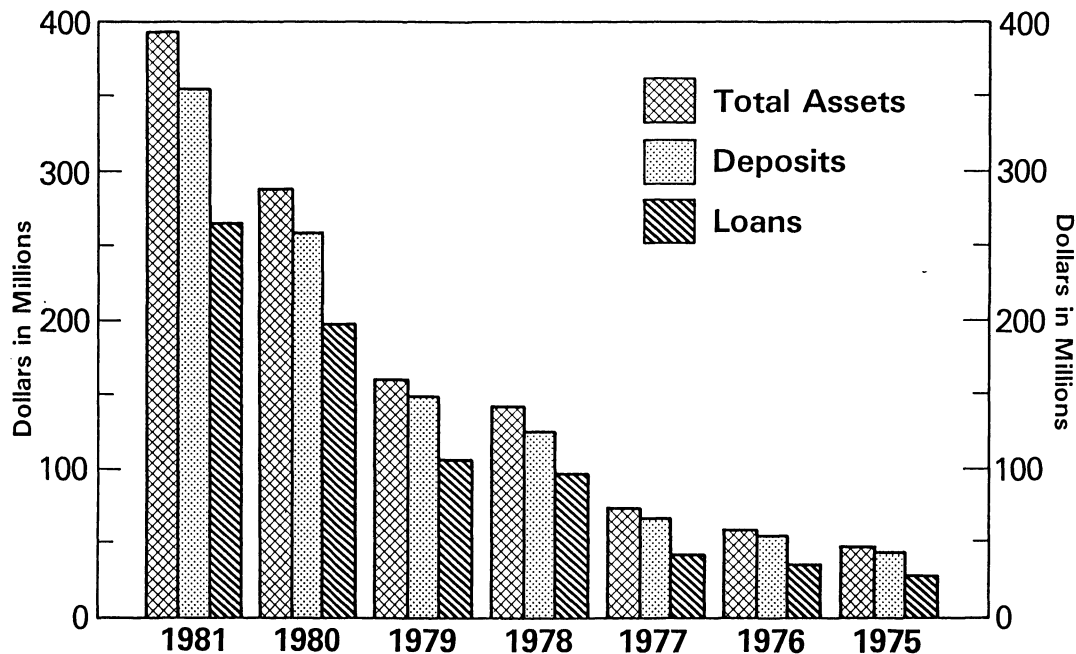
TIME DEPOSITS OVER \$100M AS A PERCENT OF AVERAGE ASSETS

Penn Square Bank, N.A. Compared with Peer Group Banks



DATA Source: Comptroller of the Currency
GRAPH PREPARED BY STAFF OF THE BANKING, FINANCE
AND URBAN AFFAIRS COMMITTEE

PENN SQUARE BANK, N.A. ASSETS



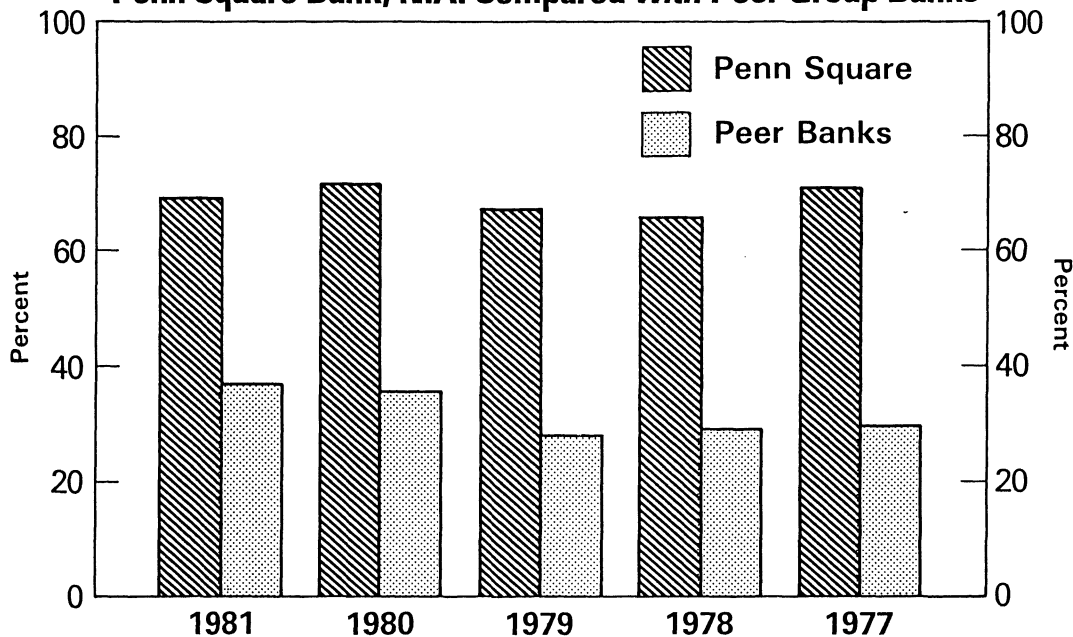
390

DATA Sources: Moody's Bank & Finance Manual; Polk's World Bank Directory

GRAPH PREPARED BY STAFF OF THE BANKING, FINANCE
AND URBAN AFFAIRS COMMITTEE

COMMERCIAL AND INDUSTRIAL LOANS AS A PERCENT OF TOTAL LOANS

Penn Square Bank, N.A. Compared with Peer Group Banks



DATA Source: Comptroller of the Currency

GRAPH PREPARED BY STAFF OF THE BANKING, FINANCE
AND URBAN AFFAIRS COMMITTEE

U.S. BANKS WHICH BOUGHT PARTICIPATIONS FROM PENN SQUARE BANK, N.A.

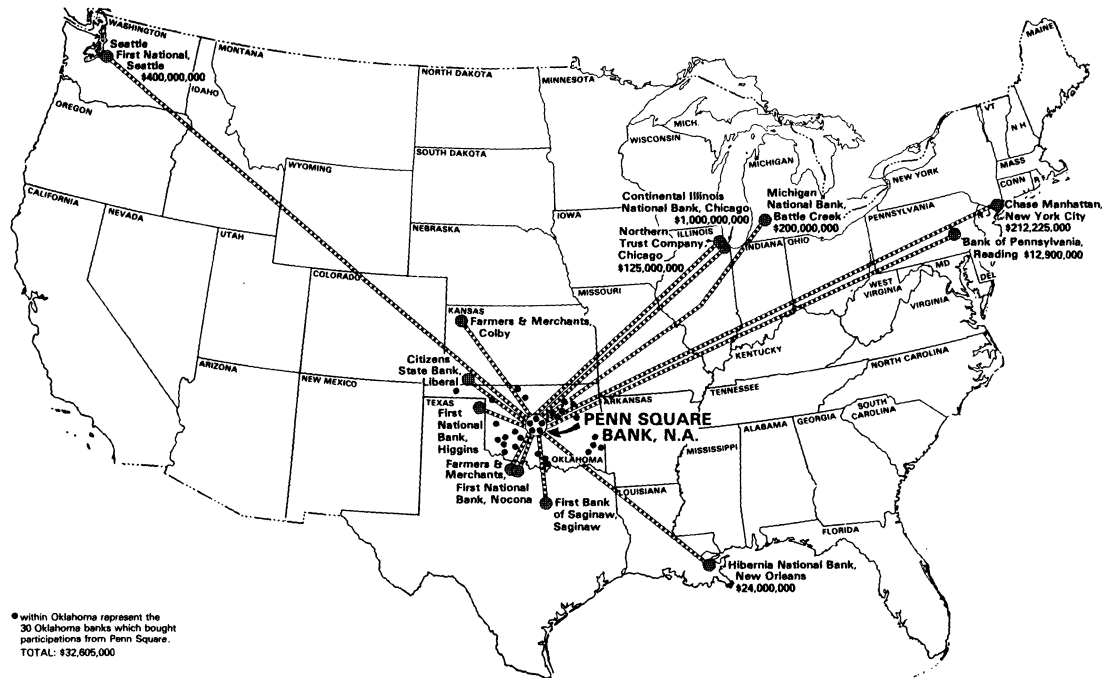


CHART PREPARED BY STAFF OF THE BANKING,
FINANCE AND URBAN AFFAIRS COMMITTEE

The CHAIRMAN. "But on the other hand these loans are comparatively new." But then we go to page 9 and \$30 million of the \$45.7 million in loans that were eventually classified as loss were made after September 30, 1981. Now, those got bad awful fast, didn't they?

Mr. POOLE. Yes, sir.

The CHAIRMAN. So they couldn't have been very good ab initio, from the beginning, right? How did they get that bad that fast?

Mr. POOLE. I think it was a matter of, in some cases, of the amount of lending to specific borrowers in relation to their collateral and in relation to the various comfort factors in the condition of the loans.

The CHAIRMAN. Do you know who was responsible for making these loans, \$30 million of the \$45.7 million in losses eventually classified as losses?

Mr. POOLE. Mr. Plunk might be able to answer that better.

Mr. PLUNK. Most of those were originated in the energy department.

The CHAIRMAN. Pardon?

Mr. PLUNK. Most of those were originated in the energy division.

The CHAIRMAN. OK. And who was the very efficient individual in the energy division who would have originated those?

Mr. PLUNK. We found in our loan review that Mr. Patterson supervised virtually all of the loans, I would say as a guess 70 percent or greater.

The CHAIRMAN. I have a little chart here that indicates, just as you've said, "The attached document provides some criticized loans of 1980, revealed that Mr. Patterson was the lending officer for over \$20 million of the \$34 million in such loans," right?

Then we come to 1982, and again he gets the prize, the big banana. That being the case, was that brought to your attention, Mr. Poole, that you had one particular gentleman in that institution who was a real hot-shot loan officer with a lot of bad loans?

Mr. POOLE. Yes, sir. But I have to point out that the deficiencies in loan portfolio were not that severe at previous examinations. That was basically what I meant when I was talking about quantifiable factors. And even the 1980, December 1980 examination, one of the major factors we used in judging what type of administrative action we would use was the level of classified assets.

The CHAIRMAN. Mr. Poole, your criticized loans in 1980 revealed Mr. Patterson was lending officer for over \$20 million of the \$34 million in such loans. OK, that's 1980. Now we come to 1982, and Mr. Plunk just stated that he was an all star again in these classified, brand-new classified loans in 1982.

I'm asking you if it was brought to your attention that you had a very, very capable gentleman here named Patterson making energy loans that had a habit of becoming classified?

Mr. POOLE. Well, it was the oil and energy department primarily, and I guess he was in charge of that if I am not mistaken.

Mr. BARTON. Yes, he was, and we were aware of it.

The CHAIRMAN. You were aware of it, Mr. Barton?

Mr. BARTON. Yes.

The CHAIRMAN. OK. You were also aware of the fact that this institution had problems?

Mr. BARTON. Yes, sir.

The CHAIRMAN. And did you give any consideration whatsoever to saying to Mr. Poole, so he could say to Mr. Conover, say, we've got a hot shot here that we can't keep up with, he's too fast for us. September of 1981 things weren't too bad at this institution. But now we come back and we've got classified loans that were made in a short period of time. This young gentleman, perhaps we should ask him to step aside.

Under the powers that you have, it doesn't have to be anything critical, just deleterious to the financial condition of the institution. Did you give that any consideration?

Mr. BARTON. We gave that consideration, but the condition of the bank, the classified assets, was not that severe during history coming up to 1982.

The CHAIRMAN. I'm talking about April and May of 1982. In May of 1982 you found, and June, you found out that there were these classified loans, comparatively new loans, correct?

Mr. BARTON. Yes.

The CHAIRMAN. And you also knew that the same gentleman who was heading up this department had a lot of classified loans in previous instances. It was the same gentleman again in May and June. The players haven't changed.

So you know you brought in Mr. Beller, you asked for all of these things to be done, and yet this area that is a rather critical one still is bad. The same individual is there. Did you give any consideration to asking for a change?

Mr. POOLE. May I answer that?

The CHAIRMAN. Yes.

Mr. POOLE. You're talking about the April 1982 examination?

The CHAIRMAN. Yes, sir. And you know, you look at a little history and you look at 1980. I read from 1980 as well, sir, the classified loans in 1980. Mr. Barton is aware. He's nodding in agreement. So I'm not isolating this so that you should have, you know, the Holy Ghost lay whole knowledge on your head in 1982. I'm saying that this has been going on for a period of time.

Mr. POOLE. I can personally assure you that had the bank survived and stayed in operation, that I feel personally very comfortable in saying that we would have recommended the removal of, or the board remove certain individuals of the bank.

But as a matter of fact, our major concern in our April examination—you have to remember, we did not complete the examination. It never was completed. The bank was closed in midexamination. We were doing our best to try to keep up with—it is very difficult to examine loans in a bank where documentation was as poor as we found in this bank and where controls are so lacking.

It is extremely difficult. You've almost got to—you've got to do everything yourself. And we sent additional staff into the bank.

It was really not a type of decision that we would have addressed during the April examination as to who we would or would not want to recommend getting out of the bank. Our major concern was determining how much of the loan portfolio was loss, so that was clearly the most critical and crucial element.

The CHAIRMAN. Weren't at the same time hoping to be able to save the institution?

Mr. POOLE. Yes, sir.

The CHAIRMAN. Just not find out how bad the loss was.

Mr. POOLE. If we could determine, for example, that the bank had only \$15 million in losses, I can assure you that we would have probably taken action according to the nature of that.

The CHAIRMAN. Let me ask you, Mr. Poole. I've heard words like procedures, visitations. It all sounds very medical. Now, frankly, you know, if a doctor is examining a patient and finds out he's got double pneumonia and a hernia and might also have ingrown toenails, does he just keep examining and making tests or does he start treating immediately? You start treating immediately, don't you?

Mr. POOLE. In my opinion the treatment that you're talking about would have done no good whatsoever by that point in time. The horse was already out of the barn.

The CHAIRMAN. But you knew at the beginning of the exam, when Mr. Plunk called you on May 13, when he called you May 13 and he said, things are very bad here, they are very bad here. Did you know the horse was out of the barn?

Mr. POOLE. No, sir. It would be practically impossible for me to make a decision to do something as drastic as even tell the board to remove somebody based upon an incomplete examination. We have to be extremely careful in documenting our position and knowing where we stand and having conclusive information when we are going to take such a step. And it would be very difficult to take such a position in midexamination.

This is the same reason that the board has testified on several occasions, that they did not know the extent of the condition of the bank until the board meeting on July 1. We were keeping management of the bank constantly apprised of our findings in classified loans and loan losses. Here again, it would be—

The CHAIRMAN. Were you keeping the board informed as well?

Mr. POOLE. It would have been irresponsible for me or for the Comptroller's Office to have called a meeting of the board of directors based upon inconclusive information and to tell them that we thought their bank was in real bad shape. It would have been, to the extent we were finding—and you have to understand that we were getting on a daily basis—we were examining loans that were extremely poorly documented. We had missing collateral sections, we had missing deeds of trust, we had just, you name it, it was missing. We were having to—and missing engineering reports.

We had to continually wait for the bank to bring us additional documentation before we could make a decision on the individual credit.

The CHAIRMAN. Would you agree that not only was this institution the worst that you have ever seen in your 26 years, but that also it is a classic case that they were able to, or they managed to, probably come up with every type of violation and misdeed and ignoring of regulations that you could think of? I look upon this as a classic. How about you?

Mr. POOLE. I feel it is a classic based upon what happened after September, but not prior to September. I feel very confident that the bank was a solid three bank as of September, but it just went to pot after September.

Mr. BARNARD. Mr. Chairman.

The CHAIRMAN. Yes, sir.

Mr. BARNARD. How can you say that, Mr. Poole, when you threatened cease-and-desist orders in the spring of 1981?

Mr. POOLE. But we didn't take a cease-and-desist order.

Mr. BARNARD. That's not the point, though. The point is that your statement this afternoon, stated that after the spring 1981 examination, you brought the board in and you threatened cease-and-desist orders. But you used psychology and decided to just go with an agreement. Oh, that was great. The directors came up and personally thanked you for your consideration.

And then, after threatening a cease-and-desist order, you sent in, from what I can understand, a single examiner 6 months later. A visitation by examiner, that was the statement. Was that a team of examiners?

Mr. POOLE. Yes, sir. I don't recall how many.

Mr. BARNARD. Does Mr. Barton know?

Mr. BARTON. No, sir, I don't know that.

Mr. BARNARD. Mr. Plunk?

Mr. PLUNK. I would have to guess. I would say five or six.

Mr. BARNARD. Five or six examiners. You normally use 15. And the result of that is—and I'm quoting again—"made significant progress in correcting deficiencies, not sufficient in taking out further classification."

Would it be logical for the Comptroller's Office, knowing of the age-old difficulty with this bank, to let it go from the spring of 1981 to the spring of 1982 without a thorough examination?

Mr. POOLE. Yes, sir.

Mr. BARNARD. Even though you had threatened cease-and-desist orders?

Mr. POOLE. I think it was extremely logical, based upon our experience, not only in our region but throughout the Comptroller's Office, with the use of formal agreements and with three-rated banks that I would say were of not dissimilar condition to Penn Square. My experience in three regions has been that when a board of directors tells you that they will correct the situation, they correct it. In the vast majority of cases, we are able to turn around our three-rated banks and bring them back to a one or two rating.

Mr. LEACH. Will the gentleman yield on this point?

Mr. BARNARD. If I might just finish quickly.

You don't think that you cried wolf just one time too many?

Mr. POOLE. No, sir.

The CHAIRMAN. I just want to make one observation and then I want to go to Mr. Leach. And that is that I would say to you, Mr. Poole, I know you've got 26 years. I have got a few years overseeing these things myself. And I don't know if you heard what I said earlier today. All because that institution, with that one strong individual who in essence is calling all of the shots and telling everybody what to do—and this gentleman, God bless his soul, I'm sure he was well intentioned. But you know, we all make errors in judgment.

But he was very strong, Mr. Jennings, and perhaps that is why that board of directors couldn't accomplish what they wanted. I

still would say to myself, was Mr. Beller brought in and used? Was he brought in to sort of placate the Comptroller? I don't know.

Mr. POOLE. In my opinion, I don't think Mr. Beller thought he was being used. The examiners were not told of any problems, for instance, that Mr. Beller had with Mr. Patterson.

The CHAIRMAN. Mr. Jennings.

Mr. POOLE. That's right. He led us to believe—he not only led us to believe, he assured us, that he had the horsepower, that he had the staff, that he had the controls that he needed to accomplish what we wanted accomplished.

The CHAIRMAN. But now we find out today that wasn't so.

Mr. POOLE. That's exactly right.

The CHAIRMAN. Mr. Leach.

Mr. LEACH. I would like to return briefly to some of the comments of the gentleman from Georgia, to tie this together from a little different perspective. If we are dealing with a bank with a possibility of failure and loss of moneys—and this situation has probably occurred once a month or so in this country for the past 20 years—a once-a-year review is fairly reasonable. What distinguishes this bank, however is that it was in large measure a loan-generating office for other banks. It was a \$500 million bank that had generated \$2 billion-plus in loans for other banks. In such a case, you are not dealing with the small loss alone; you are also dealing with the substantial losses of other banks. The ramifications end up shaking the entire banking system.

Under these circumstances, considering Penn Square's rate of growth, the Comptroller's Office cannot stand back and say that it lacks significant responsibility, that the only faults were the problems of the board of directors and the problems in the oil economy. You people must bear up to the fact that your Office has not operated perfectly. I would like to ask a series of questions in this regard.

Excuse me just a second.

[Pause.]

The CHAIRMAN. The committee—I would ask you not to jump around, because there are a lot of witnesses to hear yet. We must suspend operations for about 3 to 4 minutes. There's a satellite going over that some of us can see. We will be back within 3 to 4 minutes. We are in recess for 3 to 4 minutes.

[Recess.]

The CHAIRMAN. The committee will come to order.

Mr. Leach?

Mr. LEACH. In the case of Penn Square, you closed the bank and it's hard on the pocketbooks and the reputations of many people. It was a very abrupt and tough thing to do. In July 1982, that was the only action to take. But earlier one could have taken a less abrupt but equally firm action and fired an officer or several officers of the bank. Was serious consideration given to that possibility?

In a prior hearing the Comptroller informed us he doubted he had the authority to fire. I would like your authority in this regard clearly stated for the record, whether you have the authority to demand the firing of any officer of a bank that you supervise and whether this would be channeled through the board of director.

Mr. POOLE. Mr. Serino may want to correct me, because I'm not an attorney. It is my understanding that in the vast majority of cases it would have to be the board's decision to fire management. It is extremely difficult for an examiner to stand up in front of a board and tell that board that they need to fire an individual if the level of the criticisms in that examination is not of sufficient concern to support that action.

The board has the ongoing—the inherent responsibility, and the first responsibility of any board is to—

Mr. LEACH. I understand that, but I want an unequivocal statement. Do you have the right to demand the firing of an officer of a bank that you regulate for proper cause?

Mr. POOLE. There is a procedure for removal and there are specific criteria that must be met under the law for removal procedures.

Mr. LEACH. But you have that authority?

Mr. POOLE. I do not have the authority to fire someone on the board—I mean an officer. I'm sorry.

Mr. LEACH. You have no authority to remove?

Mr. POOLE. Through the procedures that I indicated, through the removal procedures, we do, but not on the spot to say, you are fired, or to demand—we can't demand—

Mr. LEACH. We're not talking about on the spot. In looking at this bank over a long period of time, there was strong reason to suggest that several people in the bank were operating improperly. One of the early actions of the regulatory authorities that you represent was to suggest that these individuals be removed from office. Did you ever suggest that to the board of directors?

The board has testified before us that they received many statements from your office that indicated things were improving, that indicated they were on the right track, that indicated a very positive direction. Wouldn't it have been a lot easier 1½ years ago or 1 year ago to suggest that someone be removed than it was to close this bank?

Mr. POOLE. In my judgment, we absolutely did not have the necessary documentation. We did not have the foundation which would support a removal action prior to September 1981.

Mr. LEACH. Have you ever requested removal of a bank officer?

Mr. POOLE. I've never initiated a removal proceeding and I'm not sure under what statute that falls. There have been cases where in a cease and desist order we have had an article requiring the board to strip an individual of his administrative and executive authority and to hire a new capable chief executive officer. Of course, the board has the option of either signing that document, the consent order, or not consenting to it. And it is still the board in that case that is making the decision.

I have been a party to the use of that type of document at certain times.

Mr. LEACH. I raise this because at our hearings in Washington the Comptroller indicated that he did not have that authority. Subsequently, he wrote the committee a letter. I would like to read the first paragraph because it's quite clear that there is confusion in your office about it. It says:

Dear Mr. Chairman: The purpose of this letter is to clarify the testimony before your Subcommittee July 15, 1982, regarding removal powers of 12 U.S.C. 1818(e). That statute permits each of the federal financial institution regulators to institute removal proceedings against an officer or director of an insured financial institution under certain specified conditions. In order to justify removal under the statute, the regulator must establish in an informal hearing before an administrative law judge that the following criteria have been satisfied.

Let me read a couple of those criteria:

That the officer or director of the insured bank has committed a violation of law, rule or regulation or of a cease and desist order which has become final.

Your office has claimed that this bank violated the banking laws of the United States on numerous occasions.

A second reason for which an officer may be removed: "If he has engaged or participated in any unsafe or unsound practice in connection with the bank." Here it is relevant to go back to the Arthur Young audit of this bank, which was a qualified audit. The Arthur Young auditor said that it is highly unusual to have a qualified scope audit, that it occurs maybe five times in 1,000 bank audits. How unusual do you think it is to have a qualified audit? Based on your experience, were there a large number of undocumented loans at this bank?

Mr. POOLE. At the April 1982 examination, I think the bank's own internal review process identified 3,000 documentation exceptions. That is an inordinately large number, and I would have to say that the quality—I asked Mr. Plunk earlier and he told me that he had never seen a bank with poorer loan documentation.

Mr. LEACH. But none of this appeared in the September 1981 audit.

Mr. POOLE. That degree of lacking in quality of documentation did not exist as of that date.

Mr. LEACH. There was no suggestion that perhaps the situation ought to be tightened up by removing an officer?

Mr. POOLE. I believe all of our reports did cite the deficiencies in documentation.

I might interject, with your permission, that I have a copy of that letter and if we were to—you'll notice that in each case it says "and" and it goes on from one to two and three. If we were to consider removal procedures against every officer that might fall under A, B, C, or A, B, C of two or whatever, we would be looking probably at removal procedures in every bank in the country, because there are no perfect bankers. They all make mistakes.

There are violations of law in probably every single bank that I have ever examined.

Mr. LEACH. That is why it is awfully important to have a degree of flexibility. We're not talking about a marginally bad bank; we're talking about, in your terms, the worst bank you have ever seen.

Mr. POOLE. Based upon the last examination.

The CHAIRMAN. Would you please yield to me?

Mr. LEACH. Of course.

The CHAIRMAN. Mr. Poole, the reason the statute was changed was that the regulators said to us, we are hamstrung, we are not able to act unless there is a criminal violation. I'm going to have my staff send you, and I think I will ask them to send it to every regional director in the Comptroller's Office around the country,

the committee report and the legislation and the reason for the legislation, the change in the statute, and the fact that Mr. Homan unfortunately misinterpreted it before our committee, just as you are misinterpreting now.

Mr. Isaac and his general counsel agreed with myself and our attorney. We gave you the power. We gave you this power, not to abuse it but feeling you were responsible individuals who would use it in a very judicious manner. There is the appeals process, so that if you abuse it the individual can appeal.

So please don't take that attitude, that you could do that in every bank in the country, nobody is a perfect banker. Nobody is a perfect Congressman, nobody is a perfect regional administrator, nobody is a perfect general counsel, nobody is a perfect anything. Perfection means divinity.

Mr. BARNARD. St Germain. [Laughter.]

The CHAIRMAN. And even St Germain isn't perfect. [Laughter.]

But just because you weren't aware of it, don't feel bad. Mr. Homan wasn't aware of it, Mr. Conover was not aware of it. But by cracky, you know, when I learn something new I am always happy to say, gee, thanks for telling me, I wish I had known it. That should be the attitude.

[The letter referred to follows:]



Comptroller of the Currency
Administrator of National Banks

Washington, D. C. 20219

July 29, 1982

Dear Mr. Chairman: .

The purpose of this letter is to clarify the testimony before your Subcommittee on July 15, 1982, regarding removal powers under 12 U.S.C. §1818(e). That statute permits each of the Federal financial institutions regulators to institute removal proceedings against an officer or director of an insured financial institution under certain specified conditions. In order to justify removal under the statute, the regulator must establish at a formal hearing before an administrative law judge that the following criteria have been satisfied:

- I. That the officer or director of the insured bank has committed:
 - A. any violation of law, rule, or regulation or of a cease and desist order which has become final; or
 - B. has engaged or participated in any unsafe or unsound practice in connection with the bank; or
 - C. has committed or engaged in any act, omission, or practice which constitutes a breach of his fiduciary duty as such director or officer; and
- II. The agency determines that the bank has:
 - A. suffered or will probably suffer substantial financial loss or other damage; or
 - B. that the interests of its depositors could be seriously prejudiced by reason of such violation or practice or breach of fiduciary duty; or
 - C. that the director or officer has received financial gain by reason of such violation or practice or a breach of fiduciary duty; and

III. That such violation or practice or breach of fiduciary duty:

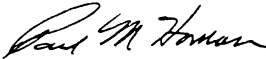
- A. is one involving personal dishonesty on the part of such officer or director; or
- B. one which demonstrates a willful or continuing disregard for the safety or soundness of the bank.

The removal provisions of the Financial Institutions Supervisory Act of 1966 (FISA) as amended by the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRA), as described above, may be invoked only under the combination of special circumstances delineated in the statute. 12 U.S.C. §1818(e) has not been subjected to direct judicial review; nevertheless, Congress made it clear when it gave the agencies the removal power that it was an extraordinary power and was not to be used by the agencies to remove an officer or director from a bank on simple grounds of incompetence or poor judgment.

The removal power is an extraordinary remedy which this agency has used on only a few occasions. The reason the agency has not needed to utilize the power is that, ordinarily, when management problems are brought to the attention of the directorate, the directorate takes action to correct them. It is a principal responsibility of the board of directors to ensure that the institution is properly managed. Thus, in the normal course, where problems are identified the board of directors will resolve the difficulties through management changes. If the board of directors does not take action to change management and there is a statutory basis to remove the individual from the bank this Office would not hesitate to consider the need to use the removal statute.

In the instant case, while problems existed in the bank prior to the April 1982 examination, in our opinion, based on the information known at the time, these problems did not then rise to a level satisfying the strict three-criteria removal standards of 12 U.S.C. §1818(e). The problems as identified in prior examinations indicated that the management team needed strengthening. The formal cease and desist Agreement required, among other things, that the board of directors evaluate and make adjustments to the current management team both in quality and depth. Because of that Agreement, the bank responded by augmenting its management through the hiring of personnel from other financial institutions. This was viewed as a positive response to the previously identified management problems. Under the circumstances, removal was viewed as neither appropriate under the statute nor necessary to effect management changes.

Sincerely,



Paul M. Homan
Senior Deputy Comptroller
for Bank Supervision

The Honorable Fernand J. St Germain, Chairman
Committee on Banking, Finance and Urban Affairs
2129 Rayburn House Office Building
Washington, D. C. 20515

Mr. LEACH. We talk to bankers all the time, and they believe that you have that power. There isn't a banker I know of who isn't very concerned with that fact. I'm convinced that it was a failure to take more timely and bolder action that has embarrassed this community very much and perhaps reduced public confidence in the whole banking system.

At what point did your office notify, either directly or indirectly, upstream banks that there might be a problem in this particular situation?

Mr. POOLE. I am personally not aware of who—or I understand just generally that contacts were made. I don't know or when.

Mr. LEACH. Were they authorized contacts?

Mr. POOLE. I have no idea.

Mr. LEACH. Approximately when were they made and were they generally made from your office? Were they made from Washington?

Mr. POOLE. I can only give you my understanding, and it may be inaccurate. It is my understanding that may be 2 weeks prior to the closure of the bank that the Washington office did notify certain upstream banks. The major reason, I'm told, for those contacts was twofold: One, it was to attempt a recuperative effort with their assistance, potentially, for the bank; and the other was to begin to try to assess the impact of the Penn Square situation on those banks.

Mr. LEACH. Did Mr. Conover tell our committee that the Dallas office—

The CHAIRMAN. That they had notified Chicago, we're having the transcript checked.

Mr. POOLE. You mean that we notified the banks?

The CHAIRMAN. No, that the Comptroller's Office notified the regional office in Chicago.

Mr. LEACH. At what point did you notify the Federal Reserve?

Mr. POOLE. In Penn Square?

Mr. LEACH. Yes.

Mr. POOLE. That contact would probably have been made in the Washington office.

Mr. LEACH. You don't know if or when?

Mr. POOLE. I'm sure contacts were made. I'm not certain when they were made.

Mr. LEACH. When would you guess?

Mr. POOLE. I have no idea.

Mr. LEACH. Would it have been shortly before last July, or would it have been 6 months or a year ago? You have no sense of that?

Mr. POOLE. I do not know.

Mr. LEACH. This is an awfully important point. What happens with Penn Square Bank has affected Seattle First and Continental at Chase Manhattan. If you're telling us you don't know when or if the regulators of these other banks were notified, that indicates a fairly extraordinary lack of governmental communication.

Mr. POOLE. I know when I notified the FDIC.

Mr. LEACH. That was May 21, in a casual conversation at the end of which you indicated there might be a problem at this bank.

Mr. POOLE. I couldn't tell them something I didn't know.

Mr. LEACH. Understood.

Mr. POOLE. I'm not trying to be smart, but I did not want to overstate the situation in the bank.

Mr. LEACH. But at no point did your office make a profound decision to inform the Federal Reserve?

Mr. POOLE. I believe—I'm sure they were notified. I read someplace they were notified. I just don't recall where.

Mr. LEACH. You're the regional director.

Mr. POOLE. No, sir, I would not notify the Fed normally.

Mr. SERINO. Mr. Leach, if I may interject. I am from the Washington office and there was extensive communication from the Washington office to the Federal Reserve Board and to the FDIC.

The CHAIRMAN. Once the Federal Reserve Board had contacted the Comptroller's Office because an unnamed individual in the Fed office decided to make a call to find out. That is what Paul Volcker told us.

Mr. SERINO. I don't know the exact time, Mr. Chairman, but there were extensive contacts in the Washington office.

Mr. LEACH. Your July letter to the board of directors was partly based on an audit which was completed in February. One wonders why it took so long for the February results to be transferred to the board when the situation was fairly serious. Can you explain that?

Mr. POOLE. That would be—I will have to admit, that was a little longer than would traditionally have been the period involved. And Mr. Barton might, after I finish, comment on what would be a more normal period of time.

Mr. BARTON. You would rather have that now?

Mr. LEACH. If you would like.

Mr. BARTON. We typically, in our problem bank processing, attempt to get the report out of the office within 30 to 45 days after receipt for processing.

Mr. LEACH. Let me just stress again that you were dealing not only with a problem bank but with a bank which was generating loans that were affecting the entire American banking system. The delay, in my estimation, takes away from Mr. Poole's comment in his opening statement that the behavior of the Comptroller's Office was exemplary. Do you consider that delay as being exemplary, or would you give it another categorization?

Mr. POOLE. I feel that the delay was justified and I can explain to you why the delay took place. It was not—it was the basis of a judgment call on my part. It was—in the first place, the bank was not in that severe a condition. It was rated three, and I would hasten to point out that we were not in great fear of the bank's demise at that time, even though we did find some significant deterioration.

There were several reasons. One was extensive discussions, as I have pointed out, between Washington and the regional office as to what type of action we would take.

The examiner in charge of that particular bank was handpicked by me. He had a position at the regional office. He was out of the office and worked 2 months on that examination, and he had his duties in the office and brought the report back more or less in pieces. There was significant work to be done on the report.

Once he came back, he could have extended the closing date of that examination for say another 30 days, which he could have legitimately done, and made it look a lot closer, say the end of March or the 1st of April. But we chose not to have him do so. But he was the individual in the office that I felt was the most qualified with respect to the funds management process and that was a major area of concern on my part at that particular time. That is why I chose him.

So that did lead to the delay. But in my opinion it did not—I did not consider that it would damage our supervisory effort with the bank. In retrospect I do not think that it did.

Mr. LEACH. We have heard from two panels of outside directors made up of individuals who are respected in this community, individuals who strike me as being articulate, intelligent, and thoughtful human beings, not unlike many boards of banks throughout this country. They indicated that one reason they didn't act with more alacrity or alarm is they felt they received rather encouraging statements from your Office in recent times that things were going better, that the bank was given a three rather than a four or five, that your Office seemed to be giving a green light on the progress report cards. Would you care to comment on those assessments?

Mr. POOLE. Yes, sir. At the board meeting in Dallas, the second one, the board was told. We were encouraged by the steps they were beginning to take by the additions to the staff, but at the same time I pointed out to them that the situation was very serious and could very easily deteriorate, and three things, if the deficiencies are not corrected, could very easily materialize into a four or five situation, and simply because we find some satisfaction with work done by the board is no indication that we mean that they are correct or that we mean they don't have remaining important deficiencies.

Mr. LEACH. It strikes me that it might well have been appropriate for you to have said that although positive steps had been taken, the board should remove this or that officer of the bank. Did that ever enter your deliberations?

Mr. POOLE. Yes, sir, it did, and I can tell you without any shame that I feel today and I felt then that had I made that decision, I would have been irresponsible, based upon the information we had and the lack of support for such action. It was a considered decision that we determined at that time that there was no basis for such action.

Mr. LEACH. But it was considered? I think that is worthy of placing in the record.

Mr. POOLE. We always try to point a finger.

Mr. LEACH. In other words, your original assessment that removal of an officer is virtually never done doesn't quite apply because you did consider it seriously in this case?

Mr. POOLE. Could I read something from this letter pertinent to that?

Mr. LEACH. Of course.

Mr. POOLE. This is the letter you were quoting from before with regards to removal procedures, the last two paragraphs. It says the removal power is an extraordinary remedy which this agency has

used on only a few occasions. The reason the agency has not needed to utilize the power is that ordinarily when management problems are brought to the attention of the directorate, the directorate takes actions to correct them. It is a principal responsibility of the board of directors to insure that the institution is properly managed. Thus, in the normal course where problems are identified, the board of directors will resolve the difficulties through management changes. If the board of directors does not take action to change management and there is a statutory basis to remove the individual from the bank, this office would not hesitate to consider the need to use the removal statute.

In the instant case, while problems existed in the bank prior to the April 1982 examination, in our opinion based upon the information known at the time of these problems, these problems did not then rise to the level satisfying the strict three criteria removal standards in the statute.

The problems as identified in prior examinations indicated that the management team needed strengthening. The formal cease-and-desist agreement required, among other things, that the board of directors evaluate and make adjustments to the current management teams, both in quality and depth. Because of that agreement, the bank responded by augmenting its management through the hiring of personnel from other financial institutions. This was viewed as a positive response to the previously identified management problems. Under the circumstances, removal was viewed as neither appropriate under the statute nor necessary to effect management changes.

Mr. LEACH. Did you realize that the new management was brought in without authority?

Mr. POOLE. No, sir, we did not. We were assured by both the board and I think the board has testified today that they felt that he had that authority, and we were assured by the board and by Mr. Beller himself that he did have the authority to correct the deficiencies.

Mr. LEACH. Even though removal is extraordinary, isn't it less extraordinary than closing the bank? Isn't it a less wrenching situation for the bank, for the community, and for the banking system?

Mr. POOLE. Yes, sir, but I do not believe that would justify its inappropriate use.

Mr. LEACH. There has been a good deal of discussion about options that were considered in the last few weeks of the bank's life: Whether the bank should be closed, whether there should be a P&A, or whether the bank should survive. It is my understanding that your office's recommendation was that the bank not be closed. Is that correct?

Mr. POOLE. I'm sorry. We recommended the bank——

Mr. LEACH. Not be closed. My understanding is that the FDIC was very firm; based upon its statutory authority, there was very little choice but to close the bank. Your office, and perhaps the Federal Reserve, had a somewhat different opinion. Could you enlighten this panel as to the discussions held in the last week or two and your recommendations?

Mr. POOLE. I was not present at those discussions. If I'm not mistaken, I believe they were between the Comptroller and the chair-

man of the FDIC and Mr. Volcker. The Comptroller's Office declared the bank insolvent. It was then turned over to the FDIC, and it would be the FDIC's decision as to whether to effect the closing of the bank.

Mr. LEACH. Did your office make a recommendation?

Mr. POOLE. I do not know.

The CHAIRMAN. As a matter of fact, I think the FDIC said the Comptroller's Office waited too long to declare it insolvent, giving them no time whatsoever. That is one of the reasons they went the route they want. That is not a question, that is a statement.

Mr. POOLE. Well, I would like to make a comment. The only comment I can make on that is that we declared the bank insolvent when we knew it wasn't solvent, and it wasn't possible for us to do so prior to that time.

The CHAIRMAN. You mean you couldn't do it Saturday afternoon at 1 o'clock after the bank closed.

Mr. POOLE. I don't believe—as I recall, the loan losses were not sufficient to wipe out the capital at that point in time.

The CHAIRMAN. But you did it before reopening on Tuesday.

Mr. POOLE. Yes, sir.

The CHAIRMAN. As I said, I wasn't asking that as a question.

Mr. LEACH. If the chairman would yield. Earlier you testified that Jennings came to you and said the bank was insolvent, and you disagreed. Is that an accurate assessment?

Mr. POOLE. I don't recall. I don't know about that comment.

Mr. LEACH. Do any of you know of that conversation?

Mr. PLUNK. No.

Mr. BARTON. No.

Mr. LEACH. Thank you.

The CHAIRMAN. I would like to state that from the briefing that was held in Washington a few weeks back, I said they were informed of the fact that this bank, prior to the closing, Mr. Conover—that is, it was during that previous week, yes, and the chairman of Chase Manhattan was informed, now Mr. Homan, I believe that is correct, and Mr. Homan said they were advised they had significant problems in their portfolio as a result of loans they purchased from Penn Square and were placing them under examination in terms of our trying to come to grips with them and their internal people, come to grips with the loss exposure in those particular loans.

One further statement. Were you aware of the fact that one of the people from Oklahoma, and I am quoting Mr. Homan at page 36 of the briefing:

We also sent our energy examiner, one of the experts in Oklahoma, to Continental, to A&R examiners in the assessment of their portfolio.

Were you aware of that?

Mr. POOLE. Yes, sir.

The CHAIRMAN. So you are aware of the fact that Continental had been informed by an examiner from this area?

Mr. POOLE. Yes, sir.

The CHAIRMAN. I just want to get that straight because there seemed to be a little cloud on that earlier.

Mr. LEACH. Mr. Chairman, may I pursue one other point? It is apparent that your office did talk with other regulators.

Mr. POOLE. Did or did not?

Mr. LEACH. Did.

Mr. POOLE. Yes, sir.

Mr. LEACH. Did it also talk with the National Credit Union Administration?

Mr. POOLE. I have no knowledge that the Comptroller's Office did.

Mr. LEACH. That is of some significance because, as you know, in the last several weeks credit unions were pumping money into this particular bank when banks were not. That raises some very interesting questions both in terms of Federal coordination as well as in terms of—

The CHAIRMAN. If the gentleman would yield, the NCUA and the Home Loan Bank Board, by the Comptroller's Office in Washington were informed about the time or maybe a day or two after Continental and Chase.

Mr. Annunzio.

Mr. ANNUNZIO. Thank you, Mr. Chairman.

Now, Mr. Poole, what benefits were gained by closing the bank that would have been lost had the bank been kept open and financially assisted?

Mr. POOLE. I believe we had a responsibility to close the bank, as I indicated. I don't believe the Federal Reserve—the bank had a liquidity crisis. It was our assessment, it was the Comptroller's Office's assessment that the bank could not open on Tuesday morning without experiencing a run on the bank. The bank had a negative capital structure as a result of its losses, and it is my impression that the Federal Reserve would not lend funds to a bank that we would declare insolvent.

Mr. ANNUNZIO. Could it have been worse than it is now?

Mr. POOLE. No, sir, not the condition of the bank.

Mr. ANNUNZIO. I mean the condition of the community, the financial community.

Mr. POOLE. We don't have a choice in the matter, in my estimation. We have to close a bank that has a negative capital structure.

Mr. ANNUNZIO. I have no reason for saying this, but I have been very patiently listening and asking questions all day. I am absolutely convinced that you people were conned just like the directors, and somebody tried to get to the two con artists and it was a lot of emotion involved here and hundreds of people are suffering because of the action that was taken by the Comptroller's Office.

Now Mr. Poole, Mr. Conover testified in Washington that he had no choice except to close the bank because under the law he had no other legal recourse. Isn't it true that you could have appointed a conservator to run the bank, you could have removed management and put your own people in place? That has been done in the past. Why wasn't it done in Penn Square?

Mr. POOLE. The bank was insolvent. I don't believe that can be done when the bank is insolvent. Here again, these are—

Mr. ANNUNZIO. But I know of banks where it was done. It was done in Miami where they appointed a conservator. It is being done

every day. Isn't it possible that your office panicked and closed the bank? Could you have made a mistake?

Mr. POOLE. No, sir, we didn't make a mistake.

Mr. ANNUNZIO. Why, then, why didn't you give the bank more time to raise capital? I heard testimony today from the directors, if they had the time, they didn't want money from one of the agencies or the regulators. They could have raised private capital.

Mr. POOLE. They had—the temporary cease-and-desist order was issued and they were given until the following Friday to raise the capital. As it turned out, the losses were so great that the bank would have suffered a closure under any circumstances had it tried to reopen.

Can I make one comment?

Mr. ANNUNZIO. Really, did you really give them time to raise this capital? Did you sit down together and did you say you have a week, 10 days, or a month?

Mr. POOLE. They didn't have that long because the bank was in an insolvent condition. It was not in an insolvent condition the day of the board meeting.

Mr. ANNUNZIO. Well, how long did they have? You said they didn't have that long. How long did they have?

Mr. POOLE. They had to raise it by the 9th, and the Comptroller declared the bank insolvent on the 5th.

Mr. ANNUNZIO. You said they had until the 9th. Was it the 9th to close, to raise the money?

Mr. POOLE. I am informed that the agreement, that the temporary cease-and-desist was amended subsequent to give them to, what, the 2d. It was said the capital should be in the bank originally, \$30 million, by the 9th, and it was amended the next day to the 2d, the close of business.

Mr. ANNUNZIO. And when did the bank close?

Mr. POOLE. On the 5th.

Mr. ANNUNZIO. On the 5th?

Mr. POOLE. It did not reopen on the 6th.

Mr. ANNUNZIO. And did they raise the money?

Mr. POOLE. No.

Mr. BARTON. No, sir.

Mr. ANNUNZIO. Could you tell the committee what they did? Did they raise any amount?

Mr. POOLE. They made attempts, as I understand it, contacts were made with individuals. This is only what I am told.

Mr. ANNUNZIO. It just doesn't sound right to me. In other words, they are in the process of raising money and they are cut off even before they have a chance to raise the money.

Mr. POOLE. But sir, if the bank is insolvent, we have no choice.

Mr. ANNUNZIO. It reminds me of a case of a few bad management officials like, again, like I stated, that are being punished by ruining the lives of hundreds of people, and we have heard the testimony from people in this community who lost \$850, who lost \$2 million, who lost \$1 million, not counting the reputation of the financial institutions in this country that have gotten publicity from coast to coast. I don't really believe that you people realize that you have created this monster, then you destroyed the monster, the havoc that this would play on the economy of this country. I don't

think you understood that. I don't think the Comptroller understands it.

Mr. POOLE. We had no choice.

Mr. ANNUNZIO. You had a choice.

Mr. POOLE. We did not create the problem.

Mr. ANNUNZIO. You had a choice. I read a report where the bank was in good shape in 6 months. It deteriorated fast. You would think it had cancer.

Mr. POOLE. It did.

Mr. ANNUNZIO. Oh, it had cancer, but a cancer can be cut out, a cancer can be arrested, a cancer can be cured today, and that is your job. What was the difference between the closing of Penn Square—and I brought this up earlier today—and the closing of the Abilene National? Just before Abilene closed, didn't your office issue a public statement saying that Abilene was in good shape?

Mr. POOLE. No, sir.

Mr. ANNUNZIO. Oh, yes, you did. I asked the Comptroller in Washington.

Mr. POOLE. I can give you a copy of my statement if you would like to have it.

Mr. ANNUNZIO. I would like to have it.

Mr. POOLE. My statement was, and it was in the judgment of the Washington office—

Mr. ANNUNZIO. Are you talking now as an individual, your personal statement, or your office statement?

Mr. POOLE. It was a personal statement that I made after consultation with the Washington office, and it was a statement I made with regard to the intentions of the Comptroller of the Currency's Office, and that statement was that the Abilene National Bank is not in liquidation and the Comptroller's Office has no plans to liquidate the bank at this time. That statement was good only for the moment it was made.

That statement was made in response to a rumor that was circulating in the Abilene area and that was going to be discussed and aired on a television station that night, that the bank was in the process of liquidation, which was not a true statement, and the office felt an obligation, as much as it would be our office to declare the bank insolvent and put it in liquidation, to refute that statement.

It was unprecedented and that statement said nothing other than we did not have plans to place the bank in liquidation. It did not attest in any way to the condition of the bank.

Mr. ANNUNZIO. But your office has helped the people of Abilene, but you sure have let the people of Oklahoma City suffer.

Mr. POOLE. It would be impossible for me to contrast for you the relative conditions of the two banks and it would be improper for me to do so, but I can assure you that they differ significantly.

Mr. ANNUNZIO. I want to give you another example. It has come to my attention that some of your examiners have encouraged other banks, national banks, to take the fast track route of Penn Square. It has been reported to me that your examiners, in a meeting with officials of banks that were growing slowly, told those bank officials that they should follow Penn Square's rapid growth

policy by getting into the oil and gas loan business in a big way. Why would your examiners make such recommendation?

Mr. POOLE. I have no knowledge of such recommendations.

Mr. ANNUNZIO. And is it possible that maybe some other banks are following your examiners' recommendations and it may well be the future Penn Square problems?

Mr. POOLE. I have no knowledge of such recommendations and I would doubt very seriously that they exist.

Mr. ANNUNZIO. If we get the proof and we bring it in, what would you do?

Mr. POOLE. You will have to bring it in first and then we will see.

Mr. ANNUNZIO. Oh, I've got to bring it in and then you will take action as far as these examiners are concerned? I have news for you. I come from the city of Chicago where we don't have one bank but dozens and dozens of banks, and you know, after 18 years on this committee how many times the Comptroller, the Regional Director in the city of Chicago has called in bankers and said, you get rid of that cashier, you get rid of this, you get rid of that, and the banks did it. They got rid of those people.

And if the bad actors in this bank were the people who created this condition, it was your responsibility to get rid of them, to bring action under the law that we passed in Congress. Your general counsel is here to fight those individuals. They should have made the changes that you recommended so that this could not happen in this community, especially at this time when we are facing the most serious crisis that we have ever faced in this country. I don't think that that was taken under consideration, Mr. Poole, the general condition of the financial structure of this country and how dangerous it is today.

Mr. POOLE. I would have been extremely irresponsible had I taken such action based upon the information that we had at the time prior to the April examination.

Mr. ANNUNZIO. Well, I just don't believe it, and I will bring you my proof.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Weber.

Mr. WEBER. Thank you, Mr. Chairman.

You know, our purpose in these hearings is to make sure we find out what happened so that it doesn't happen again, and I would have been much more happy if you had come in, Mr. Poole, with a statement that said we are not satisfied with the results we have achieved, we have tried our best, now we want to learn from this experience, or that this isn't to be repeated. But instead you brought us a statement that says, in conclusion, I am fully satisfied with our supervision of the Penn Square Bank. The statement says our conduct was totally appropriate, and then, I believe, although it is not in your written statement, I believe I heard you say we did our job in an exemplary fashion.

Well, I don't think any of us are satisfied where you had this bank under your supervision for a couple of years and yet it continued to go downhill and ultimately failed, with the consequences that Mr. Annunzio has pointed out. None of us is perfect, but I

think we have to learn from this experience and do a better job next time.

Now let me come to the chargeoff of the loans, and maybe we can get Mr. Plunk into this. Mr. Plunk, what examination and test of the soundness of collectability of these loans did you apply under these circumstances? In other words, I think the people of this community and also the people across the country—and we had a credit union in Toledo that had an investment—deserve to know why this bank was suddenly declared insolvent, and what test did you use to determine the fact that these loans were dead? I think that was your expression.

Mr. PLUNK. I think we used general credit standards; that being primarily the performance of those loans—as Mr. St Germain pointed out earlier, there was a substantial instance of upstream interest where these borrowers had to rely on the bank to pay their interest. I might add that by the time our crew entered the bank, that that amount, that \$2.5 million amount had quadrupled. And also the overdue percentage was quite substantial at 13 percent, which was 4 to 5 times what we see in a normal bank.

Mr. WEBER. Well, you charged off something like \$45 million in loans, isn't that right? How many loans did you decide to charge off?

Mr. PLUNK. The final report revealed slightly over \$49 million in losses, which would include loans and other accounts such as accrued interest.

Mr. WEBER. What was the criteria for charging those off? Were they just overdue or overdue by a certain number of months, or how did you do it?

Mr. PLUNK. Overdue. When you say overdue—

Mr. WEBER. Did you have a rule-of-thumb that you used? I would like you to explain to the people in this room how you decided whether a loan was dead or whether it still should be carried on the books.

Mr. PLUNK. When it could not perform as evidenced by its past due status or its upstream interest status or substantial overdrafts; second, the financial capacity of the borrower was not supportive; and finally, when there was no collateral or insufficient collateral, we determined it to be a loss.

Mr. WEBER. But you are absolutely sure that those \$49 million that you charged off were dead?

Mr. PLUNK. Yes, sir, I think they were uncollectable.

Mr. WEBER. How much do you think will be realized on those \$49 million?

Mr. PLUNK. I don't know. It would surprise me if it were greater than 25 cents on the dollar. And I might add that I think, given the turn in the oil industry, that there are substantially more losses in the portfolio.

Mr. WEBER. Some mention was made earlier of runs on the bank. Can anyone elucidate? Were there runs on the bank in the last days of Penn Square?

Mr. PLUNK. I'm not sure of the definition of a run. I know that the lobby traffic was extremely heavy and that the bank initially, I think on a Friday, they instituted a policy of letting no more than \$10,000 in cash go out, and then they made up the difference with

a cashier's check or official check. By Saturday that had been amended to no more than \$5,000 in cash, and then by closing on Saturday, no more than \$1,000 in cash.

Mr. WEBER. That sounds to me as though the bank had a liquidity problem of some dimensions.

Mr. PLUNK. Yes, sir, I would agree.

Mr. WEBER. In the report that you did dated March 31 of 1982, there was a statement that the external audit was rated unacceptable. Can you explain what external audit you are speaking of?

Mr. PLUNK. That is the December 31, 1981, audit, the external audit, the CPA audit.

Mr. WEBER. Performed by Peat Marwick?

Mr. PLUNK. I believe so.

Mr. WEBER. What were the reasons to lead you to believe that it was unacceptable.

Mr. PLUNK. We had a difference over their approach toward the loan review. My examiners told me that from their review of the accountants' workpapers, that they had performed only a 15-percent penetration into the bank's loan portfolio, which, of course, as you know, is a very limited type of approach. I think most banks prefer to have an 80 percent coverage or penetration.

Second, the collateral and credit documentation exceptions were just overwhelming. They were 3,000 in number. And on a gross loan basis, it was about \$1.1 million. These were also hard exceptions in that they were unsigned notes; the failure to take an oil and gas mortgage, and the failure to get engineering reports. They were quite substantial collateral exceptions.

And also we had trouble with various accounting in the bank, such as the accrued interest account and I suppose to this date it is still unreconciled.

Mr. WEBER. Did you bring those criticisms to the attention of the auditors of Peat, Marwick, Mitchell & Co.?

Mr. PLUNK. They were outside the bank. They had left the bank by the time our crew had gotten there. We did question some of their techniques.

Mr. WEBER. Did you bring those specific criticisms to the attention of the auditors?

Mr. POOLE. The bank closed before we had an opportunity to do that.

Mr. WEBER. Well, I was looking at something that I thought was dated March 31, 1982, long before the bank was closed.

Mr. POOLE. That was as of the date of examination. It was commenced on April 17.

Mr. WEBER. I understand. Thank you.

Earlier I think you heard me talk rather critically about your efforts to communicate to the board of directors, and if you were here earlier today, you heard the directors say that most of them were not even aware of the numerous ways in which you were trying to communicate to them because your reports were sent to the bank and the board of directors wouldn't receive these reports until they came to the board meetings, and then for different reasons they didn't even take them home. They were persuaded that it was unwise to take them home.

Have you considered mailing your reports or your communications directly to the directors either at their own offices or at their homes?

Mr. POOLE. Well, of course, a decision like that would probably be one that would not only be made by—well, it would be made certainly by the Comptroller's Office in Washington, but I personally feel that I would not recommend such a procedure because we might have 25 directors and it would be not only voluminous to send 25 copies of a report, potentially this thick, out to the directors, but I personally would not like to have that many copies of such sensitive information floating around the community.

Mr. WEBER. Would you consider sending a resume or calling attention by direct letter to the directors to the fact that an important report containing sensitive information critical of the performance of the bank is on file in the bank's headquarters and they had better make themselves aware of it?

Mr. POOLE. I think our current procedure is fully adequate. The report is sent out with, as was reported earlier, a page, a copy of which I have here and would like to submit as evidence, which reads at the top: "We the undersigned directors of Penn Square Bank, NA, Oklahoma City, Okla., have personally reviewed"—personally reviewed—"the contents of the report of examination dated September 30, 1981." It is signed by every director of the bank and it is dated. There is one here from each of the last three examinations.

Now, it would seem to me that since directors primarily do their business regarding the bank at board meetings in the bank, that that would be the appropriate place to discuss examinations, and it would seem sufficient to me to have them sign a statement that indicates they have personally reviewed, not had it read to them as was discussed here earlier, but personally reviewed and signed that statement, that should be sufficient.

The CHAIRMAN. Would the gentleman yield?

Mr. WEBER. I would yield to the Chairman.

The CHAIRMAN. Mr. Poole, that is amazing. You just finished saying it is a voluminous report. Voluminous report. When did you contact the regional Federal Reserve Board official here relative to shutting down Penn Square? Excuse me, sir, I want Mr. Poole.

Mr. POOLE. I don't believe the regional office contacted the Kansas City Fed regarding that. Contact was made in Washington. We would normally not have reason to contact with the Federal Reserve.

The CHAIRMAN. It seems to me there was a letter on July 5 that went to the gentleman at the Fed from you.

Mr. POOLE. No, sir, not from me.

The CHAIRMAN. OK, Mr. Serino.

[The witness conferred with counsel.]

The CHAIRMAN. Has your memory been refreshed?

Mr. POOLE. No, sir. We contacted before—first of all, the Federal Reserve gets copies of our reports.

The CHAIRMAN. I am sure that I read in my briefing papers that on that fateful weekend of July 4, 5 and 6, that there was a contact that had to be made between you and the gentleman who is going to be testifying here, Mr. Guffey, wherein you sent him a letter

saying that—you sent this and he sent a letter back saying no, we can't do anything, and that would sort of confirm that nothing could be done.

Mr. SERINO. Mr. Chairman, may I clarify it for you?

The CHAIRMAN. Yes, Mr. Serino.

Mr. SERINO. Prior to the administrative action in 1980, there was a letter sent, as is our procedure in all administrative actions.

The CHAIRMAN. I am sorry, that is not the one I am referring to. Actually what I was trying to do was to make a point here.

Mr. POOLE. We did send the letter that you are talking about. You are talking about the letter on the 5th.

The CHAIRMAN. Yes. It went and came back the same day.

Mr. POOLE. That was not my letter.

The CHAIRMAN. Whose was that, the FDIC?

Mr. POOLE. The Comptroller of the Currency himself.

The CHAIRMAN. Mr. Conover in Washington?

Mr. POOLE. Yes.

The CHAIRMAN. Terrific. You got him in Washington, to the regional office here and back? Fantastic.

Mr. POOLE. No, sir.

The CHAIRMAN. Federal Express? Was that the Fed in Washington?

Mr. POOLE. At that particular time, the bank was under the control of the Washington office and its staff from Washington.

The CHAIRMAN. I stand corrected. I misread the thing. But my point is you were saying—here are ordinary individuals that I don't think are gifted with photographic memory, voluminous reports, they sign a sheet, yes, I've seen the report. In reality, realistically, do you think that they remember every point in that voluminous report at the end of that meeting at which they went over that report of the Comptroller criticizing and making recommendations? In truth, can you expect any member of the board of directors to remember all of that?

Mr. POOLE. I expect them to remember a sufficient detail from the report to enable them to live up to their responsibilities in supervising the activities at the bank. That is their innate responsibility.

The CHAIRMAN. Did you go through college and whatever schools you went through with 100 percent on every test you took? I didn't.

Mr. POOLE. Not by a long shot.

The CHAIRMAN. I didn't, but it seems to me, couldn't you provide each of them a copy of the points, what was it, about three or four pages long, of the points, the corrections that they agreed to in the letter of agreement?

Mr. POOLE. Well, the report has a cover letter and it is addressed to the board of directors and it is sent to the bank.

The CHAIRMAN. Yes, sir. Shouldn't the members of the board—if you had asked the members of the board to sign the letter of agreement, that letter of agreement—what was it, five or six pages long?

Mr. POOLE. Yes, sir.

The CHAIRMAN. Shouldn't they all have copies of that letter they signed?

Mr. POOLE. Of the agreement?

The CHAIRMAN. The letter of agreement.

Mr. POOLE. No, sir. I don't think we need to have any more copies of that document circulated around than we have to.

The CHAIRMAN. How in God's name do you expect them to remember 3 days later what they signed?

Mr. POOLE. Well, the agreement appointed members of the board to establish compliance committees to see that the articles were complied with, and they were to therefore have constant contact in the bank on a regular basis to oversee the compliance with those articles.

The CHAIRMAN. I apologize to Mr. Weber for taking his time. It is just absolutely incredible. You know, it is as though everybody in the Comptroller's Office took the vow of silence. You know, you can be oh-so-oversecretive here. This whole secrecy bit is absolutely banal, idiotic and ridiculous.

Mr. POOLE. I would like to point out that the procedures where we send only one report to the bank with a letter to the board and also one copy or whatever of the administrative agreements has in the vast majority of cases worked well for the Office and has not led to a breakdown in the quality of communication between the Office and the banks. It has worked well and we have not deemed it necessary to change it. But this is a Washington policy matter. It is not my policy.

The CHAIRMAN. I agree with you you are not the one. You don't set the policy. But I still say to you and to everybody here assembled that I think it is absolutely ridiculous and preposterous the way we dealt with these people today. These are nice people, these people on that board of directors, high class individuals, and, by cracky, I think that they could have been trusted with the copies of those letters of agreement, very definitely. I am going to tell you there are going to be some changes made here. Hopefully we are going to make some changes in things like that.

Mr. WEBER. I only have one more question. Let me just follow through with what the chairman said. My evaluation of the people that we saw on that board of directors, a lot of good, solid citizens of this and other communities trying to do the best they could but way in over their heads in dealing with a management that was in many ways headstrong and recalcitrant and possibly devious, and there perhaps are some other criticisms that I could make; but my question really is to what extent did you gentlemen share that observation and proceed and give this board of directors the kind of help that they needed?

Did you specifically tell them how to implement policy and how to monitor and how to enforce? Or did you just tell them, this is your job, you go to it? Because it sounds as though you told them these are the policies the bank has to have and it is your job to enforce them, but you didn't tell them how to do it. And maybe I stand corrected, but did you tell them specifically this is what you need in the way of a compliance committee or whatever it is that will have the power and the ability and the capacity to oversee what this management is doing and to be able to override their judgments since you were not willing to go so far as to recommend their removal?

Did you go so far as to recommend a committee that would review every loan and report to the directors, not report to Mr. Jennings and not report to Mr. Patterson?

Mr. POOLE. The administrative agreement was fairly detailed in addressing how the compliance committee would be set up and how it would report to the Office and how it would function.

Mr. WEBER. Excuse me. Who was on that compliance committee?

Mr. POOLE. I do not recall.

Mr. WEBER. Do you know if a compliance committee actually was set up?

Mr. PLUNK. Yes.

Mr. POOLE. I believe it was.

Mr. WEBER. Did you review whether or not the compliance committee had regular meetings and kept minutes of those meetings?

Mr. POOLE. I believe the compliance committee was established after our meeting in July, and we found that it was established at our September meeting. I do not recall the extent to which they were sending information to us. It would have been requested. But my point was, as far as your question related to the detailed banking policies, that as you pointed out, it would be very difficult for the lay members of the board to conjure up, to deploy, let's say, those policies that were in effect. Our more direct direction to them was to strengthen the management team of the bank, which as I pointed out before, we thought they had done with Mr. Beller and his staff, and that these individuals, being experts in the field of banking, would aid the board in living up to its responsibilities to oversee the development of policies and the carrying out of those policies. And it was our impression based upon our examination in September that in fact this was the process that had begun, the development of these policies.

Mr. WEBER. Thank you, Mr. Chairman.

The CHAIRMAN. You say that they should have known all of this. The Comptroller's Office was not aware of the fact that this poor Mr. Beller, who was supposed to be the savior here—God bless him, I sympathize with him—that there were instructions or memorandums of agreements to the effect that he could do nothing about loans in the energy area by Mr. Jennings and Mr. Patterson? The Comptroller's Office was not aware of that?

Mr. POOLE. No, sir.

The CHAIRMAN. Yet to blame these poor members of the board of directors, they should know about everything, and you are the professionals. They are just ordinary citizens.

Mr. POOLE. Well, the board, you know—and I say this because I say it in some board meetings, and it is part of, I guess, my spiel, if you want to call it that—the boards have to realize that we have no money in the bank, we have no deposits, we have no stock in the bank; it is their bank, they are the ones who organized it, and they are the ones who are charged with the responsibility and they are the ones who meet on a monthly basis to oversee the activities of the bank. We are not in the bank 365 days a year. We can't manage the bank.

The CHAIRMAN. Wait a minute. Let me interrupt you. But don't forget your responsibility to the taxpayers of the United States of America.

Mr. POOLE. I think my responsibility——

The CHAIRMAN. And you have got to remember and I have got to remember that those responsibilities are that \$100,000 deposit guarantee to all depositors, and that is why you exist, because of the insuring fund, not just to have meetings of the boards of directors.

Let me ask you this. Is this an accurate report from the minutes of the meeting held on July 29, 1981 with the board in Dallas?

Mr. Smelser asked Mr. Poole what steps the director should take if he disagrees with the management actions. Mr. Poole answered by first noting that a director's job is to make certain the association has a good management team and to be properly informed on that. Thereafter, the director can make his disagreement known and attempt to have management change its position and ultimately to resign.

In other words, if management won't change its position, resign, because you see, in this instance——

Mr. POOLE. Would you give me a chance to explain what I said?

The CHAIRMAN. You will in half a second. In this case you have got a strong chap, Mr. Jennings. He actually appointed all of these board members, not originally but he kept them on. Like I said before, he is the big man in this operation. They couldn't remove him, could they, Mr. Poole?

Mr. POOLE. Sir?

The CHAIRMAN. They couldn't remove Mr. Jennings, the board of directors?

Mr. POOLE. I believe they could.

The CHAIRMAN. As a practical matter? Who appointed most of them? Who owns the stock in this institution?

Mr. POOLE. Why could they not?

The CHAIRMAN. Who controls the stock in the institution? Was it Mr. Jennings and his close friends and relatives?

Mr. POOLE. I believe he was a large stockholder, yes.

The CHAIRMAN. The controlling stockholder.

Mr. POOLE. Right.

The CHAIRMAN. Who calls the shots as to who remains on the board of Directors.

Mr. POOLE. In other words, you are saying you could strip him of his title, you could take him out of the bank and he would still have that power. Is that what you are saying?

The CHAIRMAN. What I am saying is when a particular gentleman appoints all the members to the board, he is the powerhouse. As a practical matter, how many times have you seen that board rebel against the powerhouse in the institution?

Mr. POOLE. I have seen it happen in certain instances.

The CHAIRMAN. Well, if you would, send me a little note to my Washington office, and I would like to review this. I don't want to waste your time here or tax your memory or the time of your people here, but I would be interested in seeing this.

Mr. POOLE. There was one case where I believe the owner owned practically all the stock of the bank and we succeeded in getting him to sell the bank. That is the only way in that case. You can strip his title. You can even have the board vote him off as a direc-

tor if that were possible, if someone were a majority owner. But if he still owns all the stock, there arises the question of will that individual still be able to exercise his authority over the bank.

The CHAIRMAN. You said you wanted to explain your statement to Mr. Smelser?

Mr. POOLE. Yes, sir.

The CHAIRMAN. About resigning.

Mr. POOLE. I don't remember exactly how the question went, but I can assure you that my answer was probably in response to a series of questions such as what does a board member do if he disagrees with the management. Well, to make sure that you have a good management team is the director's first responsibility, and to be properly informed on matters. Thereafter the director can make his disagreements known. My comment, I'm sure, was, when I was pressed, that what if you try to do this as a board member conscientiously and you failed and you have no other course of action except to sit there and compromise your principles and your integrity, I guess I said then your alternative would be to resign. I was not trying to be facetious or suggest that any board member would resign.

The CHAIRMAN. Mr. Barnard.

Mr. BARNARD. Mr. Poole, can you say that the Penn Square Bank was typical of the average national bank that you and your staff examined?

Mr. POOLE. No, sir.

Mr. BARNARD. Why was it not typical?

Mr. POOLE. It was not typical for two reasons. First, it is a 3-rated bank, a problem bank; and second, the level of growth and the concentration in energy credits made it unique.

Mr. BARNARD. The charges that are before you were taken from the records of the Comptroller of the Currency, and I think you have pretty well identified that this was an untypical bank. The problem had many, many aspects of it: rapid growth, as you just said, and concentration of loans, as you just said. Do you approve of a bank like the Penn Square Bank being a loan production office for a national banking system?

Mr. POOLE. By a national banking system—

Mr. BARNARD. I mean for Chase, Continental, Seattle First?

Mr. POOLE. It is unusual. Normally I guess the flow of correspondent relationships is in the opposite direction.

Mr. BARNARD. It is certainly not typical for a bank to hold no more than 20 percent of its total loan production, is it?

Mr. POOLE. I would say that is unusual.

Mr. BARNARD. Especially for a bank in the situation that Penn Square would be.

Mr. POOLE. I'm not sure about what you mean.

Mr. BARNARD. Well, here you are talking about a smaller bank in a big city, not by any measure the largest bank in the community.

Mr. POOLE. Correct.

Mr. BARNARD. Yet probably producing more loans than three or four other banks put together.

Mr. POOLE. It is unusual, yes, sir.

Mr. BARNARD. The whole point is that I think it was untypical to the degree that it required more attention than the Comptroller's Office gave it. Now, you said you couldn't be there all the time.

Mr. POOLE. Right.

Mr. BARNARD. But what do you do when you get a call report? Aren't call reports analyzed and aren't they compared with bank examination reports to determine what progress a bank has made in its operations?

Mr. POOLE. Well, in the case of Penn Square we had monthly reports after a period of time.

Mr. BARNARD. You had monthly reports?

Mr. POOLE. Yes, sir.

Mr. BARNARD. And yet you did not find such severe deterioration until Mr. Plunk came in in April of 1982?

Mr. POOLE. Yes, sir. The reports would only indicate the degree to which the bank was, as you pointed out, in an unusual situation.

Mr. BARNARD. It would show overdrafts, wouldn't it?

Mr. BARTON. No, the reports did not show overdrafts.

Mr. BARNARD. Do you mean to tell me a call report does not show the volume of overdrafts?

Mr. BARTON. The monthly reports we received from the bank did not.

Mr. BARNARD. Well, why didn't they? That is a typical measure of qualifications. And also I am surprised you didn't ask for a schedule of overdrafts because we found in several instances that you had—Mr. Plunk, didn't you find some overdrafts which were beyond the legal lending limit?

Mr. PLUNK. Yes, sir, we did.

Mr. BARNARD. Was that before 1982 or in 1982.

Mr. PLUNK. Most were during 1982.

Mr. POOLE. I don't believe overdrafts were a severe problem in the bank, to my memory, prior to the examination this year.

Mr. BARNARD. Some of the directors who read your examination report thought it was a severe problem. That was brought out this morning. They were concerned about overdrafts. I know you are sensitive about this and I think you have got a right to be sensitive about it, but I hope the other 215 class 3 banks that you have in the country are getting more attention than Penn Square Bank got. I don't feel that the Board of Directors were aware that the situation was as severe, even though they have had two meetings with officials of the Comptroller's Office—

Mr. POOLE. If they didn't hear it, then they didn't use their ears. It was given very clearly, as I testified. I gave it just as clearly, if not more clearly, than I have in the dozens and maybe even hundreds of board meetings that we have held in regional offices that I have been in charge of.

Mr. BARNARD. But you didn't sense the seriousness of the situation and do anything about it.

Mr. POOLE. The seriousness of the situation as it developed this year was not in existence in earlier years.

Mr. BARNARD. But it jumped from a class 3 bank to a class 5 bank.

Mr. POOLE. Yes, it did, and I think that is an accurate assessment of the degree to which the problem developed in the bank.

Mr. BARNARD. In the meeting that was held in Dallas on July 29, 1981, Mr. Clifton was reviewing the report and he was talking about the growth of continued liability. That is on page 3 of that report. It is interesting to note that he was advising the bank how they could possibly secure sources of funds to satisfy these contingent liabilities, and Mr. Clifton advised the bank that they could either go to Fed funds, to large CD's and to participations. Don't you think that they had pretty well saturated the participations area?

Mr. POOLE. At that time I think they had something like \$380 million or \$390 million of participations.

Mr. BARNARD. Out of a total loan portfolio of what?

Mr. POOLE. I don't recall what it was at that particular time.

Mr. BARNARD. So from 1981 on, it grew \$2.2 billion in loan participations?

Mr. BARTON. It grew \$1 billion after September 1981, so the market was not saturated with participations.

Mr. BARNARD. How did you know that, Mr. Barton?

Mr. BARTON. How did I know that then?

Mr. BARNARD. How did you know it was growing at this rate?

Mr. BARTON. We did not know it was growing at that speed until we began the examination in April 1982.

Mr. BARNARD. No further questions, Mr. Chairman.

The CHAIRMAN. Mr. Wortley.

Mr. WORTLEY. Thank you, Mr. Chairman.

I would like to go back to a statement made earlier today by Ronald Burks, who testified that Mr. Jennings spoke with the Comptroller's personnel July 2, indicating that the bank in his opinion was insolvent. Jennings indicated, however, that the Comptroller's personnel disagreed with his assessment at that time and that the Federal Reserve stood ready to support the bank through its discount window.

What is your understanding of this particular occurrence?

Mr. POOLE. I have no knowledge of it, sir.

Mr. WORTLEY. Somebody on your staff has to have some knowledge of it.

Mr. PLUNK. I was at a meeting, I was at several meetings on July 2, and the question of solvency or insolvency was discussed theoretically on several occasions, but there was no formal presentation or no formal statement made about insolvency.

Mr. WORTLEY. Neither you, Mr. Plunk nor anybody else told Mr. Jennings that the bank was not insolvent.

Mr. PLUNK. I don't recall the exact words used, but at that time losses identified did not exceed the bank's capital structure. Therefore, we could not say that it had been declared insolvent.

Mr. WORTLEY. Let's look at some of the other chronology of this period. Your agency commenced general examination of the bank on April 19, but you didn't notify the FDIC until June 23.

Mr. POOLE. No, sir, May 21.

Mr. WORTLEY. May 21?

Mr. POOLE. Yes, sir.

Mr. WORTLEY. Do you have documentation on that?

Mr. POOLE. Yes, sir. There is a copy in my testimony.

Mr. WORTLEY. Why did it take about a month until you got around to notifying the FDIC of the problems?

Mr. POOLE. Well, even at that time when I talked to Mr. Jackson I was not sufficiently aware of the extent of the bank's problems to give him any real feel for the problems that existed, and it was truly not until June 23 that my knowledge of the depth of the problem was sufficient to provide any detailed information. The call on May 21 it was just a preliminary indication that I could tell him what I had heard from the examiner on May 13.

Mr. WORTLEY. Did your people notify either the depositors of Penn Square or the correspondents of Penn Square during the final days of the bank's operation as to the status of the situation? In other words, did you folks tell Continental and then tell Chase that a problem existed?

Mr. POOLE. I think I was asked that question earlier with regard to the upstream banks, and to my knowledge, and my knowledge is only second hand, I think if any contacts were made, they were made in Washington. We did subsequently, as the chairman pointed out, have one of our examiners in Continental, but that was after, I think, any contact was made by the Washington office to Continental. But those contacts would not have been made by the regional people. That would have been a decision on the part of the Washington office to make those contacts.

Mr. WORTLEY. Well, what determines whether you notified?

Mr. POOLE. Normally there would not be any notification.

Mr. WORTLEY. Was anybody looking out for the small depositor?

Mr. POOLE. I don't know of any way that the small depositors could have been notified without running the risk of causing a run on the bank. If you were to call someone and tell them the bank was in crummy shape, first of all I think I would be violating the law by putting the bank in jeopardy by disclosing to someone information based upon a confidential examination report.

Mr. WORTLEY. Is there a level of interest that determines whether you are going to be notified or not?

Mr. POOLE. No, sir, I did not notify anyone. I think the notification, and I will bear being corrected on this because I was not involved, I think the decision to notify was based on the concern for the Penn Square Bank and the hope that maybe a recuperative effort as sponsored by a combination of four or five largest upstream participants might be arranged; and also, as I said before, over our office's concern with the quality of the assets in those banks too as reflected by our examination of Penn Square. But that is not necessarily accurate. It is only what I have heard was the motivation regarding action that I am guessing was taken by the Washington office.

Mr. WORTLEY. Was there any time in these final days when you became concerned about the volume of CD's that were owned by credit unions out there?

Mr. POOLE. We were concerned about the volume of uninsured deposits, yes, sir, period.

Mr. WORTLEY. Mr. Beller claims that he prepared and presented a list of CD's to Mr. Robinson in the Office of the Comptroller. Are you aware of that?

Mr. POOLE. Yes, sir, I did hear that that was done. Mr. Robertson is an official, a deputy controller in the Washington Office.

Mr. WORTLEY. Was anything done about that, to notify the credit unions?

Mr. POOLE. I don't know that that would have been proper, to notify any depositor. What would we have told them?

Mr. WORTLEY. You were notifying Continental and you were notifying Chase.

Mr. POOLE. Well, as I have indicated, I am not sure when who was notified.

The CHAIRMAN. Six to seven days before.

Mr. POOLE. Sir?

The CHAIRMAN. Six to seven days before. These were the pearls of wisdom from the mouths of Mr. Homan and Mr. Conover.

Mr. POOLE. Well, I guess in my opinion their decisions were based on their motivation for recuperative efforts, and these were upstream participants and not upstream depositors, if I am not mistaken. These were people who shared in credit, not people, institutions that had deposits in the bank.

Mr. WORTLEY. In 1978 and 1980, and again in 1982, your examination cited insider activity on loans. In the other intervening periods there is no mention of any insider activity on loans. Am I correct in that?

Mr. POOLE. Yes, sir.

Mr. WORTLEY. Well, do you think you were doing your job effectively if you were not looking into that during those interim periods?

Mr. POOLE. Yes, sir. In the information I reviewed, even the volume of insider credit was very minimal. And when there were any loans to insiders classified, it was only a very small percentage even of that small percentage.

Mr. WORTLEY. In 1978, 1980 and 1982, there was only very light activity; is that what you are saying?

Mr. POOLE. Yes, sir, I believe that is correct.

Mr. LEACH. Would the gentleman yield?

Mr. WORTLEY. Yes.

Mr. LEACH. I believe your 1978 examination indicated that 41 percent of the bank's capital was loaned to one officer of the bank. I believe it also pointed out that 142 percent of the bank's capital was lent in one industry. If I am mistaken, please correct me.

Mr. WORTLEY. You are right.

Mr. POOLE. But if that were neither illegal nor imprudent, it wouldn't be a subject of criticism, necessarily.

Mr. LEACH. Forty-two percent to one officer is normal operating procedure and is acceptable under your auditing guidelines?

Mr. POOLE. I am not familiar with that situation but I would have to believe that it was not an executive officer of the bank, and that it was not a type of lending situation that was combinable under the provisions of 12 U.S.C. 84, or that it fell under one of the 13 exceptions to 84.

Mr. LEACH. Let me read this and maybe you can explain it.

Other concentrations included related lines of credit of 41 percent of the capital; directors' and other related loans that have been sold to other banks and related lines sold to another bank were up 23 percent.

Mr. POOLE. It is our practice to list what we consider to be concentrations of credit, and these are not listed for purposes of criticism but for purposes of information to the board so that they might be aware of those concentrations, if they are not.

Mr. WORTLEY. Are you finished, Mr. Leach?

Mr. LEACH. Yes.

Mr. WORTLEY. Thank you. I would say 41-percent concentration in loans to insiders is pretty high. How can you say, as you did a moment ago, that it wasn't a critical issue?

Mr. POOLE. It would not be a critical issue unless the loans to the insider or to the insiders were of poor quality. There is nothing intrinsically wrong with lending—with loans to insiders, as long as those loans are not at preferential rates and as long as they are not at preferential terms, and as long as they are properly structured and are not of poor quality.

Mr. WORTLEY. And the loans that you determined should have been written off when you closed Penn Square, were any of those made to insiders?

Mr. BARTON. Yes.

Mr. WORTLEY. They were?

Mr. BARTON. Yes.

Mr. WORTLEY. Do you have the names of those insiders?

Mr. SERINO. We would prefer at this time, Mr. Congressman, not to disclose the names of the borrowers in the financial institution.

Mr. WORTLEY. I will accept that.

The CHAIRMAN. Excuse me, would the gentleman yield?

Mr. WORTLEY. I would yield.

The CHAIRMAN. Are you talking about loans to insiders that were in excess of the statutory amounts?

Mr. SERINO. Yes.

Mr. POOLE. That was not the question, was it?

The CHAIRMAN. Well, let's ask the question that way.

Mr. PLUNK. Yes, there were.

The CHAIRMAN. Were there loans to insiders beyond the—that exceeded the statutory amounts?

Mr. PLUNK. Yes.

Mr. POOLE. There were both loans to insiders that were criticized and there were loans to insiders that were in violation of the law.

The CHAIRMAN. And under FIRA, aren't you required to make those public so that they are available to the public, at the regional office of the Federal Reserve Board? Loans to officers and insiders?

Mr. SERINO. Mr. Chairman, there are some requirements in FIRA for reports to be submitted to our office. One deals with borrowings from officers of correspondent banks, and this was a loan made by this bank to certain of its directors.

The CHAIRMAN. Do you have the aggregates among the insiders at the end of the year?

Mr. SERINO. Yes. I believe that is in the summary that was submitted today.

The CHAIRMAN. I thank the gentleman for yielding.

Mr. WORTLEY. You concerned yourself with insider loans that had been originated by the bank that then were taken over or participated in by Continental Illinois or Chase or someone else?

Mr. POOLE. Loans that were sold by one bank—insider loans—to another.

Mr. WORTLEY. Insider loans made by Penn Square and then sold to another bank.

Mr. POOLE. We would be concerned from the standpoint of FIRA, the extent to which we would make sure that the directors of one financial institution were not using their influence as insiders of that institution to gain preferential loans at another institution. Yes.

Mr. WORTLEY. Thank you. I yield back the balance of my time, Mr. Chairman.

The CHAIRMAN. Mr. Plunk, you stated that there were what, 3,000 loans? What was that 3,000 number you gave us a little while ago?

Mr. PLUNK. That was an internally prepared list of collateral and credit-filed exceptions.

The CHAIRMAN. That is an internally prepared list prepared by the bank?

Mr. PLUNK. By the bank's internal review.

The CHAIRMAN. And when did you first come across that list?

Mr. PLUNK. I think that would have been early May.

The CHAIRMAN. And when was the previous list prepared? Was that the first time they prepared one?

Mr. PLUNK. I think so. That was the first list, and it was prepared as of March 31 and was manually prepared, so it took that long to get it together.

The CHAIRMAN. Manually prepared? There are quite a number, aren't there? How long do you think it took to accumulate 3,000 loans that were improperly collateralized, et cetera, or documented?

Mr. PLUNK. Given their loan volume, which was a billion dollars in loans were put on the books in the last 7 to 8 months.

The CHAIRMAN. Well, you are giving us a number, but a lot of those loans were of pretty high numbers, weren't they?

Mr. PLUNK. Yes, sir.

The CHAIRMAN. How many loans would that \$1 billion represent?

Mr. PLUNK. I have no way of knowing.

The CHAIRMAN. Would you supply that for the record?

Mr. PLUNK. Pardon?

The CHAIRMAN. Would you supply that for the record?

Mr. POOLE. Yes, sir.

[As a result of the above colloquy, the following letter, dated September 28, 1982, was received from Comptroller of the Currency C. T. Conover:]



 Comptroller of the Currency
 Administrator of National Banks

Washington, D. C. 20219

September 28, 1982

 Re: Penn Square Bank, N.A., Oklahoma City, Oklahoma
 Loans sold after 9/81

Dear Mr. Chairman:

During testimony in Oklahoma City, you asked for information regarding the volume of loans sold by Penn Square Bank, N.A., after the September 1981 OCC presence in the bank. While our records do not reflect the actual number of transactions, the figures listed below, and displayed graphically in the attachment, demonstrate the massive change in the bank's loan volume in late 1981 and early 1982.

<u>Date</u>	<u>Balance of Total Participations Sold</u>
9-30-81	\$1,135,000,000
12-31-81	1,573,000,000
3-31-82	1,873,000,000
6-30-82	2,116,000,000

Total change - \$981,000,000 or 86%

You also asked for some additional information regarding loan documentation exceptions. The credit and collateral exceptions, as developed during the April 1982 examination, reflected 709 loans, totalling \$1.1 billion, with 3,101 exceptions. Of these loans, \$798,000,000, or 73% of the total, were made after September 30, 1981.

Also, the losses on assets originating after September 1981 break down as follows:

Accrual interest on loans	\$(2,801,000)
Miscellaneous, other assets and overdrafts	(733,000)
Overdrafts related to borrowers' lines	(6,548,000)
Actual loan balances	(18,424,000)
	<hr/>
TOTAL	(\$28,506,000)

Sincerely,

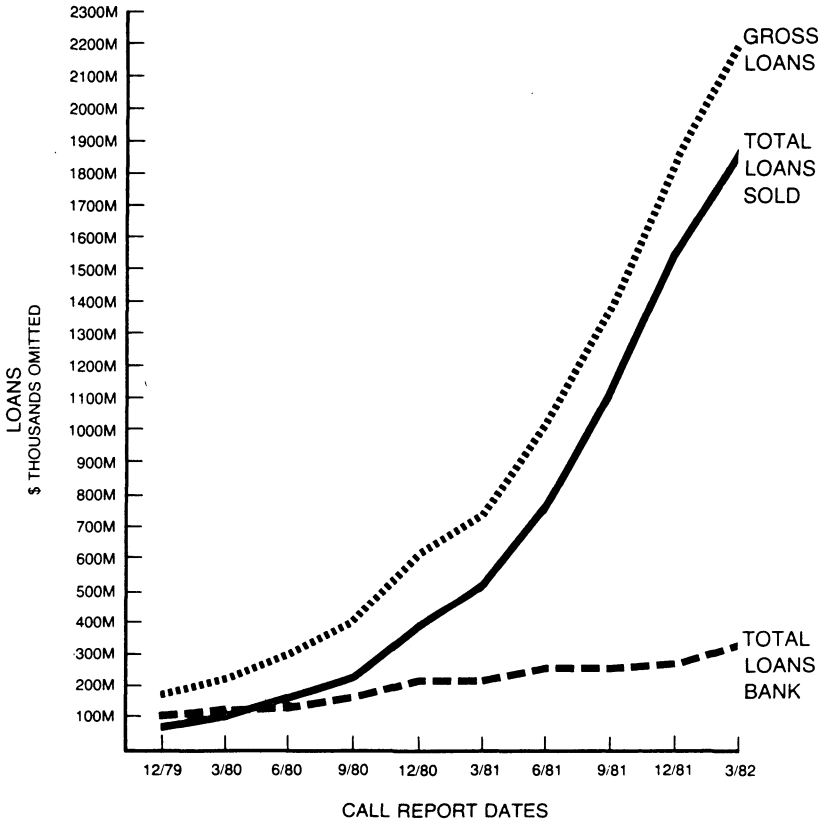
C. T. Conover

C.T. Conover
Comptroller of the Currency

The Honorable
Fernand J. St Germain
Chairman, Committee on Banking,
Finance and Urban Affairs
2129 Rayburn House Office Building
Washington, D.C. 20515

Attachment

PENN SQUARE BANK, N.A.
 LOAN GROWTH HISTORY
 (\$ MILLIONS)



Mr. POOLE. There could be a number of documentation exceptions.

The CHAIRMAN. We would like to know how many loans this involved. That would be most helpful.

Mr. BARTON. With the billion-dollar increase in the participation sold?

The CHAIRMAN. Correct.

Mr. BARTON. OK.

The CHAIRMAN. Do any other members have anything else?

Mr. LEACH. Just one conclusion. Financial institutions have modes of operation that perhaps change faster than we in Congress or the regulatory bodies realize. But it strikes me that this bank has been examined as kind of a community bank when in reality it was on the cutting edge of a new kind of go-go banking. Penn Square was the queen of spades in the house of cards that stretches the length and breadth of American banking, and based upon changes in banking, I think bank regulators are going to have to be a little quicker in looking at problems as they arise over time.

I would say finally, though, on the positive side, that you people understood and followed the problem and, in the final measure, closed the bank in decisive fashion. Some of us, in retrospect, might have wished it were closed a little bit earlier or that corrective action had been taken that would have preserved the bank and, more importantly, the relationships with other banks. But I think that you did act very promptly before the American banking system was stretched too far.

It is my hope this is going to be a lesson for the entire banking industry and I am sure you are going to have to look at your agency, just as we in Congress are going to have to look at our legislation, in a little different way given the new type of banking that is developing. I don't think you get an A, but I also don't think you get an F. The fact of the matter is that all of us have a lot to learn from this.

Mr. POOLE. I can assure you that the Comptroller's Office, and I personally as a regional administrator, and all of our examiners, it is not a pleasant experience, and our people have had to work hard and we are deeply troubled by the closing. And while we believe we acted properly, we are continuing to evaluate our procedures, as we always are, and we will make changes in our procedures and, hopefully, we will learn from this situation, too. But it is an expensive lesson.

Mr. LEACH. Mr. Poole, I appreciate that statement more than anything that has been said here today. Thank you.

The CHAIRMAN. The Chair would like to thank the witnesses. There may well be some additional questions that we would like answered in writing. Some of those I have myself, but I am sure you do not have the answers at your fingertips.

Mr. Evans also has some questions he would like to submit, and we will submit them to you and we would appreciate your answering them for the record. Thank you, gentlemen.

We will call Mr. Roy Jackson, regional director, FDIC, and James Hudson, FDIC liquidator in charge of liquidation at Penn Square.

[Witnesses sworn.]

**TESTIMONY OF ROY E. JACKSON, REGIONAL DIRECTOR, FDIC;
AND JAMES HUDSON, LIQUIDATOR IN CHARGE OF PENN
SQUARE, FDIC**

The CHAIRMAN. Mr. Hudson, we have read some complaints on the FDIC's handling of the liquidation of Penn Square. They have ranged from accusations that you allowed large banks to take files out of the bank; that you have frozen set-aside accounts; that you have not been cooperative with borrowers in seeking to find other financing sources.

We would like to have your version of these stories, specifically, did upstream banks have access to the bank records, and have accounts been frozen, and under what circumstances. What is the process used in allowing loans to be refinanced with other banks? Just start with those three, just so we can clear them up. First, did upstream banks have access to bank records over and beyond what others have had?

Mr. HUDSON. We arranged for them to receive copies, yes, sir.

The CHAIRMAN. Have accounts been frozen, and under what circumstances?

Mr. HUDSON. Yes, accounts have been frozen. We freeze the accounts of directors and we freeze accounts where we have offset capabilities. When a loan is past due, we have the right of offset.

The CHAIRMAN. In other words, the same individual has a deposit—

Mr. HUDSON. It was mutual, yes, sir.

The CHAIRMAN. Has a loan as well.

Mr. HUDSON. Yes, sir.

The CHAIRMAN. That is what you mean by offset?

Mr. HUDSON. Yes, sir.

The CHAIRMAN. What is the process used in allowing loans to be refinanced with other banks?

Mr. HUDSON. We encourage customers to go out to—they need an ongoing banking affiliation, and we encourage them to go out and refinance if at all possible. If not, we collect the loans in accordance with their terms.

The CHAIRMAN. Mr. Hudson, have you completed your inventory of the assets of the bank?

Mr. HUDSON. Almost; not quite, sir.

The CHAIRMAN. Can you at this point tell us as to those assets that you have inventoried what is the percentage of and/or the dollar volume of energy loans? What does it look like to you at this point?

Mr. HUDSON. Approximately \$321 million.

The CHAIRMAN. In energy loans?

Mr. HUDSON. Yes, sir.

The CHAIRMAN. That are assets?

Mr. HUDSON. Yes, sir.

The CHAIRMAN. That includes the participations that were sold off? Is that correct?

Mr. HUDSON. No, sir.

The CHAIRMAN. Mr. Hudson, has everyone received receiverhip certificates of their accounts in amounts receivable from the bank?

Mr. HUDSON. No, sir. The ones that have claimed, most of them have received a receipt, but it is not a receivership certificate. They will be processed and it will take some period of time to access all of those.

The CHAIRMAN. Can you tell us approximately how long that might take?

Mr. HUDSON. Thirty to 90 days; I understand some of the financial institutions have received certificates so they could discount it to the Fed.

The CHAIRMAN. Mr. Jackson, when were you first contacted by the regional administrator in Dallas of the Comptroller's Office regarding the problems at Penn Square?

Mr. JACKSON. Mr. Chairman, the first reference I had to Penn Square was the May 21 conversation with Mr. Poole in which he concluded by indicating that he would soon be providing my office with a copy of 4-rated banks, and included on that list would be Penn Square after the conclusion of the examination.

The CHAIRMAN. And the next contact?

Mr. JACKSON. The next contact was on a Wednesday, late in the afternoon, June 23, at which time he advised me that the loans classification at that time approximated \$22 million against a capital account of about \$37 million. And I believe I have those figures about right.

He also informed me of the fact that there were a great deal of upstream participations and downstream participations.

The CHAIRMAN. As the regional director of the FDIC, what were you doing during that period June 28 through the liquidation period itself?

Mr. JACKSON. Beginning on June 30, my first act was to move two people into Oklahoma City for the purpose of going into Penn Square on Thursday morning. It was sort of a dual thrust. One, we needed to get as much information as we could to determine whether or not a purchase and assumption transaction would be feasible.

Second, they wanted to be developing financial data and other information so that in case we could do a purchase and assumption transaction, an assisted transaction, that we would be in a position to do so. That was Wednesday.

Thursday, we determined to move six more people into Oklahoma City as backup for the purpose of going into the bank to help with this package. And we placed, I suppose, an additional 17 or 18 field examiners on notice, preparing them to go to Oklahoma City on short notice.

On Friday morning, we determined to move the balance of our examiners that were on alert to Oklahoma City to be on standby for whatever occurred. On Friday afternoon I moved to Oklahoma City myself to be there for whatever might transpire.

I worked at the Oklahoma City field office throughout the week-end coordinating matters with our examiners in the bank, and continued to develop financial data for the purpose of an assisted transaction, if such were possible.

One other action that I was taking—and this began about Wednesday—we started developing a list of what we refer to as potential bidders; those groups and individuals who we think might

have the financial capability and the expertise to enter into some sort of an assisted transaction, if we do such.

The CHAIRMAN. What happened to that list? It was not a very long list that you came up with, was it?

Mr. JACKSON. It is very difficult in Oklahoma. Yes, sir. I think we ended up with a basic list of about 12 groups and individuals that we thought might have some interest. With the State law being like it is, it is very difficult in Oklahoma.

The CHAIRMAN. But obviously, as a result of what happened, that list of 12 just withered away.

Mr. JACKSON. That is correct, sir.

The CHAIRMAN. It became nonexistent, is that correct?

Mr. JACKSON. It resides somewhere in the files, yes, sir.

The CHAIRMAN. The Comptroller of the Currency's witness a little earlier—I think he was sitting right back there—stated—Mr. Plunk said that the loans, many of these loans, might bring about 25 cents on the dollar. How does this compare with the 80 percent numbers that the FDIC has been floating to date?

Mr. JACKSON. That estimate would not compare very favorably, sir.

The CHAIRMAN. Well, whose estimate do you think might be closer to accuracy?

Mr. JACKSON. I am not sure I would be in a position to respond. I have never looked at the loans. I only have the figures that were given to me, sir.

The CHAIRMAN. But we are getting those numbers from—did we get that from the FDIC? Who gave us those? The Federal Reserve gave us that?

Mr. JACKSON. The 80 percent you referred to?

The CHAIRMAN. Yes.

Mr. JACKSON. I am not sure where it was originated. It was passed down to me from our Washington office immediately after the closing of the bank, but I am not too sure who came up with the figure.

Mr. LEACH. If you would yield, Mr. Chairman.

The CHAIRMAN. Let me just ask Mr. Hudson if he has a feel for what this will be worth.

Mr. HUDSON. No, sir.

The CHAIRMAN. Is 25 cents on the dollar more accurate than 80 cents, or is 80 cents more accurate than 25 cents?

Mr. HUDSON. It is difficult to tell at this time, with the amount of loans that have been upstream and downstream, estimating where the losses are going to go. It would be impossible, in this short period of time, to have any degree of accuracy in the forecast of that.

Mr. BARNARD. Mr. Chairman, would you yield? Isn't this estimate included in the receivership certificate?

Mr. HUDSON. No, sir.

Mr. BARNARD. I was under the impression that it was.

The CHAIRMAN. You are not the only one.

Mr. JACKSON. I believe the estimate represents the allowable value against each certificate. The certificate would represent 100 percent of the claim, if I am not incorrect, and the banks or financial institutions were allowed to book 80 percent of that figure.

The CHAIRMAN. Mr. Leach?

Mr. LEACH. Mr. Chairman, we are here not just to criticize; we want to learn from this experience. From the FDIC's perspective, what weaknesses exist in the regulatory process that should be corrected, and what changes should be considered by Congress so that we don't have another Penn Square? Specifically, do you think that there is a need for five banking regulatory agencies? Is there a need for three separate deposit insurance funds? Do you think deposit insurance premiums should reflect the risk posed by the insured entity rather than continue the present flat rate system?

Mr. JACKSON. If you will keep in mind that I am speaking as a lowly regional director and not a policymaking body from Washington, I will certainly try to respond.

Mr. LEACH. Please.

Mr. JACKSON. I have opinions on most of those subjects. The first one I believe dealt with which one, Mr. Leach?

Mr. LEACH. The five regulatory—

Mr. JACKSON. Despite my allegiance to the FDIC and my conviction that deposit insurance has, indeed, served its purpose and served it well, I have reluctantly come to the conclusion sometime back and shared it with whoever would take time to listen to me, that that is not really realistic. That this many regulatory bodies simply does not make a great deal of sense, and it is with a great deal of reluctance that I say that.

The CHAIRMAN. Don't feel bad.

Mr. LEACH. How about the three deposit insurance funds?

Mr. JACKSON. Well, you know, once again I have a personal problem here. We have a very stable fund and one that has a 50-year buildup behind it. The \$12, \$13 billion did not happen by accident; it happened because a lot of responsible people dealt very carefully with the assessment funds that we received. And I think a great deal of study would have to go into the various funds to see if, in fact, overall, we would be improving or not improving. I am not sure I could express an opinion on that.

Mr. LEACH. Should deposit premiums be based upon risk?

Mr. JACKSON. I think it would be a wonderful concept. I am very much in favor of it. The only thing is I have never been able to figure out how we could come up with that factor. It would be the ideal solution, if we could simply come up with the answer.

Mr. LEACH. Mr. Hudson, would you concur in these observations?

Mr. HUDSON. My observation would be no, yes and no. [Laughter.]

Mr. LEACH. Fair enough. Let me conclude with two brief comments. Whenever we look at a bank failure, it is tempting to see only the bad. Because of the FDIC, because of the Comptroller's office, and because of the State regulatory agencies, however, bank failures are unusual occurrences rather than the norm.

If I were a college professor giving grades, the Comptroller's office would get a C or a C- in this case. The FDIC, however, would get a very high mark, indeed. When it was brought into the Penn Square case, the FDIC made decisions with a resoluteness that is admirable. In the final measure, the Federal Government exercised good judgment, which reflects very well on the FDIC and

less well, but certainly not negatively, on the Comptroller of the Currency.

The CHAIRMAN. Mr. Barnard?

Mr. BARNARD. I have no questions, Mr. Chairman.

The CHAIRMAN. Mr. Weber?

Mr. WEBER. I just wish you a lot of luck in collecting those assets.

Mr. JACKSON. Thank you.

Mr. HUDSON. Thank you.

Mr. Chairman, may we have permission to put our statements in the record?

The CHAIRMAN. Yes, at the conclusion, we will place your entire statements in the record.

[The statements of Mr. Jackson and Mr. Hudson follow:]

STATEMENT OF

ROY E. JACKSON
REGIONAL DIRECTOR
FEDERAL DEPOSIT INSURANCE CORPORATION

BEFORE THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

August 16, 1982

OKLAHOMA CITY, OKLAHOMA

The letter inviting me to appear before this Committee suggested that my testimony would be valuable to the Committee's understanding of the relationship between the FDIC and the OCC and of the events leading to the closing of the Penn Square Bank, N.A. I'm happy to be of as much assistance as I can.

The FDIC's Dallas Office works at maintaining cooperative relations with the Office of the Regional Administrator of National Banks, as well as with the other bank supervisory agencies. Our efforts are, I believe, reciprocated. As example of efforts by the various agencies to improve interagency coordination and cooperation is the quarterly meetings of members of executive staffs of the agencies. The last such meeting, held on July 22, included senior representatives from the Federal Reserve Bank, Dallas; Federal Reserve Bank, Kansas City; Office of the Comptroller of the Currency, Dallas; FDIC, Dallas; State Banking Department, Austin; and State Banking Department, Oklahoma City.

Regional Administrator of National Banks Poole and I have frequent telephone conversations on banking matters of mutual interest and our staff members do not hesitate to call their counterparts as the need arises. My office routinely receives and reviews copies of all reports of examination of National banks, developing and maintaining basic statistical and narrative data from all examination reports and providing our Washington Office with comprehensive memorandums on 4 and 5 rated banks in which we focus on the identification and nature of the problem and the corrective action being taken.

In developing an outline of the chronology of events leading up to the Penn Square Bank closing, I have reviewed my telephone notes and submit the following:

On May 21, 1982, a telephone conversation with Regional Administrator of National Banks Clifton Poole, on supervisory matters in general, concluded with an indication that he would soon send me a list of any "4" rated National banks in Oklahoma, and that the list would include Penn Square after the examination in process was concluded.

On June 23, 1982, Mr. Poole informed me by phone that the incomplete examination of Penn Square had disclosed loan losses of \$22 million, sizable overall adverse classifications, and a heavy volume of loan participations sold. Total capital was indicated to be some \$37 million with owners professing to have \$22 million available for injection if necessary. The information was relayed by telephone to our Washington Office with a File Memorandum prepared for the record.

On June 28, 1982, Mr. Poole called to inform me that he and other representatives of OCC were to meet with the Penn Square directorate either Wednesday, June 30, or Thursday, July 1, to inform them of findings to date. Mr. Poole indicated he would place a Cease-and-Desist Order on the bank which would require additional capital and correction of defects in loan documentation. This conversation was reduced to File Memorandum and also relayed to our Washington Office.

On Wednesday, June 30, I arranged for FDIC examiners to go to Oklahoma City to develop data needed by the FDIC. Also, the FDIC Dallas Regional Office staff spent Thursday, July 1 and the morning of Friday, July 2, primarily in continuing to prepare for a possible purchase and assumption transaction and in arranging for additional examiners to move in the direction of Oklahoma City from various parts of our four-State region. On Friday afternoon, July 2, I moved my base of operations to Oklahoma City, where I worked out of our Oklahoma City Field Office preparing for a purchase and assumption transaction or payoff, depending upon the determination of the Board of Directors of the FDIC. I returned to my Dallas office July 7, 1982.

I hope the Committee will find the foregoing comments to be helpful.

August 5, 1982

MEMORANDUM TO: Committee on Banking, Finance and
Urban Affairs
House of Representatives

FROM: James P. Hudson

MR. CHAIRMAN:

I AM PLEASED TO HAVE THE OPPORTUNITY TO TESTIFY BEFORE THIS COMMITTEE REGARDING FEDERAL DEPOSIT INSURANCE CORPORATION'S LIQUIDATION PROCESS IN THE FIELD REGARDING PENN SQUARE BANK, N.A. OF OKLAHOMA CITY.

ON THURSDAY NIGHT, JULY 1, 1982, I RECEIVED NOTICE THAT PENN SQUARE BANK OF OKLAHOMA CITY WAS IN IMMINENT DANGER OF FAILING AND THAT I WOULD BE NAMED LIQUIDATOR-IN-CHARGE. I WAS AT THAT TIME ATTENDING A TRAINING SESSION IN WASHINGTON, D.C. AND ARRANGEMENTS WERE MADE FOR ME TO TRAVEL TO OKLAHOMA CITY FRIDAY MORNING.

UPON ARRIVAL IN OKLAHOMA CITY THAT AFTERNOON, URGENT NOTICE WAS RECEIVED FROM THE OFFICE OF THE COMPTROLLER OF THE CURRENCY'S EXAMINERS IN THE BANK THAT THEY REQUESTED SENIOR FDIC EMPLOYEES ON HAND TO COME TO THE

BANK AS IT APPEARED THAT THE BANK MIGHT CLOSE THAT AFTERNOON. MICHAEL NEWTON, WAYNE NESS AND I RESPONDED TO THE REQUEST AND MET MR. WILLIAM L. ROBERTSON OF THE COMPTROLLER'S OFFICE AT THE BANK.

ALL FDIC EMPLOYEES IN OKLAHOMA CITY WERE PLACED ON READY ALERT FOR A POSSIBLE CLOSING AT 12:00 NOON SATURDAY. THIS WAS CONSIDERED A CRITICAL TIME IF WE WERE TO PREPARE FOR ANY EVENTUALITY ON TUESDAY MORNING, MONDAY BEING THE FOURTH OF JULY HOLIDAY. ACCESS TO THE BANK'S RECORDS AND EMPLOYEES ARE CRITICAL TO OUR OPERATIONS.

SATURDAY AFTERNOON WE RECEIVED A CALL FROM WASHINGTON THAT NEWTON, NESS AND I WERE TO PROCEED TO THE BANK TO MEET WITH MR. BILL JENNINGS. WHEN WE ARRIVED AT THE BANK WE MET IN MR. JENNINGS' OFFICE WITH HIS ATTORNEY MARION BAUMAN. WE HAD A GENERAL DISCUSSION OF FDIC PROCEDURES AND MR. JENNINGS OFFERED TO BRING IN SOME OF THE BANK'S SENIOR OFFICERS TO MEET WITH US TO PLAN FOR ANY EVENTUALITY ON TUESDAY. AFTER LEAVING THE BANK, WE WERE INFORMED TO KEEP OUR STAFF ON READY ALERT.

ON SUNDAY AFTERNOON WE WERE AGAIN ORDERED TO THE BANK TO MEET WITH MR. JENNINGS AND REQUEST SPECIAL SERVICES OF THE DATA PROCESSOR AND OTHER INFORMATION FROM THE BANK PERSONNEL TO PREPARE FOR A POSSIBLE CLOSING ON TUESDAY. WE WERE INSTRUCTED NOT TO TAKE ANY ACTION, HOWEVER, THAT WOULD CAUSE THE BANK NOT TO REOPEN AS USUAL ON TUESDAY MORNING. WE EXPLAINED FDIC'S PROCEDURES ON A STRAIGHT PAYOFF AND A DEPOSIT INSURANCE NATIONAL BANK (HEREAFTER REFERRED TO AS "DINB") OPTION TO MR. JENNINGS. WE ADVISED THAT THE OPERATIONS OF A DINB WOULD BE IN THE BEST INTERESTS OF THE DEPOSITORS SINCE THE INSURED DEPOSITORS WOULD HAVE IMMEDIATE ACCESS TO THEIR FUNDS. WE ADVISED THAT WITHOUT ACCESS TO EMPLOYEES, RECORDS AND DATA PROCESSING FACILITIES, WE WOULD BE UNABLE TO OPEN A DEPOSIT INSURANCE NATIONAL BANK ON TUESDAY MORNING. MR. JENNINGS ADVISED THAT HE WOULD CALL IN THE SENIOR OPERATIONS OFFICERS TO ASSIST US IN PLANNING.

~~WE MET~~ THAT NIGHT WITH SOME OF THE SENIOR OFFICERS AND WE BEGAN PREPARING A WORK PLAN FOR TUESDAY. SPECIAL RUNS WERE MADE AND DELIVERED BY SUNDAY MIDNIGHT. FDIC EMPLOYEES WORKED ALL NIGHT SUNDAY IDENTIFYING,

WITH THE HELP OF BANK PERSONNEL, THE EXCESS DEPOSITS AND POSSIBLE OFFSETS AGAINST DELINQUENT LOANS. WE WERE SOMEWHAT HANDICAPPED BECAUSE SOME OF SATURDAY'S WORK WAS LOCKED IN VAULTS AND WE COULD NOT HAVE ACCESS UNTIL TUESDAY MORNING. WE AGREED TO MEET WITH THE OFFICERS THE NEXT MORNING (THE MONDAY HOLIDAY) TO CONTINUE OUR WORK. THROUGHOUT MONDAY OUR WORK CONTINUED ON FREEZING EXCESS AND OFFSET ACCOUNTS. SOME BANK EMPLOYEES WERE BROUGHT IN TO HELP. OUR STAFF WAS STILL UNDER ORDERS NOT TO DO ANYTHING THAT WOULD KEEP THE BANK FROM NOT OPENING TUESDAY. THAT AFTERNOON WE MET WITH SENIOR AND EXECUTIVE OFFICERS OF THE BANK AT WHICH TIME THE PLAN WAS DISCUSSED.

AT 7:05 P.M. WE RECEIVED WORD THAT THE BANK WAS DECLARED INSOLVENT BY THE COMPTROLLER OF THE CURRENCY, FDIC WAS APPOINTED RECEIVER AND A DEPOSIT INSURANCE NATIONAL BANK WOULD BE OPENED AT 9:00 A.M. TUESDAY MORNING. THE DINB OPENED AT 9:00 A.M. TUESDAY MORNING AND LINES FORMED THROUGHOUT THE DAY. HOWEVER, AT 7:00 P.M. THE LINES HAD DISAPPEARED AND THE BANK CLOSED FOR THE EVENING. AFTER MAKING TRAFFICING CHANGES ON WEDNESDAY, THE LINES FOR SMALL DEPOSITORS DISAPPEARED, HOWEVER, BECAUSE

OF ADMINISTRATIVE PROCEDURES IN PROCESSING TIME AND EXCESS DEPOSITS, A LINE OF APPROXIMATELY 30 PEOPLE REMAINED THROUGH THE WEEK. BY TEMPORARILY PAYING INTEREST ON TIME DEPOSITS, WE WERE ABLE TO AVOID VERY EXTENSIVE LINES. DEPOSITORS COULD CONTINUE WRITING CHECKS TO THE EXTENT OF THE INSURED DEPOSIT TRANSFERRED EXCEPT THOSE CUSTOMERS WHO HAD ACCOUNTS FROZEN FOR EXCESS AND POSSIBLE OFFSET PURPOSES. WE ATTEMPTED TO ACCOMMODATE THE EXCESS DEPOSITORS WITH TRANSACTION ACCOUNTS AS QUICKLY AS POSSIBLE. CUSTOMERS WERE ENCOURAGED TO OPEN ACCOUNTS AT OTHER BANKS IN THE AREA TO AVOID COMING TO THE BANK AND THE AUTOMATIC TELLER MACHINE WAS TEMPORARILY UTILIZED TO PROVIDE FURTHER ACCESS TO THE DEPOSITORS FUNDS.

THE DINB IS STILL IN OPERATION AND AS OF 8-12-82 THERE REMAINED ON DEPOSIT \$30,500,000.00. IN ADDITION WE HAVE ISSUED 558 RECEIVERSHIP CERTIFICATES TOTALING APPROXIMATELY \$153,000,000.00 AND OFFSET 250 ACCOUNTS TOTALING APPROXIMATELY \$31,500,000.00. A TREMENDOUS VOLUME OF WORK HAS BEEN PROCESSED BY THE DINB AND IT PROVED TO BE A QUICK METHOD OF MEETING FDIC'S OBLIGATION TO THE INSURED DEPOSITORS. LONGER LINES

AND PANIC WERE AVOIDED BY THE SMALL DEPOSITORS WHO WOULD HAVE BEEN
REQUIRED UNDER A STRAIGHT PAY OFF TO WAIT IN LONGER LINES IN THE 100°
JULY HEAT.

MICHAEL NEWTON IS RESPONSIBLE FOR THE OPERATIONS OF THE TEMPORARY
DEPOSIT INSURANCE NATIONAL BANK AND AL PORTERFIELD IS RESPONSIBLE FOR
THE ADMINISTRATION OF CLAIMS. I AM RESPONSIBLE FOR RECEIVERSHIP
ACTIVITIES AND THE COLLECTION OF ASSETS.

WHILE TAKING CONTROL OF THE BANK AND PROVIDING FOR THE INSURED
DEPOSITORS, OUR PRIMARY OBLIGATION, WE SIMULTANEOUSLY FOCUS OUR
ATTENTION TO THE COLLECTION OF ASSETS. AS OF 8-12-82, THE LIQUIDATION
STAFF TOTALS 50 LIQUIDATORS, 72 LOCAL PROFESSIONAL EMPLOYEES AND 178
CLERICAL SUPPORT EMPLOYEES. WE ARE UTILIZING THE BANK'S COMPUTER SYSTEM
FOR THE ASSETS.

THE TASK AHEAD OF US IS GREAT AND TO THIS END WE ARE PREPARED TO USE OUR
YEARS OF EXPERIENCE IN LIQUIDATING BANKS TO MAXIMIZE THE RETURN TO THE
CREDITORS.

The CHAIRMAN. We will have some additional written questions for you. I am still holding my ratings in abeyance, unlike Mr. Leach. Don't be concerned about your opinion as to the consolidation of the regulatory agencies. If you think back a while, I think you will remember that I recommended this quite a few years ago and still feel that way. And it seems as though more and more people are beginning to feel that way.

Mr. LEACH. Mr. Chairman, we will give you an A. [Laughter.]

The CHAIRMAN. Thank you, gentlemen. As I say, we may have some written questions for you.

At this point, we would ask Mr. Guffey, the president of the Kansas City Federal Reserve Bank, to approach the witness table. [Witness sworn.]

TESTIMONY OF ROGER GUFFEY, PRESIDENT, KANSAS CITY FEDERAL RESERVE BANK

The CHAIRMAN. Mr. Guffey, Penn Square, as you know, is owned by a holding company.

Mr. GUFFEY. Yes, sir.

The CHAIRMAN. And holding companies naturally are under the direct supervision of the Federal Reserve Board. Could you tell us what oversight was performed by the Kansas City Federal Reserve Bank relative to the holding company that had control of Penn Square Bank?

Mr. GUFFEY. Yes, Mr. Chairman. The Federal Reserve Bank of Kansas City conducted an inspection of First Penn Corp. in February of 1981, and again in January of 1982.

The CHAIRMAN. And what were the results of the inspections, as it were?

Mr. GUFFEY. We are referring now to the February 1981 inspection. We had some question with respect to the condition of the corporation, particularly with regard to the procedures that were in place for management of the corporation.

Second, there was some indication at that time that the commercial paper was being sold through the holding company, and it was being sold at the bank and without the proper notification on the face of the commercial paper certificate. And we asked that they correct those procedures.

And an additional concern was the capitalization of the holding company, and at the time the holding company was approved in early 1976, there was a commitment by the directors of the holding company that they would maintain the capital at an 8 percent of ratio of capital to assets, and it had fallen below that level. And we required them to come forth with a plan to provide capital to the holding company.

The CHAIRMAN. That was 1981?

Mr. GUFFEY. That was in February 1981, yes, sir.

The CHAIRMAN. When did you next revisit them?

Mr. GUFFEY. The next inspection was in January 1982, and that inspection revealed some improvement in the holding company's written procedures that had been put in place. Further, there had been considerable capital injected into the holding company during 1981.

Part of our review, of course, is based upon the supervisor's report of the bank itself which was the principal asset of the holding company, and we noted at that time that there was some improvement in the bank itself.

I guess I should also add that the criticism that we had of the commercial paper issuance within the bank lobby, and particularly with respect to the notation on the face of those certificates that they were not obligations of the bank had been corrected.

The CHAIRMAN. Were you aware of the fact that indeed, what was happening with that commercial paper was that during 1980, the holding company entered the commercial paper market; by yearend 1981, it had over \$30 million outstanding in commercial paper. Information indicates that portions of the proceeds from such sales were invested in Penn Square CD's. The rate paid on the commercial paper was higher than that paid by the bank on the CD's. Thus, the holding company had a negative spread at one point, leading to a negative cash flow of \$1.5 million. Was that brought to your attention?

Mr. GUFFEY. Yes, that was brought to our attention. As a matter of fact, I believe it is correct to say that there were some of those funds that were raised through the commercial paper market that were invested in bank CD's that bore no interest payment at all.

The CHAIRMAN. And so, what did the Kansas City Federal Reserve Bank do about this?

Mr. GUFFEY. Well, our concern, of course, was that the paper was being used or utilized for the principal purpose of, or the principal asset of the corporation, and our concern was that they were funding the bank with very short-term paper. And it was our urging that they bring forth a further injection of capital and lengthen their liabilities of the holding company for the purpose of pouring funds into the bank.

The CHAIRMAN. Were you aware that the real estate subsidiary formed by the holding company in 1981 was originally owned by Mr. Jennings, and that the company injected capital into the realty company, and in turn, used the proceeds to repay loans made to it by Mr. Jennings? So assets of Penn Realty on an apartment project that was funded by Penn Square Bank?

Mr. GUFFEY. I am aware that a realty subsidiary was formed and with our permission for the purpose of taking over from the bank the Quail Run apartment project. And I believe that came into the holding company—at one point, \$2 million, if I recall—and came from the bank into the holding company.

The CHAIRMAN. \$1.250, right. And then Penn Realty in turn used that money to repay loans made to it by Mr. Jennings and four other directors of the company. Were you aware of what the use of the proceeds was?

Mr. GUFFEY. After the property came in as an asset of the holding company. What the holding company then paid the bank for the use of those funds may have been, I am not aware of.

The CHAIRMAN. When the \$20 million was provided by the Federal Reserve Board on June 30 through the discount window of the Kansas City Bank, were you aware of this, and were you consulted about this?

Mr. GUFFEY. Yes, I was.

The CHAIRMAN. And did you contact Washington on this, as well?

Mr. GUFFEY. No, I did not.

The CHAIRMAN. What collateral was behind that \$20 million loan, and how did you determine that the funds you had were sufficient collateral? This was done in a very speedy fashion.

Mr. GUFFEY. First of all, maybe—

The CHAIRMAN. This is the \$20 million, June 30. That was repaid very rapidly. But nonetheless, you had to have collateral, right?

Mr. GUFFEY. That is right.

The CHAIRMAN. Who looked at that collateral for you?

Mr. GUFFEY. Let me, if I may, in response to your question about speedily—the request came to the bank on Monday, June 28, for a line of credit of \$15 million for 30 days, and in preparation for those discussions, the bank had delivered to our branch located here in Oklahoma City customer notes totaling something in the area of \$21 million for the purpose of collateralizing any borrowing from the Federal Reserve.

The CHAIRMAN. Customer notes in the amount of \$20 million?

Mr. GUFFEY. That is correct.

The CHAIRMAN. But you had no way of knowing what the value of those customer notes was?

Mr. GUFFEY. It was our understanding that the notes that would be delivered, customer notes that would be delivered and used as collateral for any loan that might transpire in that period ahead would be those notes properly collateralized that had been inspected or looked at by the Comptroller during the course of his examination. When those notes were delivered and our staff took a look at them, they returned some \$3.5 million of the notes because—and I don't know that these numbers are precise, but—one \$300,000 note, for example, had not been signed. Another \$2½ million or so was a nonperforming loan.

So at the time that—after those loans had been returned to the bank, there remained then approximately \$17 million of customer notes held in the possession of our branch here in Oklahoma City.

Before the loan was made on I believe it was Tuesday, an additional \$7.9 million of customer notes were delivered to the branch and inspected or reviewed by our staff.

The CHAIRMAN. How did that inspection go?

Mr. GUFFEY. Pardon me?

The CHAIRMAN. How did that inspection go?

Mr. GUFFEY. It went—

The CHAIRMAN. On that \$7.9 million additional.

Mr. GUFFEY. We took those and looked at them. We had our credit people here from Kansas City that took a look at those \$7.9 million, which was added then to the \$17 million roughly, which gave a total of \$26 million in collateral, which was available at the time the \$20 million in loans was made.

The CHAIRMAN. On June 30?

Mr. GUFFEY. Yes.

The CHAIRMAN. That is a very interesting story.

Now, I would like to ask would it be possible for you to provide to the committee the customer notes that you accepted?

Mr. GUFFEY. I do not have those available.

The CHAIRMAN. I realize you don't have them now.

Mr. GUFFEY. I would also hesitate to make a commitment to provide them because it does involve some confidential information with regard to individuals.

The CHAIRMAN. Well, your staff knows about it, right?

Mr. GUFFEY. Our staff, of course, knows about it.

The CHAIRMAN. Yet—you know I am pretty proud of our staff, our bipartisan staff, and of the Members of Congress, and of the fact that we can honor confidential information as well. So I hope that you will consult with the Chairman of the Federal Reserve Board, and I hope that you will find that we are as responsible as any employee of the Federal Reserve Bank of Kansas City is—

Mr. GUFFEY. I trust that is true, Mr. Chairman.

The CHAIRMAN [continuing]. To honor confidentiality. Now, let us get back. You tell us that the Comptroller's Office OK'd the \$24 million; said they were wonderful, but then your staff went over them and you found \$2½ million was what, undercollateralized? Or—no, was on which they weren't making payments, right?

Mr. GUFFEY. Mr. Chairman, I believe I testified that our agreement with Penn Square officials was that they would deliver to the branch here in Oklahoma City customer notes, only customer notes that had been reviewed and passed by the Comptroller. And obviously, that did not take place.

The CHAIRMAN. Oh, you mean those \$24 million had not been reviewed and OK'd by or approved by the Comptroller?

Mr. GUFFEY. Well, I would assume that one of the notes for \$300,000 that wasn't even signed certainly would not have been passed in a review by the Comptroller's examination staff.

I am suggesting to you, sir, that the notes that were delivered to us, the customer notes that were delivered to us, may not have complied with the agreement we had with the officials of Penn Square Bank.

The CHAIRMAN. How can we find out? Is there anyone left here from the Comptroller's Office?

VOICE. I think they are in the hall, Mr. Chairman.

The CHAIRMAN. Mr. Serino, could you find out if, indeed, the Comptroller's Office OK'd that \$24 million in customer notes?

Mr. SERINO. We will find out and provide the committee.

The CHAIRMAN. We will wait around. I would like to know about it now. This is very exciting. I am holding my breath.

So you returned that, and now you have \$17 million. You have another \$7.9 million, right?

Mr. GUFFEY. Yes, I believe those figures are correct, Mr. Chairman.

The CHAIRMAN. Now, that \$7.9 on the second sweep, your people looked at those. Were they more customer notes?

Mr. GUFFEY. Yes, they were.

The CHAIRMAN. And had they been reviewed or examined or approved by the Comptroller's Office?

Mr. GUFFEY. I cannot tell you that. I cannot tell you whether those specific notes had been reviewed or not.

The CHAIRMAN. Now, you are getting collateral so that you can lend money at the discount window to Penn Square Bank.

Mr. GUFFEY. That is correct. But let me point out, Mr. Chairman, that we did not rely upon the Comptroller's evaluation of those notes, nor did we ask the Comptroller specifically to look at those notes. Either the \$17 million or the \$7.9 million. We relied upon our own analysis of our own people as to the creditworthiness of the notes that we took as collateral for the \$20 million loan.

The CHAIRMAN. Were some of the notes energy loans?

Mr. GUFFEY. Yes, I am sure some of them were.

The CHAIRMAN. And some of them were backed up by reserves? In other words, oil or gas in the ground?

Mr. GUFFEY. I am sure that they were.

The CHAIRMAN. And in that period of time, did the Fed have some energy experts, engineers, et cetera, et cetera, who could determine whether or not these loans were worth their salt?

Mr. GUFFEY. The answer is "no." We have what we believe to be—and the people who reviewed these loans in a very short time-frame, very short, that looked at these loans and determined the creditworthiness. And as a matter of fact, it was our agreement with the bank that we would take those loans that they allegedly—that had been delivered to us and allegedly looked at by the Comptroller's Office, that we were prepared to take—

The CHAIRMAN. Excuse me, but you don't know that the Comptroller's Office—we are confused about that now. We do not really know whether the Comptroller saw those.

Mr. GUFFEY. Our agreement with the bank was that they would give us only customer notes that had been reviewed and approved or passed, if you will, by the Comptroller's Office.

The CHAIRMAN. But you now are not sure whether or not that happened. You told me that a few minutes ago before I asked Mr. Serino to check with Mr. Poole.

Mr. GUFFEY. Yes. If I said that the Comptroller specifically looked at the \$21 million of notes, then I misspoke.

The CHAIRMAN. I have been informed that we may be fortunate. Mr. Poole? Has he returned?

Mr. J. COYNE. I have the answer, Mr. Chairman.

The CHAIRMAN. Were those customer notes, \$24 million worth, sent over to the Fed from Penn Square, were they approved by the Comptroller before they were sent over?

Mr. J. COYNE. No, sir. We were not asked to certify nor did we certify.

The CHAIRMAN. Ah-ha. Therefore, Penn Square Bank did not comply with that which they told you they would do; to wit: To have it certified or examined by the Comptroller. In view of what we have just heard—

Mr. GUFFEY. I think there is a misunderstanding, and I would like to clarify that misunderstanding, if I might, with this statement.

Our understanding with the Penn Square officials on Monday was that they would provide to us customer notes in some amount, and that we asked them to send to us only those notes that had already been reviewed by the Comptroller. Whether or not they complied with that I can only surmise they did not.

The CHAIRMAN. Let me understand you. What you are saying is not that the Comptroller on that day looked at the customer notes

that you were getting, but that the bank told you that maybe a week ago, 2 weeks ago, a month ago, 6 months ago, the Comptroller looked at those customer notes and certified that they were in good condition?

Mr. GUFFEY. I do not think the Comptroller certified, nor did we ask him to certify.

The CHAIRMAN. OK, approved them.

Mr. GUFFEY. We were concerned about the creditworthiness of the collateral that would be submitted to us.

The CHAIRMAN. I imagine that you should be.

Mr. GUFFEY. One, because of the shortness of time. One of the conditions that we asked them to meet—and I am talking about the bank—was to send loans that had already been looked at by the Comptroller's Office.

The CHAIRMAN. What exactly does that mean, that were looked at?

Mr. GUFFEY. That they had been reviewed and, I assume, not classified.

The CHAIRMAN. You assume not classified, but you are not certain of that?

Mr. GUFFEY. Of course not.

The CHAIRMAN. Because you, indeed, got some that were classified, right?

Mr. GUFFEY. I do not know that they were classified.

The CHAIRMAN. Well, if they weren't classified, they were not performing. \$7½ million was not performing.

Mr. GUFFEY. No. \$300,000—a note for \$300,000, the note was not signed.

The CHAIRMAN. How about the other portion?

Mr. GUFFEY. The remainder, of about \$3 million roughly, were either nonperforming or our people, when they took a look at them, felt that they were not creditworthy for the purpose of securing a loan from the Federal Reserve.

The CHAIRMAN. So then, subsequently, you got another—to replace that you got another how much?

Mr. GUFFEY. \$7.9 million.

The CHAIRMAN. \$7.9 million, and your people looked at that \$7.9 million.

Mr. GUFFEY. That is right, but we relied upon—

The CHAIRMAN. Your own individuals. And you made a decision that they were, indeed, good collateral.

Mr. GUFFEY. Yes.

The CHAIRMAN. So you had the collateral of \$24.9 million?

Mr. GUFFEY. No, approximately \$26 million.

The CHAIRMAN. Of \$26 million at that point.

Mr. GUFFEY. Of which, because of some uncertainty, I should say, Mr. Chairman, we valued for collateral purposes those loans that had been provided and looked at, supposedly looked at, by the Comptroller's Office of 75 percent—for collateral purposes, 75 percent of face. And of the \$7.9 million that our people had reviewed in some detail, we were prepared to take those at 90 percent of face value.

The CHAIRMAN. So what was your total? Did you have \$26 million?

Mr. GUFFEY. We had \$26 million.

The CHAIRMAN. Of which 75 percent of \$17 million, right, you felt was good?

Mr. GUFFEY. That is correct.

The CHAIRMAN. And what was the percentage of that?

Mr. GUFFEY. Not that we thought was good, Mr. Chairman.

The CHAIRMAN. I mean, that is what you were—the tag you were putting on it, right? The value you were—

Mr. GUFFEY. For collateral purposes, yes, sir.

The CHAIRMAN. And what percentage of the balance?

Mr. GUFFEY. Ninety percent of the \$7.9 million.

The CHAIRMAN. Ninety percent of the \$7.9 million.

Mr. GUFFEY. I believe I saw the figure someplace, that came out to have a collateral value, for our valuation purposes, of \$21,834,000.

The CHAIRMAN. \$21,834,000. You know, I would like to tell you a little story. We were asking about this in Washington a little while ago, and initially, we were told that the advances at the discount window at the Penn Square Bank were preferential, and therefore, would take precedence. That was later corrected. We said oh, that was erroneous; they were not preferential? They were supercollateralized with three to four times—remember that, Jim, you were there—three to four times the amount of collateral as against the loan.

[See excerpts from conduct of monetary policy hearing of the Banking, Finance and Urban Affairs Committee held on July 21, 1982, appearing in the appendix section as appendix G.]

Now we find out it is \$21 million some-odd as against \$20 million. I will tell you what, sir. I am a little disappointed. The story changes every time we listen or hear it told. It is the first time you tell it. Yours has not changed.

Mr. GUFFEY. Fortunately, that is correct.

The CHAIRMAN. But this is the third version. Really and truly, this version No. 3. You talk about the perils of Pauline!

The other thing that interests me is when did it come to your attention that Penn Square Bank was in difficulty, to you at the Kansas City Bank. Now, Paul Volcker told us they found out about it maybe a week before the Fourth of July weekend, because some ingenious individual at the Federal Reserve Bank in Washington decided to make a phone call to the comptroller's office.

Now, when did it come to your attention?

Mr. GUFFEY. I believe that a call came to one of our staff members on June 18, which was on a Friday, and he was unable to return a call to the Dallas comptroller's office. He returned that call on Monday, June 21, at which time he was told that they were in the process of the examination course; that they had identified what they believed to be about \$22 million of loss, and that there had been some passing of criticized loans from the bank up to the holding company, and suggested that we might want to take a look at the holding company.

The CHAIRMAN. Yes. Did you look at the holding company before making this \$20 million loan to the bank at the discount window?

Mr. GUFFEY. Yes, we did.

The CHAIRMAN. How many people went into the holding company?

Mr. GUFFEY. Four people were dispatched to Oklahoma City on June 24 and conducted an inspection of the holding company that was concluded on, I believe, June 29 with a review with the officers of the holding company.

The CHAIRMAN. Tell me, was this—you knew, that phone call, these phone calls—was this the first that you know of the problems at Penn Square Bank? The principal asset of the holding company, over which you have supervisory powers?

Mr. GUFFEY. Other than the examination reports from the Comptroller, the visitation reports of the Comptroller, as a matter of fact, it was in an earlier discussion that I believe took place on April 22.

The CHAIRMAN. This year?

Mr. GUFFEY. This year, 1982, in an interagency meeting with a member of my staff, together with a representative of the FDIC, and the Comptroller's Office and the State bank commissioner that was held in Dallas on April 22, in which there was knowledge apparently that the Comptroller had started an examination, or was to start an examination. They felt there was no immediate problem at that time. That the information that was exchanged in that interagency meeting—

The CHAIRMAN. In April? It wasn't May 13 that Mr. Poole got the phone call from Mr. Plunk saying hey, things aren't too good. Were you aware of the letter of agreement and the problems with Penn Square Bank prior to April of 1982? Let's go to 1981, May of 1981.

Mr. GUFFEY. Yes, I believe, Mr. Chairman—

The CHAIRMAN. How did that come to your attention?

Mr. GUFFEY. I did not have personal knowledge of it. But our staff receives copies of the Comptroller as well as the FDIC examinations, as they receive copies of our examinations. That information, I am sure, would have been available to our staff at that time.

The CHAIRMAN. What information is that?

Mr. GUFFEY. Well, the condition of the bank, and the fact that some supervisory action had been taken.

The CHAIRMAN. That supervisory action was taken in 1980. I am talking about 1981. Did a red flag come to your office in 1981?

Mr. GUFFEY. Let me reflect on the dates, Mr. Chairman. My recollection is that the Comptroller's examination of early 1981 would have been available to our staff.

The CHAIRMAN. Are all of those available to your staff in view of the fact that you have the holding company and the bank?

Mr. GUFFEY. That is right. They are a member bank and we would get them otherwise.

The CHAIRMAN. Mr. Isaac told us the reports went in to him in 1980, and I think I am being accurate. I would hate to misquote him, but he didn't get too excited about it because he gets so many. No one called him on the phone and said hey, this is a particularly important one.

I would just like to ask you this. There is a private placement offering that occurred in May of 1981, at which time if somebody were to read that, they would have read about Penn Realty Co., the

competition, the supervision and regulation, the bank, the company and that is the holding company, and the use of proceeds, et cetera, et cetera, capitalization.

If anyone read this one, they would not have put any money on deposit. They would have been reluctant to put moneys over \$100,000 on deposit into this institution. Now, this private placement letter, was that examined and looked at by your staff and personnel? And did they bring it to your attention in May of 1981?

Mr. GUFFEY. I cannot be specific that it was, but I assume that this was for the purpose of raising capital.

The CHAIRMAN. Yes, sir. As suggested.

Mr. GUFFEY. As suggested by the Federal Reserve, that is correct.

The CHAIRMAN. Would you see if you have any memos back then that would indicate whether or not this was brought to your attention by your very competent staff?

Mr. GUFFEY. I do not have.

The CHAIRMAN. On that private placement letter?

Mr. GUFFEY. No, I do not.

The CHAIRMAN. You are not aware of it. Now again, I would ask you if you would be kind enough to determine whether or not our very trustworthy staff might receive those customer notes—the first group that came in? Some were returned and what you eventually ended up with as collateral for the discount window advance of \$20 million.

Mr. GUFFEY. Well, Mr. Chairman, to avoid any confusion, we do not have the customer notes.

The CHAIRMAN. But you must have a record of those customer notes that you took as collateral.

Mr. GUFFEY. I am sure that we do. I thought you were referring to the notes themselves.

The CHAIRMAN. No, just the record of them. I realize you had to return them because the collateral was no longer needed; the \$20 million was paid back.

[Subsequent to the hearing, pertinent material was submitted for inclusion in the printed record and appears in the appendix section as appendix H.]

Mr. GUFFEY. That is right.

The CHAIRMAN. Did your inspection reveal that loans had gone into the holding company? What you stated was you heard that loans had been moved into the holding company, and you made an inspection of the holding company. Did you inspect the holding company to determine if loans had gone into the holding company then, that last week?

Mr. GUFFEY. Yes, we did. Between June 24 and June 29 we had four people in the holding company. In response to your—I think your other question, we did determine that some \$16 million of loans had been moved from the bank into the holding company.

In looking at those loans, we classified \$3 million of those loans as loss during that examination.

The CHAIRMAN. Mr. Leach?

Mr. LEACH. Mr. Chairman, I would like to ask about several unusual aspects of this situation.

It strikes me as somewhat bizarre that a bank issued commercial paper at a certain percentage rate and sometimes sold it back to

itself, or the holding company, at a lower percentage rate, even at a zero-percentage rate. One explanation could be that there are tax implications. As a nonbanker, I do not know if that is the case. Or, it might be a scam; if the bank were about to go under, this could amount to some sort of deposit to keep it afloat. Another possibility is that it represents a way to hide something from one or more of the regulators. Why do you think this bank might have behaved in this fashion?

Mr. GUFFEY. Now, let's be sure we are talking not about the bank but about the holding company.

Mr. LEACH. Yes.

Mr. GUFFEY. The holding company had commenced issuing commercial paper in 1980. The use of that commercial paper, the proceeds from that commercial paper were being funneled into essentially the sole asset of the holding company; being the bank. It was a matter, in our view, of a way of raising funds for the purpose of funding the asset growth of the bank.

There were several sources of funds. One would be a Federal funds transaction that would come directly to the bank. But the holding company could not participate in it. They could raise capital, which they did, in the holding company and funnel that money into the bank. So there are a number of ways of tapping markets, in our view. The use of the commercial paper by the holding company was a means of raising funds, and the fact that they were, indeed, funneling it into its principal asset seemed quite appropriate.

Mr. LEACH. Appropriate, not inappropriate?

Mr. GUFFEY. Appropriate.

Mr. LEACH. Even if they raised it at one rate of interest and loaned it out at a lower rate of interest?

Mr. GUFFEY. Yes. It was the consolidated balance sheet that we were looking at, and since the bank is the principal and only earning asset that the holding company had, the fact that the management chose to borrow in the market through the commercial paper route, and to then lend that to the bank in the form of deposits, of making deposits in the bank at a zero interest rate, since it was a consolidated balance sheet that was not a matter of major concern.

Mr. LEACH. Is this normal operating procedure? Do other banks do the same thing?

Mr. GUFFEY. No, I am not sure I can say it is normal operating procedure, and certainly would not be in those cases in which there are several subsidiaries of a holding company. In other words, the bank is not the sole asset.

Mr. LEACH. Does this type of activity have any tax implications? Are there any implications for capitalization ratios?

Mr. GUFFEY. I am not sure that there is. I am not sure that I am even qualified, Mr. Leach, to answer that question.

Mr. LEACH. In your judgment, does this type of activity have such implications?

Mr. GUFFEY. Not in my judgment, no.

Mr. LEACH. Let me turn to another issue. Once the Comptroller's Office started to develop a file on the difficulties at this bank, at what point do you think they should have shared those difficulties

with the Federal Reserve, the regulator of the upstream banks involved?

Mr. GUFFEY. I think that is very difficult for me to respond to. I would hope that they would share that information as quickly as they feel that it is credible information.

Mr. LEACH. Credible or critical?

Mr. GUFFEY. Credible.

Mr. LEACH. We must not lose sight of the fact that this bank wasn't simply a community bank in trouble. It was a bank in trouble jeopardizing other banks and putting them in trouble.

Given this situation, were there any alarm bells that went off in the Federal Reserve signaling that this bank in Oklahoma was operating differently than virtually any other bank in America?

Mr. GUFFEY. Any alarm bells? I think we were concerned in our examination or inspection of the holding company in 1981 and again in January of 1982 that the principal asset of the holding company had experienced rather dramatic growth, and that that has an implication for capital requirements for the bank and the holding company. And we were pressing hard at both of those times for the provision of capital and/or to slow the growth to some more reasonable pace.

Mr. LEACH. Fine. I have no further questions. Thank you.

The CHAIRMAN. Mr. Barnard?

Mr. BARNARD. Mr. Guffey, what instigated the interagency meeting in the spring of this year?

Mr. GUFFEY. Well, Mr. Congressman, I believe that that would be just a usual exchange of information that we conduct with other bank supervisory agencies. And there was nothing unusual about the meeting. I think those are quarterly meetings, if I recall correctly.

Mr. BARNARD. Does that happen with banks that are in excellent condition or good condition, as well as a bank like the Penn Square Bank?

Mr. GUFFEY. Well, maybe I have not characterized that meeting properly or well enough. But these meetings are simply meetings in which the regulators join together in one location to talk about the problem.

Mr. BARNARD. The problem banks?

Mr. GUFFEY. Not only problem banks, but common problems that might be arising in their particular areas.

Mr. BARNARD. Well, to what extent was the condition of Penn Square mentioned? Was it brought up as a problem bank by the Comptroller?

Mr. GUFFEY. I did not attend that meeting, but it is my impression, Mr. Barnard, that the Comptroller had just started his examination and there was perhaps very little discussion about that bank particularly, other than a comment that there was no immediate concern that was arising which prompted the commencement of an examination at that time.

Mr. BARNARD. Do you have knowledge that at previous interagency meetings Penn Square was discussed?

Mr. GUFFEY. I have no such knowledge. But that doesn't mean that this wasn't discussed.

Mr. BARNARD. Who attends that meeting? Who represents that meeting for the Fed?

Mr. GUFFEY. Normally that is a senior vice president in our bank whose name is Mr. Billington.

Mr. BARNARD. Is he out of the Dallas office?

Mr. GUFFEY. No. You're talking about our representative from the Federal Reserve out of Kansas City.

Mr. BARNARD. Mr. Guffey, you described the inspection of the holding company. They are done, I would presume, here on location?

Mr. GUFFEY. Yes, that is correct.

Mr. BARNARD. During those inspections do you review the last examination report of the bank, the principal asset of the holding company?

Mr. GUFFEY. That is not done on location, Congressman, but rather that is a part of the preparatory process before they actually go into the holding company for the inspection. But yes, they would have the benefit of the last examination.

Mr. BARNARD. So then, when they come and have this inspection and they meet with management I would presume that your examination of holding companies is very similar to a bank examination, and that you have at the end of the inspection a meeting with the executives of the management team?

Mr. GUFFEY. That is correct.

Mr. BARNARD. Did you have occasion to go over the examination report of the Comptroller with the management team?

Mr. GUFFEY. I did not attend those meetings, nor did I attend this specific meeting if you are referring to the one that was held on June 29. I cannot answer specifically whether or not there was any reference to the Comptroller's examination report. Since it is a rather major part of the review and conclusion that leads to the closing conversation with the holding company officials, I assume that there was some reference indeed to it.

Mr. BARNARD. Well, I was suspecting that this might be a part of the normal check and balance process between the Fed, who has responsibility over holding company inspections, and the Comptroller or FDIC and even a State banking department as far as determining the strength of an asset of a holding company. I was hoping that this would be a part of the check and balance process, whereby you would have an opportunity to even further check what the Comptroller's Office had done.

Mr. GUFFEY. The examination report of the bank, of course, is of bank assets and liabilities and capital position, and the inspection of the holding company is a similar review of the holding company position and their procedures and so forth. But the holding company inspection process does not include going into the bank, for an example, and inspecting loan portfolio or investment portfolio of the bank, but rather we depend upon or rely upon the principal supervisor's report for that purpose.

Mr. BARNARD. So in essence these inspections are not really worth much, are they?

The CHAIRMAN. That is what Arthur Burns used to say.

Mr. GUFFEY. Pardon me?

The CHAIRMAN. I said that's what Arthur Burns used to say.

Mr. GUFFEY. Well, I heard Arthur Burns say a lot of things, Mr. Chairman.

The CHAIRMAN. The Fed doesn't do a good enough job and didn't do a good enough job inspecting holding companies. That was back then. Maybe it's improving.

Mr. GUFFEY. With deference to past Chairman Burns, let me say that there has been considerable improvement in that process. I might also say that it commenced under his direction, because he was uncomfortable with what we were doing with holding companies at that time.

Mr. BARNARD. Well, I'm not really meaning to be critical of the Fed. After I found out that all the Fed and the FDIC do with examination reports and call reports is just file them, I was bewildered, because I thought that there is a check and balance process, that if the Fed got the call report, and didn't think the bank was being run properly, they would call up Mr. Conover and say that according to this call report it appears that something is going wrong with Penn Square.

But you don't do that. You say, that is the jurisdiction of the Comptroller, so therefore we're not going to do anything about it. We hope and pray the bank won't go broke. But this one did.

So that disturbs me. I thought that the examination departments of the regulators took note of the examinations of other agencies and cataloged the condition of the banks, especially—in the case of the Fed—if they were part of a holding company operation.

But it does disturb me a little that there is just not a feeling of responsibility, of reviewing critically an examination report and making an evaluation different from what the examining agency has made.

Am I absolutely wrong in that evaluation?

Mr. GUFFEY. Not totally.

Mr. BARNARD. Thank you. [Laughter.]

Where am I wrong, though?

Mr. GUFFEY. Let me say that every examination report that we receive, either from the Comptroller or from the State agency or the FDIC, we do have a staff that analyzes that report and breaks it down. We do put it into a computerized form for the purpose, particularly if it's an asset of a holding company, for the purpose of running some tests against the assets, the loans, the capital, and those kinds of tests.

We do not, however, get in a position where a particular loan may be criticized or not criticized and not even mentioned in the report and make some judgment that the examining agency made a mistake on that particular loan.

I hope that clarifies somewhat.

Mr. BARNARD. I wouldn't expect you to have to analyze the examination report loan for loan. But I certainly would think that you would look at it from the standpoint of percentages, the percentage of risk assets, the percentage of contingent liabilities to capital, and other pertinent ratios.

I think that they would indicate that a bank classified by the Comptroller as in precarious condition would qualify with you as a dangerous situation, and that you would call them up and suggest that the way the figures you put together on this bank, came out

would indicate that maybe they had better go back and recalculate it again. You would not really be finding fault but just trying to clarify the situation.

I thought that is why we have these very worthwhile interagency meetings, that if you discovered something and the FDIC discovered something you would discuss it. But I'm not going to continue further.

But I appreciate those answers.

The CHAIRMAN. Mr. Weber?

Mr. WEBER. No questions.

The CHAIRMAN. Mr. Wortley?

Mr. WORTLEY. I pass, Mr. Chairman.

The CHAIRMAN. Any further questions, Mr. Leach?

Mr. LEACH. No, sir.

The CHAIRMAN. One further question for the record. Mr. Guffey, would you be able to provide this committee with copies of your inspection reports of First Penn Corp. for the time period from the formation of the holding company through July of 1982?

Mr. GUFFEY. Mr. Chairman, I would take that under consideration and respond to you in writing if I may. I do believe that that is confidential information that I would not be able to provide to you. But if you would permit me, I would like to take a look at the law. And my lawyer tells me I can't, and I think he is correct. But if you would want me to respond in writing, to either deny or confirm.

[See appendix H.]

The CHAIRMAN. Then we can take it from there. Thank you, kindly.

Now I will call on—well, let me say this. The members will note that the next proceeding was to call and swear in Mr. Robert Hefner, Mr. J. D. Allen, Mr. Frank Mahan, and Mr. William Rowsey III. With respect to Mr. Mahan and Mr. Rowsey, unfortunately the request to them went out a little late.

With respect to Mr. Hefner, originally counsel said he would be joining us, and at the last minute, frankly, they changed their minds. It's rather peculiar. However, I'm told that he said that at a mutually convenient time he shall come to Washington, and so I'm certain we look forward to chatting with Mr. Hefner in Washington. So we will look forward to that.

However, we do have with us, because we did issue a subpoena in this case—we would have done it for Mr. Hefner as well, except that we got lulled into a false sense of security. [Laughter.]

Mr. BARNARD. Did you get conned, Mr. Chairman?

The CHAIRMAN. It seems as though I got conned. [Laughter.]

We have with us Mr. J. D. Allen. Would he be kind enough to approach the witness table.

Mr. Allen, would you stand and raise your right hand, please.

[Witness sworn.]

The CHAIRMAN. Mr. Allen, do you have any sworn statement you would like to make at this time?

TESTIMONY OF J. D. ALLEN

Mr. ALLEN. Yes, Mr. Chairman, I do.

On advice of counsel, I request, pursuant to clause 2(a)(5) of the Rules of the House of Representatives, I request that the committee go into executive session for the purpose of asking questions or talking with me about my responses to the committee.

The CHAIRMAN. Let me ask you this, Mr. Allen. Have you provided the committee with documents required to be produced under the subpoena that was issued to you?

Mr. ALLEN. That was totally impossible, which is very easy to see from the date of the subpoena.

The CHAIRMAN. Do you intend to comply with that portion of the subpoena?

Mr. ALLEN. Yes. We have no reason to see why not to.

The CHAIRMAN. And so counsel for the committee will discuss with your counsel a schedule to produce the documents in a timely fashion, and we do expect you to comply as you have stated, because—and we certainly understand—I understand that there was a time problem, and I appreciate that.

If we can work together, that will be perfectly acceptable.

Mr. ALLEN. I would appreciate it if you would help me get some of my documents from the FDIC.

The CHAIRMAN. We will do what we can there, too.

Now, as to the other portion of your request, I would ask that, if you don't mind, just hold off a few minutes. We have a few other people and then we will get to that other portion. You can just stay right close by and just move back to one seat right behind. It will save you from having to walk too far.

And now the Chair would call on Mr. William Jennings and Mr. Bill G. Patterson, who have been subpoenaed, and Mr. Carl Swan. Mr. Jennings, Mr. Patterson and Mr. Swan, would you please stand and raise your right hand. We don't need the counsel.

[Witnesses sworn.]

TESTIMONY OF WILLIAM JENNINGS, BILL G. PATTERSON, AND CARL SWAN

The CHAIRMAN. Mr. Jennings?

Mr. JENNINGS. Yes, sir.

The CHAIRMAN. I think we've got the name tags messed up here.

Mr. JENNINGS, do you have a sworn statement to present to the committee?

Mr. JENNINGS. No, sir, I do not, Mr. Chairman. I have obtained counsel only on Thursday of last week and have not had time to sufficiently discuss the complexities of this case with them. And in view of that, I would respectfully request that I delay giving testimony until a later date, at which time I will have had time to converse with my counsel in view of the various charges and allegations that have been made to date.

[Pause.]

The CHAIRMAN. Mr. Jennings, certainly we appreciate, having been here all day and certainly having looked at much of this prior to arriving in Oklahoma City—I think you've been here for a good part of the day—we appreciate your dilemma and your request.

We want to be cooperative. We therefore would state that you will remain under subpoena, and we would hope to have you—there-

fore, we will ask you—unfortunately, we will have to ask you to come to Washington, because we can't be coming back here again, to testify at that time. So if we could have your counsel—do you now have counsel?

Mr. JENNINGS. I do, sir.

The CHAIRMAN. Could we have your counsel consult with committee counsel, and we could arrange for a date for you to come to Washington?

Mr. JENNINGS. Yes, Mr. Chairman, we will do that.

The CHAIRMAN. I am informed by our counsel that we know who your counsel is.

Now, Mr. Swan, do you have any sworn statement that you would like to provide to the committee?

Mr. SWAN. Yes. I have provided the records you subpoenaed, and before answering any questions I would like to make a request, under the committee and House of Representative rules, request that the committee take my testimony in executive session pursuant to rule 7 of your committee and pursuant to rule 11 of the House of Representatives.

The CHAIRMAN. As with Mr. Allen, we will defer that for a few moments.

Mr. Swan, as to the documents provided, were you able to provide that which was requested?

Mr. SWAN. Yes.

The CHAIRMAN. Thank you.

And now Mr. Patterson. Do you have any sworn statement that you wish to present to the committee?

Mr. PATTERSON. No. I request that the testimony I give would be under executive session pursuant to the rules.

The CHAIRMAN. Pursuant to who?

Mr. PATTERSON. Pursuant to the rules that I was sent in the mail, the House of Representatives rule 7(g)(5).

The CHAIRMAN. Mr. Patterson, you were also asked for records and documents. Have you brought those with you?

[Witness confers with counsel.]

Mr. PATTERSON. I would rather talk about that in executive session.

The CHAIRMAN. About the records and the documents? You're under subpoena to provide those now and not in executive session, my counsel informs me.

Mr. BAILEY. My name is Burck Bailey, Mr. Chairman.

The CHAIRMAN. Mr. Bailey.

Mr. BAILEY. If the request for executive session pursuant to this committee's rule 7(g)(5) is to be denied, I will give Mr. Patterson advice with reference to his response to his subpoena for records.

The CHAIRMAN. There are two separate items here, Mr. Attorney. Mr. Swan provided the documents to the committee. We would like the documents and records that were requested. The next is the step of the request to go into executive session.

Are you telling us Mr. Patterson is not going to provide the documents requested?

Mr. BAILEY. I would ask that question of Mr. Patterson.

Mr. PATTERSON. I decline to answer because it might tend to incriminate me.

The CHAIRMAN. I asked you if you were going to provide documents and records, as requested under the subpoena, Mr. Patterson. Now maybe your counsel should whisper into your ear that your answer is not responsive.

You see, there are documents here, corporate documents that are in your possession as a result of your being a member of the management of the bank, and my counsel informs me that they are not in any way—that they don't come under that privilege that you claim for yourself, which we don't deny you.

Mr. PATTERSON. I will answer you that I have no possession of any Penn Square documents.

The CHAIRMAN. Well, suppose we go through it this way. We asked for originals or copies of the following: Examination reports of Penn Square Bank, North America, by the Comptroller of the Currency from January 1, 1980, to the date of the subpoena. Do you have any of those?

Mr. PATTERSON. No.

The CHAIRMAN. You do not. OK.

Minutes of the meetings of the board of directors of Penn Square Bank from January 1, 1980, to the date of the subpoena?

Mr. PATTERSON. No.

The CHAIRMAN. The agreement between Penn Square Bank, its directors, and the Comptroller entered into on or about September 9, 1980?

Mr. PATTERSON. No.

The CHAIRMAN. The temporary cease and desist order issued on or about June 30, 1982, against Penn Square Bank by the Comptroller of the Currency and the amended orders dated July 2 and July 4, 1982?

Mr. PATTERSON. I don't have those.

The CHAIRMAN. You do not have those in your possession?

Mr. PATTERSON. No.

The CHAIRMAN. Each monthly report filed by the Penn Square Bank pursuant to the September 9, 1980, agreement between Penn Square Bank, its directors, and the Comptroller of the Currency?

Mr. PATTERSON. No.

The CHAIRMAN. You do not have those, is that correct?

Mr. PATTERSON. That is correct.

The CHAIRMAN. All reports filed from January 1, 1980, to the date of the subpoena by Penn Square Bank or its regulatory agencies, directors or officers, on loans by its correspondent banks to the directors or officers of Penn Square Bank.

Mr. PATTERSON. I do not have those.

The CHAIRMAN. Memos and/or notes of and/or logs and/or other books or records reflecting discussions, decisions or other actions taking place between January 1980 and the date of the subpoena which relate to: (a), loans or investments by Penn Square Bank, NA; (b), the acceptance by or withdrawal of from Penn Square Bank, NA, of deposits or deposit instruments; the purchase or sale of stock or other securities of Penn Square Bank, NA, by the person summoned by the subpoena or by any other person.

Mr. PATTERSON. No, I have none of those documents.

The CHAIRMAN. You don't have any of these documents?

Mr. PATTERSON. No.

The CHAIRMAN. Now, you're under oath.

Mr. PATTERSON. I know.

The CHAIRMAN. You don't have any records whatsoever? I just want to be certain. Memoranda, notes, telephone logs, or messages, or other books, records or documents reflecting discussions, decisions or other actions taking place between January 1980 and the date of the subpoena, and which relate to loans or investments by Penn Square Bank, the acceptance by or withdrawal from the Penn Square Bank of deposits or deposit instruments.

Now, on this third one I will go slowly: The purchase or sale of stock or other securities of Penn Square Bank, North America, by the person—meaning Mr. Patterson—summoned by the subpoena or any other person. In other words, it seems to me that I read that Mr. Patterson owns stock in Penn Square Bank.

[Witness confers with counsel.]

Mr. BAILEY. That latter category, Mr. Chairman, seems so broad and ambiguous, it is very difficult to respond to.

The CHAIRMAN. The last one, about the stock possession of the person subject to this subpoena, Mr. Patterson?

Mr. BAILEY. As I recall, there was something about any documents of a personal nature. And I'm instructing Mr. Patterson to decline to respond.

[On August 19, Mr. Bailey did forward some material to the committee.]

The CHAIRMAN. The question now revolves upon Mr. Jennings at this point. We're hoping to see you at a later date.

Would Mr. Allen and his attorney please return for a moment?

Mr. Allen has requested that we go into executive session, being under subpoena of this committee, has invoked the rules of the House and asked that we go into executive session to take his testimony. All those in favor signify by saying aye.

[A chorus of "ayes."]

The CHAIRMAN. Opposed?

[No response.]

The CHAIRMAN. The "ayes" have it.

The Chair would state that, very frankly, we have no alternative, because unfortunately we do not have a quorum of the full committee with us. The only action we can take at this point would be to indeed vote in the affirmative on this request. To do anything otherwise would require a quorum of the full committee. Obviously a quorum of the full committee is not present, so we will follow this course of action for this evening, and then of course do more later on if we decide to in Washington when we have a quorum of the full committee.

At this point we will consider the request of Mr. Swan under the rules of the House that we go into executive session to hear his testimony. All those in favor signify by saying aye.

[A chorus of "ayes."]

The CHAIRMAN. Opposed, no.

[No response.]

The CHAIRMAN. The ayes have it.

At this time we would consider the matter or the request of Mr. Patterson under the rules to go into executive session to take his

testimony, he being under subpena. All those in favor signify by saying aye.

[A chorus of ayes.]

The CHAIRMAN. Opposed, no.

[No response.]

The CHAIRMAN. The ayes have it.

We have, in order to be able to proceed in an orderly fashion, we have a room, the Cherokee Room next door. And we will ask the reporter to take himself there with his chair and his equipment. And we will start with Mr. Allen and then will go to Mr. Swan and Mr. Patterson. And so we will now—the Chair would ask at this point unanimous consent to have placed—we will place in the record the letters from the counsel for these witnesses, telling us of the requests that their clients would be making and have indeed made. And without objection they will be placed in the record at this point.

[The material referred to follows:]

Wallace H. Scott, Jr.
 Frank Douglass
 Richard P. Keeton (Houston)
 Frank P. Youngblood
 H. Philip Whitworth, Jr.
 Thomas W. Reavley
 Jacks C. Nickens (Houston)
 John G. Soule
 John R. Hays, Jr.
 John L. Yates
 Steve McConnico
 Morgan L. Copeland (Houston)
 Michael M. Wilson (Houston)
 Richard P. Marshall, Jr.
 Carroll G. Martin
 Steve Selby
 Daniel L. Rashin (Houston)
 David E. Sharp (Houston)
 Elizabeth N. Miller

Law Offices
Scott, Douglass & Keeton
 Ninth Floor
 1300 Main Street
 Houston, Texas 77002
 AC 713 759-1657

Austin Office:
 Twelfth Floor
 City Bank Building
 Austin, Texas 78701
 512 / 476-6337

Page Keeton
 Guy T. Buell
 of Counsel
 (Austin)

August 16, 1982

The Honorable Fernand J. St Germain
 Chairman, House Committee on Banking,
 Finance and Urban Affairs
 United States House of Representatives
 Washington, D. C. 20515

Dear Mr. Chairman:

On Friday, August 13, our firm first received a copy of a subpoena duces tecum directed to Mr. J. D. Allen. Mr. Allen was never personally served. The subpoena directed Mr. Allen to appear before this Committee at 2:00 p.m. today. The subpoena also contained a very broad request for documents, requesting all documents relating to financial relationships between Penn Square Bank, N. A. and Mr. Allen's business interests. In the short time provided it is not physically possible for Mr. Allen to respond to the document request. In addition, we have not had an opportunity to review any documents that may be responsive to the request.

My partner, Richard P. Keeton, first received notice of the Committee's stated intention to subpoena Mr. Allen at 4:00 p.m. on Wednesday, August 11. We are told that most witnesses received several weeks notice of this proceeding. Mr. Keeton is Mr. Allen's counsel of choice in this matter. He advised the Committee staff that he had previously planned a trip with his family to London, England. Mr. Keeton delayed his travel plans as long as possible, but he had to leave for London to meet his family this weekend.

Even though the subpoena arguably was not properly served and even though our first notice of the subpoena was less than one business day before Mr. Allen's scheduled appearance, he has now voluntarily appeared. I might add that this appearance required Mr. Allen to cancel a long-planned important business meeting in New York, which meeting concerns efforts to alleviate financial problems and losses incurred by Mr. Allen because of the failure of the Penn Square Bank. In any event, neither Mr. Keeton nor I have had an adequate opportunity to consult with Mr. Allen. We are not familiar with the purposes of this hearing, the underlying basis for the investigation, or what reasons, if any, the Committee is seeking Mr. Allen's testimony. The Committee

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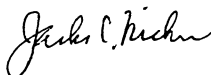
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rules provide that witnesses at investigative hearings may "be accompanied by their own counsel for the purpose of advising them concerning their constitutional rights." This must, of course, mean effective assistance of counsel. Given the very short notice, the apparent complexities of this matter, and our lack of familiarity with the factual basis for the investigation, we are not in a position to provide Mr. Allen with the assistance of counsel to which he is entitled. In effect, this Committee is asking Mr. Allen to testify and produce documents without advice of counsel. We have, therefore, no responsible choice but to advise our client to assert his privileges under the Constitution of the United States.

If the Committee insists on propounding such questions to Mr. Allen, despite our advice to him to assert his privilege, I request that pursuant to clause 2(k) (5) of Rule XI, Rules of the House of Representatives it go into executive session for the purpose of taking Mr. Allen's responses to the Committee's questions.

Very truly yours,



Jacks C. Nickens

JCN:dh

cc: Lawrence Hollar

LAW OFFICES
WILLIAMS & CONNOLLY
 HILL BUILDING

839 SEVENTEENTH STREET, N. W.

WASHINGTON, D. C. 20006

AREA CODE 202
 331-5000

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 DANIELA WINKLER
 JO CAROLE RECHT *
 G. DAVID FENSTERHEIM
 COUNSEL
 HAROLD UNGAR
 LYMAN G. FRIEDMAN
 DONALD E. SCHWARTZ

* MEMBER NY BAR ONLY

August 9, 1982

HAND DELIVERED

Dr. Paul Nelson
 Staff Director of the House
 Committee on Banking, Finance
 and Urban Affairs
 United States House of Representatives
 Washington, D.C. 20501

RECEIVED

AUG 9

Banking, Finance & Urban Affairs C.

Re: Subpoena Duces Tecum to
Carl W. Swan

Dear Dr. Nelson:

On Friday, August 6, 1982, our client, Mr. Carl W. Swan, was served with a subpoena duces tecum to appear before the Committee on Monday, August 16, 1982 in Oklahoma City. (Attachment 1). Prior to the service of the subpoena, we had on several occasions advised Mr. Hollar of the Committee's staff that Mr. Swan would not voluntarily appear before the Committee and, if subpoenaed, would assert his constitutional privilege against self-incrimination. We had also asked Mr. Hollar to convey to the Committee our request that Mr. Swan not be subpoenaed at this time based upon our representation that he would invoke the privilege. If the subpoena were to be issued over our objections, we had requested, through Mr. Hollar, a meeting with the Chairman to discuss these issues. No date for the meeting has yet been scheduled. The purpose of this letter is to summarize the legal authorities which support our position that forcing Mr. Swan to appear in public session and invoke his privilege against self-incrimination would constitute a wholly unwarranted infringement of his constitutional rights and would serve no legitimate legislative purpose.

As you are aware, representatives of the United States Department of Justice and the Federal Bureau of Investigation have stated that the events leading up to the closing of the Penn Square Bank, and the financial activities of many individuals associated with the Bank, are currently the subject of a criminal investigation. Indeed, the local Oklahoma City newspapers

have reported that a federal grand jury was empanelled on August 2, 1982 to inquire into the lending practices of Penn Square Bank. (Attachment 2). Because of Mr. Swan's position as a director and customer of the Bank, the grand jury will be reviewing his activities along with those of a number of other individuals in deciding whether and against whom to bring criminal charges.

Compelling Mr. Swan to appear at the highly-publicized Committee hearings on August 16, 1982 and publicly assert his privilege against self-incrimination would severely and irreparably prejudice Mr. Swan in the eyes of the grand jurors who now sit in judgment on him. It could also deprive Mr. Swan of a fair trial in any future trial or proceeding (civil or criminal) which may arise out of the Bank's closing. Thus, the Committee's proposed actions in requiring Mr. Swan to assert his privilege at the August 16 hearing would constitute a clear violation of Mr. Swan's rights, which are guaranteed by the due process clause of the Fifth Amendment. Gannett Co. Inc. v. DePasquale, 443 U.S. 368, 378 (1979) (recognizing that adverse pretrial publicity can interfere with the right to a fair trial).

The principle recognized by the Supreme Court has also been adopted by the Justice Department guidelines governing the conduct of criminal investigations and has been strongly endorsed by the American Bar Association. The Department of Justice guidelines governing the conduct of grand jury proceedings for all United States Attorneys' Offices throughout the nation specifically prohibit prosecutors, except in extraordinary circumstances, from calling a witness before the grand jury if the witness has previously indicated that he or she will assert the privilege against self-incrimination. U.S. Attorney Manual: Amendments §9-11.254 (Dec. 16, 1977). Similarly, the American Bar Association has developed nationwide standards for the conduct of criminal investigations, and Standard 3-3.6(e) provides:

"The prosecutor should not compel the appearance of a witness before the grand jury whose activities are the subject of the inquiry if the witness states in advance that if called he or she will exercise the constitutional privilege not to testify, unless the prosecutor intends to seek a grant of immunity according to the law."

I ABA Standards for Criminal Justice, Standard 3-3.6(e) at p.3-50 (2d Ed. 1980).

The reason for both the Justice Department Guideline and the ABA rule was explained in the ABA's commentary on Standard 3-3.6(e), i.e. that failure to adhere to the standard would be "unfair in that the very exercise of the privilege may prejudice the witness in the eyes of the grand jury." These principles apply with even greater force to the August 16 Committee hearing because Mr. Swan's assertion of the privilege will not only reach the ears of the grand jurors, it will reach the entire community.

The grave constitutional damage that the Committee's proposed actions would cause are even less justified when measured against the potential benefit to the legislative process from having Mr. Swan invoke the Fifth Amendment privilege in a public forum. In the words of the Supreme Court, this would amount to "expos[ure] for the sake of exposure", Watkins v. United States, 354 U.S. 178, 200 (1957).

Assuming that there is any legitimate benefit to the legislative process in having Mr. Swan assert his constitutional privilege to the members of the Committee, then the Committee should follow Rule VII(g)(5) of the Committee's Rules which is directly pertinent here:

If the committee determines that evidence or testimony at an investigative hearing may tend to defame, degrade, or incriminate any person it shall --
 (A) receive such evidence or testimony in executive session

127 Cong. Rec. H724 (daily ed. March 2, 1981) (emphasis added). A majority of members comprising a quorum must, pursuant to general rules of the House of Representatives, determine whether the testimony at issue is defamatory, degrading, or incriminating, "[w]henever it is asserted" that an executive session is warranted. Rules of the House of Representatives, Rule XI, cl.2(k)(5), H.R. Doc. No. 95-403, 95th Cong., 2d Sess. (1979). These rules, or their predecessors, have, for several decades, formed the basis of the well-established practice of closing committee hearings likely to prejudice ongoing criminal proceedings. Where, as here, the subject matter of the hearings has received extensive publicity, congressional committees have long recognized the importance of taking evidence in executive session. See, e.g., Calley v. Callaway, 519 F.2d 184, 219 (5th Cir. 1975), cert. den., 425 U.S. 911 (1976) (quoting committee chairman's explanation for closing hearings on My Lai incident in light of pending investigations).

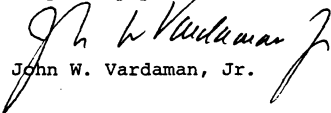
The United States Supreme Court has unequivocally held that a committee's failure to adhere to its executive session rules constitutes a complete defense in a prosecution for contempt for refusal to testify. In Yellin v. United States, 374 U.S. 109

(1963), the Supreme Court reversed the contempt conviction of an individual who, like Mr. Swan, asked not to appear at public hearings. Emphasizing that committee hearing rules are "judicially cognizable" and that they define "the witness' rights and privileges," *id.* at 114-15, Chief Justice Earl Warren's opinion for the Court concluded that requests for executive session must be seriously and carefully considered by the membership of the committee and cannot be rejected by the staff. *Id.* at 118-20. The Supreme Court relied on the nearly century-old principle that Congress may not violate rules that fundamentally affect non-members. See *U.S. v. Ballin*, 144 U.S. 1, 5 (1892); *U.S. v. Smith*, 286 U.S. 6, 33 (1932) (Brandeis, J.). That principle has been repeatedly reaffirmed by the United States Courts of Appeal. See, e.g., *Murray v. Buchanan*, 674 F.2d 14, 22 (D.C. Cir. 1982); *In re Beef Industry Antitrust Litigation*, 589 F.2d 786, 789-90 (5th Cir. 1979). Indeed, *Yellin* itself was expressly approved by both the majority and the dissent in a recent Supreme Court decision. *United States v. Caceres*, 440 U.S. 741, 751-52 n.14; *id.* at 757-58 (Marshall, J., dissenting) (1979).

Mr. Swan's circumstances present an even more compelling argument against public hearings than that which prevailed in *Yellin*. In that case, the committee rule at issue required an executive session only when an open hearing would "unjustly injure [the witness's] reputation." 374 U.S. at 115. The Supreme Court found a wide range of testimony within that standard including "many things which would discredit [the witness] without subjecting him[] to the risk of criminal prosecution." *Id.* at 122. In contrast, public invocation of the Fifth Amendment privilege by Mr. Swan would not merely "injure his reputation." It would substantially undermine the prospects for a fair evaluation of any criminal charges that may be brought against him.

As Mr. Swan's counsel, we hereby request that the subpoena duces tecum for August 16 be withdrawn or at least deferred until the Committee has an opportunity to vote on the question of having Mr. Swan appear in executive session pursuant to the Committee's rules. We also reaffirm our request to meet with the Chairman to express our views in person.

Very truly yours,


John W. Vardaman, Jr.

cc: The Honorable Fernand J. St Germain
Michael Flaherty, Esq.

FERNAND J. ST GERMAIN, R.J., CHAIRMAN
 HENRY S. REUSS, WIS.
 HENRY E. GONZALEZ, TEX.
 JOSEPH B. MURPHY, N.J.
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 BARNEY FRANK, MASS.
 BILL PATMAN, TEX.
 WILLIAM J. COYNE, PA.
 STENY H. HOYER, MD.

U.S. HOUSE OF REPRESENTATIVES
 COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
 NINETY-SEVENTH CONGRESS
 2129 RAYBURN HOUSE OFFICE BUILDING
 WASHINGTON, D.C. 20515

August 12, 1982

J. WILLIAM STANTON, OHIO
 CHALMERS F. WYLIE, OHIO
 STEWART B. MCKINNEY, CONN.
 GEORGE HANSEN, IDAHO
 JIM LEACH, IOWA
 THOMAS B. EVANS, JR., DEL.
 RON PAUL, TEX.
 ED BETHUNE, ARK.
 NORMAN D. SHUMWAY, CALIF.
 STAN PARRIS, VA.
 ED WEBER, OHIO
 BILL MCCOLLUM, FLA.
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 MARGE ROUKEMA, N.J.
 BILL LOWERY, CALIF.
 JAMES K. COYNE, PA.
 DOUGLAS K. BEREUTER, NEBR.
 DAVID DREZER, CALIF.
 22-4107

John W. Vardaman, Jr. Esquire
 Williams & Connolly
 Hill Building
 839 Seventeenth Street, N.W.
 Washington, D.C. 20006

Dear Mr. Vardaman:

I am in receipt of your letter of August 9, 1982 in which you make reference to a subpoena issued to Mr. Carl W. Swan. After thoroughly considering the issues raised in your letter, I must advise you to inform Mr. Swan to be present in Oklahoma City pursuant to the subpoena.

Sincerely,


 Fernand J. St Germain
 Chairman

LAW OFFICES
WILLIAMS & CONNOLLY
 HILL BUILDING

839 SEVENTEENTH STREET, N. W.
 WASHINGTON, D. C. 20006

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 JO CAROLE RECHT *
 G. DAVID FENSTERHEIM

 COUNSEL
 MAROLD UNGAR
 IRWAN G. FRIEDMAN
 DONALD E. SCHWARTZ

 * MEMBER NY BAR ONLY

August 16, 1982

Fernand J. St Germain
 Chairman
 House Committee on Banking,
 Finance and Urban Affairs
 United States House of Representatives
 Wahsington, D.C.


RE: Subpoena Duces Tecum to Carl W. Swan

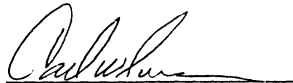
Dear Mr. St Germain:

Pursuant to Clause (2) (k) (5) of Rule XI of the Rules of the House of Representatives and Rule VII (g) (5) of the Rules of this Committee, I hereby formally request that the Committee receive the testimony of my client, Mr. Carl Swan, in executive session. Mr. Swan has co-signed this letter to certify his approval of this request.

We also request that the Committee not call upon Mr. Swan in public session to disclose the reasons for this assertion because that would deprive him of the very rights that the House rules are intended to protect.

Very truly yours,


 John K. Villa


 Carl W. Swan

cc: Larry Hollar

The CHAIRMAN. So again, I will say we will go in the order that we have, Mr. Allen first and his counsel, and then we will hear from Mr. Swan and his counsel, and then Mr. Patterson and his counsel. And we will adjourn.

That, incidentally, will be the conclusion of the public hearing, because the balance of this will be in privacy. So as far as the public hearing is concerned, it stands adjourned.

[Whereupon, at 9:30 p.m., the committee was adjourned, to reconvene immediately in executive session.]

APPENDIXES

ADDITIONAL MATERIAL SUBMITTED FOR INCLUSION IN THE RECORD

APPENDIX A

COPY NO. _____
 RECEIVED
 MAY 27 1981
 FEDERAL RESERVE BANK OF ST. LOUIS

CONFIDENTIAL OFFERING CIRCULAR

DRAFT OF

35,000 Shares

MAY 27 1981

FIRST PENN CORPORATION
 1919 Penn Square
 Oklahoma City, Oklahoma 73118

35,000 Shares of Common Stock, \$1.00 Par Value

First Penn Corporation (the "Company") is offering to a limited number of qualified investors who are current shareholders of the Company or substantial clients of Penn Square Bank, N.A., 35,000 shares of its Common Stock, par value \$1.00 per share ("Shares"). The minimum subscription per investor is 2,000 Shares (\$270,000). The offer will expire at 3:00 p.m., local time, on Friday, June 26, 1981.

The Subscription Price for each Share is \$135.00

	Subscription Price	Proceeds to Company (1)
Per Share.....	\$ 135.00	\$ 135.00
Total.....	\$4,725,000.00	\$4,725,000.00(1)

- (1) Before deduction of expenses payable by the Company estimated at \$20,000. No solicitation fee or commission will be paid by the Company to any person for or on account of solicitations or sales made pursuant to this offering. Officers, directors and employees of the Company may in its behalf engage in the distribution of this Confidential Offering Circular and assist in the offer and sale of the Shares. Such persons will not be paid any additional compensation therefor or any solicitation fees or commissions.
-

THESE SECURITIES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, OR ANY STATE SECURITIES ACT. THE SECURITIES ARE NOT BEING OFFERED OR SOLD TO THE GENERAL PUBLIC BUT ARE PART OF A PRIVATE PLACEMENT TO A RESTRICTED NUMBER OF QUALIFIED INVESTORS. NEITHER THE DELIVERY OF THIS CONFIDENTIAL OFFERING CIRCULAR NOR ANY SALE HEREUNDER SHALL UNDER ANY CIRCUMSTANCES CREATE AN IMPLICATION THAT THERE HAS BEEN NO CHANGE IN THE AFFAIRS OF THE COMPANY OR THE BANK SINCE THE DATE HEREOF.

THE SECURITIES OFFERED HEREBY ARE SUBJECT TO CERTAIN LEGAL RESTRICTIONS. SEE "RESTRICTIONS ON RESALE" WITHIN.

The date of this Offering Circular is June __, 1981.

ACKNOWLEDGMENT OF RECEIPT OF
 CONFIDENTIAL OFFERING CIRCULAR NO. _____
 OF
FIRST PENN CORPORATION

The original of this Acknowledgment must be signed and returned by each person receiving the attached Confidential Offering Circular of First Penn Corporation (the "Circular"). The securities as set forth in the Circular have not been registered with the Securities and Exchange Commission and the offer described therein is being made pursuant to Section 4(2) of the Securities Act of 1933 and Rule 146 adopted pursuant thereto, which exempts any offering by an issuer not including a public distribution.

As a condition to the receipt of this Confidential Offering Circular, the undersigned represents, on behalf of himself or, if the proposed offeree is a corporation, trust, partnership or other entity, on behalf of the proposed offeree:

(1) that the offeree's financial responsibility measured by annual income and net worth is suitable to a proposed investment in the securities of First Penn Corporation, and that the offeree has (i) a net worth of at least \$500,000 exclusive of home, furnishings and automobiles) or (ii) net worth of at least \$250,000 (exclusive of home, furnishings and automobiles) and taxable income of which some portion is subject to federal income taxation at a rate of not less than 50%;

(2) the offeree recognizes the speculative nature of an investment of First Penn Corporation and the risk of loss from such investment. I also understand that since such an investment is not liquid or readily transferable, the subscriber must be prepared to hold this investment indefinitely. By virtue of the offeree's investment acumen, business experience, or independent advice, including that of an offeree representative, if any, the offeree is capable of evaluating the hazards and merits of making this investment.

(3) I acknowledge that:

- (a) I have received the numbered Confidential Offering Circular;
- (b) the Circular will be used only by the offeree;
- (c) I will not further distribute the Circular except to designated representatives of the offeree.

EXECUTION OF THIS DOCUMENT DOES NOT INDICATE ANY INTENT TO SUBSCRIBE TO SHARES OFFERED IN THE CONFIDENTIAL OFFERING CIRCULAR. THE OFFER CONTAINED THEREIN SHALL BE INEFFECTIVE AS TO ANY PERSON WHO DOES NOT SIGN AND RETURN THIS ACKNOWLEDGMENT.

Date: _____

_____ Name
_____ Address

This document must be signed and returned to the person from whom you receive the Confidential Offering Circular at the time you receive it since such person must account for each Confidential Offering Circular.

THE COMPANY

First Penn Corporation (the "Company") was organized as a corporation under the laws of the State of Oklahoma on January 14, 1975, by officers and directors of Penn Square Bank, N.A., of Oklahoma City, Oklahoma (the "Bank"). The Company is a one bank holding company registered under the Bank Holding Company Act of 1956, as amended, and owns 100% of the issued and outstanding shares of Common Stock of the Bank. The Company recently acquired all of the stock of Penn Realty Company from Bill P. Jennings, Chairman and Chief Executive Officer, a Director and a major shareholder of the Company. See "Business - Penn Realty Company", "Officers and Directors of the Company and the Bank - Certain Transactions" and Note 12 to the Notes to the Company's Consolidated Financial Statements, March 31, 1981. The Bank is the sole income generating asset of the Company.

THE BANK

The Bank was organized as a National Banking Association in 1960 in the Penn Square Shopping Center located at the North-east corner of the intersection of Northwest Highway and Pennsylvania Avenue in Oklahoma City. At December 31, 1980, the Bank ranked fourth among the 31 banks in the City of Oklahoma City in terms of total assets, with total assets of approximately \$326 million. At that date, however, the three largest banks in the City of Oklahoma City accounted for approximately 65% of total deposits in the area. The Bank's share of total deposits in the City of Oklahoma City was 6% at December 31, 1980.

OFFERING

Nature of the Offer

The Company is offering to certain qualified investors at the Subscription Price set forth on the cover page of this Circular, 35,000 shares of Common Stock, par value \$1 ("Shares") of the Company. All offerees are either current shareholders of the Company or are major clients of the Bank. The minimum subscription per investor will be 1,120 Shares (\$151,200).

Time of Expiration

The offer will expire and become void at 3:00 o'clock p.m., Oklahoma City Time, on June 26, 1981 ("Time of Expiration").

Method of Subscribing for Shares

As a precondition to subscription for the Shares offered hereby, offerees must execute and return to the Company the copy of the "Acknowledgment of Receipt" contained on perforated paper at page 3 of this Circular. Shares may be subscribed by removing, completing and signing one copy of the Subscription Agreement attached at the back of this Circular on perforated paper and mailing or delivering it to Penn Square Bank, N.A., Oklahoma City, Oklahoma 73118, Attention: Bill P. Jennings, Chairman of the Board, accompanied by the full payment of the Subscription Price for the Shares subscribed under the offer, so as to be received by the Bank before the Time of Expiration.

Payment of the Subscription Price should be by certified or cashier's check, or bank draft payable in United States dollars to the order of the Company.

The Company reserves the right to reject any subscription which in its judgment is not properly exercised in accordance with this Circular and the subscription instructions contained herein or to waive any deficiencies in connection therewith.

Obligation to Purchase

To the extent Shares are subscribed for prior to the termination of this offering, persons who subscribe for the Shares offered hereby will be obligated to purchase the Shares subscribed for by them even if all Shares offered hereby are not purchased.

Delivery of Shares

The stock certificates evidencing the Shares purchased pursuant to the offering described herein are expected to be issued on or about July 1, 1981.

Investor Suitability Requirements.

The offering is directed only to persons who meet certain net worth requirements and who, or whose offeree representatives (if any), have sufficient knowledge and experience in financial and business matters to be capable of utilizing the information contained herein and of evaluating the risks involved. Generally, subscribers must have: (i) a net worth of at least \$500,000 (exclusive of home, furnishings and automobiles); or

(ii) a net worth of at least \$250,000 (exclusive of home, furnishings and automobiles) and taxable income of which some portion is subject to federal income taxation at a rate of not less than 50%. See the Subscription Agreement.

DILUTION

At March 31, 1981, the Company's common stock had a net tangible book value per share of \$91.04. "Net tangible book value per share" represents the amount of total assets less liabilities, preferred stock and related surplus, divided by the number of shares of common stock outstanding. Giving effect to the sale of 35,000 Shares at the price of \$135 per share, the net tangible book value will be \$98.83 per share, representing an immediate increase of \$7.79 to present shareholders and an immediate dilution (i.e., the difference between the purchase price of shares and the net tangible book value after the offering) of \$36.17 per share to the persons purchasing such shares at the offering price.

The following table illustrates the foregoing:

Offering Price.....	\$135.00
Net Tangible book value per share before offering.....	\$91.04
Increase per share attributable to payments by new investor.....	\$ 7.79
Net tangible book value per share after offering.....	<u>\$ 98.83</u>
Dilution to new investors.....	\$ 36.17

The Company intends to relocate the Bank in a proposed 20-story office tower. See "Business-Bank Premises." The proposed building, to be named "Penn Bank Tower" (the "Tower"), will be constructed and owned by an Oklahoma limited partnership to be named Penn Bank Tower Investors, Ltd. (the "Partnership"). The general partner of the Partnership will be Ronald H. Burks, a Director of the Company and the Bank. In the event the Partnership should contract for the sale of the Tower within four years of the date of formation of the Partnership, the Company will have the option to purchase the interests of the limited partners for cash (equal to the expenses theretofore incurred and charged to the limited partners with respect to the Partnership) and warrants to purchase up to approximately 47,500 shares of the Company's Common Stock. Each warrant will entitle the holder to purchase one share of the Company's Common Stock at the purchase price of \$135 per share. The warrants will be exercisable until the expiration of five years after the date of formation of the Partnership.

Assuming that the Company exercises its option to purchase the limited partners' interest in the Partnership, and assuming that all 47,500 warrants were issued and immediately exercised, the Company would issue 47,500 additional shares of its Common Stock for \$6,412,500. Depending upon the then current net tangible book value of the Company's Common Stock, the sale of additional shares would cause either an increase or decrease in the net tangible book value per share of then existing shareholders of the Company, and a reciprocal dilution or profit to the Partnership's limited partners.

USE OF PROCEEDS

The Company has undertaken a recapitalization plan for the Bank, and in accordance with an agreement reached with the Regional Administrator of National Banks, \$2,000,000 of the proceeds of the offering will be used to increase capital accounts of the Bank. The agreement with the Regional Administrator provides that the capital position of the Bank will be periodically evaluated in the future, and additional capital will be added to maintain the Bank's capital accounts at an adequate level. Management has estimated that the Company will need to provide approximately \$2,000,000 (in addition to \$2,000,000 of the proceeds from this offering) additional capital to the Bank later this year. In addition, proceeds of the offering may be used to service or reduce present debt of the Company or to eliminate the negative cash flow now experienced by the Company on sales of commercial paper. At present, the Company invests the proceeds of sales of commercial paper in deposits in the Bank. Interest paid by the Bank to the Company is less than interest paid by the Company on its commercial paper. Negative cash flow to the Company from this source as of May 1, 1981, is estimated at approximately \$1.5 million. It is anticipated that some of these funds may be obtained from additional borrowings by the Company. The actual amount of additional capital which the Company will need to provide the Bank will be based on the actual asset growth and income of the Bank.

CAPITALIZATION

The following table, which should be read in conjunction with the financial statements, and the notes thereto, of the Company included elsewhere in this Circular, sets forth certain information with respect to the long-term debt, authorized and outstanding capital stock and stockholders' equity of the Company

as at December 31, 1980, March 31, 1981 and as adjusted to give retroactive pro forma effect to the sale by the Company of 35,000 Shares (net proceeds of \$4,705,000 after estimated expenses):

	Amount at December 31, 1980	Amount at March 31, 1981	As Adjusted for Sale of 35,000 Shares
Notes payable and other liabilities(1)	\$8,606,800	\$8,606,800	\$8,606,800
Shareholders' Equity:			
Common Stock, \$1.00 par value (250,000 Shares authorized and 162,466 Shares outstanding at December 31, 1980 and at March 31, 1981; 250,000 Shares authorized and 197,466 Shares outstanding-as adjusted for sale of 35,000 Shares)	162,466	162,466	197,466
Capital Surplus	7,420,753	7,420,753	12,110,753
Undivided Profits	6,398,824	7,220,013	7,220,013
6.5% Cumulative Preferred Stock, \$60 par value (5,000 shares authorized, 4,225 shares issued)	<u>253,500</u>	<u>253,500</u>	<u>253,500</u>
Total Shareholders' Equity	<u>\$14,235,543</u>	<u>\$15,056,732</u>	<u>\$19,781,732</u>
Book Value Per Share of Common Stock	\$85.99	\$91.04	\$98.83

(1) See Note 8 of Notes to the Company's Consolidated Financial Statements, March 31, 1981.

DIVIDENDS AND STOCK REDEMPTIONS

Holders of the shares of Common Stock of the Company are entitled to dividends when, as and if declared by the Company's Board of Directors payable out of funds legally available for dividends in accordance with the provisions of the Oklahoma Business

Corporation Act. However, because the Bank, which continues to be the sole income generating asset of the Company, is subject to the National Bank Act regarding the payment of dividends by the Bank, the Company's ability to pay dividends is dependent upon the Bank's ability to pay dividends. Generally, Section 60 of the National Bank Act limits the amount which a nationally chartered bank can pay as dividends to the sum of its undivided net profits, except that, until the surplus fund of a bank equals its common capital account, no cash dividends may be declared unless there is a transfer to the surplus fund of not more than a one-tenth part of the bank's net profits of the preceding half year in the case of quarterly or semi-annual dividends, or not less than a one-tenth part of its net profits of the preceding two consecutive half-years in the case of annual dividends.

As of the date of this Circular, the Company has not paid any dividends on its shares of Common Stock. There can be no assurance as to the payment of dividends on the Common Stock of the Company in the future since such payment will be dependent upon the earnings and the financial condition of the Bank and other factors.

Holders of the Preferred Stock of the Company are entitled to receive dividends at the annual rate of 6.5%, which dividends are cumulative and payable on January 30 of each year. Payment of dividends are in preference to dividends on Common Stock and no dividend shall be paid on Common Stock if the payment of dividends on the Preferred Stock is in arrears.

Each share of Preferred Stock is subject to conversion into one Share of Common Stock of the Company at any time at the option of the holder thereof. The shares of Preferred Stock are subject to redemption at the option of the Company, in whole or in part, upon payment of the par value thereof and accrued dividends at any time following January 1, 1989. See Note 10 of Notes to the Company's Consolidated Financial Statements, March 31, 1981.

As of the date of this Circular no shares of Preferred Stock had been converted to Common Stock, and no shares of Preferred Stock had been redeemed.

As of the date of this Circular, payment of dividends on Preferred Stock was not in arrears.

PENN SQUARE BANK, N.A.

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

	(in thousands)				
	Year Ended December 31,				
	1980	1979	1978	1977	1976
Total Interest Income	26,551	12,237	6,676	4,427	3,615
Total Interest Expense	<u>13,694</u>	<u>5,930</u>	<u>2,912</u>	<u>2,009</u>	<u>1,630</u>
Net Interest Income	12,857	6,307	3,764	2,418	1,985
Provision for Possible Loan Losses	<u>(1,408)</u>	<u>(615)</u>	<u>(468)</u>	<u>(167)</u>	<u>(120)</u>
Net Interest Income After Provision for Loan Losses	11,449	5,692	3,296	2,251	1,865
Other Income:					
Trust	19	1	0	0	0
SC Deposit Acct.	367	108	224	237	192
Other SC-Fees	432	337	115	76	60
Other	<u>126</u>	<u>6</u>	<u>2</u>	<u>47</u>	<u>22</u>
Total Other Income	944	452	341	360	274
Total Net Interest and Other Income	12,393	6,144	3,637	2,611	2,139
Other Expenses:					
Salaries & Benefits	2,339	1,481	1,158	945	741
Net Occupancy Expense	619	390	302	154	91
Depreciation and Amortization	0	0	0	90	46
Other	<u>2,429</u>	<u>1,170</u>	<u>875</u>	<u>648</u>	<u>530</u>
Total Expense	<u>5,387</u>	<u>3,041</u>	<u>2,335</u>	<u>1,837</u>	<u>1,408</u>

	(in thousands)				
	Year Ended December 31,				
	<u>1980</u>	<u>1979</u>	<u>1978</u>	<u>1977</u>	<u>1976</u>
Income (Loss) Before Income Taxes	7,006	3,103	1,302	774	731
Securities Gains and Extraordinary Item	0	(16)	(102)	2	303
Income taxes	2,721	1,064	334	220	86
Income (loss) before Securities Gains and Extraordinary Items	4,285	2,039	968	554	645
Security Gains - Net of Tax	0	(9)	(53)	1	152
Income (Loss) Before Extraordinary Item	4,285	2,030	915	555	797
Extraordinary Item	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Net Income (Loss)	<u>4,285</u>	<u>2,030</u>	<u>915</u>	<u>555</u>	<u>797</u>

	Year Ended December 31,				
	<u>1980</u>	<u>1979</u>	<u>1978</u>	<u>1977</u>	<u>1976</u>
<u>Per Share Data</u>					
Income (Loss) Before Securities Gains and Extraordinary Item	\$42.85	\$20.39	\$ 9.68	\$ 5.54	\$6.45
Income (Loss) Before Extraordinary Item	42.85	20.30	9.15	5.55	7.97
Net Income (Loss)	42.85	20.30	9.15	5.55	7.97
Cash Dividends	3.00	2.80	2.80	2.80	2.80
Weighted Average Number of Shares Outstanding	100,000	100,000	100,000	100,000	100,000

BUSINESS

The Company

The Company's business since its acquisition of the Bank has been the oversight of the Bank's operations and the acquisition of Penn Realty Company, which are more fully discussed below.

The Bank

As of December 31, 1980, Penn Square Bank was the fourth largest bank in terms of total deposits of the 31 commercial banks located in Oklahoma City. The three largest banks in the City of Oklahoma City, however, accounted for approximately 65% of total deposits, and the Bank's share of total deposits was approximately 6%.

The Bank is engaged in the general business of commercial banking, and in transacting such business it receives deposits, makes and services secured and unsecured loans, and provides other functions for the benefit of persons, business and corporate customers. The Bank makes various types of loans to businesses and individuals, including the oil and gas industry, and offers various forms of installment credit to consumers and also finances construction of housing and business properties.

Commercial and Personal Banking Activities

The Bank is engaged in a wide range of commercial and personal banking activities, including the usual acceptance of deposits for checking, personal and savings and time deposit accounts, making of secured and unsecured loans to corporations, individuals and others, issuance of letters of credit, foreign exchange transactions, rental of safe deposit boxes and rendering of investment and financial counsel to institutions and individuals.

Correspondent Banking Services

The Bank acts as correspondent for approximately 53 banks throughout Oklahoma, providing such services as transfer of funds, loan participations, and securities custody and clearance.

Trust Services

The Bank, through its trust department, provides a wide range of personal and corporate trust and related services to individuals, corporations and others, including serving as executor

of estates, as trustee under testamentary and inter vivos trust and various pension and other employee benefit plans, as escrow agent under various agreements, and as an investment advisor to individuals, corporations and others. Through its corporate trust department, the Bank serves as transfer agent for corporate securities and as corporate trustee under corporate trust indentures.

Bank Premises

The main building of the Bank is currently located in the Penn Square Shopping Center at the northeast corner of the intersection of Northwest Highway and Pennsylvania Avenue in Oklahoma City. The three story building contains approximately 16,500 square feet, virtually all of which is occupied by the Bank. The Bank has lease agreements for (1) the land under the main Bank, expiring in 2029, (2) the office facilities one of which expires in 1985 with renewal options for three five-year terms, one of which expires in 1981, and two of which expire in 1984 both with renewal options for three one-year terms. Minimum annual rentals under these leases are as follows:

1981	\$118,353
1982-1983	122,752
1984	21,119
1985	7,980
1986-1989	7,200
1990-2029	3,000

In addition to the minimum rental for one of the office facility leases, the Bank also pays additional rental based on a percent of average total deposits as defined for each lease year. The lease covering the land provides for rental payments to be adjusted every 10 years based on a cost of living index. Total rental expense for 1980 amounted to approximately \$99,000.

The Bank has a motor bank located immediately north of the Penn Square Shopping Center along Pennsylvania Avenue. The motor bank has approximately 6,000 square feet in which there are two lobbies, a personal banking lobby with four tellers and a commercial lobby with three tellers. The motor bank also has six full service drive-in lanes. All commercial banking services except loans are offered at the drive-in.

The Bank has filed an application with the Regional Administrator of National Banks to move its main office to a new building which is planned to be located immediately east of the Penn Square Shopping Center on Northwest Highway. The Bank will

have the right to occupy approximately 89,000 square feet in the new building at an annual rent of approximately \$1,450,000. See "Dilution."

Competition

The Bank competes actively with national and state banks and certain other financial institutions in the Oklahoma City metropolitan area for all types of deposits, loans, trust accounts and financial and other services offered by the Bank. In addition, the Bank competes with banks from other metropolitan areas, as well as, with respect to certain of its banking services, insurance companies, savings and loan associations, credit unions and other financial institutions. Many of the banks and other financial institutions with which the Bank competes have capital and resources substantially in excess of the capital and resources of the Bank.

Employees

At May 1, 1981 the Bank has 180 employees. Management considers employee relations to be good. None of the Bank's employees are covered by a collective bargaining agreement.

Penn Realty Company.

In January, 1981, the Company acquired all of the outstanding stock of Penn Realty Company ("Penn Realty"), from Mr. Bill P. Jennings, Chairman and President of the Company. The Company then contributed capital to Penn Realty equal to \$1,250,061.48 which Penn Realty in turn used to repay loans made to it by Mr. Jennings and four other Directors of the Company. See "Officers and Directors of the Company and the Bank-Certain Transactions" and Note 13 of the Notes to the Company's Consolidated Financial Statements, March 31, 1981. Penn Realty was organized in September, 1980, solely for the purpose of acquiring title to the Quail Run Apartment project ("Quail Run") which was in the process of construction with construction financing provided by the Bank. Penn Realty acquired Quail Run upon default on the construction loan to the Bank. Pending receipt of approval from the Federal Reserve for the Company to acquire Quail Run and Penn Realty, Mr. Jennings became the sole shareholder of Penn Realty and other officers and directors of the Company and the Bank loaned funds to Penn Realty to enable Penn Realty to acquire Quail Run. Following the receipt of Federal Reserve approval, Penn Realty was transferred to the Company and Mr. Jennings and the other officers and directors who had provided funds to Penn Realty were reimbursed on a cost basis. As of March 31, 1981, the

investment by the Company in Penn Realty was \$1,248,964 (See the Company's Consolidated Financial Statements, March 31, 1981). It is the intention of the Company that Penn Realty will complete construction of Quail Run and that Quail Run will be sold, thereby avoiding a loss to the Bank on the construction loan. If Quail Run cannot ultimately be sold for an amount sufficient to repay the construction loan and any other costs, it is possible that the Company might not recover its entire investment in Penn Realty.

Supervision and Regulation and Related Matters

The Bank. The Bank is a member of the Federal Reserve System and its deposits are insured by the Federal Deposit Insurance Corporation to the extent permitted by law. As a national bank, the Bank is subject to regular examination by the office of the Comptroller of the Currency, the Federal Reserve Board and the Federal Deposit Insurance Corporation and is also subject to certain laws of the State of Oklahoma, including those which prohibit branch banking. The Company is an affiliate of the Bank within the meaning of the Federal Reserve Act, and, therefore, subject to certain restrictions as to (a) loans by the Bank to the Company; (b) investments by the Bank in the securities of the Company; and (c) the Bank's taking shares of the Company's stock, or other securities as collateral security for loans by the Bank to any borrower. Further, under Section 106 of the Bank Holding Company Act of 1956, as amended (the "Act"), and the Board's regulations, a bank holding company and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit or the provision of any property or service.

The Company. The Company is a bank holding company, is regulated under the Act and is subject to supervision by the Federal Reserve Board. The Company is obligated to file annual reports with the Federal Reserve Board and such other reports as may be required from time to time by the Federal Reserve Board. In addition, the Federal Reserve Board is authorized to make examinations of the Company and each of its subsidiaries with the cost thereof being paid by the Company. In general, the Act limits the business of bank holding companies to owning or controlling banks and engaging in such other activities as the Federal Reserve Board may determine to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. The Company must obtain the prior approval of the Federal Reserve Board before acquiring direct or indirect ownership or control of any voting shares of any bank or other business if after such acquisition it would own or control, directly or indirectly, more than 5% of the voting shares of such bank or other business, before merging or consolidating with another bank holding company, and before acquiring substantially all of the assets of any additional bank or other business. The Act also prohibits the acquisition by the Company

of any such interest in any bank or bank holding company located in a state other than Oklahoma unless the laws of the state in which such bank is located expressly authorizes such acquisition, which none presently do. With certain exceptions, the Act prohibits bank holding companies from retaining or acquiring direct or indirect ownership or control of voting shares in any company which is not a bank or bank holding company unless the Federal Reserve Board determines the activities of such company are so closely related to banking or managing or controlling banks as to be a proper incident thereto. In making such determinations the Federal Reserve Board considers whether the performance of such activities by the bank holding company would offer advantages to the public which outweigh possible adverse effects.

Monetary Policy. The business of the Bank and therefore, the Company, is affected in important respects by the policies of monetary authorities, including the Federal Reserve System. An important function of the Federal Reserve System is to regulate the national supply of bank credit in order to achieve, among other things, maximum employment and a stable price level. Among the instruments of monetary policy used by the Federal Reserve to implement these objectives are open market operations in U.S. Government securities, changes in the discount rate on member bank borrowings, changes in reserve requirements against member bank deposits, and limitations on interest rates which member banks may pay on time and savings deposits. These means are used in varying combinations to influence over-all growth of bank loans, investments and deposits, and may also affect interest rates charged on loans or paid for deposits. The monetary policies of the Federal Reserve authorities have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. In view of changing conditions in the national economy, in the money markets and in the relationships of international currencies, as well as the effect of actions by monetary and fiscal authorities, including the Federal Reserve System, no prediction can be made as to possible future changes in interest rates, deposit levels, loan demands, capital requirements or the business and earnings of the Bank.

SELECTED STATISTICAL INFORMATION

Distribution of Assets, Liabilities and Shareholders' Equity

The table on the following page sets forth the condensed balance sheets of the Bank for the periods indicated and, with respect to each period, the percentage of each principal category of liabilities and equity capital to total liabilities and equity capital (dollar amounts in thousands):

	(Figures in thousands)									
	Three Months Ended		Year Ended December 31,							
	3/30/81		1980		1979		1978		1977	
ASSETS										
Cash & due from banks..	\$30,794	9.75%	\$59,626	18.15%	\$25,672	15.95%	\$10,597	10.67%	\$10,256	14.36%
Investment Securities:										
U.S. Treasury.....	13,041	4.13%	10,992	3.35%	3,181	1.97%	3,979	4.00%	2,689	3.76%
States & political subdivisions.....	34,057	10.79%	31,335	9.54%	19,742	12.26%	13,632	13.72%	8,660	12.13%
Other.....	345	.11%	300	-.09%	60	-.04%	60	.06%	136	.19%
Total investment securities.....	47,443	15.03%	42,627	12.98%	22,983	14.27%	17,671	17.78%	11,485	16.08%
Federal funds sold....	-0-		16,000	4.87%	1,100	.68%	4,000	4.03%	6,500	9.10%
Bank loans, excluding Unearned income....	224,900	71.25%	201,725	61.40%	107,466	66.75%	64,136	64.55%	40,861	57.21%
Less: Reserve for loan losses..	-2,269	.72%	-2,004	.61%	-1,002	.62%	-627	.63%	-325	.46%
Net bank loans.....	222,631	70.53%	199,721	60.79%	106,464	66.13%	63,509	63.92%	40,536	56.75%
Bank premises and equipment.....	3,192	1.01%	2,482	.76%	1,936	1.20%	1,886	1.90%	1,827	2.56%
Other Assets.....	11,601	3.68%	8,061	2.45%	2,847	1.77%	1,691	1.70%	818	1.15%
Total Assets	\$315,661	100%	\$328,517	100%	161,002	100%	99,354	100%	71,422	100%
LIABILITIES										
Deposits:										
Demand deposits....	\$ 97,260	30.81%	\$142,682	43.43%	\$ 79,790	49.56%	\$44,093	44.38%	\$28,572	40.00%
Time & Savings deposits.....	182,214	57.73%	158,164	48.14%	69,983	43.47%	46,639	46.94%	36,729	51.43%
Total deposits.....	279,474	88.54%	300,846	91.57%	149,773	93.03%	90,732	91.32%	65,301	91.43%
Federal funds purchased.....	6,200	1.96%	650	.20%	400	.24%	-0-	-0-	-0-	-0-
Accrued expense & other liabilities...	8,404	2.66%	6,599	2.01%	1,892	1.18%	3,432	3.45%	1,560	2.18%
Total Liabilities	294,078	93.16%	308,095	93.78%	152,065	94.45%	94,164	94.77%	66,861	93.61%
Shareholders' equity:										
Common Stock.....	1,000	.32%	1,000	.30%	1,000	.62%	1,000	1.01%	1,000	1.40%
Surplus.....	10,500	3.33%	10,500	3.20%	3,000	1.86%	1,000	1.01%	1,000	1.40%
Retained earnings...	10,083	3.19%	8,922	2.72%	4,937	3.07%	3,190	3.21%	2,561	3.59%
Total shareholders' equity.....	21,583	6.84%	20,422	6.22%	8,937	5.55%	5,190	5.23%	4,561	6.39%
Total Liabilities and Equity	\$315,661	100%	\$328,517	100%	\$161,002	100%	99,354	100%	71,422	100%

Asset and Liability Management

As will be noted from examining the statistical data regarding distribution of assets, liabilities and capital included at page 19, deposits of the Bank have decreased from \$300,846,000 at December 31, 1980, to \$279,474,000 at March 31, 1981. On December 31, 1980, demand deposits accounted for 47.4% of total deposits, with time deposits constituting the remaining 52.6%. On March 31, 1981, demand deposits accounted for 34.8% of total deposits, with time deposits constituting the remaining 65.2%. For the first quarter of 1981, net loans have increased to 80% of total deposits. Generally, the increase in interest costs associated with an increase in time deposits would dictate adjustments in the Bank's asset allocations in order to offset the increased interest expense, while an increase in net loans would be accompanied by an increase in deposits. In the case of the Bank, both factors, together with market conditions causing movement from demand deposits to time deposits, have been at work. In connection with the increase in loans, Bank management has adopted a policy of attempting to shorten the average maturities of its municipal bond portfolio in order to improve the ratio of liquid to nonliquid assets. Furthermore, the Bank is in the process of formalizing its procedures relative to asset and liability management, and has, among other things, established an Asset and Liability Management Committee composed of eight officers who report directly to the Board of Directors.

Investment Portfolio

The carrying amounts of investment securities held by the Bank at the dates indicated are summarized as follows (amounts in thousands):

	Three Months Ended <u>3/31/81</u>	<u>Year Ended December 31,</u>			
		<u>1980</u>	<u>1979</u>	<u>1978</u>	<u>1977</u>
U.S. Treasury Securities...	\$13,041	\$10,992	\$ 3,181	\$ 3,979	\$ 2,689
Obligations of state and political subdivisions....	34,057	31,335	19,742	13,632	8,660
Other investment securities.....	<u>345</u>	<u>300</u>	<u>60</u>	<u>60</u>	<u>136</u>
TOTALS	<u>\$47,443</u>	<u>\$42,627</u>	<u>\$22,983</u>	<u>\$17,671</u>	<u>\$11,485</u>

The approximate market values of the investment securities held by the Bank at March 31, 1981, were \$42,818 million.

At March 31, 1981, investment securities having a recorded value of approximately \$16.4 million were pledged to secure public and trust fund deposits and for other purposes required or permitted by law.

The following table shows maturities at par value of bonds, notes and debentures held by the Bank at March 31, 1981 and the weighted average yields (dollar amounts in thousands):

	Due Within One Year		After One But Within Five Years		After One But Within Ten Years		After Ten Years	
	<u>Amount</u>	<u>Yield</u>	<u>Amount</u>	<u>Yield</u>	<u>Amount</u>	<u>Yield</u>	<u>Amount</u>	<u>Yield</u>
U.S. Treasury Securities	1,240	12.13	9,500	13.58	2,450	7.70	-0-	-0-
Obligations of state and political sub- divisions(1)	4,530	7.46	13,803	6.3	5,696	5.82	9,790	5.63
Other in- vestment securities(2)	-0-	-0-	-0-	-0-	-0-	-0-	345	6.00

(1) Represents federally tax exempt securities.

(2) Represents investments required by the Federal Reserve Board.

The weighted average yields shown above are calculated on the basis of the book value and effective yields, weighted according to par value, for the scheduled maturity of each security.

Loan Portfolio

The amount of loans of the Bank outstanding at the indicated dates are shown in the following table according to the type of loan (amounts in thousands):

	Three Months		Year Ended December 31,			
	Ended 3/31/81	1980	1979	1978	1977	1976
Real Estate Loans....	\$38,267	\$29,433	\$13,917	\$ 6,294	\$ 4,691	\$ 3,169
Loans to financial institutions.....	-0-	-0-	430	-0-	-0-	-0
Loans for purchas- ing or carrying securities.....	1,604	1,110	636	1,203	-0-	-0
Loans to farmers....	546	546	548	625	-0-	-0
Commercial and industrial loans....	161,372	146,895	74,180	40,495	29,135	24,87
Loans to individuals.	14,751	13,375	17,232	13,733	7,762	6,17
Other Loans (in- cluding overdrafts).	9,753	11,834	2,423	2,976	20	70
Gross Loans.....	226,293	203,193	109,366	65,326	41,608	34,280
Less unearned interest.....	1,393	1,467	1,900	1,190	747	57
Total Loans	224,900	201,726	107,466	64,136	40,861	33,700
Less allowance for possible loan losses	2,269	2,005	1,002	627	325	230
Net Loans	\$222,631	199,721	\$106,464	\$63,509	\$40,536	\$33,470

Due to the very rapid increase in the Bank's loan portfolio over the past several years, the Bank has experienced certain difficulties in documentation of collateral and credit analysis. These problems have resulted in a greater number of loans being criticized during examinations of the Bank than is desirable. To alleviate these problems, the Bank has hired a number of additional personnel, including Mr. Eldon Beller who assumed duties as President of the Bank on April 17, 1981, and Mr. Richard T. Dunn, who joined the Bank in May of 1981 as Executive Vice President in charge of credit and collateral. A large part of the increase in loans of the Bank has been in oil and gas loans and other energy related areas. To further insure quality of loans made in these areas, the Bank has employed two qualified petroleum engineers, three petroleum technicians and one technical assistant on a full time basis to work with oil and gas loans and has established an energy lending department:

The following table presents information concerning non-performing loans of the Bank. Nonperforming loans comprise loans which are contractually past due sixty days or more as to interest or principal payments:

	March 31, <u>1981</u>	December 31, <u>1980</u>	December 31, <u>1979</u>
Loans contractually past due sixty days or more as to interest or principal payments:			
Real estate loans.....	\$ 400,560	\$ -0-	\$162,991
Oil and gas.....	-0-	23,462	221,751
All other loans.....	639,936	1,654,873	151,743
Total.....	<u>\$1,040,496</u>	<u>\$1,678,335</u>	<u>\$536,485</u>

Summary of Loan Loss Experience

As of March 31, 1981 and December 31, 1980, the Bank had total loans outstanding of \$224,900,000 and \$201,726,000, respectively, including consumer loans, to borrowers of all sizes in a wide variety of industries and businesses. Implicit in the lending function is the fact that loan losses will be experienced and that the risk of loss will vary with the type of loan, the credit worthiness of the borrower over the term of the loan and general economic conditions. The Bank's Reserve for Possible Losses (the "Reserve"), which is available to absorb such losses, reflects the currently perceived risks of loss associated with the loan portfolio and assets required through foreclosure.

Loans charged off for the three months ended March 31, 1981 totaled \$942,000. Approximately \$1,000 previously charged off loans were recovered during that period, resulting in net chargeoffs of \$941,000. Loans charged off for the year ended December 31, 1980 totaled \$617,000. Approximately \$212,000 previously charged off loans were recovered during that year, resulting in net chargeoffs of \$405,000. For the year ended December 31, 1979, loans totaling \$259,000 were charged off and \$19,000 was recovered, resulting in net charge-offs of \$240,000. The provisions for loan losses is created by direct charges to operations. Losses on loans and foreclosed assets are charged against the Reserve, and recoveries during the period on any loan or foreclosed asset charged-off in a prior period are added to the Reserve.

The Provision for Possible Losses charged to operations in each period reflects the amount which, in the judgment of management, is required to make the total Allowance adequate. If actual charge-offs should exceed the amount of the Allowance, additional charges to operations sufficient to maintain its adequacy would be required. There is no precise method of predicting loan and other losses and the determination that a loan is likely to become uncollectible in whole or in part, and be charged off, is an exercise in judgment. The adequacy of the Reserve is assessed by management based upon continuing reviews of the loan portfolio and assets acquired through foreclosure and of prevailing economic

conditions. The factors considered in the evaluation of loans include the financial condition of the borrower, the value and liquidity of collateral, delinquency, and, if delinquent, the probability that the loan will be brought to a current status. Inasmuch as many factors relevant to such review are essentially judgmental, there can be no assurance that in any given period the Bank might not sustain charges against operating income which are substantial in relation to the size of the Allowance or that substantial additional charges against operating income may not be required. Management believes that its procedures for administering and reviewing its loan portfolio are effective in identifying loans as to which potential loss may exist, that the Reserve established at December 31, 1980 and March 31, 1981 was adequate on those dates to absorb potential losses in the Bank's then existing loan portfolio, and that provisions for possible loan and other losses under present credit policies of the Bank are sufficient to maintain the adequacy of the Reserve.

The following table summarizes the loan balances of the Bank at the end of each period, changes in the Allowance arising from charge-offs and recoveries by categories, and additions to the Reserve which have been charged to operations (dollar amounts in thousands):

	Three Months	Year Ended December 31,			
	Ended 3/31/81	1980	1979	1978	1977
Balances (thousands):					
Loans:					
Average loans.....	\$220,342	\$147,386	\$ 77,605	\$50,701	\$36,858
Loans at end of period..	224,900	201,725	107,466	64,136	40,861
Actual chargeoffs.....	(942)	(617)	(259)	(314)	(172)
Less recoveries.....	1	212	19	149	50
Net loan chargeoffs....	(941)	(405)	(240)	(165)	(122)
Reserve for possible loan losses.....	2,269	2,005	1,002	627	325
Provision for possible loan losses.....	\$ 1,205	\$ 1,408	\$ 615	\$ 468	\$ 167
Ratios:					
Net loan chargeoffs to average loans.....	.427%	.275%	.358%	.325%	.331%
Net loan chargeoffs to loans end of period.....	.418%	.201%	.259%	.257%	.299%
Reserve for possible loan losses to average loans.....	1.030%	1.360%	1.29%	1.24%	.88%

Reserve for possible loan losses to loans end of period.....	1.010%	.994%	.93%	.98%	.795
Net loan chargeoffs to reserve for loan losses.....	41.470%	20.200%	27.74%	26.27%	37.54%
Net loan chargeoffs to provision for loan losses.....	78.090%	28.760%	45.20%	35.26%	73.05%

Deposits

The average amounts of deposits of the Bank are summarized below (amounts in thousands):

	Three Months Ended <u>3/31/81</u>	Year Ended December 31,			
		<u>1980</u>	<u>1979</u>	<u>1978</u>	<u>1977</u>
Demand deposits.....	105,168	72,385	39,432	28,757	21,017
Savings.....	12,948	13,673	14,529	15,624	13,814
Consumer Certificates.....	27,073	23,595	16,290	11,827	-0-
NOW Accounts.....	3,545	-0-	-0-	-0-	-0-
Time certificates of deposit of \$100,000 or more.....	113,547	69,792	22,090	10,779	-0-
Public Time.....	19,325	6,162	6,370	4,117	-0-
Other Time.....	138	53	1,157	154	21,334(1)

(1) The amount shown includes all public time deposits, certificates of deposit of \$100,000 or more, and other time deposits.

Return on Equity and on Assets

Certain ratios of the Bank are presented below:

	Three Months Ended <u>3/31/81</u>	Year Ended December 31,			
		<u>1980</u>	<u>1979</u>	<u>1978</u>	<u>1977</u>
Percentages of net income to:					
Daily average total assets.....	.473%	2.07%	1.78%	1.16%	.91%
Daily average stock- holders' equity.....	7.050%	32.99%	34.04%	19.30%	12.80%

Percentage of dividends declared per common share to net income per share.....	23.17%	7.00%	13.79%	30.63%	50.45%
Percentage of daily average stockholders' equity to daily average total assets.....	6.71%	6.27%	5.22%	6.01%	7.08%

Commitments and Lines of Credit

In the normal course of business, the Bank makes contractual commitments to extend credit, including the issuance of foreign and domestic letters of credit. Such commitments may be short-term or long-term (but generally not longer than one year) and have a fixed expiration date. Prior to issuance of a commitment, an analysis of the credit worthiness of the client is made based on historical information and examination of future prospects.

In addition, the Bank extends lines of credit covering future borrowings of a customer after similar analysis of credit worthiness. In most instances a maximum amount will be specified and the line may be cancelled at the Bank's option with notice to the customer. Certain of such lines are available for short-term advances, either secured or unsecured; others may be multipurpose.

Average Balances and Average
Rates Earned and Paid

The following table sets forth each major category of interest-earning assets and interest-bearing liabilities, the average amount outstanding during the period (in thousands), the interest earned on such amount and the average rate:

	(thousands) AVERAGE BALANCE 3/31/81	INTEREST EARNED	RATE	(thousands) AVERAGE BALANCE 12-31-80	INTEREST EARNED	RATE	(thousands) AVERAGE BALANCE 12-31-79	INTEREST EARNED	RATE
INTEREST BEARING ASSETS									
U.S. Treasury Securities	12,438	346,688	11.30	3,661	299,777	8.19	3,542	277,395	7.83
State & Municipal (Tax Exempt)	32,969	535,691	12.20	23,495	1,308,325	10.31	16,763	900,530	9.95
Other Securities	324	4,878	6.11	172	10,491	6.11	60	6,307	10.51
Fed Funds Sold	5,954	282,661	19.25	2,350	282,715	12.03	119	14,933	12.55
Tax Exempt Loans	-0-	-0-	-0-	-0-	-0-	-0-	231	11,634	5.04
Commercial Loans	169,088	8,921,076	19.63	115,414	20,434,457	17.71	57,361	8,537,609	14.88
Real Estate Loans	31,434	1,181,116	15.24	16,294	2,274,435	13.96	8,183	1,021,416	12.48
Installment Loans	16,426	570,022	14.07	14,585	1,940,790	13.31	11,660	1,467,300	12.58
Other Loans	3,395	-0-	-0-	1,092	-0-	-0-	170	-0-	-0-
INTEREST BEARING LIABILITIES									
Savings	12,948	(166,487)	5.21	13,673	722,581	5.28	14,529	734,974	5.06
Consumer Certificates	27,073	(822,014)	12.31	23,594	2,525,938	10.71	16,290	1,262,950	7.75
C.D. Over \$100M	113,547	(4,500,694)	16.08	69,792	8,764,631	12.56	22,090	2,375,569	10.75
Public Time	19,325	(532,476)	11.17	6,162	800,736	13.00	6,370	650,969	10.22
Other Time	138	(6,000)	17.66	53	6,417	12.08	1,157	103,024	8.90
Now	3,545	48,671	5.57	-0-	-0-	-0-	-0-	-0-	-0-
Fed Funds Purchased	9,156	336,766	14.92	5,048	739,354	14.65	5,883	710,846	12.08
Other Borrowed Funds	2,612	149,491	23.21	1,002	134,609	13.43	131	12,460	9.52
Subordinated Notes	-0-	-0-	-0-	-0-	-0-	-0-	975	74,409	7.64

PRINCIPAL STOCKHOLDERS OF THE COMPANY AND THE BANK

The Company is the sole shareholder of the Bank's Common stock, excluding directors qualifying Shares. At the present time, the Company has issued and outstanding 162,466 Shares of its \$1.00 par value Common Stock. The following table sets forth, as of May 1, 1981, the number of Shares of Common Stock of the Company held by each person who is known by management of the Company to own beneficially more than 5% of its outstanding shares of Common Stock:

<u>NAME OF BENEFICIAL OWNER</u>	<u>NUMBER OF SHARES BENEFICIALLY OWNED</u>	<u>PERCENTAGE OF OUTSTANDING SHARES</u>
Bill P. Jennings Oklahoma City, Oklahoma	59,423	36.58%
The Rooney Corporation(1) Tulsa, Oklahoma	15,065	9.27%
Ronald H. Burkes Oklahoma City, Oklahoma	8,307	5.11%
Carl W. Swan Oklahoma City, Oklahoma	9,819	6.04%

(1) Mr. John E. Rooney, a director of the Company who owns an additional 2,252 Shares, is a principal stockholder and officer of The Rooney Corporation.

Currently, the Company has issued and outstanding 4,225 shares of its \$60.00 par value Preferred Stock. The following table sets forth, as of May 1, 1981, the number of shares of Preferred Stock of the Company held by each person who is known by management of the Company to own beneficially more than 5% of its outstanding Preferred Stock:

<u>NAME OF BENEFICIAL OWNER</u>	<u>NUMBER OF SHARES BENEFICIALLY OWNED</u>	<u>PERCENTAGE OF OUTSTANDING SHARES</u>
Frank L. Murphy Oklahoma City, Oklahoma	2,540	60.12%
Allen B. and Collen Pease Oklahoma City, Oklahoma	931	22.04%
Hazel and J. C. Cravens Oklahoma City, Oklahoma	454	10.75%

OFFICERS AND DIRECTORS OF THE COMPANY AND THE BANK

Set forth below are the names and ages of the directors and executive officers of the Company and the Bank, the year each first became a director of the Company and of the Bank, together with the number of Shares of Common Stock of the Company, and shares of Preferred Stock of the Company owned beneficially on May 1, 1981.

NAME AND PRINCIPAL OCCUPATION	AGE	A DIRECTOR OF	SHARES OF	SHARES OF
		(i) COMPANY AND (ii) BANK SINCE	COMPANY COM- MON STOCK OWNED BENEFICIALLY	COMPANY PRE- FERRED STOCK OWNED BENEFICIALLY
Bill P. Jennings Chairman & Chief Executive Officer of Bank	57	(i) 1975 (ii) 1975	59,423	-0-
Frank L. Murphy Vice Chairman of the Board	60	(i) 1979 (ii) 1964	225	2,540
Eldon L. Beller President of Bank	57	(i) N/A (ii) 1981	1,000	-0-
Elizabeth M. Coe President of Merrick Foundation	57	(i) N/A (ii) 1975	2,800	-0-
C. F. Kimberling Owner, Kimberling Food Markets	62	(i) N/A (ii) 1963	450	-0-
Marvin Margo, M.D. McBride Clinic, Inc.	57	(i) N/A (ii) 1965	400	-0-
Jerry Richardson President of Dub Richardson Ford	39	(i) N/A (ii) 1975	319	-0-
W. A. Ross President of Dub Ross Company	53	(i) 1979 (ii) 1975	2,944	-0-

Richard C. Haugland Vice President Citizens National Bank, Muskogee, Oklahoma	45	(i) N/A (ii) 1981	15	-0-
Gene H. Smelser President of Val Gene's Food Services	62	(i) N/A (ii) 1968	450	-0-
Bill Stubbs Real Estate Investments	59	(i) N/A (ii) 1964	1,765	-0-
Carl W. Swan Independent Oil Producer	55	(i) 1979 (ii) 1976	9,819	-0-
Ronald H. Burks Chairman of the Board Burks Investments, Inc.	39	(i) 1980 (ii) 1980	8,207	-0-
John E. Rooney President Rooney Corporation	--	(i) 1975 (ii) N/A	17,317	-0-
Gary M. Cook Chairman, Trend Construction Corporation	39	(i) N/A (ii) 1980	1,500	-0-
J. C. Cravens Investments	77	(i) N/A (ii) 1960	-0-	454
H. Mead Norton President, Norton Invest- ment Co.	79	(i) N/A (ii) 1974	1,346.5	-0-
James G. Randolph President Kerr-McGee Coal Corporation	51	(i) N/A (ii) 1979	3,000	-0-

Tony W. Williams Executive Vice President, Bank	40	(i) N/A (ii) N/A	-0-	-0-
Bill G. Patterson Executive Vice President, Bank	31	(i) N/A (ii) 1981	8,032	-0-
Bill Coy Senior Vice President, Bank	47	(i) N/A (ii) N/A	-0-	-0-
John H. Miller Vice President and Trust Officer, Bank	64	(i) N/A (ii) N/A	600	-0-
Den Thompson Senior Vice President, Bank	30	(i) N/A (ii) N/A	150	-0-

Remuneration of Directors
and Executive Officers

The following tabulation shows all direct remuneration paid by the Company and its subsidiaries for the year ended December 31, 1980, for services in all capacities to (i) each director of the Bank whose aggregate total remuneration exceeded \$50,000, (ii) each of the five highest paid executive officers of the Bank whose aggregate total remuneration exceeded \$50,000, and (iii) all directors and executive officers of the Bank as a group.

Cash and Cash-Equivalent
Forms of Remuneration

<u>Name of Individual or Identity of Group</u>	<u>Salaries, Fees, Commissions and Bonuses</u>	<u>Securities or Property, In- surance Benefits or Reimbursement, Personal Benefits</u>	<u>Aggregate of Contingent Forms of Remuneration</u>
Bill P. Jennings President and Chief Executive Officer	75,133.24	1,400	-0- (1)

Frank L. Murphy Secretary-Treasurer Vice Chairman	63,300	1,300	-0- (1)
All Directors and Executive Officers as a group (18) Persons(2)	220,700	5,300	73,512(1)

- (1) During calendar year 1980 the Bank contributed \$73,512 to the Defined Benefit Plan (the "Plan") in which there were 55 active participants (including 6 Executive Officers of the Bank) at December 31, 1980. The amount of the Bank's contribution under the Plan in respect of a specific person is not and cannot readily be separately or individually calculated.
- (2) As used above, the term "Executive Officers" means all Senior Vice Presidents and above.

Certain Transactions

Certain of the executive officers, directors and principal stockholders of the Company, and their related interest have deposit accounts with the Bank, and also have other transactions with the Bank, including loans in the ordinary course of business. See Note 3 to Notes to Financial Statements of the Company at March 31, 1981. A related interest includes any company or other organization of which an executive officer or director of the Bank (i) owns, controls, or has the power to vote 25% or more of any class of voting securities of the company; (ii) controls the election of a majority of the directors of the company; or (iii) has the power to exercise a controlling influence over the management of policies of the company. The Bank does not make loans to its officers in the ordinary course of business; isolated consumer loans have been made to officers in compliance with applicable federal laws and regulations. The aggregate amount of loans to directors and their related interest as a group outstanding at March 31, 1981 was approximately \$2,804,600, representing approximately 13% of the total of the Bank's capital stock, surplus and undivided profits (the "Bank's equity capital accounts") on that date.

In January 1981, the Company acquired Penn Realty from Bill P. Jennings, Chairman and Chief Executive of the Company. Penn Realty was formed in September 1980 for the purpose of acquiring title to the Quail Run Apartment project ("Quail Run") after Quail Run had defaulted on a construction loan to the Bank. Subsequent to acquiring Penn Realty, the Company contributed \$1,250,061.48 to its capital which was used by Penn Realty to repay loans made to it by the following persons (all Directors of the Company):

Bill P. Jennings	\$ 625,030.74
W. A. Ross	104,171.29
Frank L. Murphy	104,171.79
Ronald H. Burks	208,343.58
Carl W. Swan	208,343.58

DESCRIPTION OF CAPITAL STOCK

General

The table appearing under the heading "Capitalization" sets forth the authorized capital stock of the Company at March 31, 1981, and as adjusted to give effect to the sale of Shares offered hereby.

Common Stock

The holders of Common Stock are entitled to receive such dividends as may be declared by the Board of Directors of the Company with respect to the Common Stock out of funds legally available therefor. The payment of dividends on the Common Stock is also subject to limitations contained in the Oklahoma Business Corporation Act. See "Dividends and Stock Redemption."

In the event of liquidation, dissolution or winding-up of the affairs of the Company, the holders of outstanding shares of Common Stock are entitled to share pro rata according to their respective interests in the Bank's assets and funds remaining after payment or provision for payment of all debts and other liabilities of the Bank and after payment in the full amount of the liquidation preference and any class of preferred stock or other equity security senior in right of payment to the Common Stock.

Preferred Stock

The Company has authorized one class of \$60.00 par value 6.5% cumulative preferred stock. Holders of preferred stock are entitled to receive annual cumulative dividends of \$3.90 per share in preference to any dividends upon the Company's common stock. In the event of liquidation, the holders of preferred stock shall be entitled to be paid in full both the par value of such shares and any dividends accrued but unpaid, before any amount is paid to owners of the Company's common stock. Each share of preferred stock is subject to conversion into one share of common stock of the Company at any time at the option of the holder thereof. The shares of preferred stock are subject to redemption at the option of the Company, in whole or in part, upon payment of the par value thereof and accrued dividends at any time following January 1, 1989.

RESTRICTIONS ON RESALE

The shares offered herein have not been registered with the Securities and Exchange Commission or any state regulatory authority, and are offered pursuant to Section 4(2) of the Securities Act of 1933 and Rule 146 adopted pursuant thereto and pursuant to Section 401(b)(9) of the Oklahoma Securities Act, which exempt transactions by an issuer not involving a public offering.

All shares to be issued pursuant to the Offer will bear the following legend:

THE SECURITIES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933 OR THE OKLAHOMA SECURITIES ACT. THE SECURITIES HAVE BEEN ACQUIRED FOR INVESTMENT AND MAY NOT BE TRANSFERRED FOR VALUE IN THE ABSENCE OF AN EFFECTIVE REGISTRATION OF THEM UNDER THE SECURITIES ACT OF 1933 AND/OR APPLICABLE STATE SECURITIES LAWS, OR AN OPINION OF COUNSEL TO THE COMPANY THAT SUCH REGISTRATION IS NOT REQUIRED UNDER SUCH ACT OR ACTS.

LEGAL PROCEEDINGS

The Company is not a party to any legal proceedings. The Bank is a party, both as plaintiff and defendant, to several legal actions arising out of the conduct of its business. In the opinion of management, the ultimate liability, if any, resulting from the legal actions to which the Bank is a party will not

materially affect the financial position or results of operation of the Bank.

LEGAL OPINION

The Company has received an opinion from McAfee & Taft A Professional Corporation, 100 Park Avenue, Oklahoma City, Oklahoma 73102, to the effect that the shares of Common Stock have been duly and validly authorized and, when the Subscription Price therefor has been paid and the shares of Common Stock issued in accordance with appropriate corporate proceedings, will be duly and validly issued, fully paid and nonassessable.

ACCOUNTANTS

The financial statements of the Company included in this Offering Circular with respect to the year ended December 31, 1980 have been examined by Arthur Young & Company, independent certified public accountants, whose report thereon appears elsewhere herein.

FIRST PENN CORPORATION
CONSOLIDATED BALANCE SHEET

MARCH 31, 1981

(UNAUDITED)

ASSETS

Cash and due from banks	\$ 30,794,191
Investment securities (Note 3)	47,442,707
Loans, less reserve for possible loan losses of \$2,269,467 (Notes 4 and 5)	222,795,538
Premises and equipment (Notes 6 and 8)	4,442,608
Investment in Real Estate Project (Note 12)	1,248,964
Accrued interest receivable	10,847,119
Other assets (Note 2)	<u>1,266,161</u>
Total assets	<u>\$318,837,288</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Deposits:	
Demand	\$ 87,826,098
Savings	13,431,058
Time	<u>144,513,478</u>
Total deposits	245,770,634
Federal funds purchased	6,200,000
Other liabilities (Note 7)	4,669,568
Notes payable (Note 8)	8,606,800
Commercial paper	34,845,667
Loans sold under agreement to repurchase	<u>3,687,887</u>
Total liabilities	303,780,556
Stockholders' equity (Note 10):	
6.5% cumulative preferred stock, \$60 par value; 5,000 shares authorized, 4,225 shares issued	253,500
Common stock, \$1 par value; 250,000 shares authorized, 162,466 shares issued	162,466
Surplus	7,420,753
Retained earnings	<u>7,220,013</u>
Total stockholders' equity	<u>15,056,732</u>
Total liabilities and stockholders' equity	<u>\$318,837,288</u>

See accompanying notes.

FIRST PENN CORPORATION
 CONSOLIDATED STATEMENTS OF INCOME
 Three Months Ended March 31, 1981
 (UNAUDITED)

Interest income:	
Interest and fees on loans	\$10,136,890
Interest on investment securities:	
Taxable	346,688
Tax exempt	<u>535,692</u>
Total interest on investment securities	882,380
Interest on federal funds sold	<u>282,662</u>
Total interest income	11,301,932
Interest expense:	
Interest on deposits:	
Savings	166,488
Time	5,227,289
Other	<u>123,356</u>
Total interest on deposits	5,517,133
Interest on commercial paper	1,489,272
Interest on federal funds purchased	414,276
Interest on notes payable	<u>415,329</u>
Total interest expense	7,836,010
Net interest earnings	3,465,922
Provision for possible loan losses	<u>1,205,000</u>
Net interest earnings after provision for possible loan losses	2,260,922
Other income:	
Service charges on deposit accounts	153,829
Other service charges and fee income	669,547
Other	<u>30,726</u>
Total other income	854,102

(Continued on following page)

FIRST PENN CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Three Months Ended March 31, 1981
(UNAUDITED)

Other expense:	
Salaries	\$ 755,485
Employee benefits	107,654
Occupancy and equipment expense	272,534
Other	<u>808,684</u>
Total other expense	1,944,357
Income before income taxes	1,170,667
Provision for income taxes (Note 9)	<u>333,000</u>
Net Income	<u>\$ 837,667</u>

See accompanying notes.

FIRST PENN CORPORATION
(consolidated and parent company)

STATEMENTS OF STOCKHOLDERS' EQUITY
Three Months Ended March 31, 1981

(UNAUDITED)

	<u>Preferred stock</u>	<u>Common stock</u>	<u>Surplus</u>	<u>Retained earnings</u>
Balance at December 31, 1980	\$253,500	\$162,466	\$7,420,753	\$6,398,824
Net income	-	-	-	837,667
Preferred stock dividends	<u>-</u>	<u>-</u>	<u>-</u>	<u>(16,478)</u>
Balance at March 31, 1981	<u>\$253,500</u>	<u>\$162,466</u>	<u>\$7,420,753</u>	<u>\$7,220,013</u>

See accompanying notes.

FIRST PENN CORPORATION
(parent company only)

BALANCE SHEETS

MARCH 31, 1981

(UNAUDITED)

<u>ASSETS</u>	<u>March 31, 1981</u>
Cash on deposit with subsidiary bank	\$ 9,362,728
Certificate of deposit of subsidiary bank	24,269,535
Receivable from Penn Realty	500
Receivable from subsidiary bank	1,141,672
Investment in stock of subsidiary Bank (Note 2):	
Equity in net assets	21,583,035
Cost in excess of net assets acquired	741,842
	<hr/>
Investment in real estate project (Note 12)	22,324,877
	<hr/>
	1,250,061
	<hr/>
Land (Note 8)	23,574,938
	<hr/>
	1,250,890
	<hr/>
TOTAL ASSETS	<u>\$ 59,600,263</u>
	<hr/>
 <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>	
Liabilities:	
Other liabilities:	
Income taxes payable	855,535
Interest payable	218,664
Other	16,865
	<hr/>
	1,091,064
Commercial paper	34,845,667
Notes payable (Note 8)	8,606,800
	<hr/>
TOTAL LIABILITIES	\$ 44,543,531
 Stockholders' equity (Note 10):	
6.5% cumulative preferred stock , \$60 par value; 5,000 shares authorized, 4,225 shares issued	253,500
Common stock, \$1 par value; 250,000 shares authorized, 162,466 shares issued	162,466
Surplus	7,420,753
Retained earnings	7,220,013
	<hr/>
TOTAL STOCKHOLDERS' EQUITY	15,056,732
	<hr/>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$ 59,600,263</u>
	<hr/>

See accompanying notes

FIRST PENN CORPORATION
(parent company only)

STATEMENTS OF INCOME

THREE MONTHS ENDED MARCH 31, 1981

(UNAUDITED)

	<u>March 31, 1981</u>
Income from subsidiary bank:	
Dividends	\$ 350,000
Interest on certificates of deposit	631,192
Total income from subsidiary bank	<u>981,192</u>
Other income	497
Total income	<u>981,689</u>
Expenses:	
Interest	1,904,601
Amortization	5,338
Other expenses	4,965
Total expenses	<u>1,914,904</u>
Loss before income tax benefit, equity in undistributed earnings of subsidiary	(933,215)
Income tax benefit (Note 9)	<u>610,250</u>
Loss before undistributed earnings of subsidiary	(322,965)
Equity in undistributed earnings of subsidiary	<u>1,160,632</u>
Net income	<u>\$ 837,667</u>

See accompanying notes

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1981

(UNAUDITED)

1. Summary of significant accounting policies

Principles of consolidation - The consolidated financial statements include the accounts of First Penn Corporation ("the Company") and its subsidiaries, Penn Square Bank, N.A. ("the Bank") and Penn Realty Company. All significant intercompany transactions and accounts have been eliminated.

Investment securities - Investment securities are stated at cost adjusted for amortization of premiums and accretion of discounts on the straight-line method to maturity. Gains and losses on sales of investment securities are computed on the specific cost identification method.

Interest on loans - Interest on commercial and real estate loans is accrued based on the principal amount outstanding. Interest on installment loans is recognized as revenue based on the sum-of-the-months-digits method.

Reserve for possible loan losses - The reserve for possible loan losses is a valuation reserve which has been provided from charges to earnings in the form of provisions for possible loan losses. The provision charged to earnings is the amount which, in the opinion of management, is considered necessary to maintain the balance in the reserve for possible loan losses at a level adequate to absorb potential losses in the loan portfolio. The provision is based on loans specifically identified as probable losses and other factors which, in management's judgment, deserve recognition in estimating possible loan losses.

Premises and equipment - Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line and declining balance basis over the estimated useful lives of the individual assets.

Retirement plan - The Bank has a noncontributory retirement plan covering substantially all full-time employees. The Bank's policy is to fund costs accrued, including amortization of prior service costs.

Income taxes - The Company and its subsidiaries file a consolidated income tax return. Income tax charges are allocated to the subsidiaries on the basis of its taxable income included in the consolidated financial statements.

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1981

(UNAUDITED)

1. Summary of significant accounting policies (continued)

Deferred income taxes are provided on all significant timing differences. These differences relate primarily to (1) the difference between the provision for possible loan losses reported for income tax purposes and that reported for financial statement purposes and (2) amortization over a ten-year period of the effect of the change for income tax purposes in 1978 from the cash basis to the accrual basis of reporting certain revenues and expenses.

Investment tax credits are accounted for on the flow-through method.

2. Investment in subsidiary

During 1976 and 1977, the Company acquired 83,259 shares of the 100,000 outstanding shares of the Bank. This acquisition was accounted for as a purchase and the excess of cost over fair market value of the net assets acquired of \$851,792 is being amortized on a straight-line basis over a period of forty years. The unamortized balance of \$741,842 at March 31, 1981 is included in other assets in the consolidated balance sheet.

During 1979, the Company offered to issue to the minority shareholders of the Bank for each share of the Bank's common stock owned either (1) one and one-half shares of the Company's \$1 par value common stock or (2) one share of the Company's preferred stock.

In September 1979 the following exchanges were effected:

Number of shares of bank stock exchanged	Number of shares of company stock issued	
	Common	Preferred
16,731	18,759	4,225

The additional investment acquired in the Bank was recorded at net book value of the Bank stock which in management's opinion approximated fair market value of the net assets acquired.

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1981

(UNAUDITED)

2. Investment in subsidiary (continued)

In addition, the Company offered to exchange one share of its common stock for each \$40 of principal face value of the Bank's \$1,000,000 subordinated notes. All note holders exercised their options in exchange for 25,000 shares of the Company's common stock. In October, the Company canceled the Bank's liability on these notes resulting in an additional \$1,000,000 investment in the subsidiary bank. In addition, a cash capital contribution of \$1,000,000 was made by the Company to its subsidiary bank in 1979.

In January, 1980, the Company purchased the remaining 10 outstanding shares of the Bank at a cost of \$200 per share. The excess of cost over fair market value of the shares acquired was \$1,206. This amount is included in the unamortized excess cost at March 31, 1981. A cash capital contribution of \$7,500,000 was made by the Company to its subsidiary bank in 1980.

3. Investment securities

The carrying values and estimated market values of investment securities at March 31, 1981 are as follows:

	<u>March 31, 1981</u>	
	<u>Carrying Value</u>	<u>Market Value</u>
United States Treasury securities	\$13,041,279	\$12,484,814
Obligations of states and political subdivisions	34,056,428	29,988,083
Other	345,000	345,000
	<u>\$47,442,707</u>	<u>\$42,817,897</u>

- (1) Before deduction of expenses payable by the Company estimated at \$20,000. No solicitation fee or commission will be paid by the Company to any person for or on account of solicitations or sales made pursuant to this offering. Officers, directors and employees of the Company may in its behalf engage in the distribution of this Confidential Offering Circular and assist in the offer and sale of the Shares. Such persons will not be paid any additional compensation therefor or any solicitation fees or commissions.
-

THESE SECURITIES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, OR ANY STATE SECURITIES ACT. THE SECURITIES ARE NOT BEING OFFERED OR SOLD TO THE GENERAL PUBLIC BUT ARE PART OF A PRIVATE PLACEMENT TO A RESTRICTED NUMBER OF QUALIFIED INVESTORS. NEITHER THE DELIVERY OF THIS CONFIDENTIAL OFFERING CIRCULAR NOR ANY SALE HEREUNDER SHALL UNDER ANY CIRCUMSTANCES CREATE AN IMPLICATION THAT THERE HAS BEEN NO CHANGE IN THE AFFAIRS OF THE COMPANY OR THE BANK SINCE THE DATE HEREOF.

THE SECURITIES OFFERED HEREBY ARE SUBJECT TO CERTAIN LEGAL RESTRICTIONS. SEE "RESTRICTIONS ON RESALE" WITHIN.

The date of this Offering Circular is June __, 1981.

APPENDIX B

Minutes of the
MEETING OF THE BOARD OF DIRECTORS
PENN SQUARE BANK, N.A.

April 14, 1981

The meeting was called to order by Mr. Bill P. Jennings, Chairman of the Board. The following Directors were present:

Bill P. Jennings
Frank L. Murphy
Ronald H. Burks
Elizabeth Merrick Coe
Gary M. Cook
Richard C. Haugland
C. F. Kimberling
Marvin K. Margo
*H. Mead Norton
Jerry Richardson
W. A. Ross
Gene H. Smelser
Carl W. Swan

(*Advisory Director)

The minutes of the Directors Meeting of March 10, 1981, were examined and approved.

The Bank's Statement of Condition, including High and Low figures on Assets and Deposits, and Comparative Statement of Condition and Liquidity was approved.

The Income and Expense Reports for the month of March, 1981, including Donations, Dues and Subscriptions, were reviewed and approved.

First Penn Leasing Corporation Statement of Condition and Income and Expense Reports were reviewed and approved for the month of March, 1981.

Bond transactions for the month of March, 1981, were approved and a copy of these transactions is attached and will become a permanent part of these records.

The report of the Discount Committee was accepted as presented with Commercial Loans in excess of \$250,000.00, all previously approved by the Discount Committee on March 19, 26th, and April 2, 1981.

The report of the Discount Committee was accepted as presented with Installment Loans totaling \$1,419,576.12, representing 252 loans, all previously approved by the Discount Committee on March 19th, 26th and April 2, 1981.

Overdrafts in the amount of \$2,833,731.33 as of March 31, 1981, were reported with Mr. Richard C. Haugland abstaining from the vote due to the excessive amount of overdrafts. Cash Items in the amount of \$1,239.13 and Over and Short in the amount of \$199.12 (short) were reported. All of the foregoing figures were examined and approved.

The Safe Deposit Box report for the month of April, 1981, was examined and approved.

Motion was made and unanimously approved that Mr. Frank L. Murphy be elevated from President to Vice Chairman of the Board.

Motion was made and approved that Mr. Eldon Beller be employed as President and Chief Administrative Officer under an employment contract and also be elected to the Board of Directors. It was also approved that Mr. Beller have unlimited authority on signing all Cashiers Checks, Official Checks, Interest Checks, Expense Checks, Certificate of Deposit, Chase and Correspondent Drafts, and Unlimited Individual Lending Authority.

Motion was made and approved that Mr. Bill G. Patterson be elected to the Board of Directors.

Motion was made and approved that Randy Allison and Billie J. Dean be employed as Assistant Vice President's, Correspondent Banking.

The Board of Directors next approved the promotions of the following officers:

Bill McBain from Assistant Cashier to Assistant Vice President;
 Geraldine Yearley to Assistant Vice President;
 Wayne Hunteman to Purchasing Officer;
 Jerry Pendry to Security Officer.

Motion was made and approved that Tom Harrison be named Vice President and Assistant Security Officer instead of Vice President and Security Officer.

The Board of Directors next approved the following resignations:

Thomas Orr
Clark Long
Sheryl Walker

The Board of Directors was next advised of the following borrowings and renewals:

Bill P. Jennings reported borrowings from Liberty National Bank & Trust Company, Oklahoma City, Oklahoma, in the amount of \$150,000.00, dated April 6, 1981, maturing June 6, 1981, Unsecured, for the purpose of purchasing Quality Inn; and

renewal of a loan with Fidelity Bank, N.A., Oklahoma City, Oklahoma, in the amount of \$500,000.00, dated March 24, 1981, maturing September 24, 1981, secured by various stocks and oil and gas production; and

renewal of a loan with Fidelity Bank, N.A., Oklahoma City, Oklahoma, in the amount of \$543,965.00, dated March 3, 1981, maturing August 31, 1981, secured by various stocks and oil and gas production.

Tony W. Williams reported renewals of loans with Liberty Bank & Trust, Oklahoma City, Oklahoma, in the amount of \$200,000.00, increasing the line of \$34,000.00, dated April 1, 1981, maturing June 1, 1981, secured by oil & gas interest; and

renewal in the amount of \$10,000.00, with Liberty Bank & Trust, Oklahoma City, Oklahoma, dated April 1, 1981, maturing October 1, 1981, secured by oil and gas interest.

Kenneth R. Wilson reported the renewal of a loan with Lakeshore Bank, N.A., Oklahoma City, Oklahoma, dated March 17, 1981, maturing September 13, 1981, secured by an automobile; and

renewal of a Line of Credit with Lakeshore Bank, N.A., dated March 16, 1981, maturing May 15, 1981, in the amount of \$25,000.00, Unsecured.

Bill G. Patterson reported borrowings from Bank of Healdton, Healdton, Oklahoma, in the amount of \$18,000.00, dated March 31, 1981, maturing in six (6) months, secured by First of Amarillo stock, for the purpose of purchasing stock.

Jeff Callard reported borrowings from Bank of Healdton, Healdton, Oklahoma, dated February 5, 1981, with a three (3) year balloon, in the amount of \$75,000.00 secured by a Mortgage of Real Estate, for the purpose of purchasing same.

Norma Babb reported borrowings from Local Federal Savings and Loan, Oklahoma City, Oklahoma, in the amount of \$30,000.00, dated April 1, 1981, maturing April, 1996, secured by a Second Mortgage of Real Estate, for the purpose home improvement.

Motion was made and approved that the Resolution regarding the Security Program be adopted as follows:

WHEREAS, the Penn Square Bank Security Committee has established a kidnap - extortion contingency plan for its fellow officers;

BE IT RESOLVED that the Bank Security Officer and Bank Auditor are directed to secure, designate, and record monies in the amount of \$2,000.00 to be used as bait money and maintained in the main bank vault.

BE IT FURTHER RESOLVED that in the case of an attempted or actual kidnap - extortion incident involving a Penn Square Bank Officer, Officer Family Member, Executive Secretary, or Bank Employee, the Chairman of the Board, Vice Chairman of the Board, President, or Executive Vice President, in line of succession, shall automatically and without further action of the Board of Directors, be hereby authorized to remove and release said bait money to the bank Officers as designated above, in order to provide for the safety and well being of said employees.

Motion was made and approved that Page 11 and Page 21 of the Asset/Liability Management Plan be approved as follows:

Page -11- Senior Vice Presidents, Vice Presidents, and Manager of the Certificate of Deposit Department have the authority to pay up to .50 percent in excess of Penn Square Bank published \$100M Certificate of Deposit rates. Executive Vice Presidents and above have the authority to pay up to 1 percent in excess of Penn Square Bank published \$100M Certificate of Deposit rates. Any exceptions to this shall have prior written approval from three (3) members of the ALCO Committee.

Page -21- The Investment Officer, Vice Presidents, Cashier, Vice Chairman of the Board, and the President have been authorized by the Board of Directors to borrow, (1) from the Federal Reserve Bank, (2) under repurchase agreements, or (3) from an upstream correspondent, up to an amount not to exceed 50 percent of our bank's capital. When the amount exceeds 50 percent, additional approval must be obtained from the Vice Chairman, President, Investment Officer, Cashier or Chief Executive Officer. This borrowing will be reported to the Board routinely at each month's Board Meeting. The Investment Portfolio will not be increased or decreased by more than 10 percent in any one month without the approval of the Asset/Liability Management Committee or the Board of Directors.

The Board of Directors next approved the following Resolution:

Officers working Saturdays as Motor Bank Manager will be compensated at the rate of \$75.00 per Saturday;

Officers assigned weekly security duty, subject to 24-hour call during that week, will be paid \$50.00 per week expense reimbursement.

The Certificate of Deposit Interest Rate Policy Exception was approved by the Board of Directors, a copy of which is attached and will become a permanent part of these minutes.

The Community Reinvestment Act was approved by the Board of Directors as follows:

The following shall be adopted as the local community for Penn Square Bank, N.A. in reference to the Community Reinvestment Act of 1977.

Starting at Northeast 122nd Street and Santa Fe, extending South to Northeast 23rd Street and extending West to Meridian Street and extending North to Northwest 122nd Street and extending East to the place of beginning. (A map is attached and will become a permanent part of these minutes).

Penn Square Bank, N. A. is prepared to extend to our local community the following types of loans:

Interim financing for residential and commercial real estate loans;

Minutes of the
MEETING OF THE BOARD OF DIRECTORS
PENN SQUARE BANK, N.A.

May 19, 1981

The meeting was called to order by Mr. Bill P. Jennings, Chairman of the Board. The following Directors were present:

Bill P. Jennings
Frank L. Murphy
Eldon L. Beller
Ronald H. Burks
Elizabeth Merrick Coe
Gary M. Cook
Richard C. Haugland
C. F. Kimberling
Marvin K. Margo
*H. Mead Norton
Bill G. Patterson
Jerry Richardson
W. A. Ross
Gene H. Smelser
Bill Stubbs

The following Directors were not present:

*J. C. Cravens
James G. Randolph
Carl W. Swan

(*Advisory Director)

The minutes of the Directors Meeting of April 14, 1981, were examined and approved.

The Bank's Statement of Condition, including High and Low figures on Assets and Deposits, and Comparative Statement of Condition and Liquidity was approved.

The Income and Expense Reports for the month of April, 1981, including Donations, Dues and Subscriptions, were reviewed and approved.

First Penn Leasing Corporation Statement of Condition and Income and Expense Reports were reviewed and approved for the month of April, 1981.

Bond transactions for the month of April, 1981, were approved and a copy of these transactions is attached and will become a permanent part of these minutes.

The report of the Discount Committee was accepted as presented with Commercial Loans in excess of \$250,000.00, all previously approved by the Discount Committee on April 9th, 23rd, and 30th.

The report of the Discount Committee was accepted as presented with Installment Loans totaling \$2,157,049.90, representing 301 loans, all previously approved by the Discount Committee on April 9th, 23rd and 30th, 1981.

Commercial and Installment Loan Charge-offs were discussed and the following Installment Loans were approved for charge-off:

<u>LOAN NO.</u>	<u>NAME</u>	<u>AMOUNT</u>
82-0076	James R. Dickey	\$ 10,281.32
85-9005	Merle Owens	\$ 1,385.29
87-3679	Thompson Inter-America	\$ 2,239.10
86-3635	Thompson Inter-America	\$ 33,636.35
	TOTAL:	\$ 47,542.06

Overdrafts in the amount of \$6,137,685.23 as of April 30, 1981, were reported with the following overdrawn accounts approved for charge-off:

<u>Name</u>	<u>Amount</u>
David Duncan	\$ 2,622.80
I E C Petroleum	\$10,711.65
Total:	\$13,334.45

Cash Items in the amount of \$76.01 and Over and Short in the amount of \$719.85 (short) were reported. All of the foregoing figures were examined and approved.

The Safe Deposit Box report for the month of April, 1981, was examined and approved.

The Board of Directors was next advised of the following borrowings and renewals:

Bill P. Jennings reported the renewal of a note with Fidelity Bank, N.A., Oklahoma City, Oklahoma, in the amount of \$387,562.32, dated May 6, 1981, maturing November 6, 1981, secured by First Penn Corporation Stock; and

renewal of a note with Fidelity Bank, N.A., Oklahoma City, Oklahoma, in the amount of \$900,000.00, dated April 30, 1981, maturing October 31, 1981, secured by various stocks and oil and gas production; and

renewal of a note with Liberty National Bank & Trust Company, Oklahoma City, Oklahoma, in the amount of \$191,760.05, dated April 8, 1981, secured by 35% interest in Chi-Chi's Restaurant in Atlanta, Georgia, maturing April 8, 1982; and

a loan in the amount of \$100,000.00, with Community Bank & Trust Company, Enid, Oklahoma, dated May 1, 1981, maturing July 29, 1981, Unsecured, for the purpose of a capital contribution to Texas Oil Field Supply Company.

Tony Williams reported his borrowings from the Bank of Healdton, Healdton, Oklahoma, in the amount of \$10,000.00, dated April 24, 1981, maturing October 16, 1981, Unsecured, for the purpose of home improvement; and

the renewal of two (2) notes with the Bank of Healdton, Healdton, Oklahoma, dated April 24, 1981, in the amount of \$6,500.00 and \$12,500.00, secured by oil and gas interest maturing October 21, 1981; and

renewal of a note with Liberty National Bank & Trust Company in the amount of \$59,500.00, dated April 17, 1981, maturing July 17, 1981, secured by a second mortgage of real estate..

James W. Pitts reported borrowings from Central National Bank & Trust Company, Enid, Oklahoma, in the amount of \$10,000.00, dated May 4, 1981, maturing November 4, 1981, Unsecured, for the purpose of oil and gas drilling exploration; and

\$5,600.00 from the Central National Bank, Enid, Oklahoma, dated May 4, 1981, maturing November 4, 1981, Unsecured, for the purpose of oil and gas drilling exploration.

The Board of Directors next approved the Minutes of the Meeting of the Trust Investment Committee of Penn Square Bank, N.A., dated April 14, 1981. A copy of these minutes will become a permanent part of these records.

The Board of Directors next approved the following resignations:

Leon M. Huff, Jr.

Ann Douglass

The Board of Directors next approved the employment of the following officers:

Phill Foss, Vice President, Commercial Loans;

John Preston, General Counsel;

Rick Dunn, Executive Vice President, Credit and Collateral;

Ray Hicks, Vice President;

Tom Swineford, Vice President, Energy Department.

The Board of Directors next approved the promotion of Shary Mitchell from Administrative Officer to Banking Officer. Salaries submitted were approved.

The Board of Directors approved the increase in Don Chappel's individual lending limit from \$50,000.00 (secured) to \$100,000.00 (secured).

Motion was made and approved that the Board of Directors adopt the following resolution:

RESOLUTION

WHEREAS, certain provisions of the Financial Institutions Regulatory and Interest Rate Control Act, and regulations promulgated thereunder, require that certain actions be taken by the Board of Directors of this Association.

NOW, THEREFORE, BE IT RESOLVED, that for the purposes of Regulation O of the Board of Governors of the Federal Reserve System, and any other Federal Banking law or regulation to which this Association is subject, the Executive Officers of this Association shall only be the following persons who hold positions with this Association.

<u>NAME</u>	<u>TITLE</u>
Bill P. Jennings	Chairman of the Board
Frank L. Murphy	Vice Chairman of the Board
Eldon L. Beller	President and Chief Administrative Officer

The above individuals, in such capacities (and because they are also members of the Board of Directors of this Association), shall have the exclusive authority to participate in the major policy-making functions of this Association. The decisions of all other officers of this Association, notwithstanding their title, may be limited by policy standards fixed by the above-named Executive Officers. In addition, no officer of First Penn Corporation and no officer of any subsidiary thereof, unless such officer is also one of the above-named Executive Officers, shall participate in the major policy-making functions of this Association.

The Board of Directors was next advised of a Board Meeting of the Directors of First Penn Corporation and approval thereof for the issuance of 35,000 shares of stock of First Penn Corporation at \$135.00 per share. Of the \$4,725,000.00 to be received from this offering, \$4,000,000.00 is to be injected into capital of Penn Square Bank, N.A., and approximately \$460,000.00 to be used to purchase land owned by the bank just East of the present motor bank facility, and the remainder will be used for other operating expenses of First Penn Corporation.

A copy of the proposed capital injection and ending capital as of December 31, 1981, is attached and will become a permanent part of these minutes.

The Cash Dividend to the Bank from the Holding Company in the amount of \$350,000.00 was approved.

There being no further business to be discussed, the meeting was adjourned.

RESPECTIVELY SUBMITTED:

Frank L. Murphy
Frank L. Murphy, Vice Chairman

ATTEST:

Daniel W. Thompson
Daniel W. Thompson, Cashier

MINUTES OF THE REGULAR
MEETING OF THE BOARD OF DIRECTORS OF
PENN SQUARE BANK, N.A.

June 9, 1981

Minutes of the regular meeting of the Board of Directors of Penn Square Bank, N.A. held at 4:00 p.m. on Tuesday, June 9, 1981, in the Board Room.

Present were:

Eldon Beller	H. Mead Norton*
Ronald H. Burks	Bill Patterson
J.C. Cravens*	John Preston
Richard C. Haugland	Jerry Richardson
Bill P. Jennings	W.A. Ross
C.F. Kimberling	Gene H. Smelser
Marvin K. Margo	Bill Stubbs
Frank L. Murphy	Carl W. Swan

Absent were:

Elizabeth Merrick Coe
Gary M. Cook
James G. Randolph

*Advisory Directors

Also present was Richard T. Dunn, Executive Vice President.

Bill P. Jennings, Chairman of the Board, called the meeting to order. He moved the election of John Preston as a Director and as Secretary to the Board, which motion was seconded and unanimously approved. The Chairman commented that future Board meetings would be more streamlined and that more condensed material provided to the Directors. He noted that any Director desiring more detailed information on any matter should request same.

The Secretary gave a synopsis of the minutes of the May 19, 1981 Board meeting, noting that copies of the actual minutes were in each Director's book. Upon motion made and seconded, the minutes of the May 19, 1981 Board meeting were unanimously approved.

The Chairman reviewed the Bank's Statement of Condition, Statement of Income and Expense and liquidity analysis report for the month of May 1981, which review included an analysis of changes from April 1981, and upon motion duly made and seconded, the reports were unanimously approved.

The Chairman gave a securities report for transactions occurring during May 1981, and upon motion duly made and seconded, the report was unanimously approved.

Frank L. Murphy, the Vice Chairman, reviewed the Discount Committee reports and overdraft report for the month of May 1981, which reports upon motion duly made and seconded, were unanimously approved.

Mr. Patterson reviewed new loans which had been made during May 1981, and such report, upon motion duly made and seconded, was unanimously approved.

The Chairman called on Mr. Patterson to report on drilling rig loans. Mr. Patterson reported on the ten best and two worst drilling rig loans in excess of \$250,000 and gave an overview on oil and gas and drilling activities in Oklahoma and nationwide.

The Secretary advised that several administrative matters needed to be considered. Each matter was reviewed and upon motion duly made and seconded, resolutions (attached as Exhibits hereto) were unanimously adopted in each instance covering the following matters:

- * Resolution designating Trust Department employees as representatives of the Trust Department to have access to Trust Department securities in the safe deposit vault (Exhibit A).
- * Resolution approving lending authorities for Rick Dunn, Phil Foss, and Tom Swineford (Exhibit B).
- * Resolution declaring cash dividend of \$3.50 per share (Exhibit C).
- * Resolution electing J.C. Cravens and H. Mead Norton as Advisory Directors (Exhibit D).

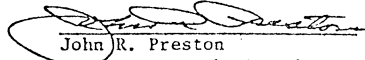
In addition, upon motion duly made and seconded, minutes of the Trust Investment Committee meeting of May 19, 1981, after being read, were unanimously approved. The minutes are attached as Exhibit E. Mr. Eeller's memo of May 28, 1981 (Exhibit F) reporting on his borrowings was reviewed with the Board.

The Chairman next called on Mr. Dunn to give a presentation concerning Loan Administration. Mr. Dunn reviewed with the Board the functions of a loan administration area and the goals he intends to achieve with the Loan Administration Division.

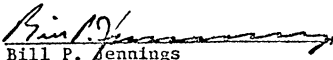
The Chairman advised that (1) the First Penn private stock offering was in process, with the goal of raising sufficient capital so that the Bank could obtain \$4,000,000 of new capital; (2) that the structuring of the partnerships to allow the new Bank building to be built was proceeding; and (3) that representatives of the Comptroller's examining staff are scheduled to attend the July Board meeting to review the recently received official examination report. He noted that due to the examining staff's attendance, the July Board meeting would begin at 3:00 p.m. instead of at 4:00 p.m. The Chairman read the first few paragraphs of the examination report to the Board.

Mr. Beller reviewed with the Board the newly formed Examination Corrections Committee. He advised that the Committee has been created to deal with correcting Comptroller examination criticisms and to set up policies and procedures to allow the Bank to comply with the Administrative Agreement.

There being no further business, upon motion duly made, seconded, and unanimously adopted, the meeting was adjourned.


John R. Preston
Secretary to the Board

APPROVED:


Bill P. Jennings
Chairman of the Board

MINUTES OF A SPECIAL
MEETING OF THE BOARD OF DIRECTORS OF
PENN SQUARE BANK, N.A.

July 29, 1981

Minutes of a Special Meeting of the Board of Directors of Penn Square Bank, N.A. was held at 3:30 p.m., in the offices of the Comptroller of the Currency, in Dallas, Texas, on Wednesday, July 29, 1981.

Present were:

Eldon Beller	Bill Patterson
Ronald H. Burks	John Preston
Elizabeth Merrick Coe	James Randolph
J.C. Cravens*	Jerry Richardson
Richard C. Haugland	W.A. Ross
Bill P. Jennings	Gene H. Smelser
C.F. Kimberling	Bill Stubbs
Marvin K. Margo	Carl W. Swan
Frank L. Murphy	

Absent were:

Gary Cook
H. Mead Norton*

*Advisory Directors

Also present were Richard T. Dunn, Executive Vice President, and Marion Bauman, Esquire, the Association's outside counsel.

Present from the Comptroller's office were:

George E. Clifton, Jr.
William C. Greenhaw
Jerry L. Lanier
Dixon L. Mitchell
Preston Morrow
Patrick Parise
Clifton A. Poole, Jr.

Mr. Poole, Regional Administrator of the Office of the Comptroller of the Currency, opened the meeting. He introduced the representatives of the Office of the Comptroller of the Currency. He advised that the condition of the Association, compliance with the Letter Agreement, and changes since the last examination are a major concern of his office. He characterized the meeting as one of information gathering.

Mr. Poole introduced George Clifton, Jr., the examiner in charge during the last examination of the Association, who would review the examination. Mr. Clifton outlined his concerns as follows: of ten primary articles of the Letter Agreement, nine have not been complied with; the Association appears to be only concerned with capital adequacy; the most serious concern should be in funds management; there has been a serious interest rate sensitivity gap, with the Association's ratio being high in relation to average; and mismatching of maturities is great.

Mr. Clifton, Jr. then began reviewing the examination. He noted that the Association had 121 violations of law, 46 related directly to Directors or Executive Officers, many due to non-compliance with the Financial Institutions Regulatory Act. He stated that the three violations of legal lending limit are very serious, as such violations create a personal liability on each Director in the event of a loss related thereto. He stated that either management does not have the ability to control the Association or the system management uses does not work.

With regard to management and supervision of the Association, Mr. Clifton, Jr. advised that the Board does not provide the direction to management which it should, and that the Association lacked written policies and procedures which would set the parameters within which management is to work. He further noted that management's forecasting has been inaccurate and that no budgeting exists, recommending that internal control provided by a written budget is needed. He said that the Association does not lack quality in its people, only quantity thereof, which caused there not to be enough time for development of procedures and for planning.

He next advised that there had been a significant deterioration in the quality of the assets of the Association. He reviewed the statistics from previous examinations: 1978-28% of assets classified as to capital; 1979-28% classified; February 1980-42% classified; December 1980-77% classified. He emphasized the seriousness of such increases in light of the growth of capital during the period. With regard to ODEM assets, the percentages during the same periods were:

6%, 15%, 37%, and 66%. Credit and collateral exceptions were: 1979-2%; February 1980-6%; December 1980-22%. He questioned whether the Association knows enough about its new customers to allow document and credit exceptions, and opined that it does not. He questioned the quality of the internal loan and review system, noting that the Association's list of problem credits was \$4,000,000, while the examination listed \$32,000,000 with \$17,000,000 classified substandard or worse.

He raised concerns about the wire transfer function and the necessity of controls in this area. He noted that at the time of examination, the Association only had one written policy - the loan policy, and that in his opinion, it needed improvement.

He reviewed the funds management area, using an overhead projection to show the material on sheets which he distributed, which sheets are attached as Exhibit A. He discussed liquidity, noting that net liquid assets during the second quarter ranged between \$40,000,000 to \$60,000,000, averaging roughly \$50,000,000. He further noted, with concern, that while the Association grew \$25,000,000 in assets during the period, the trend of net liquid assets slightly dropped and that for four days during the period, borrowings exceed net liquid assets, resulting in the Association having no liquidity on those days.

He reviewed the growth of contingent liabilities, as follows: June 1979-\$3MM; February 1980-\$6MM; December 1980-\$86MM; representing unfunded loan commitments and letters of credit outstanding (\$30MM). He stated that there were no firm commitments in place to take out the contingent liabilities. He recommended that the Association needs to have appropriate sources of funds to meet commitments and the demands of depositors, advising that possible sources are fed funds, large CD's, and participations. To raise such funds, he noted that the Association needs to convince those sources that the Association has an appropriate plan so as not to impair the profitability or the viability of the Association.

He then reviewed net interest margin, that is the return on earning assets. He stated that, in general, interest rate movements should not impact net interest margin, and that anything less than a 1% net interest margin would not allow the Association to be profitable. He showed how net interest margin of the Association "tracked" the rise and fall in the prime rate, recommending that it not do so, except within a narrow band of between 2% to 3%, which is average in the peer group.

Mr. Jennings, Chairman of the Board, commented that the average was on target and that the lag effect (45 days) was not great.

Mr. Poole then made the following comments. He noted that his office considers the degree of non-compliance with the Administrative Agreement a very serious offense and that such non-compliance must be corrected, that asset quality needs improvement, and that there is a need for liquidity and funds management. He said that these three problems indicate to his office a lack of control by management and that his office is not satisfied.

He further commented that the Association is headed in the wrong direction with the Office of the Comptroller of the Currency. He noted that there are various forms of administrative action which his office can take and that his office had decided by only a very narrow margin not to issue a cease and desist order, which would have done terrible damage to the Association if "word" thereof had gotten around. He said that he thought about the need to amend the Letter Agreement, but that after review thereof he could find nothing in it which needs to be added. He said the problem is that the Association is not following the Agreement.

He discussed funds management, saying that he does not know what to put in the policy, that he does not want to manage the Association, and that it is up to the Directors to take care of the matter. He recommended that the Association nail down sources of secondary liquidity; do a better job of documentation; and do a better job of operating in a tightly confined manner, more so than most if need be. He stated that the Association is an anomaly and highly unusual, not fitting the norms presented by other associations.

Mr. Poole stated: "We find in our opinion - you don't have to accept it, but you ought to - that Penn Square Bank is flirting with disaster." He commented that the new people recently hired has been taken as a positive sign that the Association will be handled in a more orthodox manner. He advised that an examination will be conducted in the next two or three months, and that if no significant improvement is shown, his office will use stronger enforcement actions. He recommended the adoption of contingency plans, diversification of the loan portfolio, and the need for internal controls.

Mr. Preston Morrow discussed the need of the Association to relieve the problems of finding CD's, fed funds, and loan participants. He said he considers unfunded commitments the biggest problems the Association faces, particularly if

secondary liquidity sources are not available. He noted that while the Association's assets grew 40% during the first quarter, liquid funds slightly shrank. He said that liquid funds should be growing, particularly with the high ratio of demand deposits to total deposits. He noted that the Association borrows in increasing amounts to meet the need for liquid funds. He stated that insolvency of associations are caused by either erosion of capital or an inability to pay a cash letter, and that the later was the bigger cause.

Mr. Poole commented that the Washington office of the Comptroller of the Currency had reviewed the Association's funds management and found same unacceptable on a national standard. He noted that he had gone to bat with the Washington office to keep from having a cease and desist order issued.

Mr. Dixon Mitchell agreed with Mr. Poole's comments. He further commented that although there may appear to be \$60MM in liquid funds, he submitted that if called upon such funds may not really be available.

Mr. Poole stated that the Board is being given an opportunity to do something about the problem. He said that his office did not do a good job at the December 1980 examination of explaining its concerns with respect to liquidity and funds management.

The Chairman said that the Association is not lulled on liquidity and considers the matter extremely disturbing. He said he appreciated the opportunity to talk with the Comptroller's office, and expressed the sense of responsibility and dedication in making the Association a good bank which was shown by attendance at the meeting of 17 of the 19 Directors. He said that the Association had failing marks and that same were embarrassing, but not willful. He noted that his duty as chief executive officer is to staff the organization properly, and while that had not been promptly accomplished, new additions recently hired had made great progress. He commented that good people are hard to find and that he wanted to fill openings with qualified persons, not just bodies. He indicated that he wants the Association to be something to be proud of and that the Association wants to meet the needs of its community. He asked Mr. Beller, the President, to discuss the new officers in more detail, and to make any other comments.

The President noted that the examination was thorough, tough, and accurate, and that he had no disagreement with it

or with the Letter Agreement, which he noted was proper. He then reviewed the personal and banking backgrounds of the following key personnel he had hired in the last 90 days, noting their responsibilities:

John Preston	-	Legal matters, law violations, documentation corrections
Rick Dunn	-	Loan administration
John Baldwin	-	Loan review
Jim Gunter	-	Chief financial officer, ALCO chairman
Ray Hicks	-	Accounting
Harold Armstrong	-	Real estate, loan diversification
Bob Van Laanen	-	Commercial loans
Phil Foss	-	Commercial loans
Tom Swinford	-	Commercial loans

He commented that it is people who correct problems and that he is relying on the Association's people to correct the current problems. He said that the Letter Agreement will be complied with.

Mr. Jennings added that he appreciates the attitude of Mr. Poole's office in allowing corrections of criticized matters prior to stronger enforcement action being taken.

Mr. Poole again addressed the matters of liquidity and funds management. He noted that there has never been a bank like Penn Square, but nonetheless the wide spread in its net interest margins do not make sense. He said he does not intend to impose a philosophy of funds management. He stated that the Association needs more liquidity. He asked that the Association address the following issues: what might happen on a worse case basis and what preparation is needed in such eventuality. He requested management to determine the answers to the above, inform the Board as to what the risks are, and have the Board make an informed judgment with respect to the risks. He stated that he is encouraged by the quality of the personnel recently hired. He appreciated the fact that management had not discussed details at the meeting. He believed that management's attitude is good, but that action is needed. He said he will adopt a wait and see attitude.

The Chairman commented that it would not hurt the Association to get the loans down a little. Mr. Poole stated that high loans are the seat of the Association's liquidity problems.

Mr. Smelser asked Mr. Poole what steps a Director should take if he disagrees with management's actions. Mr. Poole answered by first noting that a Director's job is to make certain the Association has a good management team and to be properly informed on matters; thereafter the Director can make his disagreement known, attempt to have management change its position, and ultimately to resign.

Mr. Swan asked management what steps had been taken to reduce the \$32MM in criticized assets. Mr. Patterson responded that \$5MM classified substandard or doubtful had been cleared up, that \$5MM OAEM had been cleared up, and that \$500,000 of total charge-offs of \$900,000 had been collected.

Mr. Swan asked about the contingent liabilities. Mr. Clifton, Jr. responded that although oral commitments to fund might be in place from participants, there were no written commitments. Mr. Patterson stated that the contingent liabilities are now only \$20MM.

The President noted that reports are now being forwarded weekly and that other information has been sent, which Mr. Poole acknowledged. The President noted that his desire is to get out from under the Letter Agreement and will use the examination as a blueprint to correct criticized matters.

Mr. Patterson noted that the oil and gas division had recently hired three new officers, with a total of 35 years of experience.

Mr. Haugland asked whether net interest fluctuations of other associations had been outside the 2% to 3% band during 1980. Mr. Clifton, Jr. responded that other associations had had that fluctuation, but that associations which were better matched had less fluctuation and did not lose two-thirds of the margin as Penn Square did.

Mr. Richardson noted that for the year the average worked out. Mr. Poole agreed that it did, but that it had taken two quarters for Penn Square to earn back what it had lost in one quarter.

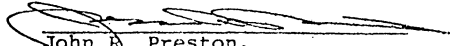
Mr. Stubbs asked the Chairman whether the problem was caused by CD maturities. The Chairman agreed. Mr. Clifton, Jr. said that the weighted average maturity of CD's at December 1980 was 77 days.

Mr. Poole stated that the Association could live with alternating periods of high and low earnings, but that such action could hurt long range planning for the holding company. He recommended that the Association eliminate the impact of external factors and that same can be done without significantly changing the Association's philosophy.


The Chairman noted that last week borrowings had only been 4% to 5% of assets.

Mr. Poole thanked the Board for its attendance. He requested the Secretary send a copy of the minutes to his office.

There being no further business the meeting was adjourned.


John A. Preston,
Secretary to the Board

APPROVED:


Bill P. Jennings,
Chairman of the Board

MINUTES OF THE REGULAR
MEETING OF THE BOARD OF DIRECTORS OF
PENN SQUARE BANK, N.A.

August 11, 1981

Minutes of the regular meeting of the Board of Directors of Penn Square Bank, N.A. held at 4:00 p.m. on Tuesday, August 11, 1981, in the Board Room.

Present were:

Eldon L. Beller	Frank L. Murphy
Ronald H. Burks	H. Mead Norton *
Elizabeth Merrick Coe	Bill G. Patterson
Gary M. Cook	John R. Preston
Richard C. Haugland	James G. Randolph
Bill P. Jennings	Gene H. Smelser
C. F. Kimberling	Bill Stubbs
Marvin K. Margo	

Absent were:

J. C. Cravens *
Jerry Richardson
W. A. Ross
Carl W. Swan

* Advisory Directors

Also present was Richard T. Dunn, Executive Vice President.

Bill P. Jennings, Chairman of the Board, called the meeting to order. He commented that the Board table would soon be enlarged and that his office and the Board Room would be switched.

The Secretary gave a synopsis of the minutes of the July 14, 1981 Board meeting, a copy of such minutes being in each Director's book. Upon motion duly made and seconded, the minutes were unanimously approved.

The Chairman reviewed this Association's Statement of Condition (at July 31, 1981), high and low deposits and assets report, liquidity analysis, comparative Statement of Condition, and comparative Statement of Income. Upon motion duly made and seconded, said reports were unanimously approved. He discussed the sale of up to \$50,000,000 in small (under

\$250,000) loans and liquidity needs in light of the recent meeting with the Comptroller's Office in Dallas.

The Chairman gave a securities report for transactions occurring during July 1981, which report, upon motion duly made and seconded, was unanimously approved. A discussion was held concerning capital adequacy and the charge-off, and interest non-accrual, of loans in the portfolio.

Bill G. Patterson, reviewed past due loans, concerning which there was a lengthy discussion. A number of Directors expressed concern over the volume of past due loans. It was agreed that a cover sheet would be included in the future which would give a synopsis of past due loans by category, similar to a receivables aging report, and a historical trend on past dues. A discussion was held on the adequacy of the loan loss reserve. It was agreed that Mr. Dunn would give a report at the next Board meeting on loans made by Tom Orr. Inquiry was made of John Preston, General Counsel, as to what actions on past dues could be taken and he outlined several administrative and legal alternatives. The Chairman offered to meet with the Board bi-monthly or weekly if necessary to review past dues until the Board felt comfortable thereon. In the alternative, the Board agreed that a detailed report at the September Board meeting would suffice. After inquiry, Mr. Patterson assured the Board that overdrafts are closely watched to make certain the Association's lending limit is not exceeded. The Chairman asked that the minutes reflect the concerns of Messrs. Cook, Haugland, and Randolph as to the amount of past due loans.

Mr. Patterson next reviewed new loans which had been made during July 1981, which report, upon motion duly made and seconded, was unanimously approved. He next reviewed overdrafts, discussing the ones which had been cleared. Frank L. Murphy, Vice Chairman, requested the charge-off of an installment loan. Upon motion duly made and seconded, the Board unanimously approved a Resolution charging-off a loan to George Delaney (see Exhibit A attached).

The Secretary advised that several administrative matters needed to be considered. Each matter was reviewed and upon motion duly made and seconded, Resolutions (attached as Exhibits hereto) were unanimously adopted in each instance concerning the following matters:

- * Appointment of new officers and promotion of current officers (Exhibit B).
- * Approval of minutes of the Trust Investment Committee of July 14, 1981 (Exhibit C).
- * Change in date and time of September Board meeting. (Exhibit D).

The Secretary read borrowing reports submitted by Executive Officers (Exhibits E through G attached).

The Secretary gave a litigation report, updating the status of cases reported on in the July 14, 1981 Board meeting.

Eldon L. Beller, President, next reviewed the minutes of the Board meeting held in Dallas with the Comptroller's office. He made a copy available for any Director desiring to review same. After discussion, upon motion duly made and seconded, a Resolution (see Exhibit H attached) was unanimously adopted approving the minutes and directing the Secretary to forward a copy to the Dallas Regional Administrator of the Comptroller's office. Mr. Cook abstained from voting on approval of the minutes due to his not having attended the Dallas meeting.

The President next reviewed each of the following management committees which had been formed, or re-formed, recently. As to each of the following Committees, he listed the Chairman, Vice Chairman, Secretary, and voting members; gave the frequency of its meetings; and reviewed its functions:

Credit Policy Committee
 Loan Review Committee
 Asset and Liability Committee
 Examination Corrections Committee
 Executive Management Committee

He advised that the accomplishments of the various committees would be reviewed at future Board meetings. He called on Mr. Dunn to review accomplishments of the Examination Corrections Committee, which review Mr. Dunn gave.

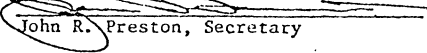
The President next asked that officer lending authorities as proposed (see Exhibit I attached) be approved. Upon motion duly made and seconded, the officer lending authorities as proposed were unanimously approved.

The President called on Mr. Dunn to distribute the revised Loan Policy. Due to the need to adjourn the meeting soon, he asked for tentative Board approval of the Loan Policy so that it could be sent to the Comptroller's Dallas office. He advised that the Loan Policy would be reviewed in detail at the September Board meeting and a reaffirmation sought at that time. Upon motion duly made and seconded, a Resolution (see Exhibit J attached) was unanimously adopted approving the Loan Policy.

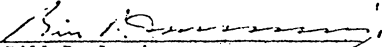
The Chairman gave a status report on the new building. He next recommended the election of Ken Kenworthy, Treasurer of CMI Corp., as a Director of this Association. He reviewed Mr. Kenworthy's background and the President noted that Mr. Kenworthy's knowledge of financial matters would be of special benefit to the Board and to the Asset and Liability Committee. Upon motion duly made and seconded, Ken Kenworthy

was unanimously elected a Director of this Association to serve until the next annual meeting of shareholders of this Association or until his successor is duly elected and qualified.

There being no further business, upon motion duly made, seconded and unanimously adopted, the meeting was adjourned.


John R. Preston, Secretary

Approved:


Bill P. Jennings,
Chairman of the Board

MINUTES OF THE REGULAR MEETING

OF THE BOARD OF DIRECTORS OF

PENN SQUARE BANK, N.A.

SEPTEMBER 15, 1981

Minutes of the regular meeting of the Board of Directors of Penn Square Bank, N.A. held at 3:00 p.m. on Tuesday, September 15, 1981, in the Board Room.

Present were:

Ronald H. Burks	Frank L. Murphy
Elizabeth Merrick Coe	H. Mead Norton*
Gary M. Cook	Bill G. Patterson
J. C. Cravens*	John R. Preston
Richard C. Haugland	James G. Randolph
Bill P. Jennings	W. A. Ross
Ken L. Kenworthy	Gene H. Smelser
C. F. Kimberling	Bill Stubbs
Marvin K. Margo	Carl W. Swan

Absent were:

Eldon L. Beller	Jerry Richardson
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*Advisory Directors

Bill P. Jennings, Chairman of the Board, called the meeting to order. He advised the Board that Eldon Beller was in the hospital, but that he was expected back to work in a week. He introduced and welcomed Ken L. Kenworthy as a Director. He recommended to the Board, on his behalf and that of Eldon, the election as a Director of Richard T. Dunn, noting that the sole shareholder of the Association had earlier set the number of Directors at 18 and had authorized the Board to elect two additional Directors pursuant to the Association's bylaws. After discussion, upon motion duly made and seconded, the following resolution was unanimously adopted:

RESOLVED, that Richard T. Dunn be and hereby is elected as a Director of this Association, to serve as soon as he shall qualify and until the next annual shareholder's meeting or until his successor shall be elected and qualified.

The Chairman invited Mr. Dunn to join the meeting, advising him of his election as a Director. The Secretary administered the oath to Mr. Dunn and he then took his seat as a Director.

The Secretary gave a synopsis of the minutes of the August 11, 1981 Board meeting, a copy of such minutes being in each Director's book. Upon motion duly made and seconded, the minutes were unanimously approved.

The Chairman reviewed the Association's financial statements for the month of August and the eight months year-to-date, along with consolidated

statements of the Association and First Penn Corporation, all of which were in each Director's book. He noted the charge in August to earnings for five months of fees paid to Northern Trust Company and the reversal in August of eight months of accrued interest, representing principally the non-accrual of the B. R. Rushing and Billy Underwood, Jr. loans. After discussion, upon duly made and seconded, the financial reports were unanimously approved.

The Chairman next reviewed the Association's securities reports, copies of which were in each Director's book. He noted the purchase of \$40,000 in Cowboy Hall of Fame bonds, advising that this was a part of a multi-bank purchase of bonds, the proceeds of which will be used by the Cowboy Hall of Fame to purchase property adjacent to its current land. He stated that repayment of the bonds is anticipated from a fund raising to be conducted by the Cowboy Hall of Fame. Upon motion duly made and seconded, the securities report was unanimously approved.

Bill Patterson reviewed overdrafts, noting that the report was as of Friday, September 11 and that previous reports were as of the end of the prior month. He reviewed the overdrafts, noting the ones which had been cleared through Monday, September 14. Copy of the overdraft report was in each Director's book. Mr. Burks requested that in the future the report show the date that the overdraft first occurred. Mr. Haughland noted that overdrafts need to be closely reviewed and monitored. After discussion, upon motion duly made and seconded, the overdraft report was unanimously approved.

Mr. Patterson next reviewed past due loans, a copy of which report was in each Director's book. The Directors commented that the new format was better than the old format. Mr. Jennings noted that the July 31, 1981 past due amount was \$35,000,000 higher than normal due to the GHK and Amarex credits both being temporarily (and technically) past due while being re-arranged.

Mr. Patterson advised that most of the past due loans would be reviewed in greater detail by Rick Dunn, who would give a report later in the meeting on loans made by Tom Orr.

Bill Patterson next recommended the charge-off of \$604,000 as to four credits. After discussion, upon motion duly made and seconded, the following resolution was unanimously adopted:

RESOLVED, that the following amounts as to the credits listed be and are hereby charged-off on the books of this Association:

Allerton Resources	\$400,000
Tony Braxton	\$125,000
Action Lift	\$ 74,000
William Brown	\$ 5,000

Rick Dunn reviewed the portfolio of loans made by Tom Orr, a copy of the report on same being in each Director's book. After lengthy review and discussion of each workout credit, Mr. Dunn expressed his opinion that approximately \$1,800,000 of the credits should be considered doubtful. He also recommended the charge-off of \$131,900 as to two credits. Upon motion duly made and seconded, the following resolution was unanimously adopted:

RESOLVED, that the following amounts as to the credits listed be and are hereby charged-off on the books of this Association:

North American Enterprises	\$86,000
Dick Jones	\$45,900

Mr. Dunn noted that a majority of the Directors had previously approved the extension of additional credit to B. R. Rushing, a criticized credit, on a fully secured basis for the purpose of preserving property which Mr. Rushing had agreed to pledge as additional collateral in a rearrangement of his loans. Several Directors commented favorably on the efforts put into the report and the informative way the material was presented.

Rick Dunn next reviewed the Association's loan loss reserve as to adequacy, referring to material in each Director's book which included a copy of Mr. Dunn's proposed letter of September 16, 1981, to Mr. Clifton A. Poole, Jr., Regional Administrator (Dallas) of the Office of the Comptroller of the Currency dealing with adequacy of the loan loss reserve. After discussion, upon motion duly made and seconded, the Board unanimously approved Mr. Dunn's letter.

Mr. Dunn next gave a brief update on the progress of the Examination Corrections Committee in correcting the matters criticized in the last examination and in complying with the provisions of the Letter Agreement.

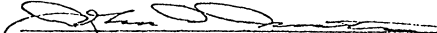
Bill Patterson next reviewed loans made during August 1981 which had previously been approved by the Discount Committee, a copy of the report being in each Director's book. After discussion, upon motion duly made and seconded, the report was unanimously approved.

The Secretary reviewed a letter of August 27, 1981, which had been sent to the Association's bonding company, concerning a possible violation of law by a former officer, which letter was read in its entirety to the Board. The Chairman cautioned the Board on the necessity of extreme confidentiality with respect to the letter, noting that the F.B.I. is conducting an investigation. The Secretary next reviewed borrowing reports of the Executive Officers (Exhibits A and B). He noted that the Executive Management Committee had recommended, as an extra precautionary measure, that any officer who is a Director, although not designated as an Executive Officer, file similar borrowing reports with the Board. Due to such recommendation, he reviewed borrowing reports filed by Bill Patterson (Exhibits C through G), and himself (Exhibits H through S), noting that Rick Dunn would file such reports, and same would be reviewed, at the next Board meeting. The Directors confirmed their desire that only Bill Jennings, Frank Murphy, and Eldon Beller have policy making authority and, therefore, be designated the Executive Officers of the Association, but concurred in the precautionary aspect of the borrowing report filings of the other officers who are also Directors.

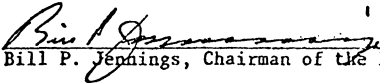
The Secretary next summarized the minutes of the Trust Investment Committee of August 11, 1981, which upon motion duly made and seconded were unanimously approved. He then reviewed the recommended appointment of new officers and the promotion of current officers. Upon motion duly made and seconded, the Board unanimously adopted a resolution (Exhibit T) making such appointments and promotions.

The Chairman briefly reported on the new building, advising that construction is expected to begin in October.

There being no further business, upon motion duly made, seconded and unanimously approved, the meeting was adjourned.


John R. Preston, Secretary

APPROVED:


Bill P. Jennings, Chairman of the Board

MINUTES OF THE REGULAR MEETING

OF THE BOARD OF DIRECTORS OF

PENN SQUARE BANK, N.A.

October 13, 1981

Minutes of the regular meeting of the Board of Directors of Penn Square Bank, N.A. held at 4:00 P.M. on Tuesday, October 13, 1981, in the Board Room.

Present were:

Eldon L. Beller	Ken L. Kenworthy	John R. Preston
Ronald H. Burks	C. F. Kimberling	James G. Randolph
Elizabeth Merrick Coe	Marvin K. Margo	Jerry Richardson
Richard T. Dunn	Frank L. Murphy	W. A. Ross
Richard C. Haugland	H. Mead Norton*	Gene H. Smelser
Bill P. Jennings	Bill G. Patterson	Bill Stubbs

Absent were:

Gary M. Cook	J. C. Cravens*	Carl W. Swan
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*Advisory Directors

Also present was James J. Gunter, Executive Vice President and Chief Financial Officer.

Bill P. Jennings, Chairman of the Board, called the meeting to order.

The Secretary gave a synopsis of the minutes of the September 15, 1981 Board meeting, a copy of such minutes being in each Director's book. Upon motion duly made and seconded, the minutes were unanimously approved.

The Chairman reviewed the Association's financial statements for the month of September and the year-to-date, all of which were in each Director's book. He highlighted significant items for the month, including the reversal of previously accrued interest and the increase in the provision for losses. After discussion, upon motion duly made and seconded, the financial reports were unanimously approved. He reviewed the Deposit and Asset Report and the Liquidity Analysis.

The Chairman next reviewed the Association's securities reports, copies of which were in each Director's book. He also reviewed the quarterly report on bond portfolio maturity distribution and on bond quality. After discussion, upon motion duly made and seconded, the securities report was unanimously approved.

Bill Patterson reviewed overdrafts of October 9, 1981, a copy of which was in each Director's book. The overdrafts were discussed. Mr. Ross

commented that the Association's customers have to be educated as to not incurring overdrafts. Bill Patterson advised that of the first 26 on the report, all but Fraley Oil, Sable Oil, Adams Weaver and MCS Exploration had been cleared through today. He also noted that Insta-Pipe had been cleared. Mr. Haugland stated that criticized assets, such as Insta-Pipe, should not be overdrawn in the future without prior written approval of a majority of the Board, in compliance with the Letter Agreement. Bill Patterson concurred. The Chairman noted that in no case are overdrafts allowed if a legal lending limit violation would result.

Bill Patterson next reviewed past due loans, a copy of which report was in each Director's book. He discussed specific credits that are currently being resolved.

Rick Dunn reviewed several charge-offs totaling \$314,900. After discussion, upon motion duly made and seconded, resolutions (Exhibit A) were unanimously adopted as to the charge-offs.

Rick Dunn next gave an update on the progress made in working out of loans made by Tom Orr. He also reported on progress of the Examination Corrections Committee.

Bill Patterson reviewed loans made during September 1981 which had been previously approved by the Discount Committee, a copy of the report being in each Director's book. After discussion, upon motion duly made and seconded, the report was unanimously approved.

The Secretary advised the Directors of a Bank Administration Institute seminar for bank directors to be held on Friday, November 6, 1981. He advised that details are available from his office. The Chairman added that the Association would pay the \$125 fee for any Director desiring to attend.

The Secretary next reviewed Executive Officer and Director-Officer borrowing reports (Exhibits B through N.)

Upon motion duly made and seconded, the minutes of the Trust Investment Committee of 10-13-81 (a copy of which was in each Director's book) were unanimously approved.

The Secretary reviewed new officer appointments, a promotion, and a resignation. Upon motion duly made and seconded, the Board unanimously adopted a resolution (Exhibit O) making such appointments and the promotion, and accepting the resignation.

Upon motion duly made, seconded, and unanimously adopted, resolutions (Exhibits P and Q) were adopted establishing Guidance Lines of Credit as follows:

John Rooney - legal lending limit
Rick Dunn - \$200,000

with Rick Dunn abstaining from voting on his own Guidance Line of Credit.

The Chairman called on Jim Gunter, who reviewed the revised ALCO Policy with the Board. After discussion, upon motion duly made and

seconded, the revised ALCO Policy (Exhibit R) was unanimously adopted.

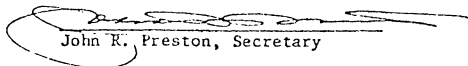
The Chairman gave a brief report on the progress of Pennbank Tower. Ron Burks advised that there is in negotiation an offer from a substantial life insurance company for purchase of the building.

The Chairman recommended the granting of an option to Penn Square Inc. for the right of first refusal to buy or lease the approximately 5.4 acres of land adjacent to the motor bank. Upon motion duly made and seconded, a resolution (Exhibit S) was unanimously adopted authorizing the execution of such an option.

The Chairman reported that the Association had obtained the accounts of Carl Anderson and his related companies, noting that such accounts represent a sizeable amount.

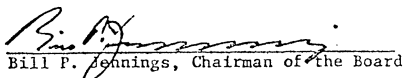
Eldon Beller advised the Board that he had previously removed all officers' lending authorities above \$50,000, with such credits subject to the approval only of the Credit Policy Committee, himself, or the Chairman.

There being no further business, upon motion duly made, seconded, and unanimously approved, the meeting was adjourned.



John R. Preston, Secretary

APPROVED:



Bill P. Jennings, Chairman of the Board

MINUTES OF THE REGULAR MEETING
OF THE BOARD OF DIRECTORS OF
PENN SQUARE BANK, N.A.

November 10, 1981

Minutes of the regular meeting of the Board of Directors of Penn Square Bank, N.A. held at 4:00 p.m. on Tuesday, November 10, 1981, in the Board Room.

Present were:

Eldon L. Beller	Bill P. Jennings	Bill G. Patterson
Elizabeth Merrick Coe	Ken L. Kenworthy	John R. Preston
Gary M. Cook	C. F. Kimberling	W. A. Ross
J. C. Cravens*	Marvin K. Margo	Gene H. Smelser
Richard T. Dunn	Frank L. Murphy	Bill Stubbs
Richard C. Haugland	H. Mead Norton*	

Absent were:

Ronald H. Burks	Jerry Richardson	Carl W. Swan
James G. Randolph		

* Advisory Directors

Bill P. Jennings, Chairman of the Board, called the meeting to order.

The Secretary gave a synopsis of the minutes of the October 13, 1981 Board meeting, a copy of such minutes being in each Director's book. Upon motion duly made and seconded, the minutes were unanimously approved.

The Chairman reviewed the Association's financial statements for the month of October and the year-to-date, all of which were in each Director's book. He highlighted significant items for the month, including the charge-off of approximately \$2.7MM in loans, with an equal charge to earnings to restore the loan loss provision. He noted that the holding company is anticipating a private stock offering of approximately \$3MM, at \$135 per share, most of the proceeds to go into capital of this Association. After discussion, upon motion duly made and seconded, the financial reports were unanimously approved. He also reviewed the Deposit and Asset Report and the Liquidity Analysis.

The Chairman next reviewed the Association's securities report, copies of which were in each Director's book. Upon motion duly made and seconded, the securities report was unanimously approved.

The Chairman reviewed the new format for overdrafts, advising that overdrafts of 15 days or more should be the consideration of the Board. A copy of the overdraft report was in each Director's book. Bill Patterson reviewed overdrafts cleared since the date of the report (November 7, 1981). Gary Cook suggested that the report should only include substantial

overdrafts in a continuous overdraft state for a substantial number of days. The Chairman advised that the report will be further refined in the future.

Bill Patterson reviewed past due loans, a copy of which report was in each Director's book. He noted the credits that had been cleared since the date of the report (October 31, 1981), advising that the examiner's require the past dues to be reported as of the end of the previous month.

Rick Dunn reviewed charge-offs totaling \$2,668,635.35, each charge-off being separately discussed. Upon motion duly made and seconded, a Resolution (Exhibit A) approving the charge-offs was unanimously adopted. He briefly noted that most of the loans made by Tom Orr were now either charged-off or sufficiently restructured.

Bill Patterson reviewed loans made during October 1981, which had been previously approved by the Discount Committee, a copy of the report being in each Director's book. After discussion, upon motion duly made and seconded, the report was unanimously approved.

The Secretary next reviewed Executive Officer and Director-officer borrowing reports (Exhibits B through I).

The Secretary reviewed management-recommended promotions and a new officer appointment. Upon motion duly made and seconded, a Resolution (Exhibit J) making such promotions and the appointment was unanimously adopted.

The Secretary reviewed Comptroller-recommended resolutions dealing with officer authorizations as to this Association's stock and with emergency preparedness. After discussion, upon motion duly made and seconded, Resolutions (Exhibits K through N) dealing with said matters were unanimously adopted.

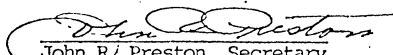
The Secretary next advised that discretionary bonuses, pursuant to the Association's discretionary bonus plan adopted December 19, 1978, are recommended by management, such bonuses to be in addition to other bonuses which may be approved the the Board. Upon motion duly made and seconded, a Resolution (Exhibit O) authorizing payment of such discretionary bonuses was unanimously adopted.

The Chairman asked Eldon Beller to review a proposed Profit Sharing and Savings and Thrift Plan recommended by management and proposed amendments to the Retirement Plan. Eldon outlined the significant aspects of the Profit Sharing and Savings and Thrift Plan. Gene Smelser advised that such plans are very beneficial to retention of employees and rewarding long-term service. After discussion, upon motion duly made and seconded, a Resolution (Exhibit P) forming such plan was unanimously adopted. Eldon Beller reviewed recommended changes to the Association's Retirement Plan, which were discussed. Upon motion duly made and seconded, a Resolution (also Exhibit P) authorizing the amendments to the Retirement Plan was unanimously adopted.

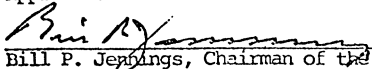
Eldon Beller commented on the recently concluded Comptroller examination, noting that it was a "spot" examination and not a full

examination. He said that although the previously reviewed charge-offs were a result of the examination, he and the examiners were pleased that in the case of each charged-off credit, and each classified credit, such credits were identified as such by the Association prior to the examination. He further commented that the examiners were pleased with the policies, procedures, staffing, and committee system implemented by the Association since the last examination and that the examiners liked the direction in which the Association is heading.

There being no further business, upon motion duly made, seconded, and unanimously approved, the meeting was adjourned.


John R. Preston, Secretary

Approved:


Bill P. Jennings, Chairman of the Board

MINUTES OF THE REGULAR MEETING
OF THE BOARD OF DIRECTORS OF
PENN SQUARE BANK, N.A.

December 8, 1981

Minutes of the regular meeting of the Board of Directors of Penn Square Bank, N.A. held at 4:00 p.m. on Tuesday, December 8, 1981, in the Board Room.

Present were:

Eldon L. Beller	Ken L. Kenworthy	Jerry Richardson
Elizabeth Merrick Coe	C. F. Kimberling	W. A. Ross
Gary M. Cook	Marvin K. Margo	Gene H. Smelser
J. C. Cravens*	Frank L. Murphy	Bill Stubbs
Richard T. Dunn	H. Mead Norton*	Carl W. Swan
Richard C. Haugland	John R. Preston	

Absent were:

Ronald H. Burks	Bill P. Jennings	Bill G. Patterson
James G. Randolph		

* Advisory Directors

Also present was James J. Gunter, Executive Vice President and Chief Financial Officer.

Frank L. Murphy, Vice Chairman of the Board, asked Eldon L. Beller, President, to chair the meeting. The President called the meeting to order.

The Secretary gave a synopsis of the minutes of the November 10, 1981 Board meeting, a copy of such minutes being in each Director's book. Upon motion duly made and seconded, the minutes were unanimously approved.

The President reviewed the Association's financial statements for the month of November and the year-to-date, all of which were in each Director's book. He highlighted significant items for the month, including the reversal of \$118M in accrued interest and the \$188M loan loss provision. He called on Jim Gunter, who noted that the holding company is anticipating a private stock offering, some of the proceeds of which will go into capital of this Association. He also briefly discussed liquidity. After discussion, upon motion duly made and seconded, the financial reports were unanimously approved. The President also reviewed the Deposit and Asset Report and the Liquidity Analysis.

The Secretary next reviewed the Association's securities report, copies of which were in each Director's book. Upon motion duly made and seconded, the securities report was unanimously approved.

The President reviewed overdrafts in a continuous overdraft state for 15 days or more, a copy of the overdraft report being in each Director's book. After discussion, upon motion duly made and seconded, the overdrafts were unanimously approved.

The President next reviewed past due loans, a copy of which report was in each Director's book. He noted the credits that had been cleared since the date of the report (November 30, 1981). The past due loans were discussed at length, after which discussion, upon motion duly made and seconded, the past due loan report was unanimously approved.

Rick Dunn reviewed charge-offs totaling \$15,869.65, each charge-off being separately discussed. Upon motion duly made and seconded, a Resolution (Exhibit A) approving the charge-offs was unanimously adopted.

Rick Dunn gave a brief report on progress of the Examination Corrections Committee work on striving for compliance with the Letter Agreement. He advised that one of the requested items, the management plan, was now complete. He highlighted the key points in the plan and distributed a copy which each Director reviewed. After discussion, upon motion duly made and seconded, the management plan (Exhibit B) was unanimously approved.

Rick Dunn next reviewed the adequacy of the loan loss reserve. He noted that the internal reserve calculation was \$4,070M, with the actual reserve currently being \$3,170M, approximately 1.2% of total loans. He stated that at a monthly increase of approximately \$200M, he considered the loan loss reserve adequate. After discussion, upon motion duly made and seconded, the loan loss reserve review was unanimously approved.

The President reviewed loans made during November 1981, which had been previously approved by the Discount Committee, a copy of the report being in each Director's book. After discussion, upon motion duly made and seconded, the report was unanimously approved.

The Secretary next reviewed Executive Officer and Director-officer borrowing reports (Exhibits C through H).

The Secretary reviewed management-recommended new officer appointments and advised that a resignation needed to be accepted. Upon motion duly made and seconded, a Resolution (Exhibit I) making such appointments and accepting such resignation was unanimously adopted.

The Secretary advised that management sought ratification of an amendment to Eldon Beller's employment contract. He outlined the reason for the change. There being no discussion, upon motion duly made and seconded, the amendment (Exhibit J) was unanimously approved, except that Mr. Beller did not participate in the discussion of the matter, did not influence the voting on the matter, and abstained from voting on the matter.

The Secretary noted that due to an oversight, no guidance line of credit had been approved by the Board for Ken L. Kenworthy. Upon motion duly made and seconded, a Resolution (Exhibit K) was unanimously approved establishing a guidance line of credit for Mr. Kenworthy and his related interests, except that Mr. Kenworthy did not participate in the discussion

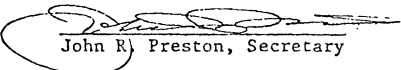
of the matter, did not influence the voting on the matter in any way, and abstained from voting on the matter.

The Secretary next read a letter (Exhibit L) which had been sent to this Association's bonding company concerning an allegation by a customer of this Association that Tom Orr, a former officer of this Association, had lent the customer Association funds so as to allow the customer to pay a horse brokerage fee to Tom Orr. The Secretary noted that the contents of the letter and the facts surrounding the matter should be treated with the utmost of confidentiality and not discussed outside of the Board room. (Mr. Swan temporarily left the room at this point.)

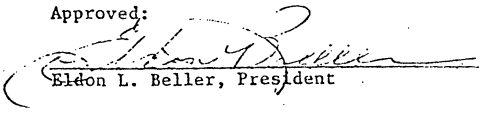
The President advised that incentive bonuses for 1981 were recommended by management in the total amount of \$86,500, to be paid by year-end as an extra reward for the special efforts of certain employees. Upon motion duly made and seconded, the payment of incentive bonuses for 1981 in the amount of \$86,500 was unanimously approved. (Mr. Swan rejoined the meeting at this point.)

The President called on Jim Gunter, who gave a brief report on year-end projections for earnings. He noted that the projections contained information supplied by Bill Patterson on fee income and that the projections were several weeks old. There was a brief discussion on the matter.

There being no further business, upon motion duly made, seconded, and unanimously approved, the meeting was adjourned.


John R. Preston, Secretary

Approved:


Eldon L. Beller, President

MINUTES OF A SPECIAL MEETING
OF THE BOARD OF DIRECTORS OF
PENN SQUARE BANK, N.A.

December 17, 1981

Minutes of a special meeting of the Board of Directors of Penn Square Bank, N.A. held at 7:30 p.m. on Thursday, December 17, 1981, at the Oklahoma City Golf and Country Club, Oklahoma City, Oklahoma.

Present were:

Eldon L. Beller	Bill P. Jennings	James G. Randolph
Ronald H. Burks	C. F. Kimberling	Jerry Richardson
Elizabeth Merrick Coe	Marvin K. Margo	Gene H. Smelser
J. C. Cravens*	H. Mead Norton*	Bill Stubbs
Richard T. Dunn	John R. Preston	Carl W. Swan

Absent were:

Gary M. Cook	Ken L. Kenworthy	Bill G. Patterson
Richard C. Haugland	Frank L. Murphy	W. A. Ross

*Advisory Directors

Bill P. Jennings, Chairman of the Board, called the meeting to order.

The Secretary advised that the Association is negotiating a sale of loans to Hibernia National Bank, New Orleans, Louisiana, and that Hibernia has required, as a condition precedent to closing, resolutions of this Board authorizing (1) the negotiation, execution, and delivery on behalf of this Association of the basic agreement (Loan Pool Purchase Agreement) and other related documents (Loan Pool Certificate, Secretary's Certificate, and Officers' Representations and Warranties) and (2) the delivery of an opinion of John R. Preston, General Counsel, with regard to matters set forth in the Loan Pool Purchase Agreement. After a brief discussion, upon motion duly made and seconded, the following resolutions were unanimously adopted:

RESOLVED, that any officer of the title of Vice President or above, including the General Counsel, is hereby authorized and empowered to negotiate on behalf of this Association the sale of up to \$10,000,000 in loans to the Hibernia National Bank, New Orleans, Louisiana, upon such terms, in such form, and subject to such conditions as such officer or officers deem to be in the best interests of this Association.

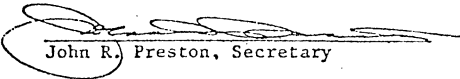
RESOLVED, further, that any officer of the title of Vice President or above, including the General Counsel, is hereby authorized and empowered to execute on behalf of this Association such agreements, documents, and other instruments as may be necessary to effect the sale of such loans, including, but not limited to, giving such representations and warranties as they may in good

faith give and execute such certificates as may be required pursuant to any such agreement(s).

RESOLVED, further, that John R. Preston, General Counsel, is hereby authorized and empowered on behalf of this Association to give an opinion as to such legal matters as may be requested of him pursuant to any such agreements.

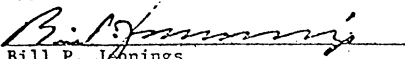
RESOLVED, further, that the Secretary and the Cashier, or either of them, are hereby authorized and empowered to certify copies of these resolutions and to deliver same to such persons as they deem appropriate to effect the sale of such loans, and to certify the incumbency of the officers of this Association and their respective signatures.

There being no further business, upon motion duly made, seconded, and unanimously adopted, the meeting was adjourned.



John R. Preston, Secretary

Approved:



Bill P. Jennings
Chairman of the Board

MINUTES OF THE REGULAR MEETING
OF THE BOARD OF DIRECTORS OF
PENN SQUARE BANK, N.A.

January 12, 1982

Minutes of the regular meeting of the Board of Directors of Penn Square Bank, N.A. held at 3:00 p.m. on Tuesday, January 12, 1982 in the Board Room.

Present were:

Eldon L. Beller	C. F. Kimberling	Gene H. Smeiser
Ronald H. Burks	Marvin K. Margo	Bill Stubbs
Elizabeth Merrick Coe	Frank L. Murphy	Carl W. Swan
Gary M. Cook	H. Mead Norton*	
Richard T. Dunn	Bill G. Patterson	
Richard C. Haugland	John R. Preston	
Bill P. Jennings	James G. Randolph	
Ken L. Kenworthy	Jerry Richardson	

Absent were:

J. C. Cravens*	W. A. Ross
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*Advisory Directors

Also present was James J. Gunter, Executive Vice President and Chief Financial Officer, and the following representatives of the Office of the Comptroller of the Currency: Preston Morrow, Dan Rabon, Charles Block, Steve Plunk, and Jack Thompson.

Bill P. Jennings, Chairman of the Board, called the meeting to order.

He introduced Preston Morrow, Deputy Regional Administrator of the Dallas office of the Office of the Comptroller of the Currency and asked him to introduce the other members of the Comptroller's office present. Mr. Morrow introduced Dan Rabon, Charles Block, Steve Plunk, and Jack Thompson, representatives of the Comptroller's office. Mr. Morrow advised that the purpose of their attendance at this Board meeting was to review the Special Supervisory Report of Examination which had recently been sent to this Association. Mr. Morrow indicated that the progress the Association had made to date was quite positive, but noted that steps yet needed to be taken. He additionally noted that a page from the Special Supervisory Report of Examination had been left out, dealing with two violations of the legal lending limit, and that such page would be forthcoming. He noted that the level of criticized assets at the Association is still high and that the level of contingent liabilities is also high. He advised that Steve Plunk would be the new examiner in charge of the Oklahoma City office and would be in charge of the next examination of the Association, tentatively scheduled to occur within the next three months. He called on Dan Rabon to make comments. Mr. Rabon noted that rate sensitivity had improved at the Association. He also referred to the two legal lending limit violations and

the work that needs to be done in the area of improving exceptions in the collateral and documentation area.

Mr. Morrow commented on our current space needs and possible move to a new headquarters building. He said the key to such a move of our headquarters would be our compliance with the letter agreement and a showing that our future earnings will support the increased cost of the space to be utilized. Mr. Beller and Mr. Morrow discussed the potential release of this Association from the Letter Agreement. Mr. Morrow indicated that the release of this Association from the Letter Agreement could occur after the next full examination. Mr. Patterson and Mr. Morrow discussed the internal review and classification system. Mr. Morrow indicated that it is important for the Association to work on its criticized loans or, as history has shown the Comptroller's office, charge-offs will result from classified loans.

Mr. Morrow reiterated that the next full examination would occur in about three months and that a possible release from the Letter Agreement could occur within 45 days thereafter. (At this point the representatives of the Office of the Comptroller of the Currency left the meeting.)

The Board discussed at length the examination report and the progress of the Association in complying with the Letter Agreement. After discussion, the Special Supervisory Report of Examination was circulated among the Directors for their signatures.

The Chairman commented at length on the financial results for 1981. He noted that there was approximately a 72% asset growth, that liquidity was up, and that although the Association had taken a \$4 million net charge-off during the year, it was able to earn \$4.7 million after tax, which compares with \$4.2 million earned in 1980. He further noted that the Association was in compliance with the Letter Agreement as to capital requirement during the fourth quarter. He made other general comments with regard to financial and nonfinancial performance during 1981.

The Chairman asked if there were any changes to the minutes of the December 8, 1981 Board meeting or to the minutes of the December 17, 1981 special Board meeting, a copy of such minutes being in each Director's book. There being no changes, upon motion duly made and seconded, the Minutes of both meetings were unanimously approved.

The Chairman reviewed the Association's financial statements for the month of December and the year 1981, all of which were in each Director's book. A lengthy discussion was held concerning the various items both for the month and for the year. He noted that IRA accounts would be of significance to the growth of the Association in the future and solicited the support of each Director in obtaining IRA account relationships, particularly with corporate customers. After discussion, upon motion duly made and seconded, the financial reports were unanimously approved. The Chairman also reviewed the Deposit and Asset Report and the Liquidity Analysis.

The Chairman next reviewed the Association's Securities Report, copies of which were in each Director's book. Upon motion duly made and seconded, the Securities Report was unanimously approved.

Bill Patterson reviewed overdrafts in a continuous overdraft state for fifteen days or more, a copy of the overdraft report being in each Director's book. He noted that certain of the lengthy overdrafts would likely be charged-off in the future. After discussion, upon motion duly made and seconded, the overdrafts were unanimously approved.

Bill Patterson next reviewed past-due Loans, a copy of which report was in each Director's book. He noted the credits that had been cleared since the date of the report (December 31, 1981). He further noted that past-dues tend to rise at year end due to the reworking of loan agreements for the coming year. After discussion, upon motion duly made and seconded, the past-due loan report was unanimously approved.

Rick Dunn reviewed a charge-off of \$745.19. Upon motion duly made and seconded, the Board unanimously approved charging-off such amount as to the loan to Verna Mae Fletcher (an installment loan).

Rick Dunn distributed a folder to each Director with regard to the criticized loan improvement plans. He reviewed the format of the improvement plans and advised that the plans would be sent to the Comptroller's Office in Dallas, subject to approval of the format by the Board. Bill Patterson and Eldon Beller both commended the efforts that had been put into the criticized loan improvement plans. After discussion, upon motion duly made and seconded, the Board unanimously approved the format of the criticized loan improvement plans and the forwarding of same to the Comptroller's Office per the Letter Agreement.

Bill Patterson reviewed loans made during December, 1981 which had been previously approved by the Discount Committee, a copy of the report being in each Director's book. After discussion, upon motion duly made and seconded, the report was unanimously approved.

The Secretary reviewed Executive Officer and Director-officer borrowing reports (Exhibits A through J). The Secretary noted that as to the loan of this Association to Bill Patterson in the amount of \$650,000.00 (as reported on Exhibit C), Board approval would be required at this meeting per the FIRA resolutions adopted by the Board at its meeting on July 14, 1981. After discussion, upon motion duly made and seconded, the following resolution was unanimously approved:

RESOLVED, that the President of this Association is hereby authorized and empowered to make a loan to Bill Patterson in the amount of \$650,000.00 upon such terms and conditions as he deems appropriate, provided however, that such loan shall not be on more favorable terms and conditions, in accordance with the provisions of FIRA and Regulation O, as may be given to regular customers of this Association.

Bill Patterson abstained from voting on the foregoing resolution, did not participate in discussion of same, and did not influence the voting thereon.

The Secretary reviewed management recommended officer appointments and promotions. Upon motion duly made and seconded, a resolution (Exhibit K)

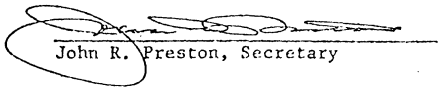
making such appointments and approving such promotions was unanimously adopted.

The Secretary reviewed the Minutes of the Meeting of the Trust Investment Committee of December 8, 1981, a copy of which minutes were in each Director's book. Upon motion duly made and seconded, the minutes were unanimously approved.

The Chairman suggested a change in the regular Board meeting date from the second Tuesday of each month to the third Tuesday of each month. The Director's fully supported such change. Upon motion duly made and seconded, a resolution (Exhibit L) changing the regular meeting date of the Board of Directors (from the second Tuesday to the third Tuesday of each month) was unanimously adopted.

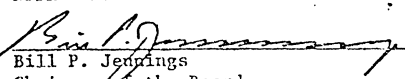
Eldon Beller commented that although the recent examination showed that substantial progress had been made, there continues to be a lot of hard work that needs to be done and commented that the Board should not become complacent with regard to the progress that needs to be accomplished. The Chairman thanked the Board for its continuing help and support in working out of the Letter Agreement, with which comments Mr. Beller concurred.

There being no further business, upon motion duly made, seconded, and unanimously approved, the meeting was adjourned.



John R. Preston, Secretary

APPROVED:



Bill P. Jennings
Chairman of the Board

MINUTES OF THE REGULAR MEETING
OF THE BOARD OF DIRECTORS OF
PENN SQUARE BANK, N.A.

February 16, 1982

Minutes of the regular meeting of the Board of Directors of Penn Square Bank, N.A., held at 4:00 p.m. on Tuesday, February 16, 1982, in the Board Room.

Present were:

Eldon L. Beller	Marvin K. Margo	Gene H. Smelser
Elizabeth Merrick Coe	Frank L. Murphy	Carl W. Swan
Gary M. Cook	H. Mead Norton*	
Richard T. Dunn	John R. Preston	
Richard C. Haugland	James C. Randolph	
Bill P. Jennings	Jerry Richardson	
Ken L. Kenworthy	W. A. Ross	

Absent were:

Ronald H. Burks	C. F. Kimberling	Bill Stubbs
J. C. Cravens*	Bill G. Patterson	

*Advisory Directors

Also present were James J. Gunter, Executive Vice President and Chief Financial Officer and Janelle Cates, Vice President.

The Chairman, Bill P. Jennings, called the meeting to order.

The Secretary reviewed the minutes of the previous meeting (1-12-82), a copy of which were in each Director's book. There being no changes, upon motion duly made and seconded, the minutes of the previous meeting were unanimously approved.

The Chairman reviewed the Association's financial statements for the month of January and the year-to-date, a copy of which were in each Director's book. He noted that the 1981 numbers have been adjusted to reflect non-accruals which were initiated in the later part of 1981 for the whole year. He reviewed charts which highlighted the Bank's last five years financially and commented on same. A discussion was held on the adequacy of the loan loss reserve, which the Chairman noted is "comfortable" at 1.35% of assets. A discussion was held on the effect a decline in oil prices might have on the quality of the loan portfolio, the Chairman commenting that the production loans would remain secure, but take slightly longer to pay out. At the conclusion of the discussion, upon motion duly made and seconded, the financial reports were unanimously approved. The Chairman also reviewed the Deposit and Asset Report and the Liquidity Analysis.

The Secretary reviewed the Association's Securities Report, copies of which were in each Director's book. He highlighted changes from the December report. Upon motion duly made and seconded, the Securities report was unanimously approved.

Rick Dunn reviewed overdrafts in a continuous overdraft state for fifteen days or more, a copy of the overdraft report being in each Director's book. He noted that no overdraft is allowed if it would result in total obligations of a customer to exceed the Association's legal lending limit. After discussion, upon motion duly made and seconded, the overdrafts were unanimously approved.

Rick Dunn next reviewed past-due loans, a copy of which report was in each Director's book. A lengthy review of the loans was made. After the review and discussion, upon motion duly made and seconded, the past-due loan report was unanimously approved.

Rick Dunn next reviewed charge-offs totaling \$413,377.04. After discussion, upon motion duly made and seconded, a resolution (Exhibit A) approving such charge-offs was unanimously adopted. The Chairman asked Rick to give quarterly reports to the Board, beginning at the April meeting for the first quarter of 1982, regarding the status of charged-off loans in excess of \$100,000.

The Chairman next reviewed loans made during January, 1982 which had been previously approved by the Discount Committee, a copy of the report being in each Director's book. He introduced Janelle Cates, who was present to give additional information as to such loans, as needed. After discussion, upon motion duly made and seconded, the loans were unanimously approved. Janelle left the meeting at this point.

The Secretary reviewed Executive Officer and Director-officer borrowing reports (Exhibits B through D). He also reviewed the report of John H. Miller, Vice President and Trust Officer as to securities transactions of Trust Department personnel, as to which Mr. Miller reported that there were none during the past quarter. The Secretary reviewed five letters which had been sent to the Association's bonding company concerning possible violations of law by a former officer, each letter being read to the Board. The Chairman cautioned the Board on the necessity of extreme confidentiality with respect to the letters, noting that the Association could be severely damaged by any disclosure of same outside the Board Room.

The Secretary next reviewed the letter of January 25, 1982 from the Dallas Regional Office of the Comptroller of the Currency to which was attached revised pages of the September 30, 1981 report of examination. The matter was reviewed and discussed.

The Secretary noted that due to a change in its operating letters, the Federal Reserve Bank of Kansas City had requested the Association to approve a new borrowing resolution as to borrowings by the Association from the Federal Reserve Bank of Kansas City. Upon motion duly made and seconded, such a resolution (Exhibit E) was unanimously adopted.

The Secretary reviewed a resolution requested by the Trust Department dealing with delegation of Trust Department oversight to the Trust Investment Committee. Upon motion duly made and seconded, such resolution (Exhibit F) was unanimously adopted. He also reviewed a resolution requested by the Trust Department dealing with assignment of securities held in trust. Upon motion duly made and seconded, such resolution (Exhibit G) was unanimously adopted.

The Secretary advised that nominations for Advisory Director were in order. Nominations of J. C. Cravens and H. Mead Norton as Advisory Directors were made. There being no discussion, upon motion duly made and seconded, J. C. Cravens and H. Mead Norton were unanimously appointed as Advisory Directors in accordance with Comptroller's Interpretive Ruling 7.4110.

The Secretary reviewed new officer elections, promotions, and reelections of current officers, a copy of which was in each Director's book. He noted that officer salaries are currently \$3,107,000 on an annual basis. Upon motion duly made and seconded the officers listed in Exhibit I were unanimously elected to serve until the next annual Directors' organizational meeting, or until their successors are duly elected. In addition, upon motion duly made and seconded, John R. Preston was unanimously elected Secretary of the Association, Richard D. Forshee was unanimously elected Assistant Secretary of the Association, and Raymond L. Hicks was unanimously elected Controller of the Association.

The Secretary advised that for the purposes of attesting official documents, management recommended the election of all Vice Presidents and Assistant Vice Presidents as Assistant Cashiers. Upon motion duly made and seconded, all Vice Presidents and all Assistant Vice Presidents were unanimously elected as Assistant Cashiers for the purpose of attesting any documents to be signed by the Association requiring the attestation by the Cashier or an Assistant Cashier.

The Secretary next reviewed the minutes of the Audit Committee meeting of January 21, 1982, a copy of which was in each Director's book. Upon motion duly made and seconded, the Audit Committee minutes were unanimously approved.

The Chairman next called for the appointment of Board Committees for the ensuing year. Upon motion duly made and seconded, a resolution (Exhibit J) appointing Board committee members was unanimously adopted.

The Chairman advised that the Association is in the process of restructuring its capital accounts and requested approval of all actions necessary to cause the Association to have a \$10,000,000 capital stock account, a \$10,000,000 surplus account, and the balance as retained earnings. After discussion, upon motion duly made and seconded, a resolution (Exhibit K) approving such restructuring of the capital accounts of the Association was unanimously adopted.

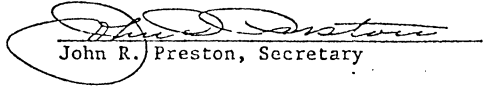
The Chairman reported that Pennbank Tower is progressing within two weeks of schedule and reviewed the possibility of the Association

building or leasing an operations center to be built near the motor bank.

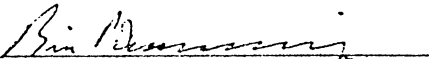
The President reviewed expenses and advised the Board that the management's thrust in the future would be to hold back on expenses, new hires, promotions, travel, and entertainment. He also reviewed how leasing activities would help to hold down the Association's income tax in the future, and reviewed new hires in the leasing area. The Chairman noted that the Association's occupancy expense is currently below peer group averages.

The Chairman concluded his remarks by noting that Colleen Beller was in the hospital and that the Board wished her a speedy recovery, with which the Directors concurred.

There being no further business, upon motion duly made, seconded, and unanimously adopted, the meeting was adjourned.


John R. Preston, Secretary

APPROVED:


Bill P. Jennings, Chairman

MINUTES
ANNUAL SHAREHOLDERS' MEETING

Tuesday February 16, 1982 3:30 p.m.

Minutes of the annual meeting of the shareholders of Penn Square Bank, N.A., Oklahoma City, Oklahoma, held in the Board Room on Tuesday, February 16, 1982, at 3:30 p.m. Present was Bill P. Jennings, Chairman of the Board, Frank L. Murphy, Vice Chairman of the Board, and John R. Preston, Secretary. Bill P. Jennings also represented the sole shareholder of the Association, First Penn Corporation, as its Chairman of the Board and President.

The sole shareholder waived the requirement of notice of the meeting and of appointment of judges of election. The Chairman stated that a quorum was present, in that all 100,000 common shares outstanding were represented at the meeting.

The Chairman stated that the first order of business was the fixing of the number of Directors and the election of same. Upon motion duly made and seconded, the number of Directors was set at nineteen (19) and the following were nominated:

Eldon L. Beller	Ken L. Kenworthy	Jerry Richardson
Ronald H. Burks	C. F. Kimberling	W. A. Ross
Elizabeth Merrick Coe	Marvin K. Margo	Gene H. Smelser
Gary M. Cook	Frank L. Murphy	Bill Stubbs
Richard T. Dunn	Bill G. Patterson	Carl W. Swan
Richard C. Haugland	John R. Preston	
Bill P. Jennings	James G. Randolph	

The sole shareholder voted all 100,000 shares of common stock of the Association outstanding and owned by it in favor of the election of said Directors. The Chairman declared all nineteen Directors duly elected and instructed the Secretary to proceed to obtain their oaths.

The Chairman stated that the next matter was amendment of the Articles of Association. Upon motion duly made and seconded, a resolution amending the Articles of Association (Exhibit A) was presented for adoption. The sole shareholder voted all 100,000 shares of common stock of the Association outstanding and owned by it in favor of the adoption of said resolution.

A motion was duly made and seconded for the approval of all actions of the officers and Directors taken since the previous annual meeting of shareholders held February 10, 1981. The sole shareholder voted all 100,000 shares of common stock of the Association outstanding and owned by it in favor of such motion approving all actions of the officers and Directors taken since the previous annual meeting of shareholders held February 10, 1981.

There being no further business, upon motion duly made, seconded, and unanimously approved, the meeting was adjourned.

APPROVED:

John R. Preston, Secretary

Bill P. Jennings
Chairman of the Board

MINUTES OF THE REGULAR MEETING
OF THE BOARD OF DIRECTORS OF
PENN SQUARE BANK, N.A.

March 16, 1982

Minutes of the regular meeting of the Board of Directors of Penn Square Bank, N.A., held at 4:00 p.m. on Tuesday, March 16, 1982, in the Board Room.

Present were:

Eldon L. Beller	Bill P. Jennings	Bill G. Patterson
Ronald H. Burks	Ken L. Kenworthy	John R. Preston
Elizabeth Merrick Coe	C. F. Kimberling	James C. Randolph
Gary M. Cook	Marvin K. Margo	W. A. Ross
Richard T. Dunn	Frank L. Murphy	Gene H. Smelser
Richard C. Haugland	H. Mead Norton*	Bill Stubbs

Absent were:

J. C. Cravens*	Jerry Richardson	Carl W. Swan
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*Advisory Directors

Also present was James J. Gunter, Executive Vice President and Chief Financial Officer.

The Chairman, Bill P. Jennings, called the meeting to order.

The Secretary reviewed the minutes of the previous meeting (2-16-82), a copy of which were in each Director's book. There being no changes, upon motion duly made and seconded, the minutes of the previous meeting were unanimously approved.

The Chairman called on Jim Gunter, who reviewed the Association's financial statements for the month of February and the year-to-date, a copy of which were in each Director's book. A discussion was held on certain aspects of the financial report. The Chairman commented on the move of the Energy Division to newly leased space and the reutilization of its old space by other departments. He also commented that loan fees may not continue at the pace that they have for the first two months of the year. He noted that it is the current commitment of management to keep pressure on the loan areas to reduce the total loans outstanding. He commented that interest spread is getting better without loan fees. He noted specifically that management of the Bank will progressively pursue loan fees so long as the loan to deposit ratio can be kept in line and that the fees can be generated off of sound credits. There being no further discussion, upon motion duly made and seconded, the financial reports were unanimously approved. Jim Gunter also reviewed the Deposit and Asset Report and the Liquidity Analysis.

The Secretary reviewed the Association's Securities Report, copies of which were in each Director's book. He highlighted changes from the

February report. Upon motion duly made and seconded, the Securities Report was unanimously approved.

Bill Patterson reviewed overdrafts in a continuous overdraft state for fifteen days or more, a copy of the overdraft report being in each Director's book. He noted that over \$2.5 million of the \$4.7 million of overdrafts on the report had been removed since the date of the report. He noted that many of the overdrafts are the result of a lag in getting loan documentation prepared for sale of a loan to an upstream correspondent. He noted further that he established a loan documentation section in the Oil and Gas Division to help alleviate the problem in the future. A lengthy discussion was held on overdrafts, at the conclusion of which it was agreed that the overdraft report would be modified to include comments on which overdrafts presented real problems to the Bank and which ones were merely a result of documentation or other technical problems. Upon motion duly made and seconded, the overdrafts were unanimously approved.

Bill Patterson next reviewed past-due loans, a copy of which report was in each Director's book. A lengthy review and discussion of the loans was made. Bill Patterson noted the same problems that cause overdrafts to be in effect for more than fifteen days cause many of the past-due problems. At the conclusion of the discussion, it was agreed that the past-due report would be modified so as to show which loans represented thereon presented real problems versus those that present documentation or other technical problems.

Rick Dunn next reviewed charge-offs totaling \$1,072,376.31. After discussion, upon motion duly made and seconded, a resolution (Exhibit A) approving such charge-offs was unanimously adopted. The Chairman noted that Rick would be giving a quarterly report to the Board, beginning at the next meeting, regarding the status of charged-off loans in excess of \$100,000.

Rick Dunn next reviewed the adequacy of the loan loss reserve, a copy of the report thereon being in each Director's book. A lengthy discussion was held with regard to the reserve and Rick Dunn noted that he considered the loan loss reserve to be adequate. A discussion was held on how the risk factors were determined and on the probability of losses. At the conclusion of the discussion, upon motion duly made and seconded, the loan loss reserve report was unanimously approved.

Rick Dunn next reviewed changes that had been made in the loan policy, noting that the changes would be sent to the Comptroller's office in Dallas. After discussion, upon motion duly made and seconded, the loan policy changes were unanimously approved.

Bill Patterson next reviewed loans made during February 1982 which had been previously approved by the Discount Committee, a copy of the report being in each Director's book. After discussion, upon motion duly made and seconded, the loans were unanimously approved.

Rick Dunn reviewed the proposed restructuring of the Billy Underwood, Sr. and Billy Underwood, Jr. credits. After discussion, he distributed a write-up to each Director for signature approving the loan restructuring.

The Secretary reviewed Executive Officer and Director-officer borrowing reports (Exhibits B through H). He noted that specific approval would be required with regard to the loans made by this Association to Bill Patterson. After discussion, in which Bill Patterson did not participate, upon motion duly made and seconded, the loans to Bill Patterson totalling \$2,800,000.00 were unanimously approved, except that Bill Patterson did not participate in nor influence the vote thereon.

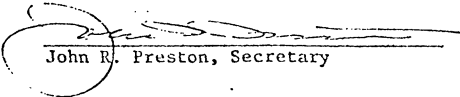
The Secretary reviewed new officer elections and promotions, giving a brief report on the responsibilities of each new officer and the officer's salary. Upon motion duly made and seconded, a resolution (Exhibit I) was unanimously adopted making such new officer elections and approving such promotions.

The Secretary advised that the Community Reinvestment Act Statement for 1982 had been prepared and had been reviewed and approved both by Rick Dunn and the Secretary. He told the Directors that a copy of the Statement with Exhibits was available for any Director caring to review same. After a brief discussion, upon motion duly made and seconded, the Community Reinvestment Act Statement for 1982 (Exhibit J) was unanimously approved.

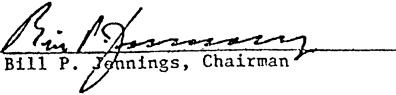
Eldon Beller commented that past-due loans, overdrafts, and the loan to deposit ratio are all currently too high and that management of the Bank would be accelerating efforts in those specific areas in the near future to make corrections as necessary.

The Chairman commented on the following matters: (1) the holding company Stock Option Committee had met and approved options for twenty-seven officers all of the title of Vice President and above; (2) the annual report would be available soon and should be distributed by the end of the month; (3) the new building is progressing close to schedule and should be topped out by mid-year; (4) the new building owners are looking at acquiring land north and east of the new building for an entrance/exit to Classen Boulevard and a possible heliport; and (5) a report on the possibility of an Operations Center will be given at the next meeting.

There being no further business, upon motion duly made, seconded, and unanimously adopted, the meeting was adjourned.


John R. Preston, Secretary

APPROVED:


Bill P. Jennings, Chairman

MINUTES OF AN INFORMAL, SPECIAL MEETING
OF THE BOARD OF DIRECTORS OF
PENN SQUARE BANK, N.A.

April 2, 1982

Minutes of an informal, special meeting of the Board of Directors of Penn Square Bank, N.A., held at 12:00 noon on Friday, April 2, 1982, in the Board Room.

Present were:

Eldon L. Beller	Marvin K. Margo	Gene H. Smelser
Elizabeth Merrick Coe	Bill G. Patterson	Bill Stubbs
Richard T. Dunn	John R. Preston	Carl W. Swan
Bill P. Jennings	Jerry Richardson	
C. F. Kimberling	W. A. Ross	

Not in attendance were:

Ronald H. Burks	Richard C. Haugland	H. Mead Norton*
Gary M. Cook	Ken L. Kenworthy	James G. Randolph
J. C. Cravens*	Frank L. Murphy	

* Advisory Directors

The Chairman, Bill P. Jennings, called the meeting to order. He thanked the Directors present for being available on such short notice.

He explained that the purpose of the meeting was to inform the Directors that a reporter (Phillip Zweig) for the trade newspaper, American Banker (which he described), is apparently trying to do some "investigative" reporting on the energy industry and the Bank, particularly in light of the current downturn in oil prices and the increase in idle drilling rigs within the industry. He described the background of his previous conversations with the reporter, noting that the reporter had cancelled a scheduled interview with the Chairman and while rescheduling was pending, the reporter began calling Directors, correspondents, regulators, auditors, and competitors in an attempt to "get a story." The Chairman described the reporter's style as being "accusatory" instead of inquisitive. He noted that the reporter's "facts" were highly inaccurate and in some cases absurd.

Two Directors (Marvin Margo and Dub Ross) described their conversations with the reporter and concurred in the Chairman's characterization of the reporter's style as being accusatory. Eldon Beller described his conversation with Preston Morrow, of the Comptroller's Office (who the reporter had called). Eldon noted that he had emphasized to Preston that if the reporter continued to make inaccurate and harmful statements

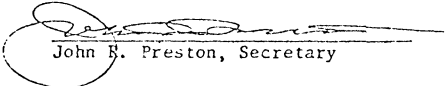
about the Bank to third parties, which could harm the Bank, he would expect the Comptroller's Office to assist us at our request.

Bill Patterson described his conversations with the Bank's correspondent banks, noting that they had made highly supportive statements to the reporter concerning their good relationships with this Bank. He and the Chairman advised that they had consulted and spoken with Jim Linn about the matter.

The Chairman reiterated his concern as to any false statements which might be made. He advised that he, Eldon, and John Preston would probably meet with the reporter next week to set the record straight. He noted that discussing Bank matters outside of the Board Room is inappropriate and that a good response to the reporter, should a Director be called, would be to indicate that Bank business is confidential and is not discussed outside of the Board Room. He reminded the Directors that they could be receiving phone calls from the reporter.

The Chairman concluded that a low-key approach would be appropriate and that he would update the Directors as needed.

Upon motion duly made, seconded, and unanimously adopted, the meeting was adjourned.



John K. Preston, Secretary

Approved:

Bill P. Jennings, Chairman

MINUTES OF THE REGULAR MEETING
OF THE BOARD OF DIRECTORS OF
PENN SQUARE BANK, N.A.

April 20, 1982

Minutes of the regular meeting of the Board of Directors of Penn Square Bank, N.A., held at 4:00 p.m. on Tuesday, April 20, 1982, in the Board Room.

Present were:

Eldon L. Beller	Bill P. Jennings	John R. Preston
Ronald H. Burks	Ken L. Kenworthy	James C. Randolph
Elizabeth Merrick Coe	Frank L. Murphy	W. T. Richardson, Jr.
Cary M. Cook	H. Mead Norton*	W. A. Ross
Richard T. Dunn	Bill G. Patterson	Gene H. Smeiser

Absent were:

J. C. Cravens*	C. F. Kimberling	Bill Stubbs
Richard C. Haugland	Marvin K. Margo	Carl W. Swan

*Advisory Directors

Also present were James J. Gunter, Executive Vice President and Chief Financial Officer, and Jim Blanton, Dean York, and Kim Shoemake of Peat, Marwick, Mitchell & Company, the Association's outside auditors.

The Chairman, Bill P. Jennings, called the meeting to order. He remarked that a reporter from the American Banker had been in to visit he and Eldon and other staff members and that a possible article about Penn Square Association may be published by American Banker in the future.

The Chairman called on Eldon Beller who introduced Jim Blanton, Dean York, and Kim Shoemake, representatives of Peat, Marwick, Mitchell & Company. Jim Blanton made general remarks and then introduced Dean York, the partner in charge of the Association's audit. Dean distributed financial statements of First Penn Corporation and the Association to each Director. He reviewed briefly the scope of the audit performed by Peat, Marwick, Mitchell & Company and noted that the financial statements contained the unqualified accountant's report. Dean discussed the procedures involved in the audit and reviewed the numbers contained in the financial statements. He then asked for questions and answered the questions that were raised. He noted that a management letter will be forthcoming. He recommended that the Association begin to address a total management information system, particularly with regard to data processing and account profitability information. He noted further that steps have been taken by management to provide for an early warning system so that problems can be addressed before they become major items. (Jim Blanton, Dean York, and Kim Shoemake left the meeting at this point.)

Jim Gunter reviewed the Association's financial statements for the month of March and, the year-to-date, a copy of which were in each Director's book. He noted that the capital asset ratio during the first quarter was 7.8% and

that same was in full compliance with the Letter Agreement. He also reviewed the changes in the Association's capital structure and commented that management had placed a freeze on hiring. After discussion, upon motion duly made and seconded, the financial reports were unanimously approved. Jim Gunter also reviewed the deposit and asset report and the liquidity analysis.

The Secretary reviewed the Association's Securities Report, copies of which were in each Director's book. He highlighted changes from the March report and reviewed the bond portfolio maturity distribution and quality reports for the quarter ending March 31, 1982. Upon motion duly made and seconded, the Securities Report was unanimously approved.

Bill Patterson reviewed overdrafts in a continuous overdraft state for fifteen days or more, a copy of the overdraft report being in each Director's book. A general discussion with regard to oil drilling and oil markets was held. After discussion, upon motion duly made and seconded, the overdrafts were unanimously approved.

Bill Patterson next reviewed past-due loans, a copy of which report was in each Director's book. A discussion was held on same including the loans related to Quail Run. Rick Dunn gave a brief report on the percentage of past-due loans in relation to the total portfolio. After discussion, upon motion duly made and seconded, the past-due loans report was unanimously approved.

Rick Dunn next reviewed charge-offs totaling \$1,929,009.55, which had been taken during the month of March. After discussion, upon motion duly made and seconded, a resolution (Exhibit A) approving such charge-offs was unanimously adopted. Rick Dunn next gave a quarterly charge-off review, distributing material with respect to the charge-offs and recoveries to date. A discussion of the charge-offs and recoveries was held.

Bill Patterson next reviewed loans made during March 1982 which had been previously approved by the Discount Committee, a copy of the report being in each Director's book. After discussion, upon motion duly made and seconded, the loans were unanimously approved.

Bill Patterson gave a presentation on Mahan-Rowsey, Inc. and related credits. A discussion was held on the presentation. Bill Patterson noted that future presentations would be given on major energy-related credits.

The Secretary reviewed Executive Officer and Director-officer borrowing reports (Exhibits B through D). He also reviewed the Trust Department personnel quarterly investment report (Exhibit E).

The Secretary reviewed the trust examination which commenced February 1, 1982, a copy of which was available in the room for each Director to review. He reviewed the matters of major importance requiring attention as outlined in the report. After the review the report of trust examination was distributed for signature by the Directors present.

The Secretary reviewed new officer elections, promotions, and a resignation. He gave a brief report on the responsibilities of each new

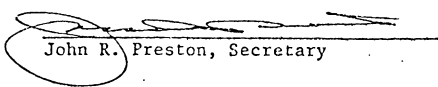
officer and the officer's salary. By motion duly made and seconded, a resolution (Exhibit F) was unanimously adopted making such new officer elections, approving such promotions, and accepting the resignation.

The Secretary reviewed a resolution with regard to funds transfer (Exhibit G). Upon motion duly made, seconded and unanimously adopted, the resolutions contained in Exhibit G were unanimously approved.

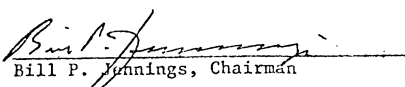
The Chairman advised that the operations center proposal for a free standing building east of the motor bank has been put on hold at the present time and gave the reasons therefor.

The Chairman noted that the personnel level in the Association is under constant control and supervision and would be for some time. He noted that the Comptroller's examination would begin on Monday, April 26. Eldon Beller noted that the examination is an important examination for the Association but otherwise is a routine examination which the Association has generally one every year.

There being no further business, upon motion duly made, seconded, and unanimously adopted, the meeting was adjourned.


John R. Preston, Secretary

APPROVED:


Bill P. Jennings, Chairman

MINUTES OF THE REGULAR MEETING
OF THE BOARD OF DIRECTORS OF
PENN SQUARE BANK, N.A.

May 18, 1982

Minutes of the regular meeting of the Board of Directors of Penn Square Bank, N.A., held at 4:00 p.m. on Tuesday, May 18, 1982, in the Board Room.

Present were:

Eldon L. Beller	Ken L. Kenworthy	James C. Randolph
Ronald H. Burks	C. F. Kimberling	W. T. Richardson, Jr.
Elizabeth Merrick Coe	Marvin K. Margo	W. A. Ross
J. C. Cravens*	Frank L. Murphy	Gene H. Smelser
Richard T. Dunn	H. Mead Norton*	Carl W. Swan
Richard C. Haugland	Bill G. Patterson	
Bill P. Jennings	John R. Preston	

Absent were:

Gary M. Cook Bill Stubbs

*Advisory Directors

Also present was James J. Gunter, Executive Vice President and Chief Financial Officer.

The Chairman, Bill P. Jennings, called the meeting to order. The Secretary reviewed the minutes of the meetings of March 16 and April 20, copies of which were in each Directors' book. Upon motion duly made and seconded, the minutes were unanimously approved.

Jim Gunter reviewed the Association's financial statements for the month of April, and the year-to-date, copies of which were in each Director's book. He also reviewed the results year-to-date compared to plan and reviewed projected plan for the rest of the year. A discussion was held on the loan to deposit ratio and the financial statements and plan in general. discussion was also held on spreading fee income over the life of a loan as opposed to the current practice of recognizing fee income when received. After discussion, upon motion duly made and seconded, the financial reports were unanimously approved. Jim Gunter also reviewed the deposit and asset report and the liquidity analysis. A JGR

The Secretary reviewed the Association's Securities Report, copies of which were in each Director's book. He highlighted the changes from the April report. Upon motion duly made and seconded, the Securities Report was unanimously approved.

Bill Patterson reviewed overdrafts in a continuous overdraft state for fifteen days or more, a copy of the overdraft report being in each Director's book. He noted the overdrafts that had been cleared since the report had been prepared. Discussion was held on the general trend of overdrafts heading upwards. After discussion, upon motion duly made and seconded, the overdrafts were unanimously approved.

Bill Patterson next reviewed past-due loans, a copy of which report was in each Director's book. A discussion was held on the past-due loans and the trend of the past-due loans. Mr. Patterson made comments on certain problem credits. After discussion, upon motion duly made and seconded, the past-due loan report was unanimously approved.

Rick Dunn next reviewed charge-offs totaling \$169,140.16, which had been taken during the month of April. After discussion, upon motion duly made and seconded, a resolution (Exhibit A) approving such charge-offs was unanimously adopted.

Bill Patterson next reviewed loans made during April 1982 which had been previously approved by the Discount Committee, a copy of the report being in each Director's book. A lengthy discussion was held with regard to the Discount Committee process. Mr. Randolph, a member of the Discount Committee, noted the concern of the Discount Committee of the ability of loan officers to show how customers can repay, particularly knowing what the coverage ratio is and what the ratio of debt to capitalization is. A discussion was held on the method of reviewing credits and how loans are documented in the Bank's files. After discussion, upon motion duly made and seconded, the loans were unanimously approved. JGR

Bill Patterson gave a presentation on the Robinson Brothers credit and an update on Mahan-Rowsey, Inc. and related credits. A lengthy discussion was held with regard to both credits. Bill Patterson noted that he will give reports in the future on other energy-related credits. JGR Dub Rev.

The Secretary reviewed Executive Officer and Director-officer borrowing reports (Exhibits B through I). The Secretary noted that as to the loan of this Association to Bill Patterson in the amount of \$2,100,000.00 (as reported on Exhibit D), the loan of \$682,758.22 (as reported on Exhibit E), and the loan to Bill Patterson in the amount of \$770,000.00 (as reported on Exhibit F), Board approval would be required at this meeting per the FIRA resolutions adopted by the Board at its meeting on July 14, 1981, as supplemented by the initial approval of these loans at the Board meetings held on January 12, 1982 and March 16, 1982. After discussion, upon motion duly made and seconded, the following resolution was unanimously approved:

RESOLVED, that the President of this Association and/or Richard T. Dunn, Executive Vice President of this Association, each are hereby authorized and empowered to make loans to Bill Patterson in the total amount of up to \$3,000,000.00, and that the extension of any loans previously made to Bill Patterson by said officers is hereby specifically ratified and approved.

Bill Patterson abstained from voting on the foregoing resolution, did not participate in the discussion of same, and did not influence the voting thereon.

The Secretary reviewed new officer elections and promotions. He gave a brief report on the responsibilities of each new officer and the officer's

salary. Upon motion duly made and seconded, a resolution (Exhibit J) was unanimously adopted making such new officer elections, and approving such promotions.


The Secretary reviewed the equal employment policy as recommended by the personnel division and management of the Bank. Upon motion duly made and seconded, the policy (Exhibit K) was unanimously approved.

The Secretary advised that the Trust Investment Committee had met prior to the Board meeting. He noted that during that meeting the Committee had reviewed the annual financial report of the Bank's pension plan. He reviewed the highlights of the financial report on the pension plan.

The Chairman advise that the First Penn Corporation Board meeting had been held earlier in the afternoon. He noted that at that meeting the Board of the holding company had authorized the issuance of an additional 50,000 shares of stock at a minimum of \$150.00 per share. The Chairman advised that the stock would be sold in June or July with \$2.5MM of the proceeds being used as a capital injection in the Association. He also reviewed briefly the progress on Pennbank Tower, the new headquarters building for the Association. He also noted that the Board would be asked at a future meeting to approve a lease for Association space in the building. He commented on the American Banker article about the Association which appeared in the April 26 issue of American Banker. The Chairman concluded his remarks by noting that the Association had received a management letter from Peat, Marwick, Mitchell & Company and that same would be reviewed in detail in the future.

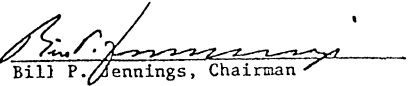
The President, Eldon L. Beller, commented on the current examination by the Comptroller's Office, which is in progress. He noted that the examiners were currently interviewing lending officers and that they had not raised any subjects with management which it was not already aware of. He advised the Board that management of the Bank had held a follow-up staff meeting to the staff-meeting held in January. He reviewed the highlights of that meeting, noting that ten priority items had been identified, being diversification, deposit growth development, tax elimination and shelter, building a real estate commercial portfolio, forming a small business investment company and entering into venture capital transactions, possibly acquiring a trust company, expanding the Association's correspondent network, finding a new head for the Trust Department (per John Miller's specific request as he desires to only work part time), developing a sales oriented marketing department, and preparing a formal budget for the Association along with continuing control of expenses.

There being no further business, upon motion duly made, seconded, and unanimously adopted, the meeting was adjourned.



John R. Preston, Secretary

APPROVED:



Bill P. Jennings, Chairman

MINUTES OF THE REGULAR MEETING
OF THE BOARD OF DIRECTORS OF
PENN SQUARE BANK, N.A.

June 15, 1982

Minutes of the regular meeting of the Board of Directors of Penn Square Bank, N.A., held at 4:00 p.m. on Tuesday, June 15, 1982, in the Board Room.

Present were:

Eldon L. Beller	Ken L. Kenworthy	W. T. Richardson, Jr.
Elizabeth Merrick Coe	Marvin K. Margo	W. A. Ross
Gary M. Cook	Frank L. Murphy	Gene H. Smelser
J. C. Cravens *	H. Mead Norton *	Bill Stubbs
Richard T. Dunn	Bill G. Patterson	Carl W. Swan
Richard C. Haugland	John R. Preston	
Bill P. Jennings	James C. Randolph	

Absent were:

Ronald E. Burks	C. F. Kimberling
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* Advisory Directors

Also present was James J. Gunter, Executive Vice President and Chief Financial Officer.

The Chairman, Bill P. Jennings, called the meeting to order. The Secretary reviewed the minutes of the meeting of May 18, a copy of which was in each Director's book. Upon motion duly made and seconded, the minutes were unanimously approved.

Jim Gunter reviewed the Association's financial statements for the month of May and the year-to-date, copies of which were in each Director's book. He commented that the Association's earnings for the second quarter would not meet plan. He reminded the Directors of the pending capital infusion from First Penn Corporation as a result of its proposed stock sale. The Chairman commented that the funds should come in during July and that the allocation noted in the May Board meeting between the Association and First Penn Corporation may change. After discussion, upon motion duly made and seconded, the financial reports were unanimously approved (except that Messrs. Patterson and Richardson were temporarily absent from the room). Jim Gunter also reviewed the deposit and asset report and the liquidity analysis, noting that consolidated liquidity is exceptionally high.

Jim Gunter reviewed the Association's Securities Report, a copy of which was in each Director's book. (Mr. Randolph joined the meeting

(Minutes of June 15, 1982 Board of Directors Meeting Re-typed by Banking Committee Staff for clarity)

MINUTES OF THE REGULAR MEETING
OF THE BOARD OF DIRECTORS OF
PENN SQUARE BANK, N.A.

June 15, 1982

Minutes of the regular meeting of the Board of Directors of Penn Square Bank, N.A., held at 4:00 p.m. on Tuesday, June 15, 1982, in the Board Room.

Present were:

Eldon L. Beller	Ken L. Kenworthy	W. T. Richardson, Jr.
Elizabeth Merrick Coe	Marvin K. Margo	W. A. Ross
Gary M. Cook	Frank L. Murphy	Gene H. Smelser
J. C. Cravens*	H. Mead Norton*	Bill Stubbs
Richard T. Dunn	Bill G. Patterson	Carl Swan
Richard C. Haugland	John R. Preston	
Bill P. Jennings	James C. Randolph	

Absent were:

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* Advisory Directors

Also present was James J. Gunter, Executive Vice President and Chief Financial Officer.

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Jim Gunter reviewed the Association's Securities Report, a copy of which was in each Director's book. (Mr. Randolph Joined the meeting

during presentation of the report.) Upon motion duly made and seconded, the Securities Report was unanimously approved (except that Mr. Patterson was temporarily absent from the room). At the Chairman's request, Mr. Gunter commented that longer maturity securities would be sold with some loss as "windows" become available for the funds to be profitably redeployed. In response to a question, he noted that the securities portfolio is used for liquidity purposes.

Bill Patterson reviewed overdrafts in a continuous overdraft state for fifteen days or more, a copy of the overdraft report being in each Director's book. He noted the overdrafts which had been cleared since the report had been prepared, noting that with those already cleared and those which will be cleared, the total overdrafts on the report would be less than \$3MM. Mr. Kenworthy commented on Midwest Resources (#05-1165) that he heard the company may be having difficulty with certain of its trade creditors. Mr. Murphy commented on Kimberlings (#15-0055) noting that he expects its overdraft to be cleared in a week to ten days. The President, Eldon Beller, added further comments. After discussion, upon motion duly made and seconded, the overdrafts were unanimously approved.

Bill Patterson next reviewed past-due loans, a copy of which report was in each Director's book. Mr. Randolph inquired as to the comment on J. D. Allen & Co. (#27749 and 27867). Mr. Patterson responded that the officer is following the examiner's instructions. The President noted that he had discussed the loans with the examiners that morning. Mr. Stubbs inquired whether the examiners were still at the Association. The President responded that they were, noting that they had left the Association for a week or so in the middle of their examination. Mr. Randolph inquired as to the officer's remarks on G. L. Scott, Jr. (#26868). Mr. Patterson answered that he would look into the matter, as he knew of no reason why the customer could not pay interest. Mr. Swan commented that to his knowledge the customer has an excellent trade credit reputation. The Chairman commented that he believed the loan to be sufficiently collateralized. Mr. Patterson noted that Apollo Pools, Inc. (#29156) would be charged-off per the examiners. He noted further that on Petros Energy & Land (#25705, 26506, 26988, and 27046) the loans had been paid off by the customer selling its production to another customer. He commented on the substantial amount which had come off the past-due list since May 31. He noted that the examiners automatically charge off any loan past-due more than 180 days. Mr. Cook asked as to when the Association stops accruing interest on past-due loans. Messrs. Dunn, Patterson, and Beller all responded that non-accrual loans are determined by loan review committee. Mr. Cook asked that a non-accrual report be included in each Director's book in the future. The President said that such report would be included. Mr. Murphy noted that as to the Ardith Dolese past-due installment loan foreclosure action against the diamond ring held as collateral would commence soon. After discussion, upon motion duly made and seconded, the past-due report was unanimously approved.

Rick Dunn next reviewed charge-offs totaling \$380,919.53, a copy of which report was in each Director's book. He also gave a quarterly review of the loan loss reserve, a copy of which report was in each Director's book. He noted that based on internal classifications the

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reserve is currently short by \$1.3MM. He stated that the Board is not currently being asked for approval of the adequacy of the reserve and that such approval would probably be sought after the examination is concluded. Mr. Kenworthy inquired as to the reasons for the difference between the charge-off amount for May and the provision for loan loss charge against May earnings. Mr. Dunn responded that the difference is a result of the loan loss reserve being increased on a continuing basis with adjustments made each month determined by actual losses taken. The Chairman made additional comments on the reserve. After discussion, upon motion duly made and seconded, a resolution (Exhibit A) approving such charge-offs was unanimously adopted.

Bill Patterson next reviewed loans made during May 1982 which had been previously approved by the Discount Committee, a copy of the report being in each Director's book. Mr. Patterson noted his participation in the Caddo Reservoir Program, Ltd. (#31770). Mr. Randolph inquired as to whether such participation raises a conflict of interest and he noted his concern about any increase in officer participation in any borrower's activities. The Chairman noted that the ethics committee reviews officer participations as well as the details of the borrowing. He advised that two outside Directors would be added to the committee and he made other comments as to the advantages and disadvantages of such participations. The President commented that greater depth of investigation will be needed as to such participations. Mr. Randolph inquired as to when the rigs were valued which collateralize the C. W. Culpepper loan (#31648). Mr. Patterson answered that 1981 values were used. Mr. Randolph noted that some rigs have recently sold in auction sales in Texas at as little as 25% of 1981 values. Mr. Swan noted that new rigs can be bought for as little as 70% of 1981 values. Mr. Stubbs inquired whether Mr. Culpepper has any Arkansas investors as he had heard there were some problems relating thereto with some Arkansas wells. Mr. Patterson responded that to his knowledge that was not true as Mr. Culpepper had no Arkansas wells. Mr. Patterson commented further on the recent completion of the Tom Cat well by Mr. Culpepper.

The Chairman noted a typographical error in the loan report in that the Texas Upsetting & Finishing, Inc. loan (#31694) should show him as a guarantor to the upstream correspondent bank(s) and that the Mahan Rowsey, Inc. loan (#32553) should not show him as a guarantor. Mr. Patterson noted that the J. B. Hodges loan (#31711) is incorrectly reported; that the correct purpose should be acquisition of an interest in Maximo Moorings, with collateral being a pledge of such interest. He stated further that his own loan and that of Hal Clifford should also reflect such purpose and collateral. He commented that he, Mr. Hodges, and Mr. Clifford expected to sell their investments to Walter Heller & Co. in the near future. The Chairman reminded the Board of the previous reports to the Board as to the nature of the investment and the take-out of the Chase loan to Maximo Moorings by these individuals. Mr. Patterson noted that the Mahan-Rowsey, Inc. loan (#31777) was guaranteed by Sabre Energy, a subsidiary of Anson Corp., a customer. He also noted that the loan to Bill Jennings (#31789) was fully participated as of the date made; therefore such loan was in compliance with Regulation O. He noted that his loan (#31723) of \$770,000 relates to an investment being warehoused for First Penn Corporation for its ultimate assumption if and when Federal Reserve approval is granted. He advised that the loans to

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Susan Mears (#31702 and 31776) are guaranteed by Bobby Hefner and relate to the purchase of real estate which is remodeled and then sold for a profit. The Chairman commented that there were no new borrowers on May's loan list, adding that the Association is servicing its current customers in an attempt to slow down loan growth, and stating that new loan customers are accepted to the extent such loans can be profitably sold upstream. He also stated that the Association is being extremely selective in taking on new credits. After discussion, upon motion duly made and seconded, the loans were unanimously approved.

The Secretary reviewed the insurance report, a copy of which was in each Director's book, noting that the report would be reviewed annually. He answered questions as to various coverages and noted the total annual insurance premium is currently \$135,400. Mr. Cook inquired as to the adequacy of the amount of Director and officer liability coverage. The Secretary said he would look into having the coverage increased, if possible, and would report back on same.

The Secretary reviewed Executive Officer and Director-officer borrowing reports (Exhibits E through H) and an amended report of Bill Patteson with explanatory letters (Exhibits F through I). Mr. Jennings advised that as to his report (Exhibit C) the listing of the loan as unsecured may be incorrect; that the loan may be secured by oil and gas properties; and, if necessary, that he would submit a corrected report at the conclusion of the Board meeting.

The Secretary reviewed new officer elections and promotions. He gave a brief report on the responsibilities of each new officer and the officer's salary. Upon motion duly made and seconded, a resolution (Exhibit J) was unanimously adopted making such new officer elections and approving such promotions.

The Secretary reviewed management-recommended amendments to the Profit Sharing and Savings and Thrift Plan. After discussion, upon motion duly made and seconded, a resolution (Exhibit K) was unanimously adopted approving such amendments and changing the name of the plan.

The Secretary advised that temporary signature authority for JoAnn Calloway, Operations Officer and head of the main bank teller department, had been requested (Exhibit L) so as to allow her to sign cashier checks in an amount up to \$100,000. Upon motion duly made and seconded, a resolution (Exhibit M) was unanimously adopted approving such signature authority.

The Secretary advised that management recommended approval of a resolution authorizing a customer trading account with Lotan Mosle Inc. Upon motion duly made and seconded, such resolution (Exhibit N) was unanimously adopted.

The Chairman advised that management had received the Fear, Marvick, Mitchell & Co. (FMC & Co.) management letter (Exhibit O) and that Jim Gunter would review management's response to same (Exhibit P). (Mr. Cravens and Mr. Swan left the meeting during the presentation.) Jim distributed copies of his response and the management letter to each

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Director. He reviewed each of the significant items raised by PNM & Co. in summary form and his response to same. Discussion was held on various matters. The Chairman advised that the Energy Division would be restructured, with a senior official to be in charge of administration and operations and Bill Patterson to be in charge of relationships with upstream correspondents. Mr. Randolph expressed his concern on overdrafts and stated that he would like to see the trend on overdrafts. Mr. Cook noted his concern that PNM & Co. advised that overdraft charges are often being waived. The Chairman and the President discussed the current procedures and the necessity of obtaining the President's approval of any waiver of overdraft charges. Bill Patterson discussed the problem of paying interest to upstream correspondents prior to collecting same from the customer and advised that of \$10MM involved in such practice all but \$300,000 had been collected to date. Mr. Randolph inquired as to PNM & Co.'s comment on the quality of loans in our own portfolio. The Chairman and the President discussed the reasons for below market-rate loans and efforts being made to improve the portfolio. Mr. Cook inquired whether the Association is building into its pricing appropriate return to compensate it and whether our customer profitability analysis will reflect such matters. The President responded that such analysis, once in place, would reflect such matters and added that the Association is putting in place a new structure on servicing fees. The Chairman invited each Director to take management's response letter, study it, and refer any questions or comments to him or to the President. He reminded the Directors to keep the material confidential and asked that they not take the PNM & Co. letter, noting that a copy would be available from his office for any Director wishing to review same at the Association. He asked Mr. Gutter to give quarterly reports on the progress made on items raised in the management letter.

The President gave an update on the results of the Comptroller examination. He noted that the exam had been thorough and that the actual numbers would be forthcoming. He advised that the examiners had alleged numerous lending limit violations, which he and the Chairman intend to discuss with the examiners as to how they occurred. The Chairman stated that no Director had ever knowingly or intentionally assented to any lending limit violation, noting that several of the Directors had, at previous meetings, asked whether the lending limit was being violated and had been assured that it was not being violated and that policies were instituted to prohibit such violations. The President continued by noting that the examiners charge-off list is incomplete, but that he expects heavy criticisms and classifications of loans. Mr. Lemercy asked whether the amount would be \$5M and the President answered that it would be at least that amount and likely more. The President said that the examiners were digging deep into the portfolio due to the energy industry problems which had been much publicized.

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* -- Copy illegible.



Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

August 15, 1982

Re: Penn Square Bank, N.A., Oklahoma City, Oklahoma

Dear Mr. Chairman:

In your letter of July 28 you requested information from this Office to help in your investigation of the Penn Square Bank failure. In response to that request, we are enclosing:

- * A copy of the Formal Agreement executed with the bank in September 1980;
- * Copies of the Notice of Charges and Temporary Order to Cease and Desist issued in June and July of 1982; and
- * A summary of each examination report from 1976 to 1982.

We will also make the bank's monthly reports and reports concerning loans by correspondent banks available to your staff. We have eliminated the names of borrowers from all these documents because of the significant confidentiality protections that surround customers' financial transactions, as well as statutory limitations on disclosure of examination material.

For the sake of those members of the Committee who do not have your familiarity with the bank examination process, let me provide a word of caution about the use of the summaries. Examinations and the resulting reports are, as the GAO has pointed out, the first line of bank supervision used by all bank regulators. No matter how sound a business may be, its financial and managerial structures are not free of all bases of criticism when put under the rigorous scrutiny of a thorough examination. Examinations are used to point out the deficiencies identified by the examiner so that the board can institute corrective measures.

I hope this information will be of help to you. My staff and I are ready to work with you and the Committee to resolve any questions you may have.

Sincerely,



C.T. Conover
Comptroller of the Currency

The Honorable
Fernand J. St Germain
Chairman, Committee on Banking,
Finance and Urban Affairs
2129 Rayburn House Office Building
Washington, D.C. 20515

Enclosures

Regular Examination August 16, 1976 Examiner In Charge (EIC) Jerry L. Lanier

[This was the last examination of Penn Square using OCC's former examination procedures, prior to implementation of revised procedures in the fall of 1976.]

This examination emphasized criticized assets having reached an "unacceptable level" at 54% of Gross Capital Funds and stated that immediate steps should be taken to reduce them. Similar comments were directed toward documentation exceptions and loan delinquencies. Development and implementation of a written lending policy was also recommended. Criticized assets centered in Other Assets Especially Mentioned (OAEM) and Substandard, with nominal Doubtful and Loss.

Numerous internal control exceptions were cited, and the independence of the internal auditor was questioned due to his conflicting operational duties.

Other items addressed were: the need to revise procedures to comply with OCC policy regarding the disposition of credit life insurance income; need for a written EEO affirmative action program; non-compliance with two technical provisions of the bank's By-Laws; and violations of two laws and two regulations.

Net income in 1975 of \$536M had yielded a Return on Assets (ROA) of 1.32%, compared with \$464M and 1.42% in 1974. Net loan losses in 1975 had risen to \$188M versus \$22M the previous year. No dividend had been paid in 1975. However, a balance sheet and income statement for the holding company, First Penn Corporation, were included in the report and reflected that dividends received from the bank were \$225M YTD 8/13/76. The holding company's investment in the bank was reflected as \$3,938M against a holding company loan payable elsewhere \$2,500M.

Two Directors were cited for poor attendance at Board Meetings. Extensions of credit to insiders and their interests equalled only 5.26% of gross loans, but none were criticized.

A review of the bank's official Reports of Condition disclosed errors requiring resubmission of reports for 3/31/76 and 6/30/76.

Participations purchased and sold were \$521M and \$1,631M, respectively. Letters of Credit outstanding were \$73M and undisbursed loan funds were \$2,412M.

A meeting was held by the examiner with the Board of Directors during which the condition of the bank and criticisms contained in the report were discussed.

August 16, 1976, Examination (General)(1) 12 U.S.C. §84 (Lending Limits)

Violation of Section 84 occurred on March 31, 1976, when a loan to an individual was combined with separate loans to a welding and supply company on the theory that the parties were engaged in a common enterprise. See 12 C.F.R. § 7.1320(b).

(2) 12 U.S.C. § 375a(b) (Loans to Executive Officers)

One executive officer did not provide the required written report to the Board of Directors, regarding loans he received from other banks. Management promised correction by the next Board of Directors' meeting.

(3) 12 C.F.R. Part 23 (Statement of Business Interests of Directors and Principal Officers)

A director who took office in February 1976 did not file the Statement of Business Interests within 30 days as required by 12 C.F.R. § 23. Management promised correction. Part 23 was revised significantly in 1980 when the OCC deleted past requirements and adopted by reference for directors the reporting requirements of Regulation O (12 C.F.R. Part 215).

(4) 12 C.F.R. § 1.8 (Prudent Banking Judgment; Credit Information Required)

Bank did not maintain information necessary to demonstrate that it exercised prudence in purchasing various investment securities.

Specialized Examination May 20, 1977 EIC William F. Chambers

Assets had grown 15% to \$58.5 million since the August, 1976 examination, and loans were up 19% to \$35.4 million. The dollar volume of criticized assets was approximately the same as in 1976 (classified down - OREM up), but had declined to 48% of gross capital due to strong retained earnings. Loans classified doubtful and loss were up somewhat, with Loss including \$67M in two overdrafts resulting from giving immediate credit on uncollected funds. Loans to insiders and their interests equalled only 4.84% of gross loans; none were criticized. Documentation exceptions remained high at 14% of loans, but delinquencies had declined to 3.65%. No violations of law or regulation were disclosed.

The examiner summarized the overall condition of the bank as having shown improvement, with good earnings, competent management, and positive future prospects. He did, however, enumerate several significant concerns:

- need to augment the Reserve for Possible Loan Losses (RPLL) - management agreed to bring reserve up to 1% of loans by year-end, which the examiner considered adequate

- need for a system to check and prevent any concentration from developing within the oil and gas portfolio as to individual area,

leases, or wells. [management's response not indicated, but no actual oil and gas concentrations were listed in the report.]

- need for a capital planning program in view of rapid growth [management's response not indicated; however, the report acknowledged \$1 million in debentures to be issued within 90 days]

Earnings had been good in 1976 at 1.47% ROA, but were running lower at about .95% ROA through May 20, 1977. Dividends in 1976 had amounted to \$28CM, or a 38% payout. The examiner described the bank's balance sheet distribution as generally comparing favorably with other banks in its "peer group", but pointed out its generally heavier reliance on large CD's. He recommended that formal policy guidelines be developed for the funding and that the Board consider the practice of continuing to attract large, rate-sensitive deposits. Primary liquidity was 21%.

Internal controls were rated "medium" with recommendations for policy refinements. Internal and external audit activities were each described as only "partially acceptable" due to questionable independence of, and reporting by, the internal auditor, as well as the limited scope of the external audit.

The bank had recently applied to OCC for trust powers, and the examiner saw no reason to disapprove. Two Directors were again cited for poor attendance at Board Meeting. The report contained no comments regarding participations or contingent funding obligations.

May 20, 1977 Examination (Specialized)

No violations of law, regulation or rule were cited in this report of examination.

General Consumer Affairs Examination 3/13/78 - Gregory T. Martin

This was the first consumer affairs examination of the Penn Square Bank's compliance activities under the OCC's newly implemented consumer compliance examination process and procedures.

The report cited various violations of law not unusual for a bank whose mainstay is commercial lending. The primary criticism involved the failure to develop and implement a well-defined system of internal controls designed to both educate officers and employees in the requirements of the various consumer-related laws, rules, and regulations and to provide for periodic review of the extent of compliance overall.

General Examination May 19, 1978 EIC William F. Chambers

This examination comprised a comprehensive review of every operational area of Penn Square Bank. The bank had grown 26% to \$74 million in total assets since the May 1977 examination, with loans up 37% to \$48 million. Varying degrees of deterioration were noted in several areas.

- Lending: Although classified percentages were down as the result of retained earnings and new debt capital, dollar volume actually increased slightly, including \$307M loss compared to \$144M at the preceding examination. Loans with documentation exceptions totalled 32% of gross loans. Delinquencies were down slightly. The volume of documentation exceptions was in direct contravention to the bank's loan policy and the examiner requested immediate remedial action.

The bank had developed several heavy concentrations of credit, including 142% of capital vested in oil and gas production. Other concentrations included related lines of a Director at 41% of capital (the director's other related loans had been sold to other banks) and related lines of another borrower at 23% of capital.

Only a very small portion of the oil and gas concentration was subject to classification. The examiner mentioned the risk inherent in concentrations and suggested close monitoring.

Above average loan losses during the examination necessitated an additional \$100M provision to the RPLL.

- **Funds Management:** The examiner noted that the asset growth rate was several times above the peer average for the last three years. Dependence on large CD's and sale of loans and participations to other banks was becoming increasingly necessary to maintain liquidity. Recommendations included structuring the investment portfolio with more attention to liquidity needs.

- **Capital:** Despite retained earnings and \$1 million new debt capital since the previous examination, key ratios were slipping as the result of overall growth. The examiner emphasized the need for a capital planning policy, and predicted additional equity would be needed in the near future. ROA in 1977 had been .90% and was continuing at that level annualized through 5/19/78.

Loans to insiders and their interest equalled 5.35% of total loans, but were not criticized. Recurring comments appeared regarding internal audit procedures and the limited scope of the external audit.

Overall, the examiner predicated the bank's future prospects for success on its ability to plan and implement asset growth soundly and to maintain sufficient capital to support that growth.

May 19, 1978 Examination (General)(1) 12 U.S.C. § 84 (Lending Limits)

Section 84 violation arose because a separate loan to the owner of a company was used for the benefit of the company. Combination of these loans created an overline. The line was brought into conformity during the examination.

(2) 12 U.S.C. § 371d (Investment in Bank Premises)

Violations occurred when the bank exceeded the maximum allowable investment in bank premises. The bank was instructed to request from the Regional Office an increase in its limits for investment in bank premises.

(3) 12 U.S.C. § 375a(6) (Loans to Executive Officers)

An officer did not submit required reports on his borrowings from other banks to Board of Directors and did not identify collateral in connection with such loans. Corrected during examination.

(4) 12 C.F.R. § 204.2 (Regulation D) (Reserve Requirements of Depository Institutions)

Bank did not classify matured, but not renewable, certificates of deposit as demand deposits as required under 12 C.F.R. § 204.2(b)(1)(vii).

(5) 12 C.F.R. § 217 (Regulation Q) (Interest on Deposits)

Bank violated 12 C.F.R. § 217.1(e) by maintaining commercial savings accounts in excess of \$150,000.

(6) 31 C.F.R. § 103.33 (Financial Recordkeeping and Reporting of Currency and Foreign Transactions)

Bank did not file required statement of purpose for several loans over \$5,000.

(7) 12 C.F.R. § 7.3025(f) (Other Real Estate Owned)

Bank has some property for which resolutions have not been adopted.

Specialized Examination 6/22/79 - EIC William F. Chambers

The examination of the bank in June 1979 was specialized in scope with added emphasis on loan portfolio management, asset/liability management, capital adequacy and analysis of the bank's liquidity posture. The conclusion of examiner Chambers was that the bank was basically sound, although rapid asset growth was outpacing capital growth. His conclusion was grounded in management and the board's ability to address each of the areas upon which the examination focused. He requested that the board submit a capital plan designed to eliminate the identified shortfall and provide for future growth.

The Board of Directors and the management hierarchy were both dominated by the Chairman of the Board. In fact, the Chairman was the principal lending officer on a majority of the bank's large credits. Growth in both assets and loans under the Chairman's guidance was also outstripping the capability and experience of bank staff and officers.

The quality of the bank's assets had shown no material change since the May 1978 General Examination and the June 1979 examination. The percentage of classified assets to gross capital funds (GCF) declined from 28% to 27% while OAEM as a percentage of GCF increased by 9%. The nominal decline in the classified percentages was the result of a growth in GCF from \$5.9MM to \$7.6MM.

The review of the loan portfolio underscored the staffing insufficiency, due to rapid growth, within the lending departments. The growth was primarily in oil and gas related credits. The examiner was not alarmed by overall loan growth, since the Chairman gave assurances that further asset growth would be at a modest pace. Of particular note were the bank's efforts leading to a dramatic improvement in credit documentation.

The bank's net income for 1978 totalled \$915M or a return on average assets (ROA) of 1.13%. The above average earnings were continued into 1979 with net income of \$945M through June 22, 1979. The earning performance was attributable to above-average yield on earning assets combined with below-average interest and non-interest expenses.

Even though the bank was generating above-average return on assets, its phenomenal asset growth prohibited the bank from relying solely on earnings to augment capital. The percentage of equity capital to total assets on the examination date was 6.14%, while the universe of similarly sized banks had equity capital equal to approximately 8% of total assets.

The liquidity, asset and liability management function of the bank was also being taxed by the rapid growth in total assets. As the bank experienced rapid loan growth, it had to rely increasingly on purchased monies to fund those loans. Rate sensitive deposits plus purchased funds represented over 40% of total deposits at the examination date. The bank was paying rates slightly higher than those being paid by other institutions.

The bank's liquidity was characterized as marginal. Sources of liquidity other than federal funds were rate sensitive deposits such as: 1) CDs over \$100M = \$29MM; 2) Money Market CDs = \$6MM. Even though funding officers were satisfying the bank's funding needs, the basic policy and procedures necessary to administer a well-managed asset and liability management function had yet to be developed.

The internal operations of the bank were considered to be adequate. The internal audit was deemed unacceptable, but the external audit coverage was acceptable.

June 22, 1979 Examination (Specialized)(1) 12 U.S.C. § 84 (Lending Limits)

Section 84 violations involving two excessive lines to a husband and wife.

(2) 12 U.S.C. § 371d (Limitations on Investment in Bank Premises)

Regional Administrator's letter limited bank's investment in premises. During examination Bank ordered to seek approval for increase in limit as required by the statute.

(3) 12 C.F.R. § 2 (Disposition of Credit Life Insurance Income)

Bank officers paid a percentage of the premium received on the sale of credit life insurance for bank loans, in violation of regulation. See 12 C.F.R. § 2.4. Bank promised corrective action.

(4) 12 C.F.R. § 23 (Statements of Business Interests of Directors and Principal Officers of National Banks)

Failure of two directors to report material changes in their business interests within required 30-day period. Corrected during exam. This regulation was deleted in 1980. In lieu thereof, the OCC substituted by reference the reporting requirements of Regulation O (12 C.F.R. § 215). See 45 Fed. Reg. 14 (1980).

(5) 12 C.F.R. § 217 (Regulation Q) (Interest on Deposits)

Commercial savings accounts were being maintained in excess of the \$150,000 limit established by 12 C.F.R. § 217.1(e). Corrected during examination.

(6) 12 C.F.R. § 18.3(b)(6) (Annual Financial Disclosures to Shareholders)

Bank did not include required breakdown of loan portfolio in 1978 shareholders report. Corrective action promised for 1979 report. This regulation was substantially revised in 1980. See 46 Fed. Reg. 16 (1980). With certain exceptions such as banks registered under the Securities Exchange Act, the revised regulation does not require that the bank disclose such information unless requested by a shareholder.

General Trust Examination as of 1/19/80 EIC Morris B. Vaden, Jr.

This was the first examination of Penn Square Bank's trust department since the bank was granted trust powers on July 11, 1977. At the time of this examination, based on year-end 1979 figures, the department had \$1,384,000 of discretionary assets in 9 accounts. Trust department management was considered to be good, consisting of a department manager with over 25 years experience in trust, plus a staff of two.

Report comments reflected problems not unusual in an emerging trust department. The primary criticism regarded failure to achieve a suitable audit. Other criticisms involved the unauthorized purchase of trustee bank deposits and failure to adequately monitor the timely investment of fiduciary cash. In its third full year of operation, the department reflected an operating loss of \$43,000 with fees of \$19,000 and expenses of \$62,000. After consideration of an \$11,000 deposit credit, the department's net loss for 1980 was \$32,000. Prospects for future growth were stated to be poor.

Specialized Examination 2/29/80 - EIC William F. Chambers

The scope of the Specialized Examination in February 1980 was expanded in the area of loan portfolio management, asset/liability management and capital adequacy. The examiner concluded that the bank was under-capitalized, overly dependent on purchased funds, growing at an excessive pace, and showing signs of asset quality deterioration.

The Report of Examination highlighted Chairman Jennings' dominance over the daily management of the bank. The Chairman was also responsible for the majority of the larger loans in the bank.

The percentage of classified assets to GCF increased from 27% to 42% while OAEM to GCF increased from 14% to 36%. The classified assets were concentrated in the substandard category (\$4,314M) with only nominal doubtful and loss; \$181M and \$329M, respectively. The examiner did not cite the volume of classified assets as a principle concern, since the bank's capital increased from \$7.6MM to \$11.4MM, thereby offsetting the increase in classified assets. [The capital increase noted includes equity injections totalling \$3MM from external sources.]

The loan portfolio increased 66% during calendar year 1979 with an 11% growth continuing from January through March 1980. Oil and gas lending continued to

be the primary growth area. A lack of adequate staff and inexperienced employees further heightened the growth problem. A concentration of oil and gas related credits aggregated \$41MM or 30% of gross loans. Criticized and classified assets were related predominantly to energy or real estate loans.

The bank was experiencing phenomenal earnings during 1979. A net income of \$2,030M for 1979 more than doubled 1978 earnings. The maintenance of favorable interest rates spreads was responsible for the excellent earnings performance.

Despite the excellent earnings performance, the capital base continued to deteriorate as a segment of the bank's balance sheet. Retained earnings, as a source of capital, could not keep pace with asset growth. As a result of the strained liquidity and the immoderate loan and asset expansion, the examiner recommended an injection of \$6MM in new equity capital by mid-year 1980.

The examination characterizes the liquidity, asset and liability management function of the bank as being adequate; however, the examiner expressed an opinion that expanded supervision of the bank's liquidity posture was essential. Management was reminded of the hazards of maintaining low liquidity. Also, the examiner explained that rapid loan growth has resulted in the continual need to purchase Fed funds and CDs over \$100M and advised that such purchased liquidity subjected the bank to more than normal exposure to interest rate fluctuations and funds volatility.

The phenomenal growth in assets was funded primarily by an increase in deposits (35%). Since the previous examination, MCDs had tripled while CDs over \$100M had increased over 40%. The examiner considered these time deposits to be relatively stable due to the fact that most of the depositors were local customers with a history of renewing upon maturity. The examiner expressed concern that the long term loans within the bank were being funded with short-term deposits.

Internal controls were considered adequate at this examination. The internal audit was rated partially acceptable and the external audit was deemed acceptable.

Insider Transactions - 2/29/80 Specialized Examination

- o Overall a total of \$3,936M direct and indirect loans, or 3.52% of the loan portfolio, was reported. There were no insider loans criticized during the examination. There were also no concentrations noted in loans to insiders or their interests.
- o Loans to individual officers, directors, and principal shareholders consisted of 11 loans, both direct and indirect, totalling \$2,272M.
- o Loans to associated companies consisted of 9 credits aggregating \$1,293M. There was also 1 loan to an individual secured by stock of a corporation which was over 10% owned by a director.

February 29, 1980 Examination (Specialized)(1) 12 C.F.R. § 217 (Regulation Q) (Interest on Deposits)

Interest was being paid on commercial savings accounts in excess of \$150,000.

(2) 12 C.F.R. § 204 (Regulation D) (Reserve Requirements of Depository Institutions)

Bank classified matured, but not renewable, certificates of deposit, as time deposits rather than demand deposits. for reserve purposes as required under 12 C.F.R. § 204.2 (b) (1) (vii).

(3) 12 U.S.C. § 84 (Lending Limits)

- (a) Violation of section 84 arose when bank issued standby letter of credit for the account of a refining company. The bank subsequently loaned funds to the refining company and increased the excessive amount on the violation.
- (b) Loans to a drilling company and separate loans to two individuals the proceeds of which were used for the benefit of the drilling company were combined as a "single borrower" under 12 C.F.R. § 7.1310(c) (3). The combination of loans exceeded the bank's legal lending limit in a violation of section 84. An additional excessive loan was subsequently made to the refining company.
- (c) Loans to husband and wife, both of whom are partners, were combined with loans to a partnership. Combination resulted in an overline and a violation of section 84. New loans subsequently increased the excess.
- (d) Standby letters of credit issued for the account of certain individuals and a drilling company were viewed as loans to a common enterprise and combined under 12 C.F.R. § 7.1320(b). The common enterprise was a guarantee of a loan to an investment organization in which the various account parties were interested. The standbys issued on behalf of these parties were combined under the common enterprise theory as three separate lines of credit.

Consumer Affairs Examination 3/10/80 - Stuart A. Scherer

The second examination of the bank, conducted under specialized examination procedures designed to concentrate on areas of non-compliance identified at prior examinations, reflected improvement in the bank's efforts to comply with consumer laws.

The report cited various violations of law, most of which were isolated, affecting one or two loans but having no financial impact on the bank or its customers. An evaluation of internal controls indicated management had taken steps to implement an effective internal control program and to provide for review of the extent of bank compliance.

Visitation Examination 9/9/80 - EIC William F. Chambers

The limited scope Visitation encompassed previously criticized loans, loans to new borrowers, and past due commercial loans. An additional review was conducted of capital and liquidity.

Supervision of the bank continued to be under the direction of Chairman Jennings. Even though other senior officers supervised lending, Mr. Jennings appeared to function as the guiding force behind the bank's oil and gas activities.

The report emphasizes the improvement in asset quality. The bank's classified and criticized asset percentage improved between the February 1980 and the September 1980 examinations. Classified assets declined to a modest 20% of gross capital funds while criticized declined to 6%. The basis for improvement was attributed to the attention directed to documentation and repayment programs. The examiner noted the Board's positive response to the prior examination and their signing of the Administrative Agreement.

The examiner expressed concern for concentrations of credit in oil and gas loans combined with the inexperienced personnel and understaffed condition of that department. A schedule of oil and gas loans aggregating \$56MM and a list of participations sold in those loans amounting to \$196MM were included in the

report. The examiner recommended that the Board closely monitor this heavy concentration of credit.

The bank's net income through 9/9/80 was strong at \$2,584M or an approximate ROA of 1%. The net income figures represented a doubling of income over the same period in 1979.

Despite strong earnings retainages [and a \$2MM injection from external sources not recited in the report], the bank's capital adequacy continued to be outpaced by asset growth. The Administrative Agreement signed 9/9/80 required an equity to total assets percentage of 7.5%. As a result, and to comply with the Agreement, the bank holding company was in the process of selling \$4.5MM in equity for the purpose of downstreaming it to the bank. Bank management reported that the issue was over subscribed and the money would be injected during October, 1980.

Insider Transactions - 9/9/80 Special Supervisory Visitation

- o Overall - The scope of this examination did not include a review of insider related transactions. There were no violations of law noted concerning insiders or their interests. The concentration to the oil and gas industry listed in the report contained several companies which were interests of directors. No insider loans were criticized in the report.

September 9, 1980 Examination (Visitation)

This report of examination notes that all violations of 12 U.S.C. § 84 cited in previous reports have been corrected. It also notes that the Bank entered into a formal agreement with the Comptroller's Office on September 9, 1980.

General Examination 12/31/80 - EIC George E. Clifton, Jr.

The scope of the General examination encompassed a complete review of the bank's policies, procedures and overall condition. The examination covered the commercial activities as well as consumer compliance and the trust department and was completed in April 1981. The examiner concluded that the problems facing management and the board had not been resolved. Areas of concern included: non-compliance with the 9/80 Agreement, exposure to unwarranted risks in asset/liability management, asset quality considered only fair, capital surpassed once again by excessive growth, violations of law, and weak internal controls.

Supervision by the board was characterized as minimal. The board's compliance with the 9/80 Agreement had not been completely forthcoming. Only one written policy statement had been adopted by the board, although two more were adopted during the examination. Oversight committees formed by the board were ineffective. The reporting systems developed by management to keep the board informed were deemed to be inadequate. Management again resolved to address the bank's problems. The examiner cautioned that an administrative staff shortage hindered the bank's effort to achieve a successful turnaround, but acknowledged that a recruiting effort was underway.

The quality of the bank's assets experienced a marked deterioration when compared to the February 1980 Specialized examination. Classified assets as a percentage of gross capital funds increased to 76% from 42% while CAEM increased to 66%. Additionally, documentation exceptions aggregated 20% of gross loans. [The percentage increases came despite the fact that capital had doubled in one year.]

In addition to the increase in the classified percentage noted above, non-compliance with the administrative document, a significant concentration of credit, inadequate internal loan review, and the inadequacy of staffing each contributed to the concern for deteriorating asset quality. In the rather short four month period between examinations management and the board had yet to make substantive progress in addressing compliance with loan related articles of the Agreement. A large concentration of bank loans relating to oil and gas was detailed in the report. Management was forewarned to monitor trends in the oil and gas industry in view of the bank's exposure. The inadequacy of the bank's internal loan review was demonstrated by the disparity between examination identified problems and internally identified problems.

An inadequate depth and experience level of staff contributed to the decline in asset quality. Of particular concern was the continued reliance on a small number of officers and employees to administer the large and unrestricted loan portfolio. A lack of controls was particularly evident in the loan documentation area.

During 1980 the bank again generated exceptional earnings. The return on average assets was 2.07%. Actual net income was \$4,285M versus \$2,032M in 1979 and \$915M in 1978. [As the figures indicate, the bank was doubling its income each year.] The reason for the increase in income can be attributed to high yielding loans, controlled loan loss, substantial loan origination fees, and low non-interest expenses.

The bank did not maintain the required ratio of equity to total assets (7.5%) as set out in the September 1980 Agreement despite injections totalling \$7.5MM from external sources in 1980. On the examination date, the equity to asset ratio was 6.4%. Projected earnings in the first quarter of 1981 would not be sufficient to augment capital. Additional capital funds from external sources would be necessary during the first quarter.

Balance Sheet positions were taken which were not consistent with safe and sound banking principles with respect to liquidity and interest rate sensitivity. The examiner advised that failure by management and the board to alter these positions could adversely affect earnings and, ultimately, the bank's viability.

A liquidity, asset and liability management policy was adopted by the board during the examination. The policy only partially satisfied the requirements of the September 1980 Administrative Agreement. The policy required the formation of a committee to oversee funds management. Information required in the policy was not being produced for the committee. The restrictions on rate

sensitivity were not well defined. The liquidity risk segment of the policy needed to be expanded to include potential liquidity needs, maturities of assets and liabilities, sources and use of funds, etc.

During 1980, the bank's funding was highly rate sensitive. As a result of the sensitivity, the bank experienced wide swings in net interest margins. The board's policy reportedly defined a goal of consistent earnings independent of fluctuating interest rates. The rate sensitivity positions were both speculative and in direct contravention of board policy. As it stood, a sharp reduction in interest rates would have a negative impact on the bank's earnings performance.

The bank's liquidity position was dependent upon direct borrowings and the ability of management to package and sell loans. Of particular concern were the bank's unfunded commitments to lend. On 12/31/80 the bank had the following:

1) letters of credit	\$ 27MM
2) fee paid loan commitments	\$1.6MM
3) net undisbursed loan funds	\$ 57MM

The growth of the bank combined with its willingness to commit to lend had placed considerable strain on liquidity and the overall funding process.

The overall quality of the investment portfolio was good and yields were improving. Investment activities continued to operate without the benefit of

a written, board-approved policy statement. The examiner reviewed an acceptable draft policy, but noted that the bank was not in compliance with the policy statement with regard to portfolio maturity, financial information, and concentrations. Several revisions were recommended prior to board and management implementation.

Internal controls were reviewed at the examination and were considered to be inadequate. Internal audit was only partially acceptable. Concern was expressed for the internal auditor's independence, internal reporting, follow-up, and scope of work performed. The unqualified audit of the external auditors for 1979 was deemed acceptable. The audit for fiscal year 1980 was in process during the examination.

Several of the violations of law were corrected during the examination. The board was asked to notify the Regional Administrator of the method and date of each subsequent correction.

Insider Transactions - 12/31/80 General Examination

- o Overall - A total of \$5,583M direct and indirect loans to insiders and their interests, or 2.52% of the loan portfolio, was reported. Criticized insider loans amounted to only 3.78% of all criticized loans.

- o Loans to individual officers, directors, and principal shareholders consisted of 26 loans, both direct and indirect, totalling \$4,945M.

- o Loans to associated companies consisted of seven credits aggregating \$1,827M. All but two were interests of one director and were primarily related to the oil and gas industry. The vast majority of these loans were participated to correspondent banks.

- o Concentrations of loans to insiders and their companies - the loans of one director aggregated \$3,691M or 18% of the bank's capital. Participations in these loans were sold to correspondents and totalled \$76,845M.

December 31, 1980 Examination (General)

- (1) 12 U.S.C. § 82 (Limitation on Borrowing by a National Bank)

Bank sold loan participations evidenced by certificates which had an earlier maturity date than the underlying notes. The transactions were characterized as loans sold subject to a repurchase agreement. The transactions caused the Bank to exceed its borrowing limitation as of the date of the examination. Correction was effected by reissuance of the participation certificates with the same maturity dates as the underlying notes.

- (2) 12 U.S.C. § 84 (Lending Limits)

- (a) Loans to an oil and gas exploration company were combined with loans to an indirect parent apparently on the basis of 12 C.F.R. § 7.1310(c)(1). Violations arose because participations in the above loans sold to other banks had an earlier maturity date than the underlying notes. Bank promised correction would be "effected through re-issuance" of participation certificates with maturity dates corresponding to the underlying notes.
- (b) Loans to the same oil and gas exploration company and parent as in (a) above were combined on February 23, 1981. The violation was caused by the bank advancing funds to borrowers on February 23, 1981, prior to receipt of payment from a participating bank. It was corrected when funds were received from the participating bank on the same day.
- (c) Loans to related interests of an individual combined with advances to the individual. Management stated future loan advances would be monitored to avoid additional violations of section 84. Violation was subsequently considered cured by bank on advice of private counsel that Exception 7 to 12 U.S.C. § 84 involving loans secured by livestock was applicable.

- (3) 12 U.S.C. § 74 (Vacancies on Board of Directors)

Bank left unfilled a vacancy for 4 months on Board of Directors created by death of director. Bank also increased number of directors from 14 to 16, but did not fill the 2 extra positions with directors who met the age requirements in the Bank's by-laws. Vacancy created by death filled on February 10, 1981, during annual meeting of Board of Directors. Two vacancies created by increase in size of Board of Directors were filled on April 14, 1981.

(4) 12 U.S.C. § 161 (Reports of Condition and Income)

Reports of income for year-end 1979 and 1980 and reports of income for June 30, September 30, and December 31, 1980 contained numerous errors. Bank promised to improve accuracy. These errors were discussed with management and amended reports were filed with the Office.

(5) 12 U.S.C. § 371d (Investment in Bank Premises)

Bank increased its investment in bank premises without Regional Administrator's authorization. Correction effected when approval subsequently obtained for increased investment on February 6, 1981.

(6) 12 U.S.C. § 375a (Loans to Executive Officers)

(a) Certain officers did not file "detailed current financial statements" for loans made pursuant to this section. See 12 U.S.C. § 375a(1)(c). Violations were corrected by May 19, 1981, when one of the executive officer's involved resigned and the other paid his loan in full.

(b) Certain officers did not submit the required reports and identify the collateral in connection with loans received from other banks. See 12 U.S.C. § 375a(6). Corrected, in part, during examination and thereafter when last of required reports was filed with the OCC.

(7) 12 C.F.R. § 1.8 (Prudent Banking Judgment; Credit Information Required)

Bank did not maintain information to demonstrate that it exercised prudence in purchasing various investment securities.

(8) 12 C.F.R. § 7.3025(f) (Other Real Estate Owned)

Board of Directors did not adopt resolution stating plans for certain real estate acquired and held for future expansion. Management states the properties will be sold or deeded to its holding company prior to December 31, 1981.

(9) 12 C.F.R. § 7.4400 (Organization Meeting of Board of Directors)

Bank's Board of Directors' failed to hold required organizational meeting after February 12, 1980, election of directors. However, a meeting was held after the 1981 election. Bank suggests in a progress report that the hiring of a General Counsel will help ensure that director and shareholder meetings are called when required and properly documented.

(10) 12 C.F.R. § 21.5(a) (Minimum Security Devices and Procedures for National and District Banks)

Bank did not file required report certifying compliance with provisions relating to security devices and procedures. Corrected during examination. Bank notes that its security officer has been informed of the necessity of complying with this provision.

(11) 12 C.F.R. § 215 (Regulation O) (Loans by Member Banks to Their Executive Officers, Directors and Principal Shareholders)

- (a) Examination report listed 19 violations of 12 C.F.R. § 215.4(b)(1) which requires prior approval by the Board of Directors for loans to executive officers, directors, or principal shareholders or their related interests in excess of \$25,000. Bank instituted corrective action, in part, by appointing "F.I.R.A. Compliance Officer" at Board of Directors meeting of July 14, 1981. All F.I.R.A. compliance matters involving "related interests" of directors, credit lines, prior credit approvals and "insider reporting" were to be administered by this officer. Subsequent to examination the Board of Directors reviewed all lines of credit to insiders and their related interests and revised them as necessary.
- (b) Bank, in four instances, did not file written reports on extensions of credit from correspondent banks to its executive officers or principal shareholders and their related interests. See 12 C.F.R. § 215.22(a). Some of the required reports were obtained during the examination. Management promised improved attention to such reporting. Progress report submitted by bank on this violation indicates that all required reports were finally submitted.
- (c) Bank did not maintain required list identifying its executive officers, directors, principal shareholders and their related interests. See 12 C.F.R. § 215.7. Newly appointed "F.I.R.A. Compliance Officer" was given responsibility for compiling the subject list on a yearly basis. Bank states that required information on directors, officers, control persons and their related interests was obtained.

(12) 12 C.F.R. § 217 (Regulation Q) (Interest on Deposits)

Bank failed to assess penalty for early withdrawal of funds invested in a particular certificate of deposit. See 12 C.F.R. § 217.4. Corrected during examination.

(13) 31 C.F.R. § 103 (Financial Recordkeeping and Reporting of Currency and Foreign Transactions)

- (a) Bank did not accurately complete certain reports involving currency transactions of \$10,000 or more. See 31 C.F.R. § 103.22. Management promised corrective action.
- (b) Required purpose statements for loans in excess of \$5,000, other than loans secured by real estate, were not maintained. See 12 C.F.R. § 103.33(a).

Consumer Affairs Examination 12/31/80 - Mark E. Hight

The third examination of the bank, conducted under general examination procedures, reflected various violations of consumer law, and some which resulted in reimbursable overcharges.

Violations cited in this examination continue to be attributable to the lack of:

1. written policies and procedures addressing consumer laws;
2. an ongoing compliance audit function; and
3. knowledge in all departments of consumer laws and regulations,

To alleviate the latter criticisms, management indicated that a full-time compliance officer was being sought who, when employed, would report directly to the Audit Committee of the Board.

Restitution was made to all customers for violations of the Truth in Lending Act, as required by Section 108 of the Act.

Correspondence of 3/16/82 indicates a \$15,289 reimbursement to 7 customers.

Special Supervisory Examination 9/30/81 - EIC Jerry L. Lanier

The examination as of September 1981 was a limited scope visit for the purpose of updating and assessing the bank's remedial action in several criticized areas. The emphasis was directed to previously criticized loans, internally identified problem credits, asset and liability management, and compliance with the 1980 Administrative Action.

Management and the board undertook major strides in strengthening supervision and administration. The board had formalized several well-documented and active committees. These included the discount, asset/liability (ALCO), executive, and examination compliance committees. Additionally, numerous new personnel had been added to the staff. The new personnel brought to the bank much needed experience and reputations for competence in the banking community.

The examination disclosed modest improvement in asset quality as the result of actions taken by management and the board. The related percentages, such as classified/GCF, actually reduced significantly, but this was primarily the result of a 30% increase in the bank's capital structure. Since the December 1980 examination, major steps had been taken to comply with the administrative action to strengthen inadequate staff and management and to institute systems to control the lending area. As a result, classified assets declined to 53% of gross capital funds. Other assets especially mentioned as a

percentage of gross capital were cut in half from the December examination, while credit documentation exceptions increased to 25% of gross loans. The latter increase was the result of improved internal identification and monitoring systems.

The net income of the bank was \$4,143M through September 30, 1981. This represented a 1% return on 9/30 assets. However, the examination disclosed \$2.7MM in loan losses which necessitated a \$2.6MM charge to earnings in order to replenish the reserve for loan loss. The bank estimated that net income for 1981 would be \$2.8MM. Thus, even though the bank met the capital minimum per the Agreement of 7.5%, the effect of reduced earnings resulted in the need for additional capital from external sources during 1981. The bank planned to inject \$2.5MM in November 1981. [The report does not mention that the bank had already received two such injections totalling \$6.5MM in 1981.]

The scope of the examination in the area of liquidity, asset and liability management emphasized the bank's action to correct deficiencies identified at prior examinations and compliance with the Administrative Document. Between examinations, management and the board developed written policies, instituted an ALCO committee, hired a chief financial officer and generally improved the bank's management information system in this critical area.

The new chief financial officer developed more sophisticated tools to identify liquidity and rate sensitivity positions for the bank. Moreover, new monitoring tools were allowing management to identify RSA/RSL goals and to monitor the effective compliance with these goals. Even though systems were

being developed, bank management was having difficulty monitoring the volume of unfunded loan commitments and other contingent liabilities. The examiner called the existing volume of unfunded commitments a significant liquidity risk.

The bank had corrected 73% of the internal control deficiencies disclosed at the prior examination. All violations from the preceding examination had been corrected; however, two new violations of 12 U.S.C. 84 were discovered which involved combining standby letters of credit with outstanding loans.

Insider Transactions - 9/30/81 Special Supervisory Examination

- o Overall - A review of insider related activities was not performed at this examination. A review of criticized assets reveals, however, that insider loans classified during prior examinations continue to be criticized. At this examination these loans totalled \$302M or only 2.73% of all criticized loans. No violations of law involving insiders or their interests were reported.

September 30, 1981 Examination (Special Supervisory)

- (1) 12 U.S.C. § 84 (Lending Limits)
 - (a) Bank issued standby letter of credit for the account of an individual which exceeded its legal lending limit. Management stated it would sell a participation equal to the excessive amount in order to correct the violation.
 - (b) Letter of credit for the account of a drilling company was issued in excess of the Bank's lending limit. Management stated it would sell participation to effect correction of the violation.

Basic Investigation Trust Examination as of 2/1/82 EIC Mickey B. Faulconer

The second examination of this department, conducted under abbreviated examination procedures designed for use in departments of this size, reflected a condition similar to that found at the preceding examination. Management had been responsive to previous criticisms, however, deficiencies in the scope of the trust audit remained as a matter warranting attention. Additionally, the report reflected the need for this new department to formalize departmental policies and procedures.

The department continued to operate at a loss, reflecting an operating loss for 1981 of \$35,000 after fees of \$39,000 and expenses of \$74,000. After consideration of a deposit credit of \$10,000, the net loss was \$25,000. Prospects for continued growth continue to be poor based on strong competition in the bank's market area. Total assets as of year-end 1981 were \$7,873,000 in 28 fiduciary accounts.

Specialized Examination March 31, 1982 EIC Stephen D. Plunk

Although a specialized examination was scheduled, general examination procedures were employed in the areas of lending and funds management. Among the more critical problems discovered were: severe deterioration in the loan portfolio (particularly oil and gas loans) which ultimately resulted in the losses exceeding the bank's capital funds; a major liquidity crisis stemming from loss of market confidence when many of the bank's problems were made public; the Board of Directors allowed unrestricted loan and asset growth without adopting proper safeguards; and, numerous violations of banking law, including several related to insider activities.

At closure, classified assets totalled to 353% of gross capital funds compared to 77% at the last general examination (12/31/80), loan losses of \$49MM exceeded the gross capital structure of the bank. The examiner summarized the causative factors for the increased classified as portfolio mismanagement, over-lending, absence of controls in the energy department, poor directorate supervision, and inadequate documentation overall. Approximately 80% of the portfolio is related to the energy industry. As recommended at the previous examination, an internal review function had been established, but as of the examination date loan review personnel had not begun a review of energy department loans despite the fact that it was the major lending department in

the bank. As a result, the bank's internal review list was determined to be an unrealistic indicator of asset quality. An acceptable loan policy was in place; however, an array of policy exceptions existed in those loans generated by the energy department. Delinquent loans approximated 13% of total loans. This percentage was considered understated because of the the liberal renewal policy employed by the bank. Several instances of non-compliance with those articles in the Administrative Agreement which address lending policies and procedures were noted.

Overall quality of the investment portfolio was good and portfolio yield was increasing with each new purchase. The investment portfolio provided only minimal support to the bank's liquidity position due to the volume of extended maturities. The examiner characterized management of the investment portfolio as adequate.

A review of the bank's liquidity, asset and liability management indicated that systems were in place to monitor the bank's RSA/RSL position and guidelines were established for acceptable ratios at 60, 90, and 180 day intervals. While the systems in place were deemed appropriate by the examiner, bank policy of permitting unrestricted loan growth constantly created liquidity exposure. The bank relied heavily upon brokered deposits and borrowed funds to fund asset growth. Additional liquidity support was provided by loan and participation sales to correspondent banks. However, evidence was derived which indicated that such sales were not always on a non-recourse basis as the bank was found to be honoring correspondents' requests to repurchase certain obligations. Each of these sources of

liquidity is subject to market risk. These sources were withdrawing as the asset quality problems of the bank received media attention. Loss of public and market confidence overall actually led to a run on the bank as the end neared.

The bank's internal audit function was rated unacceptable because the bank's internal auditor was not independent of all banking operations. The external audit was also rated unacceptable by the examiner. The unqualified opinion was rendered despite the identification of excess collateral exceptions, discovery of incidences where the bank was making payments of principal and interest to the correspondent banks on certain participations without first receiving payment from the borrowers, and acceptance of a reserve for possible loan losses which was deemed inadequate by the examiners during their review of the loan portfolio. Internal controls were considered poor. A detailed list of exceptions was provided.

The bank continued to generate good earnings with an annualized ROA of 1.39% through 3/31/82. A major source of the bank's income resulted from loan origination fees. However, the quality of earnings was suspect given the level of delinquent and non accrual loans. Loan losses taken at the examination exhausted the bank's RPLL and the capital structure, rendering the bank insolvent. The bank had injected \$7.5MM in equity capital from external sources since the prior examination to comply with the Administrative Agreement. The Bank was directed to acquire \$30MM in capital during the examination to maintain its solvency but failed to do so.

Insider Transactions - 3/31/82 Specialized Examination

- o Overall a total of \$20,530M direct and indirect loans to insiders and their interests, or 6.26% of the loan portfolio, was reported, total insider borrowings comprised 62% of capital.

- o Loans to associated companies consisted of 34 credits, both direct and indirect, aggregating \$14,373M. A majority of these loans were to the interest of one director and were directly related to the oil and gas industry.

- o Thirty-two of the loans to insiders and their interests were criticized in this report. Total criticized loans to insiders represented nearly 15% of total criticized loans. Losses on these loans totalled over \$9.5 million.

March 31, 1982 Examination (Specialized)

- (1) 12 U.S.C. § 84 (Lending Limit)
- (a) Loans to three individuals, all general partners in a partnership, were combined with the loans to the partnership on the basis of 12 C.F.R. § 7.1320(a). Line one became excessive on August 5, 1981. A second line became excessive on April 16, 1982. Letters of credit, overdrafts and loans were involved.
 - (b) Corporation incurred obligations under section 84 from direct loans, standby letters of credit issued for its account and overdrafts. Overdrafts caused a violation of the legal lending on January 8, 1982. The overline was corrected on January 13, 1982.
 - (c) Loans to a parent oil and gas corporation are combined with loans to a wholly owned subsidiary drilling company on the basis of 12 C.F.R. § 7.1310(c)(1). Loans to certain oil and gas limited partnerships, whose general partner in each case is a subsidiary of the aforementioned parent, are included in the line of credit for lending limit purposes. A violation arose on January 28, 1982, when the line exceeded the lending limit. A second line became excessive on April 16, 1982. Management claims that the Board of Directors repurchased portions of one limited partnership note on May 6, 1982, apparently in an attempt to cure the violation. No documentation was available to demonstrate that the directors took this action.
 - (d) Standby letter of credit issued jointly to four energy businesses were treated as a loan to a general partnership under 12 C.F.R. § 7.1320(a). The separate obligations of each entity were combined with the loans to the general partnership. The violation originated on February 5, 1982.
 - (e) Loans to two general partnerships and separate loans to the two general partners common to each partnership were combined, in part, based on 12 C.F.R. § 7.1320(a). The line became excessive initially on February 25, 1982. The bank corrected this overline on April 1, 1982, by selling one of the notes to First Penn Corporation. However, the line again became excessive on April 8, 1982, when this note was repurchased from the holding company. This overline remained uncorrected on July 5, 1982.

- (f) Loans and overdrafts to an individual in the energy business resulted in an overline on March 1, 1982. The overdraft was paid from proceeds of a separate note signed by this individual. The note itself was in violation of section 84. A participation in the same note was sold on May 19, 1982, apparently curing the overline. The report of examination suggests there may be some loss on the note.
- (g) Loans to an individual, to a company controlled by the individual and to a general partnership were combined on the basis of 12 C.F.R. § 7.1320(a). The loans to those entities were combined because the borrowers were co-mingling the funds. The initial violation date was April 9, 1982.
- (h) Loans to the individual in (f) above were combined with loans to another individual on the basis of 12 C.F.R. § 7.1320(a). The two individuals were viewed by the examiners as partners in a partnership because they were co-obligors on certain notes. Their line initially became excessive on March 11, 1982. A reduction in the debt of owed by the individual in (f) above made the line "conforming" on May 15, 1982. However, additional overdrafts to one of the individuals created a new overline which remained uncorrected as of the day the bank was closed.
- (i) Loans made to a parent corporation and its wholly-owned subsidiaries were combined on the basis of 12 C.F.R. § 7.1310(c)(1). The initial overline occurred on March 8, 1982. The total line remained in excess of the bank's legal lending limit from March 8, 1982 to June 9, 1982, at which time the line was "reduced to a conforming status." However, the line again became excessive on June 22, 1982, when one of the subsidiaries obtained an overdraft and remained uncorrected as of the day the bank was closed.
- (j) A corporation exceeded its legal lending limit on March 9, 1982, by obtaining certain overdrafts that were combined with direct loans and standby letters of credit issued for its account. The violation was corrected on March 12, 1982, when the overdrafts were paid.
- (k) Obligations of a drilling company and its subsidiary were combined as a violation of 12 U.S.C. § 84 pursuant to 12 C.F.R. § 7.1310(c)(1). The line became excessive on March 9, 1982, when the bank issued a standby letter of credit for the account of the parent. Amendment of the letter of credit on June 16, 1982, eliminated the overline.

- (l) Loans to an individual and his drilling business were combined on the basis of an implied partnership arrangement. The co-mingling of funds by the entities was, in effect, the implied partnership which led to a combination in violation of section 84. See 12 C.F.R. § 7.1320(a). The violation occurred on April 14, 1982, when the drilling business obtained an overdraft. Management corrected the overline on April 16, 1982. A second violation occurred on April 29, 1982, which was cured on April 30, 1982, when the bank paid a second overdraft.
- (m) A violation of section 84 arose on May 18, 1982, when the bank issued a joint letter of credit to three entities. The examiners treated the joint letter of credit as a partnership loan and combined it with separate extensions of credit to each entity on the basis of 12 C.F.R. § 7.1320(a).
- (n) Loans to an individual became excessive on April 26, 1982. Sale of a participation in one note eliminated the overline, although liability may result if the illegal advance causes a loss to the bank.

(2) 12 U.S.C. § 161(a) (Reports of Condition)

This provision requires that a national bank provide the OCC with reports of its resources and liabilities and publish the same in a local newspaper. A published statement did not accurately make certain disclosures.

(3) 12 U.S.C. § 371c (Loans to Affiliates)

Bank did not collateralize a particular "extension of credit" in accordance with paragraph two of 12 U.S.C. § 371c and did not treat an overdraft for the parent bank holding company as an extension of credit subject to the same statute.

(4) 12 U.S.C. § 375a (Loans to Executive Officers)

Section 375a limits extensions of credit to the executive officers of member banks, in part, by categories, such as \$20,000 for educational expenses of children; \$60,000 for financing a primary residence and \$10,000 for general purposes. Section 215.2(d) of Regulation O (12 C.F.R. § 214.2(d)) permits the Board of Directors of a member bank to exclude by resolution certain officers from these limits provided they do not exercise major policy making functions. The bank improperly excluded certain high ranking officers from these restrictions on borrowing. It also directly violated this section by lending in excess of the statutory limits to such officers.

(5) 12 U.S.C. § 375b (Prohibitions on Loans and Extensions of Credit to Executive Officers, Directors, Control Persons and Their Related Interests)

- (a) Section 375b(2) of Title 12, United States Code, requires that extensions of credit to any of the bank's executive officers, directors or principal shareholders or to any related interest of those persons, if when aggregated with their other extensions of credit exceed \$25,000, be approved by a majority of the Board of Directors. Virtually all directors and their related interests received extensions of credit in violation of this provision.
- (b) Extensions of credit to the entities discussed in (a) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions. See 12 U.S.C. § 375b(3). Bank violated this provision by not requiring a guarantee on loans to the chairman and Chief Executive Officer. It was apparently bank policy that its executive officers provide such guarantees. Such extensions of credit may also not involve more than the normal risk of repayment or present other unfavorable features. 12 U.S.C. § 375b(3). During the examination, 21 loans to insiders were criticized on this basis.
- (c) 12 U.S.C. § 375b(4) prohibits the payment of overdrafts of executive officers or directors of the bank. Section 215.4(d) of Regulation O (12 C.F.R. § 215.4(d)) nevertheless permits overdrafts if the person has a written agreement with the bank to transfer funds from another account. Overdrafts of one director were paid without the required advance written approval.

(6) 12 C.F.R. § 1.8 (Prudent Banking Judgment; Credit Information Required)

Bank did not maintain information to demonstrate that it exercised prudence in purchasing 11 investment securities.

(7) 12 C.F.R. § 7.3025 (Other Real Estate Owned)

Subsection (g) of this interpretive ruling provides that when real estate is transferred to the category of "Other Real Estate Owned" a statement of its fair value must be supported by a current and independent appraisal of the property. The Bank violated this requirement with respect to certain property. The violation was corrected during the examination.

Consumer Affairs Examination 4/19/82 - Dean A. Hirschy

The fourth examination of the bank, conducted under specialized examination procedures, reflected improved compliance efforts. Only two violations of law were cited, neither of which is considered substantive in nature. Internal controls were significantly improved by the addition of a full-time consumer compliance officer experienced in and knowledgeable of the various consumer laws and regulations.

The only criticism contained in the report involved the bank's less-than-satisfactory efforts to comply with the spirit and intent of the Community Reinvestment Act.

AGREEMENT BY AND BETWEEN
 PENN SQUARE BANK, NATIONAL ASSOCIATION
 OKLAHOMA CITY, OKLAHOMA
 AND
 THE OFFICE OF THE COMPTROLLER OF THE CURRENCY

WHEREAS, the Penn Square Bank, National Association, Oklahoma City, Oklahoma, (hereinafter the "BANK"), the directors thereof, and the Comptroller of the Currency of the United States of America (hereinafter the "COMPTROLLER"); wish to protect the interests of the depositors, other customers, and shareholders of the BANK, and, toward that end, wish the BANK to operate safely and soundly, and in accordance with all applicable laws, rules and regulations; and

WHEREAS, the COMPTROLLER, through his appointed National Bank Examiner, has criticized certain practices of the BANK as being unsafe and unsound within the meaning of the Financial Institutions Supervisory Act of 1966 (12 U.S.C. §1818) as amended; and

WHEREAS, in the Report of Examination of the BANK, dated February 29, 1980 (hereinafter the "REPORT OF EXAMINATION"), and incorporated herein by reference the same as if fully set forth, the COMPTROLLER, through his appointed National Bank Examiner, has cited certain violations of law, rules and regulations applicable to the BANK;

NOW, THEREFORE, IT IS HEREBY AGREED, between the BANK, through its duly elected and acting Board of Directors, and the COMPTROLLER through his duly authorized Representative, that commencing no later than the effective date of this Agreement, or as shall otherwise be specified in the Articles of this Agreement, the BANK shall operate at all times in compliance with the Articles of this Agreement.

ARTICLE I

(1) This Agreement shall be construed to be a "written Agreement entered into with the Agency" within the meaning of 12 U.S.C. §1818(b)(1), as amended.

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 FEDERAL RESERVE BANK OF ST. LOUIS

ARTICLE II

(2) The BANK shall immediately take all steps necessary to correct and eliminate the existing violations of 12 U.S.C. §84 and all other violations of law and regulation, cited in the REPORT OF EXAMINATION and the Report of Examination-Consumer Affairs dated March 10, 1980.

(3) The BANK shall notify the Regional Administrator of National Banks, Eleventh National Bank Region, Dallas, Texas, (hereinafter the "REGIONAL ADMINISTRATOR"), of the date and manner of correction of each violation and of the procedures established to ensure that similar violations do not occur in the future.

(4) The BANK shall not lend money or otherwise extend credit to any borrower, which extension is in contravention of or otherwise exceeds the lending limitations provided in 12 U.S.C. §84.

(5) The BANK shall implement policies and procedures to ensure compliance with all relevant laws and regulations, and to ensure that the officers and employees remain informed of all changes in such laws and regulations.

ARTICLE III

(6) Within sixty (60) days of the effective date of this Agreement, the Board of Directors shall submit to the REGIONAL ADMINISTRATOR for his approval:

- (a) Specific plans which will cause the injection by December 31, 1980, of equity capital in an amount sufficient to bring capital to a minimum of 7.5% of average daily assets. The amount determined by this calculation shall be based on average daily assets and average daily equity capital (capital stock, surplus, undivided profits) for the month of September, 1980. A copy of this calculation shall be submitted to the REGIONAL ADMINISTRATOR for his review.

- (b) Specific plans whereby equity capital shall be maintained at a level of not less than 7.5% of average total daily assets for each quarter based upon the daily averages for those quarters.
- (c) Specific plans for eliminating during the succeeding quarter any equity capital shortfall determined by the above calculations.

(7) Within sixty (60) days of the effective date of this Agreement, the Board of Directors shall also submit a written capital program for the next five (5) calendar years which shall include:

- (a) projections for present and future growth and capital needs based upon a detailed analysis of, at a minimum, assets, loans, earnings, liabilities, fixed asset expansion, and debt maturities; and
- (b) policies for the payment of dividends, including the rates and amounts.

(8) It shall be the responsibility of the Board of Directors to make any adjustments necessary to obtain the REGIONAL ADMINISTRATOR's approval of the BANK's capital programs and to ensure implementation and adherence to the programs.

ARTICLE IV

(9) The BANK shall, within sixty (60) days of the effective date of this Agreement, take all action necessary to obtain and maintain current and satisfactory credit information on all loans listed as lacking such information in the REPORT OF EXAMINATION. The BANK shall not grant any new loans, renewals or other extensions of credit unless supported by current and satisfactory credit information.

(10) The BANK shall, within sixty (60) days of the effective date of this Agreement, take all action necessary to correct all collateral exceptions listed in the REPORT OF EXAMINATION, and shall not grant any new loans, renewals or other extensions of credit which are not fully supported by all necessary collateral documentation.

ARTICLE V

(11) Within sixty (60) days of the effective date of this Agreement, the Board of Directors shall adopt and implement a written program designed to remove the grounds of criticism of each asset criticized in the REPORT OF EXAMINATION. Once adopted, the program shall be forwarded to the REGIONAL ADMINISTRATOR. The Board of Directors shall submit monthly progress reports to the REGIONAL ADMINISTRATOR detailing the actions taken under the above mentioned program and the status of each criticized asset.

(12) The BANK shall not extend any additional credit to any borrower whose loan or other extension of credit has been or becomes criticized in whole or in part, in the REPORT OF EXAMINATION, or in any subsequent Report of Examination, so long as the credit remains criticized.

(13) The preceding paragraph shall not be deemed applicable if such action by the BANK would be substantially and critically detrimental to the best interests of the BANK. Before any such action is taken, however, the Board of Directors shall place in the credit file of the borrower a statement, signed by the majority of the directors, detailing why failure to take such action would be detrimental to the best interests of the BANK. A copy of any such statement shall be mailed upon execution to the REGIONAL ADMINISTRATOR.

ARTICLE VI

(14) Within sixty (60) days of the effective date of this Agreement, the Board of Directors shall review and revise the BANK's lending policy. The Board of Directors shall also establish and implement procedures to monitor and enforce adherence to the lending policy. The lending policy shall include, but not be limited to:

- (a) guidelines for the purchase and sale of participations, including:
 - (1) types of loans to be considered for participation,
 - (2) documentation requirements,

- (3) servicing fees and acceptable yields, and
 - (4) maturity guidelines;
 - (b) procedures for identifying problem loans and for reporting this information to the Board of Directors on a monthly basis;
 - (c) identification of the categories of loans, if any, where concentrations of credit will be permitted and the limits thereto; and
 - (d) procedures to limit, control and document contingent liabilities.
- (15) Prior to adoption, the policy shall be submitted to the REGIONAL ADMINISTRATOR for review and comment.

ARTICLE VII

(16) The BANK shall, within thirty (30) days of the effective date of this Agreement, review and revise its investment policy which review shall consider at least the following areas:

- (a) the types or kinds of securities to be purchased and held;
- (b) limits on investment officer purchasing authority;
- (c) limits on the concentrations of credit in the securities portfolio;
- (d) a schedule of desired maturities;
- (e) the minimum quality of security to be purchased and held;
- (f) a program for obtaining and evaluating current credit information; and,
- (g) reports necessary for the Board of Directors, or a committee thereof, to properly supervise the investment portfolio.

Upon completion of this review, a copy shall be forwarded to the REGIONAL ADMINISTRATOR for his review.

ARTICLE VIII

(17) Within thirty (30) days of the effective date of this Agreement the Board of Directors, or a committee thereof, shall perform a study of current management. The study shall include, but not necessarily be limited to:

- (a) an evaluation of current management in quality and depth;
- (b) short-term objectives by which current management's effectiveness will be measured; and
- (c) appropriate adjustments to the current management structure.

(18) Within sixty (60) days of the completion of the study referred to in paragraph (16), the Board of Directors shall formulate and cause to be implemented a written management plan. The latter shall include, but not necessarily be limited to, the following:

- (a) detailed position description for current senior management;
- (b) specific lines of authority and areas of responsibility for current senior management;
- (c) identification of members of senior management responsible for reporting to the Board of Directors and the area(s) of their reporting responsibility.

(19) After the plan has been formulated, it shall be forwarded to the REGIONAL ADMINISTRATOR for his review.

ARTICLE IX

(20) The Board of Directors shall conduct a review of the BANK's Allowance for Possible Loan Losses on at least a quarterly basis to ensure that the Allowance is maintained at an adequate level commensurate with the risks and potential for loss inherent in the BANK's loan portfolio and that quarterly Reports of Condition are accurate. A copy of the results of each review shall be mailed to the REGIONAL ADMINISTRATOR.

ARTICLE X

(21) Within sixty (60) days of the effective date of this Agreement, the Board of Directors shall adopt a written Liquidity, Asset, and Liability Management policy. This policy shall provide that BANK's liquidity is maintained at a level commensurate with prudent banking practices and the BANK's needs. The policy

shall provide for the coordination and management of the BANK's assets and liabilities. The policy shall specifically include, but shall not be limited to:

- (a) a statement of the amount and identity of the earning assets which will be funded by rate-sensitive deposits, borrowed funds, and other forms of money market instruments;
- (b) the designation of an acceptable ratio relating the BANK's borrowings and purchased funds to its capital; and
- (c) a statement of the desired maturity structure and pricing strategy for rate-sensitive assets and liabilities.

A copy of the policy shall be forwarded to the REGIONAL ADMINISTRATOR.

ARTICLE XI

(22) Beginning thirty (30) days after the effective date of this Agreement, the Board of Directors or a committee thereof shall submit complete written reports to the REGIONAL ADMINISTRATOR every month detailing:

- (a) the actions taken to rectify those matters criticized in the REPORT OF EXAMINATION, the Report of Examination-Consumer Affairs dated March 10, 1980, or in any subsequent Reports of Examination;
- (b) the actions taken to correct each violation of law, regulation, or rule cited in the REPORT OF EXAMINATION, the Report of Examination-Consumer Affairs dated March 10, 1980, and the actions taken to prevent future violations;
- (c) the progress realized in strengthening, reducing, or eliminating each asset criticized in the REPORT OF EXAMINATION, or in any

- subsequent Reports of Examination;
- (d) the actions taken by the BANK to comply with the provisions of this Agreement; and
- (e) the results of those actions.

(23) The REGIONAL ADMINISTRATOR may in his discretion waive, or otherwise amend, in writing, any or all reports required by this Agreement, at such time or times, and for such periods, as he deems proper.

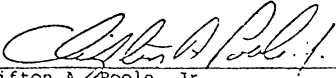
ARTICLE XII

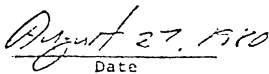
(24) Although the Board of Directors has herein agreed to submit certain programs and reports to the REGIONAL ADMINISTRATOR for his review or approval, the parties recognize that the ultimate responsibility for proper and sound management of the BANK rests with the Board of Directors.

(25) It is expressly and clearly understood that if, at any time, the COMPTROLLER deems it appropriate in fulfilling the responsibilities placed upon him by the several laws of the United States of America to undertake any action affecting the BANK, nothing in this Agreement, shall in any way inhibit, estop, waive, bar or otherwise impede or prevent the COMPTROLLER from so doing.

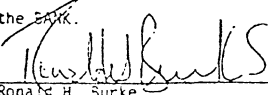
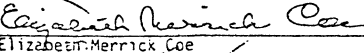
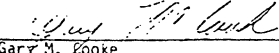
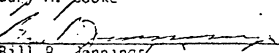
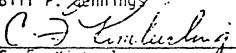
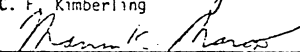
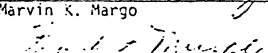
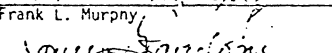
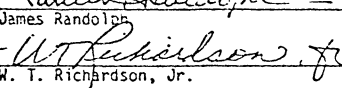
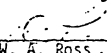
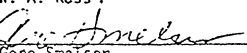
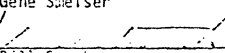
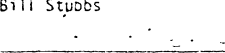
(26) This Agreement shall be effective upon its execution by the parties hereto and its provisions shall continue in full force and effect until or unless, such provisions shall be modified, suspended, excepted, waived or terminated by mutual consent of the parties of this Agreement.

IN TESTIMONY WHEREOF, the undersigned, designated by the Comptroller of the Currency as his Representative, has hereunto set his hand on behalf of the Comptroller.


 Clifton A. Poole, Jr.
 Regional Administrator of
 National Banks
 Eleventh National Bank Region
 Dallas, Texas


 Date

IN TESTIMONY WHEREOF, the undersigned, as the duly elected and acting Board of Directors of the BANK, have hereunto set their hands on behalf of the BANK.

	September 9, 1980
Ronald H. Burke	Date
	September 9, 1980
Elizabeth Merrick Coe	Date
	September 9, 1980
Gary M. Cooke	Date
	September 9, 1980
Bill P. Jennings	Date
	September 9, 1980
C. F. Kimberling	Date
	September 9, 1980
Marvin K. Margo	Date
	September 9, 1980
Frank L. Murphy	Date
	September 9, 1980
James Randolph	Date
	September 9, 1980
W. T. Richardson, Jr.	Date
_____	_____
L. F. Rooney	Date
	September 9, 1980
W. A. Ross	Date
	September 9, 1980
Gene Speiser	Date
	September 9, 1980
Bill Stubbs	Date
	September 9, 1980
Carl W. Swan	Date

UNITED STATES OF AMERICA
DEPARTMENT OF THE TREASURY
OFFICE OF THE COMPTROLLER OF THE CURRENCY

IN THE MATTER OF THE)
PENN SQUARE BANK, N.A.)
OKLAHOMA CITY, OKLAHOMA)

TEMPORARY ORDER TO CEASE AND DESIST

WHEREAS, the Comptroller of the Currency of the United States of America (hereinafter COMPTROLLER) has authorized, pursuant to 12 U.S.C. §1818(b)(1), the service of a Notice of Charges dated June 30, 1982, upon the Penn Square Bank, N.A., Oklahoma City, Oklahoma (hereinafter BANK); and

WHEREAS, the COMPTROLLER has determined pursuant to 12 U.S.C. §1818(c)(1) that the violations or threatened violations of law, rule and regulation, or the unsafe and unsound practices, specified in the attached Notice of Charges, or the continuation thereof, are likely to cause insolvency or substantial dissipation of the assets or earnings of the BANK, or are likely to seriously weaken the condition of the BANK or otherwise seriously prejudice the interests of the BANK's depositors;

NOW, THEREFORE, THE COMPTROLLER, acting by virtue of the authority conferred by 12 U.S.C. §1818(c)(1), hereby ORDERS:

ARTICLE I

(1) The Board of Directors of the BANK (hereinafter BOARD) shall immediately undertake such actions as are necessary to provide the BANK, by no later than July 9, 1982, with thirty million dollars (\$30,000,000) in new equity capital.

ARTICLE II

(2) The BANK shall not make loans or otherwise extend credit to any borrower in excess of the amounts permitted in 12 U.S.C. §84.

ARTICLE III

(3) The BANK shall immediately correct collateral and documentation deficiencies with respect to all loans, including those in which it has sold participations.

ARTICLE IV

(4) The BANK shall not extend any additional credit to any borrower whose loan or other extension of credit is criticized or classified by National Bank Examiners as "Other Assets Especially Mentioned", "Substandard", "Doubtful" or "Loss" so long as such extension of credit remains criticized or classified. A list of borrowers whose extensions of credit are currently criticized or classified is attached as Appendix A to this Temporary Order and may be supplemented from time to time by National Bank Examiners. Such supplements shall become part of this Temporary Order and shall have the same force and effect as if appended hereto.

(5) The lending restrictions contained in the preceding paragraph shall not be deemed applicable if the BANK's failure to lend additional funds would be substantially and critically detrimental to the best interests of the BANK. Before any additional credit is extended, however, the BOARD shall place in the credit file of the borrower a statement, signed by the

majority of the directors, detailing why failure to take such action would be detrimental to the best interests of the BANK. A copy of any such statement shall be mailed upon execution to the Regional Administrator of National Banks for the Eleventh National Bank Region, Dallas, Texas (hereinafter REGIONAL ADMINISTRATOR).

ARTICLE V

(6) The BANK shall make no loan, loan commitment or other extension of credit, including renewals, without first obtaining full collateral documentation as well as current and satisfactory credit information with respect to the borrower.

ARTICLE VI

(7) The BANK shall make no commitment to extend credit, whether for a fee or otherwise, without first arranging firm sources with which to fund it.

ARTICLE VII

(8) The BANK shall immediately engage independent, qualified auditors who shall:

- (a) reconcile all asset accounts carrying interest receivable and render a report with respect thereto within fifteen (15) days;

- (b) conduct, on a positive basis and within twenty (20) days, a direct verification with all participants in participations sold by the BANK and currently outstanding;
- (c) conduct, on a positive basis and within sixty (60) days, a direct verification with all borrowers on whose extensions of credit the BANK has sold a participation; and
- (d) conduct such other studies as directed by the BOARD.

The scope of subparagraphs (a) through (c), above, shall be determined by the BOARD in consultation with the REGIONAL ADMINISTRATOR, who shall promptly be provided with copies of all reports rendered pursuant to this ARTICLE.

ARTICLE VIII

(9) The BANK shall not sell any participation in any extension of credit unless the loan and collateral documentation is in conformity with the terms of the participation agreement. In addition no participation shall be sold unless the potential participant is first informed of all material facts with respect to the borrower and the credit, including, but not limited to, the following:

- (a) any criticism by National Bank Examiners or the BANK's internal loan review personnel;

- (b) the existence and status of other extensions of credit, including overdrafts, made by the BANK to the borrower;
- (c) the contingent liabilities of the borrower; and
- (d) adverse financial occurrences concerning other entities related to the borrower.

ARTICLE IX

(10) The BOARD shall ensure that officers of the BANK without lending authority are not permitted to extend credit or make commitments to extend credit on behalf of the BANK and that such persons exercise no supervisory authority over the BANK's lending function.

ARTICLE X

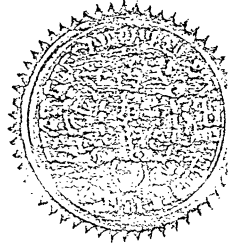
(11) This TEMPORARY ORDER is effective upon its service on the BANK and is binding upon the BANK and its directors, officers, employees, and agents and their successors and assigns. It shall remain effective and enforceable: (a) unless set aside, limited, or suspended by a court in proceedings authorized under 12 U.S.C. §1818(c)(2); or (b) pending the completion of the administrative proceedings held pursuant to the Notice of Charges served upon the BANK, until:

- (a) the dismissal by the COMPTROLLER of the charges specified in such Notice of Charges; or
- (b) the issuance of a final ORDER TO CEASE AND DESIST against the BANK.

(12) If at any time the COMPTROLLER deems it appropriate in fulfilling the responsibilities placed upon him by the several laws of the United States of America to undertake any action affecting the BANK, nothing in this TEMPORARY ORDER shall in any way inhibit, estop, bar or otherwise prevent the COMPTROLLER from so doing.

WITNESS, my hand and official seal of the Office of the Comptroller of the Currency, given at Washington, D.C., this 30th day of June, 1982.

C. T. Conover
C. T. Conover
Comptroller of the Currency



UNITED STATES OF AMERICA
 DEPARTMENT OF THE TREASURY
 OFFICE OF THE COMPTROLLER OF THE CURRENCY

IN THE MATTER OF THE)
 PENN SQUARE BANK, N.A.)
OKLAHOMA CITY, OKLAHOMA)

NOTICE OF CHARGES

TAKE NOTICE, that on the 30th day of August, 1982, and pursuant to the Financial Institutions Supervisory Act of 1966, 12 U.S.C. §1818(b)(1), a hearing will commence at 10:00 a.m. in the United States Courthouse for the Western District of Oklahoma, Oklahoma City, Oklahoma, concerning the charges set forth herein, in order to determine whether an Order to Cease and Desist should be issued, pursuant to 12 U.S.C. §1818(b)(1), against the Penn Square Bank, N.A., Oklahoma City, Oklahoma (hereinafter BANK), a national banking association chartered and examined by the Comptroller of the Currency of the United States of America (hereinafter COMPTROLLER), pursuant to the National Bank Act of 1864, 12 U.S.C. §27, and its directors, officers, employees, and agents.

After examination and other investigation of the BANK, the COMPTROLLER, acting by virtue of the authority conferred by 12 U.S.C. §1818(b)(1), charges that the BANK has violated laws, rules and regulations, and has otherwise operated in an unsafe and unsound manner as follows:

ARTICLE I

(1) The BANK is a national banking association chartered and examined by the COMPTROLLER pursuant to the National Bank Act of 1864, 12 U.S.C. §27.

(2) The COMPTROLLER is the "appropriate Federal banking agency" pursuant to 12 U.S.C. §§1813(g) and 1818(b) and (c).

ARTICLE II

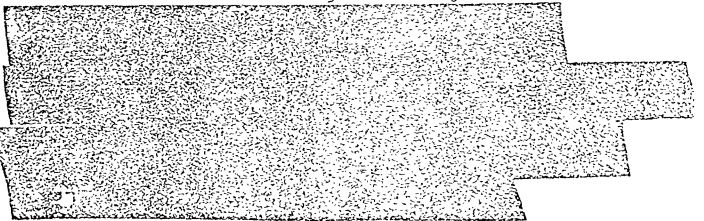
(3) On or about September 9, 1980, the BANK, through its duly elected and acting Board of Directors (hereinafter BOARD), entered into a written agreement (hereinafter AGREEMENT) with the COMPTROLLER addressing certain practices of the BANK criticized by the COMPTROLLER as unsafe and unsound. The AGREEMENT is attached hereto as Appendix A and incorporated herein by this reference the same as if fully set forth.

(4) The AGREEMENT is a "written agreement entered into with the agency" within the meaning of 12 U.S.C. §1818(b)(1).

ARTICLE III

(5) In violation of ARTICLE II of the AGREEMENT and in violation of 12 U.S.C. §84, the BANK has extended credit to the following borrowers in excess of its legal lending limit:

- (a)
- (b)
- (c)
- (d)



(e) [REDACTED]
(f) [REDACTED]
(g) [REDACTED]
(h) [REDACTED]
(i) [REDACTED]
(j) [REDACTED]
(k) [REDACTED]
(l) [REDACTED]
(m) [REDACTED]
(n) [REDACTED]

ARTICLE IV

(6) In violation of ARTICLE IV of the AGREEMENT and contrary to safe and sound banking practices, the BANK has failed to obtain and maintain current and satisfactory credit information on a significant volume of its extensions of credit.

ARTICLE V

(7) In violation of ARTICLE IV of the AGREEMENT and contrary to safe and sound banking practices, the BANK has granted credit in significant amounts which is not fully supported by all necessary collateral documentation.

ARTICLE VI

(8) In violation of ARTICLE V of the AGREEMENT, the BANK has extended additional credit to borrowers whose loans were

previously criticized without first placing in the credit file of the borrower and forwarding to the Regional Administrator of National Banks for the Eleventh National Bank Region, Dallas, Texas (hereinafter REGIONAL ADMINISTRATOR) a statement, signed by a majority of the BANK's directors, detailing why failure to make additional extensions of credit would be detrimental to the best interests of the BANK.

ARTICLE VII

(9) In violation of ARTICLE IX of the AGREEMENT and contrary to safe and sound banking practices the BOARD has failed to ensure that the BANK's Allowance for Possible Loan Losses is maintained at a level commensurate with the risks and potential for loss inherent in its loan portfolio.

ARTICLE VIII

(10) Extensions of credit made by the BANK to the borrowers identified in Appendix B have been properly criticized by the COMPTROLLER's National Bank Examiners as "Other Assets Especially Mentioned", "Substandard", "Doubtful" or "Loss". The BANK's portion of those extensions of credit aggregate to more than eighty one million dollars (\$81,000,000), an amount in excess of two hundred percent (200%) of the BANK's gross capital funds. The BANK's accumulation of poor quality assets in such a volume constitutes an unsafe and unsound practice.

ARTICLE IX

(11) The BANK, using the channels and facilities of interstate commerce, has sold participations in loans originated by the BANK without disclosing to the purchasers of those participations material, non-public information known to the BANK. Such acts constitute unsafe and unsound practices and violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.

ARTICLE X

(12) Contrary to safe and sound practices, the BANK has failed to prevent an officer without lending authority from extending credit on behalf of the BANK.

ARTICLE XI

(13) Contrary to safe and sound practices, the BANK, on loans it has originated and in which it has subsequently sold participations, has paid interest to participating institutions on behalf of the borrower without advising the participating institution of the source of the payments.

ARTICLE XII

(14) Contrary to safe and sound practices and in violation of ARTICLE VI of the AGREEMENT, the BANK has failed to implement and adhere to procedures to limit, control and document its contingent liabilities.

ARTICLE XIII

(15) Contrary to the provisions of 12 U.S.C. §375a, the BANK has extended credit in excess of the limits provided in that statute to [REDACTED], which debt is guaranteed by executive officer [REDACTED].

ARTICLE XIV

(16) Contrary to the provisions of 12 U.S.C. §375b(3), the BANK has extended credit to Directors [REDACTED] and [REDACTED] which credits involve more than the normal risk of repayment or present other unfavorable features.

THEREFORE, the BANK is directed to file an answer in writing to the charges contained herein with the Hearing Clerk, Office of the Comptroller of the Currency, Administrator of National Banks, Washington, D.C. 20219, within twenty (20) days from the date of service of this Notice of Charges.

In witness whereof, my hand and official seal of the Comptroller of the Currency, given this 30th day of June, 1982, at Washington, D.C.

C. T. Conover
C. T. Conover
Comptroller of the Currency



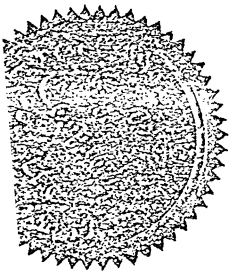
IN THE MATTER OF)
 PENN SQUARE BANK, N.A.)
 OKLAHOMA CITY, OKLAHOMA)

AMENDED TEMPORARY ORDER TO CEASE AND DESIST

The Temporary Order to Cease and Desist, dated June 30, 1982, is hereby amended at Article I thereof to require that the BANK obtain thirty million dollars (\$30,000,000) in new equity capital by the close of business on July 2, 1982.

WITNESS, my hand and official seal of the Office of the Comptroller of the Currency, at Washington, D.C., this 2nd day of July, 1982.

C. T. Conover
 C. T. Conover
 Comptroller of the Currency



[Subsequent to the hearing, the Comptroller provided these corrections to the August 15, 1982 submission:]



Comptroller of the Currency
Administrator of National Banks

Washington, D. C. 20219

September 28, 1982

Re: Penn Square Bank, N.A., Oklahoma City, Oklahoma

Dear Mr. Chairman:

When we prepared the summary of the March 31, 1982 Report of Examination which we submitted to your Committee on August 16, 1982, we had done that based on the preliminary copy of the Report of Examination. Since that time, the Report has gone through the normal processing by the Regional Office. Based on that review, certain changes have been made which clarify several of the matters in the original summary.

Enclosed is a new summary based on the final Report of Examination. It is requested that you replace the summary submitted with my August 16 letter concerning this examination with this summary.

My staff and I stand ready to review the changes made in these summaries with you or your staff.

Sincerely,

C. T. Conover

C.T. Conover
Comptroller of the Currency

The Honorable
Fernand J. St Germain
Chairman, Committee on Banking,
Finance and Urban Affairs
2129 Rayburn House Office Building
Washington, D.C. 20515

Enclosure

Specialized Examination March 31, 1982 EIC Stephen D. Plunk

Although a specialized examination was scheduled, expanded examination procedures were employed in the areas of lending and funds management. Among the more critical problems discovered were: severe deterioration in the loan portfolio (particularly oil and gas loans) which ultimately resulted in the losses exceeding the bank's capital funds; a major liquidity crisis stemming from loss of market confidence when many of the bank's problems surfaced in the press; the Board of Directors allowed unrestricted loan and asset growth without adopting proper safeguards; and numerous violations of banking law, including several related to insider activities.

At closure, classified assets totalled to 329% of gross capital funds compared to 77% at the last general examination (12/31/80), and loan losses of \$49MM exceeded the gross capital structure of the bank. The examiner summarized the causative factors for the increased classified as loan portfolio mismanagement, over-lending to both new and established customers, absence of controls in the energy department, poor directorate supervision, inadequate credit and collateral documentation, and a downturn in the energy industry. Approximately 80% of the portfolio is related to the energy industry. As recommended at the previous examination, an internal review function had been established, but as of the examination date loan review personnel had not begun a review of energy department loans despite the fact that

it was the major lending department in the bank. As a result, the bank's internal review list was determined to be an unrealistic indicator of asset quality. An acceptable loan policy was in place; however, an array of policy exceptions existed in those loans generated by the energy department. Delinquent loans approximated 13% of total loans. This percentage was considered understated because of the liberal renewal policy employed by the bank. Several instances of non-compliance with those articles in the Administrative Agreement which address lending policies and procedures were noted.

Overall quality of the investment portfolio was good and portfolio yield was increasing with each new purchase. The investment portfolio provided only minimal support to the bank's liquidity position due to the volume of extended maturities. The examiner characterized management of the investment portfolio as adequate.

A review of the bank's liquidity, asset and liability management indicated that systems were in place to monitor the bank's RSA/RSL position and guidelines were established for acceptable ratios at 60, 90, and 180-day intervals. While the systems in place were deemed appropriate by the examiner, bank policy of permitting unrestricted loan growth constantly created liquidity exposure. The bank relied heavily upon brokered deposits and borrowed funds to fund asset growth. Additional liquidity support was provided by loan and participation sales to

correspondent banks. However, evidence was derived which indicated that such sales were not always on a non-recourse basis as the bank was found to be honoring correspondents' requests to repurchase certain obligations. Each of these sources of liquidity is subject to market risk. These sources were withdrawing as the asset quality problems of the bank received media attention. Loss of public and market confidence overall actually led to a run on the bank as the end neared.

The bank's internal audit function was rated unacceptable because the bank's internal auditor was not independent of all banking operations. The external audit was also rated unacceptable by the examiner. The unqualified opinion was rendered despite the identification of excess collateral exceptions, discovery of incidences where the bank was making payments of principal and interest to the correspondent banks on certain participations without first receiving payment from the borrowers, and acceptance of a reserve for possible loan losses which was deemed inadequate by the examiners during their review of the loan portfolio. Internal controls were considered poor. A detailed list of exceptions was provided.

The bank continued to generate good earnings with an annualized ROA of 1.39% through 3/31/82. A major source of the bank's income resulted from loan origination fees. However, the quality of earnings was suspect given the level of delinquent and nonaccrual loans. Loan losses taken at the examination exhausted the bank's RPLL and the capital structure, rendering the bank insolvent. The bank had injected \$7.5MM in equity capital from external sources since the prior examination to comply with the Administrative Agreement. The bank was directed to acquire \$30MM in capital during the examination to maintain its solvency but failed to do so.

Insider Transactions - 3/31/82 Specialized Examination

- * Overall a total of \$21,967M in direct and indirect loans to insiders and their interests, or 6.70% of the loan portfolio, was reported, total insider borrowings comprised 66% of capital.

- * Loans to associated companies, both direct and indirect, aggregate \$14,633M. A majority of these loans were to the interest of one director and were directly related to the oil and gas industry.

- * Thirty-two of the loans to insiders and their interests were criticized in this report. Total criticized loans to insiders represented over 15% of total criticized loans. Losses on these loans totalled over \$9.3 million.

March 31, 1982 Examination (Specialized)(1) 12 U.S.C. §84 (Lending Limit)

- (a) Loans to three individuals, all general partners in a partnership, were combined with the loans to the partnership on the basis of 12 C.F.R. §7.1320(a). Line one became excessive on August 5, 1981. A second line became excessive on April 16, 1982. Letters of credit, overdrafts and loan were involved. In addition, numerous illegal advances were made to each of the three individuals on various dates following the initial violation.
- (b) Corporation incurred obligations under Section 84 in the form of standby letters of credit issued for its account and overdrafts. Overdrafts caused a violation of the legal lending limit on January 8, 1982. The overline was corrected on January 13, 1982.
- (c) Loans to a parent oil and gas corporation are combined with loans to a wholly owned subsidiary drilling company on the basis of 12 C.F.R. §7.1310(c)(1). Loans to certain oil and gas limited partnerships, whose general partner in each case is a subsidiary of the aforementioned parent, are included in the line of credit for lending limit purposes. A violation arose on January 28, 1982, when the line exceeded the lending limit. A second line became excessive on April 16, 1982. The bank repurchased a portion of one limited partnership's note on May 6, 1982, which had the effect of exacerbating an overline situation. No documentation, however, was available evidencing directors' approval of such repurchase. Also, several illegal advances in the form of direct loans and overdrafts were extended on various dates following January 28, 1982.
- (d) Standby letter of credit issued jointly to an individual and three energy business associates was treated as a loan to a general partnership under 12 C.F.R. §7.1320(a). The separate obligations of each borrower were combined with the extension of credit to the general partnership. The violation originated on February 5, 1982. Subsequent to that date, the bank extended several illegal advances to three of those four borrowers, individually.
- (e) Loans to two general partnerships and separate loans to the two general partners common to each partnership were combined, in part, based on 12 C.F.R. §7.1320(a). The line became excessive initially on February 25, 1982. The bank corrected this overline on April 1, 1982, by selling one of the notes to First Penn

Corporation. However, the line again became excessive on April 8, 1982, when this note was repurchased from the holding company. Also, other illegal loans were made to the partnership and partners, individually, on various occasions after the initial violation date. This combined overline remained uncorrected as of July 1, 1982.

- (f) Loans and overdrafts to an individual in the energy business resulted in an overline on March 1, 1982. The overdraft was paid from proceeds of a separate note signed by this individual. The note itself was in violation of Section 84. A participation in the same note was sold on May 19, 1982, apparently curing the overline. Other unlawful credits were extended in the form of a direct advance and a standby letter of credit. The report of examination suggests there may be some loss on these credits.
- (g) Loans to an individual, to a company controlled by the individual, and to a general partnership were combined on the basis of 12 C.F.R. §7.1320(a). The loans to those entities were combined because the borrowers were commingling loan proceeds. The initial violation date was April 9, 1982. Subsequently, the bank extended overdrafts and direct loans, which were illegal, to those borrowers, individually.
- (h) Loans to the individual in (f) above, which were already in violation, were combined with loans to another individual on the basis of 12 C.F.R. §7.1320(a). The two individuals were viewed by the examiners as partners in a partnership because they were co-obligors on certain notes. This particular line initially became excessive on March 11, 1982. A reduction in the debt owed by the individual in (f) made the line conforming on May 15, 1982. However, additional overdrafts to one of the individuals created a new overline which remained uncorrected at least through July 1, 1982.
- (i) Loans made to a parent corporation and its wholly owned subsidiaries were combined on the basis of 12 C.F.R. §7.1310(c)(1). The initial overline occurred on March 8, 1982. The total line remained in excess of the bank's legal lending limit from March 8, 1982, to June 9, 1982, at which time the line was reduced to a conforming status. However, the line again became excessive on June 22, 1982, when one of the subsidiaries obtained an overdraft; the line remained uncorrected through July 1, 1982.
- (j) Extensions of credit to a corporation and its two subsidiaries were combined pursuant to 12 C.F.R.

§7.1310(c)(1). The combined line exceeded the bank's legal lending limit on March 8, 1982, when the bank extended additional overdrafts and a direct loan to these borrowers, individually. These latter extensions of credit were combined with certain standby letters of credit issued for the benefit of one of the three borrowers. The illegal overdrafts were corrected on March 12, 1982, when a note representing the overdrafts was sold.

- (k) Obligations of a drilling company and its subsidiary were combined as a violation of 12 U.S.C. §84 pursuant to 12 C.F.R. §7.1310(c)(1). The line became excessive on March 19, 1982, when the bank issued a standby letter of credit for the account of a parent corporation and made a direct loan to a subsidiary. Subsequent amendment of the letter of credit on June 16, 1982, reducing the amount of the credit, brought the line into conformity. Subsequent to March 19, 1982, the bank extended numerous illegal overdrafts, which were apparently paid on or before July 1, 1982.
- (l) Loans to an individual and his drilling business were combined on the basis of an implied partnership agreement. The commingling of funds by this individual and his business entity was, in effect, the implied partnership which led to a combination of their borrowings. See 12 C.F.R. §7.1320(a). The violation of Section 84 occurred on April 14, 1982, when the drilling business incurred illegal overdrafts. These overdrafts were subsequently paid on April 16, 1982. The combined line became excessive again on April 29, 1982, when overdrafts were extended by the bank. These overdrafts were paid on April 30, 1982.
- (m) A violation of Section 84 arose on May 18, 1982, when the bank issued a joint letter of credit to three entities. The examiners treated the joint letter of credit as a partnership loan and combined it with separate extensions of credit to each entity on the basis of 12 C.F.R. §7.1320(a).
- (n) Loans to an individual became excessive on April 26, 1982, when a loan participation previously sold was repurchased in full by the bank. On May 4, 1982, enough of that repurchased note was resold to bring the line into conformity with Section 84; however, the balance retained by the bank was illegal. Also, on May 4, 1982, the bank made another illegal advance to this borrower of which a portion was sold. The balance of that advance retained by the bank was also illegal.
- (o) Loans to two individuals were combined because one co-signed the note of the other. Co-makers are deemed to

be partners for 12 U.S.C. §84 purposes and their separate borrowings are aggregated under 12 C.F.R. §7.1320(a). The combined loans became excessive on April 5, 1982, when the bank advanced additional funds to one of the two individuals. Subsequent advances by the bank were also illegal.

(2) 12 U.S.C. §161(a) (Reports of Condition)

This provision requires that a national bank provide the OCC with reports of its resources and liabilities and publish the same in a local newspaper. A published statement did not accurately make certain disclosures.

(3) 12 U.S.C. §371c (Loans to Affiliates)

Bank did not collateralize a particular "extension of credit" in accordance with paragraph two of 12 U.S.C. §371c and did not treat an overdraft for the parent bank holding company as an extension of credit subject to the same statute.

(4) 12 U.S.C. §375a (Loans to Executive Officers)

Section 375a limits extensions of credit to the executive officers of member banks, in part, by categories, such as \$20,000 for educational expenses of children; \$60,000 for financing a primary residence; and \$10,000 for general purposes. Section 215.2(d) of Regulation O (12 C.F.R. §215.2(d)) permits the Board of Directors of a member bank to exclude by resolution certain officers from these limits provided they do not exercise major policy making functions. The bank improperly excluded certain high ranking officers from these restrictions on borrowing. It also directly violated this section by lending in excess of the statutory limits to such officers.

(5) 12 U.S.C. §375b (Prohibitions on Loans and Extensions of Credit to Executive Officers, Directors, Control Persons and Their Related Interests)

- (a) Section 375b(2) of Title 12, United States Code, requires that extensions of credit to any of the bank's executive officers, directors, or principal shareholders or to any related interest of those persons if when aggregated with their other extensions of credit exceed \$25,000, be approved in advance by a majority of the Board of Directors, with the interested directors abstaining from voting. Six individuals, who were either directors or executive officers of the bank, or their related interests, received extensions of credit in violation of this provision.

- (b) Extensions of credit to the entities discussed in (a) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions. See 12 U.S.C. 375b(3). Bank violated this provision by not requiring a guarantee on loans to a related interest of the bank's Chairman and Chief Executive Officer. It was apparently bank policy that the principals of borrowing corporations provide guarantees for loans to their corporations. Such extensions of credit may also not involve more than the normal risk of repayment or present other unfavorable features. See 12 U.S.C. 375b(3). During the examination, at least sixteen loans to insiders were criticized on this basis.
- (c) 12 U.S.C. 375b(4) prohibits the payment of overdrafts of executive officers or directors of the bank. Section 215.4(d) of Regulation O (12 C.F.R. 215.4(d)) nevertheless permits overdrafts if the person has a written agreement with the bank to transfer funds from another account. Overdrafts of one director were paid without the required advance written approval.
- (6) 12 C.F.R. 1.8 (Prudent Banking Judgment; Credit Information Required)
- Bank did not maintain information to demonstrate that it exercised prudence in purchasing 11 investment securities.
- (7) 12 C.F.R. 7.3025 (Other Real Estate Owned)
- Subsection (g) of this interpretive ruling provides that when real estate is transferred to the category of "Other Real Estate Owned" a statement of its fair value must be supported by a current and independent appraisal of the property. The bank violated this requirement with respect to certain property. The violation was corrected during the examination.

VINSON & ELKINS

ATTORNEYS AT LAW

FIRST CITY TOWER

HOUSTON, TEXAS 77002

TELEPHONE 713 651-2222 TWX 9108816391 TELEX 762 146

OCT 4 1982

1101 CONNECTICUT AVE, N. W. SUITE 900
 WASHINGTON, D. C. 20036
 TELEPHONE 202 862-8500
 CABLE VINELKINS TELEX 89680

47 CHARLES ST. BERKELEY SQUARE
 LONDON W1X 7PB, ENGLAND
 TELEPHONE 44 01 491 7236
 CABLE VINELKINS LONDON W 1 TELEX 24140

AUSTIN NATIONAL BANK TOWER
 AUSTIN, TEXAS 78701
 TELEPHONE 512 478-2500

September 29, 1982

Honorable Ferdinand St Germain
 U. S. House of Representatives
 Committee on Banking, Finance
 and Urban Affairs
 2129 Rayburn House Office Bldg.
 Washington, D. C. 20515

Dear Sir:

Our law firm represents eight of the former outside directors of the Penn Square Bank, N.A. of Oklahoma City, Elizabeth M. Coe, Gary M. Cook, James G. Randolph, Gene H. Smelser, W. A. Ross, Richard C. Haugland, Jerry Richardson and Ken L. Kenworthy. All eight testified before your Committee on August 16, 1982. Their testimony showed that they were honest, intelligent, conscientious directors who faithfully and adequately fulfilled their responsibilities as bank directors. Therefore, we were surprised and concerned to see articles in the New York Times and the Oklahoma City and Tulsa newspapers, stating that the Comptroller of the Currency had found that "virtually all" of the Bank's directors violated federal banking laws.

We eventually discovered that the source of these newspaper reports was a summary, prepared by the Comptroller's office for this Committee, of the March 31, 1982 examination of Penn Square Bank by the Comptroller. The language in question appeared on an unnumbered page under (5)(a), referring to 12 U.S.C. §375b. This statute requires prior board approval of loans in excess of \$25,000 to officers and directors. The summary states that "Virtually all directors and their related interests received extensions of credit in violation of this provision". While we have been unable to obtain bank records, the information we have indicates that this statement was in error. We pursued the matter with Robert Serino of the Comptroller's office in

Washington and he informed us that this statement was in fact in error and that rather than "virtually all" directors receiving loans in violation of this provision, only six directors and officers did. Mr. Serino would not tell us who the six were.

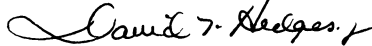
We asked Mr. Serino to report this error to the Committee and to the appropriate newspapers. We believe that he has phoned certain newspapers and informed the Committee in writing on September 28. We commend Mr. Serino for his candor and cooperation. However, we regret that this error occurred. To the best of our knowledge, this allegation by the Comptroller and its repetition by the newspapers has been the only specific allegation of wrongdoing by our clients.

Section 375b is a technical provision that could be inadvertently violated in a number of ways. Nonetheless, the newspapers simply reported the "virtually all..." quote above from the summary without citing or discussing the statute involved, thus leaving the impression that the alleged law violation could relate to fraud, embezzlement or some other serious offense.

We believe these newspaper reports have resulted in lawsuits against our clients. Therefore, we are copying the New York Times and several Oklahoma papers with this letter and strongly urge them to print corrections. Furthermore, we ask that your Committee insert this letter and the Comptroller's correction letter in the Congressional Record.

Thank you for your cooperation.

Very truly yours,



David T. Hedges, Jr.

121:26L
Enclosure

cc: Mr. Robert Serino
 Enforcement and Compliance
 Office of Controller of the
 Currency
 Washington, D. C. 20219

Mr. Jeff Gerth
 New York Times
 1000 Connecticut Avenue
 Washington, D. C. 20036

Tulsa Tribune
 P. O. Box 1770
 Tulsa, Oklahoma 74102

Daily Oklahoman
 P. O. Box 25125
 Oklahoma City, Oklahoma 73125

Oklahoma City Journal Record
 621 N. Robinson
 Oklahoma City, Oklahoma 73102

Mrs. Elizabeth Merrick Coe
 6433 Grand Mark
 Oklahoma City, Oklahoma 73120

Mr. Gary M. Cook
 320 South Boston
 Suite 805
 Tulsa, Oklahoma 74103

Mr. James G. Randolph
 P. O. Box 25861
 Oklahoma City, Oklahoma 73125

Mr. Gene H. Smelser
 Val Gene Corporation
 320 United Founders Tower
 Oklahoma City, Oklahoma 73112

Mr. W. A. Ross
 Dub Ross Company
 P. O. Box 12448
 Oklahoma City, Oklahoma 73157

Mr. Richard C. Haugland
P. O. Box 1967
Muscogee, Oklahoma 74401

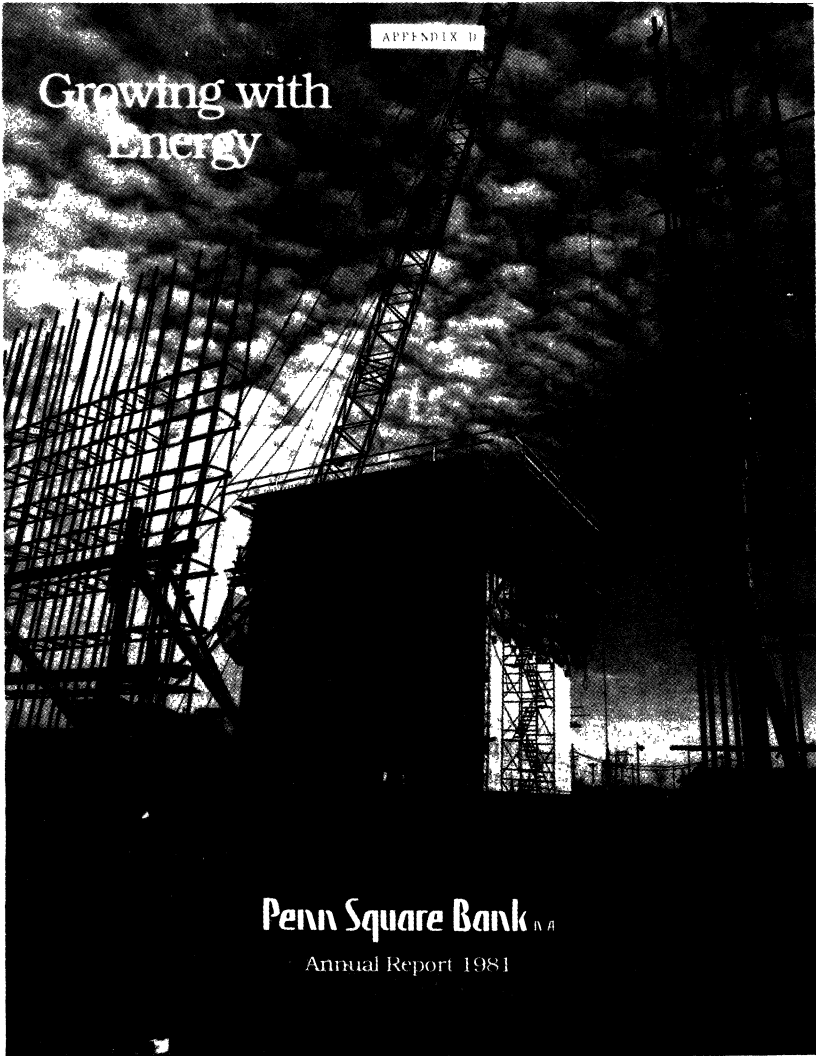
Mr. Jerry Richardson
Dub Richardson Ford
360 North May Avenue
Oklahoma City, Oklahoma 73112

Mr. Ken L. Kenworthy
4972 N.W. 30th Place
Oklahoma City, Oklahoma 73122

Mr. James E. Work
Shirk, Work, Robinson
& Williams
520 Colcord
Oklahoma City, Oklahoma 73102

Mr. Donald B. McKinley
F.D.I.C.
P. O. Box 26208
Oklahoma City, Oklahoma 73126

Mr. John C. Snodgrass (Firm)

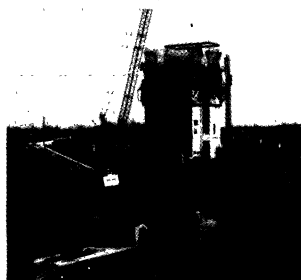


APPENDIX D

Growing with Energy

Penn Square Bank N.A.

Annual Report 1981



Energetic growth has become a recognized characteristic of Penn Square Bank over the past decade. This growth can be measured in many ways.

Since 1974 assets and stockholders' equity have increased more than tenfold, while deposits are more than twelve times their level of eight years ago.

Another measure of our growth has been the continued expansion of our facilities to accommodate increased activity and enable us to continue to provide superior customer service. Pennbank Tower, now under construction just east of our present location, is a tangible symbol that today Penn Square Bank is firmly established as one of the major banking organizations in Oklahoma.

Most importantly, managing this growth has meant broadening and strengthening our capabilities and services. In 1981, Penn Square Bank's emphasis has been on people. We have added to our management strength in every aspect of our business, creating a depth of experience at the top management level which is the equal of that found in institutions many times our size.

Banking in the 1980s will be characterized by the demand for more sophisticated financial services and increased competition from many new types of financial organizations. Penn Square Bank's growth has meant a corresponding growth in capability, in the form of both human and financial resources, to meet the changing needs of our customers.



CHAIRMAN'S MESSAGE

The year 1981 may well rank as one of the most significant periods in Penn Square Bank's growth. It was a year of visible progress in many areas.

We reported solid growth in assets, loans and deposits. An infusion of \$7 million in stockholders' equity greatly strengthened our capital structure. Earnings increased 10% over last year's record results notwithstanding the high cost of expansion into temporary facilities, the large increase in personnel necessitated by our growth, and the continuation of our policy of maintaining a strong capital position and loan loss reserve.

We were also able to implement our long range plans to provide Penn Square Bank with adequate facilities for future growth. The 22-story Pennbank Tower began construction at mid-year and is due to be ready for occupancy in 1983.

Our customer list continues to grow, a fact we believe attests to the strong reputation for performance Penn Square Bank has established in the community.

Moreover, we are particularly proud of the progress we have made in expanding our human resources during the past twelve months. Our continuing objective is to attract the highest caliber of professionals to our senior management staff and board of directors. During 1981 this effort was especially fruitful.

Beginning with the election of Eldon Beller as President and Chief Administrative Officer of the bank, we have expanded and strengthened our top management team with key additions in many areas. The extensive banking experience represented by these new people gives us a breadth and depth of knowledge unusual for an institution of our size.

In looking to the future, we must take note of the conditions prevailing in our industry and in the national economy. Two overriding concerns are continuing inflation and the national recession which so far, fortunately, has not seriously affected Oklahoma's booming economy. Changing conditions, new banking laws and regulations have also heightened competition within the banking industry and from other financial institutions.



To meet these challenges, our long range plans for growth are aggressive, flexible, yet realistic. We are dedicated to increasing our capabilities to cope with rapidly changing technology and the need for a broader range of more sophisticated services to serve our customers in the 1980s. We realize that adequate management of the rapid growth Penn Square Bank has enjoyed makes it incumbent upon management to provide the financial solidarity, the expanded facilities, the technology and the quality people who can continue to provide a superior level of services for our banking customers.

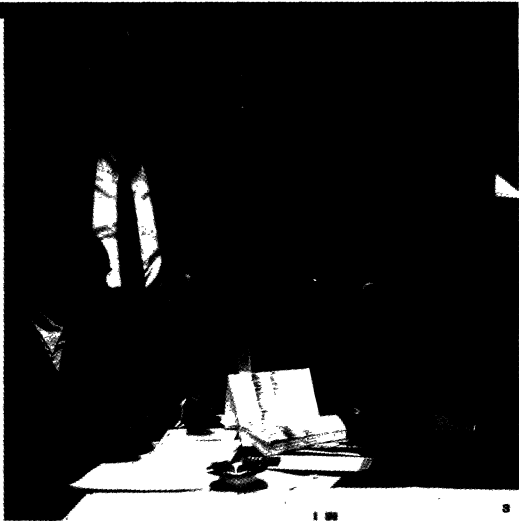


Bill P. Jennings
Chairman

*Bill P. Jennings, Chairman
and Chief Executive Officer (left)
and Eldon L. Bellec, President
and Chief Administrative Officer*



GROWING WITH ENERGY



1. Dave Squiter (left) of Energy Division, with several other employees of the Federal Reserve Bank of St. Louis, is seen here reviewing a large map of the St. Louis area. The map shows the location of the Federal Reserve Bank of St. Louis and its branches in the St. Louis area.

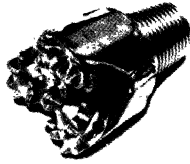
2. Joe A. Meyer, Vice President of the Federal Reserve Bank of St. Louis, is seen here reviewing a large map of the St. Louis area. The map shows the location of the Federal Reserve Bank of St. Louis and its branches in the St. Louis area.

3. A group of employees of the Federal Reserve Bank of St. Louis are seen here reviewing a large map of the St. Louis area. The map shows the location of the Federal Reserve Bank of St. Louis and its branches in the St. Louis area.



The oil and gas industry continues to be a major factor in Oklahoma's burgeoning economy. Currently, one-fifth of all the rotary rigs active in this country are drilling in Oklahoma. Oil and gas lending activities have been a prime source of growth for Penn Square Bank. Our oil and gas lending division ranks among the most active in the state. Working in participation with five of the largest oil and gas lending banks in the country, and others, Penn Square Bank presently handles more than \$2 billion in oil and gas loans and commitments.

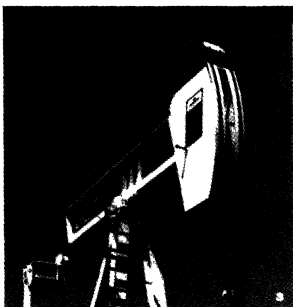
These loans are originated and monitored by a staff of more than 80 people, headed by Senior Executive Vice President Bill G. Patterson. The customers served by Penn Square Bank represent one of the strongest groups of independent oil producers and operators in the Southwest. We provide these customers with a wide range of services, including loans on production, drilling funds, equipment and oil and gas leases.



FINANCING THE SEARCH FOR ENERGY



PHOTO COURTESY OF THE FEDERAL RESERVE BANK OF ST. LOUISIS. PHOTO COURTESY OF THE FEDERAL RESERVE BANK OF ST. LOUISIS. PHOTO COURTESY OF THE FEDERAL RESERVE BANK OF ST. LOUISIS. PHOTO COURTESY OF THE FEDERAL RESERVE BANK OF ST. LOUISIS.



Penn Square Bank works closely with its oil and gas customers and its correspondent banks to provide the financing needed to search out new supplies of energy.

The bank utilizes the most modern monitoring/evaluation techniques in the banking industry to evaluate the oil and gas reserves securing these loans. Its petroleum engineering department includes two full-time petroleum engineers, plus engineering assistants. Computer and microfiche records give this staff access to detailed information on every producing well in Oklahoma and eleven surrounding states. Producing wells in loan portfolios are closely monitored to compare estimated to actual production.

The Correspondent Banking Department also is actively involved in this effort. Penn Square Bank and its large correspondent banks reach dual credit decisions, in many instances, to provide bank consortium loans to oil and gas customers.

The bank maintains firm ties to more than 50 banks in Oklahoma and other parts of the country. These relationships provide Penn Square Bank's oil and gas customers with access to the capital resources they need for their exploration and development activities.



HELPING BUSINESSES GROW



Agency Director, *Wendell A. Felt*, speaks with *Robert J. Felt*, President of *Wendell A. Felt & Associates*, a business consulting firm. *Wendell A. Felt* is a member of the *St. Louis Business Council* and the *St. Louis Chamber of Commerce*.

Paul *Robert J. Felt*, President of *Wendell A. Felt & Associates*, a business consulting firm, speaks with *Robert J. Felt*, President of *Wendell A. Felt & Associates*, a business consulting firm. *Wendell A. Felt* is a member of the *St. Louis Business Council* and the *St. Louis Chamber of Commerce*.

President *Robert J. Felt* and *Robert J. Felt*, President of *Wendell A. Felt & Associates*, a business consulting firm, speak with *Robert J. Felt*, President of *Wendell A. Felt & Associates*, a business consulting firm. *Wendell A. Felt* is a member of the *St. Louis Business Council* and the *St. Louis Chamber of Commerce*.

X



Business and consumer lending have always been important activities at Penn Square Bank. In 1981, we greatly strengthened our staff capabilities in this area with the addition of a number of experienced loan officers in real estate, industrial, commercial, construction and consumer lending.

Penn Square Bank serves a wide variety of retail, industrial and real estate enterprises. Together, these customers represent a major source of employment for residents in the Oklahoma City metropolitan area. We help these customers grow by providing many types of financing services, including equipment, accounts receivable and inventory loans.

In these days of high interest rates, a new service offered by a subsidiary, First Penn Leasing Corporation, is also of benefit to our business and professional customers. This subsidiary provides leasing services for business, medical, construction and industrial equipment, usually at lower monthly rates than the customer would pay for a loan to purchase the equipment. This is particularly beneficial to customers who do not need the tax credits available from depreciation.

We also offer consumer lending services to our individual customers, including new car loans and home improvement loans.



EMPHASIZING CUSTOMER CONVENIENCE



1. Mr. Frank John Hamilton, Mrs. Edna and Mr. Sherman
 + Elizabeth Smith, Mrs. Thos. A. Norma Webb, Mrs. Louise
 Arby Hill, J. M. Robert Harris in operation and Mrs. Hill
 J. Henry Knudsen, Assistant Director, St. Louis, Missouri.

2. Mrs. John C. and Mrs. John C. of Bank, Missouri in St. Louis, Missouri
 Bank's customer relations and Mrs. J. M. Arby, Assistant
 Director, St. Louis, Missouri, in St. Louis, Missouri
 National Bank of St. Louis, Missouri.

3. Operation Department for Mrs. J. M. Arby, Assistant Director
 Department in background. J. M. Arby, Assistant
 Director, St. Louis, Missouri.



Superior service begins by providing customer convenience. One of our primary objectives is making sure our customers — companies and individuals — find it convenient to do business with Penn Square Bank.

Our motor bank, with its drive-through service and convenient consumer and commercial lobbies, is one of our most popular customer areas. We provide a wide array of services at both our motor bank and main banking facility.

Recent changes in banking laws have given rise to many new services for consumers, particularly in the area of checking and savings accounts. These include the new Individual Retirement (IRA) accounts, NOW accounts and All-Savers Certificates as well as regular savings accounts and certificates of deposit.

The Beep Machine, located at the Motor Bank, provides automated teller service 24 hours a day, 7 days a week. Customers can withdraw cash or make deposits or handle other transactions by computer. Safe deposit boxes, for the storage of valuable papers, art objects and silver hollow and flat ware, are another consumer service offered by the bank.

Excellence in customer service begins behind the scenes, with our operations staff. Currently, our operations division employs one-third of our total work force. Automation has played a major role in the ability of our operations division to provide support services for banking functions in an efficient manner. During the past year Penn Square Bank became the first bank in the state to automate its draft collection system. We have also increased our transfer capacity by 100% over the past twelve months.

In the final analysis, however, we know that people and attitude are the vital factors in providing quality service. We are proud of the reputation our employees have established for prompt and courteous service to our customers.



THE MANY PHASES OF BANKING SERVICES



1. Business Development. Lisa Smith, Patricia R. McFarlan.
 2. Trust Distribution. John B. Miller, Cynthia B. Simon. 3. Herald
 12. Remaining paper posted on distribution. City's Square head
 telephone. 4. The Music Bank is a customer of a FRB Oklahoma

City. Beautiful market. 5. Among events from Square Bank
 sponsors to the Oklahoma City. Home Shopping Festival
 Bank of America. Card from Santa Elena. 6. Marketing
 Karen Martin, Carlo Casanovi. Linda Bell. 8. One of many.

seminar sessions sponsored by FRB by Davis Square Bank.
 9. General counsel John Preston, right, and Michael Heintz.
 Bank and other photos of M. E. Brown, Jerry Cox.



Serving the needs of our customers takes many forms at Penn Square Bank.

One important aspect is the full range of trust and financial advisory services provided by our Trust Division. This division is headed by two highly respected professionals, John H. Miller and Carolyn B. Jonas. The Trust Division provides financial and estate planning, estate management, investment and management of funds, establishment and management of many different types of trusts, pension plans and profit-sharing programs, and many other services for individuals and businesses.

Another important function is provided by our Marketing Division. It is this division's task to anticipate changing customer needs and make new products and services available. Changing regulations in the banking industry will make research and development of new products and services an even more important function of banking during the 1980s. This division also sponsors a series of financial planning seminars each year, keyed to the needs of various groups served by the bank. These have ranged from seminars for businessmen to sessions on tax shelters for various professional groups.

Penn Square Bank also becomes involved in many activities that benefit the community. Among events sponsored by the bank was a recent Penn Square Bank Oklahoma Cup tennis match featuring the Number One ranked tennis professional, John McEnroe, with a portion of the proceeds benefiting the Oklahoma City University tennis program.



STATEMENT OF CONDITION

At the Close of Business December 31, 1981 and 1980
(December Daily Averages)

ASSETS	1981	1980
Cash and due from banks.....	\$ 45,075,000	\$ 32,095,000
U. S. Treasury securities.....	13,111,000	8,861,000
State and municipal securities.....	34,397,000	30,124,000
Stock in Federal Reserve.....	541,000	235,000
Federal funds sold.....	9,855,000	8,082,000
Loans, net of reserve.....	264,594,000	197,815,000
Bank premises and equipment.....	3,679,000	2,812,000
Other assets.....	22,906,000	8,235,000
Total assets.....	<u>\$394,158,000</u>	<u>\$288,259,000</u>
 LIABILITIES		
Demand deposits.....	\$147,924,000	\$107,238,000
Time and savings deposits.....	206,859,000	151,485,000
Total deposits.....	354,783,000	258,723,000
Federal funds purchased.....	4,760,000	7,182,000
Other liabilities.....	4,211,000	1,932,000
Total liabilities.....	363,754,000	267,837,000
 STOCKHOLDERS' EQUITY		
Capital stock.....	1,000,000	1,000,000
Surplus.....	17,516,000	10,500,000
Retained earnings.....	11,888,000	8,922,000
Total stockholders' equity.....	30,404,000	20,422,000
Total liabilities and stockholders' equity.....	<u>\$394,158,000</u>	<u>\$288,259,000</u>

STATEMENT OF INCOME

Years Ended December 31

	1981	1980
REVENUE FROM EARNING ASSETS:		
Interest and fees on loans	\$50,929,000	\$24,650,000
Investment securities:		
U. S. Securities	1,597,000	300,000
State and municipal subdivisions	2,204,000	1,308,000
Other	41,000	10,000
Interest on Federal Funds sold	676,000	283,000
Total revenue from earning assets	55,447,000	26,551,000
INTEREST EXPENSE:		
Deposits	28,807,000	12,820,000
Interest on federal funds purchased	2,949,000	739,000
Other interest expense	1,132,000	135,000
Total interest expense	32,888,000	13,694,000
Net revenue from earning assets	22,559,000	12,857,000
Provision for possible loan losses	6,343,000	1,408,000
Net revenue from earning assets after provision for possible loan losses	16,216,000	11,449,000
OTHER REVENUES:		
Deposit fees	1,119,000	687,000
Other operating income	370,000	211,000
Total other income	1,489,000	898,000
OTHER EXPENSES:		
Salaries and employee benefits	5,124,000	2,339,000
Occupancy and equipment expense	1,376,000	619,000
Other expense	4,204,000	2,383,000
Total other expense	10,704,000	5,341,000
INCOME BEFORE INCOME TAXES AND SECURITIES GAINS OR LOSSES ..	7,001,000	7,006,000
Provision for income taxes	2,295,000	2,721,000
NET INCOME	\$ 4,706,000	\$ 4,285,000



Penn Square Bank Directors, left to right:

Row 1: Bill P. Jennings, Frank L. Murphy,

Eldon L. Bellier, Bill G. Patterson,

John R. Preston.

Row 2: Richard T. Dunn, Ronald H. Burks,

Elizabeth Merrick Coe, Gary M. Cook,

J. C. Craoens.

Row 3: Richard C. Haugland, Ken L. Kenuworthy,

C. F. "Tag" Kimberling, Martin K. Margo,

H. Mead Norton.

Row 4: James G. Randolph, Jerry Richardson,

W. A. "Dub" Ross.

Row 5: Gene Smelser, Bill Stubbs, Carl W. Swan.

Directors

Bill P. Jennings
Chairman
Frank L. Murphy
Vice Chairman
Eldon L. Beller
President
Bill G. Patterson
Senior Executive Vice President
Richard T. Durn
Executive Vice President
John R. Preston
Secretary and General Counsel
Ronald H. Burks
Chairman
Burks Investments, Inc.
Elizabeth Merrick Coe
President
The Merrick Foundation
Gary M. Cook
Chairman
Trend Construction Corporation
J.C. Cravers
Investments
Richard C. Haugland
Vice President
Citizens National Bank, Muskogee
Ken L. Kenworthy
Vice President, Director
Secretary, Treasurer
C.F. "Tag" Kimberling
Real Estate
Marvin K. Margo, M.D.
McIntire Clinic, Inc.
H. Mead Norton*
President
Norton Investment Co.
James G. Randolph
President
Kerr McGee Coal Corporation
Jerry Richardson
President
Dab-Richardson Fund, Inc.
W.A. "Dub" Ross
President
Dub-Ross Company
Gene Smeisler
President
Val-Gen's Food Service, Inc.
Bill Stubbs
Real Estate
Carl W. Swan
Independent Oil Producer
*Advisory Director

Officers

Bill P. Jennings
Chairman and
Chief Executive Officer
Frank L. Murphy
Vice Chairman
Eldon L. Beller,
President and
Chief Administrative Officer
Bill G. Patterson,
Senior Executive Vice President
Executive Vice Presidents
Tommy Williams
James J. Gutter
Richard T. Durn
Ashburn H. Bywaters
Dennis Wingoet
ENERGY DIVISION
Bill G. Patterson,
Senior Executive Vice President
Executive Vice Presidents
Ashburn H. Bywaters
Dennis Wingoet
Thomas D. Swineford,
Senior Vice President
Vice Presidents
Russell B. Bainbridge
Janette B. Cates
Phil C. Boney
James R. Rarcher
Gregory A. O'Leary
Assistant Vice Presidents
Robert S. Lockard
Randy Allison
Dewayne Horton
Shan L. Mitchell
Rea M. Lind
Banking Officers
Jan Stratz
Joy C. Lovance
Diana D. Swift
Sharon Luttererz
Shirley Turner
ENGINEERING DEPARTMENT
Petroleum Engineers
Jeff G. Callard
Michael R. Gilbert
John Madison,
Assistant Vice President
**CORRESPONDENT
BANKING DEPARTMENT**
Robert D. Kotarski,
Senior Vice President
Vice Presidents
Billie J. Dean
Barry A. Rudy
Randal W. Smith
R. Jan Kaser,
Assistant Vice President

**COMMERCIAL AND
CONSUMER LOAN DIVISION****COMMERCIAL LOAN
DEPARTMENT**

Robert C. Van Lanen,
Senior Vice President
Vice Presidents
Phillip E. Foss
D. Patrick McCoy

Robert T. Laing,
Assistant Vice President

**INSTALLMENT LOAN
DEPARTMENT**

Bill W. Cox,
Senior Vice President
Don R. Chappell,
Vice President

**COMMERCIAL REAL ESTATE
DEPARTMENT**

Harold D. Armstrong,
Senior Vice President

**REAL ESTATE AND
CONSTRUCTION**

Bill R. Blacksten,
Vice President
Charles M. Guthrie,
Administrative Officer

**LOAN ADMINISTRATION
DIVISION**

Richard T. Durn,
Executive Vice President

Vice Presidents
John C. Baldwin
Jean A. Peterson
Robert J. Williams, Jr.

Assistant Vice Presidents
Frankie L. Burworth
Cheryl Lemmon

Loan Review Officers
Garvin M. Chandler
M. Joseph Vercher
Joseph D. Anselmo

Banking Officers
Daniel C. Glasspy
Becky L. Smith

**BANK ADMINISTRATION
DIVISION**

Loan Review Officers
Garvin M. Chandler
M. Joseph Vercher
Joseph D. Anselmo

Banking Officers
Daniel C. Glasspy
Becky L. Smith

**BANK ADMINISTRATION
DIVISION**

Tommy Williams,
Executive Vice President

OPERATIONS DEPARTMENT

Daniel W. Thompson,
Senior Vice President
James W. Pitts,
Vice President and Cashier

Vice Presidents
M. Robert Barton
Tom Harrison
Gene Shannon

Assistant Vice Presidents

William M. McBain
Cleda C. Owens
Carol C. Stewart
Max Ellis

Operations Officers
Ada Carstairs
Corrinna Opton
Shirley A. Vint
Kerilyn J. Inman
E. Buddy McIntosh
John Callaway

ADMINISTRATIVE SERVICES

Jerry Pendley,
Banking Officer
Michael H. Mahoney,
Operations Officer
Wayne L. Hanteman,
Purchasing Officer

TRUST DIVISION

John H. Miller,
Vice President and Trust Officer
Carolyn B. Jonas,
Vice President and Trust Officer

FINANCIAL SERVICES DIVISION

James J. Gutter,
Executive Vice President
Raymond L. Hicks,
Senior Vice President and Controller
Bert Davis, III,
Senior Vice President

Vice Presidents
Mark T. White
Arlyn C. Hill

MARKETING DIVISION

Linda B. Belt,
Executive Vice President
Arlyn C. Hill

PERSONNEL DIVISION

Elaine Duke,
Vice President
Gerardine Yeager,
Assistant Vice President

**BUSINESS DEVELOPMENT
DIVISION**

Patricia R. McFarlin,
Vice President

AUDITOR

Norma L. Babb
Frances L. Gray,
Auditing Officer

GENERAL COUNSEL

John R. Preston
Richard D. Forsthee,
Assistant

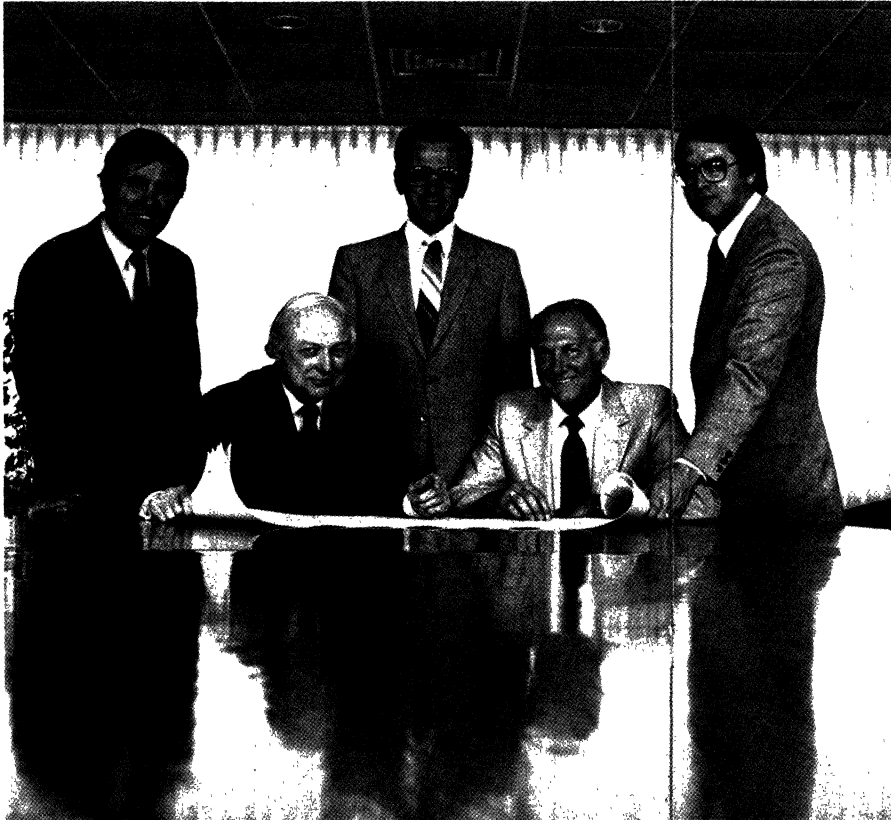
APPENDIX E



*Growing with
Energy*

**Penn
Square
Bank**
N.A.

*Five Years of
Asset Growth*



Chairman's Message

These are growth times for Oklahoma, and for Penn Square Bank. Our year-end report emphasizes the rapid growth our bank has enjoyed over the past five years.

But figures do not tell the whole story. They indicate how much we have increased in size, but do not demonstrate how we have broadened and strengthened our capabilities and services to make this growth possible.

This annual report focuses on Penn Square Bank today: our sophisticated and ever-growing capabilities in serving our commercial and industrial customers, and our full line of services for our individual customers.

Penn Square Bank as it exists today is the result of actions and decisions made yesterday. In like manner, the Penn Square Bank of tomorrow is happening today. So this annual report also focuses on the future: on the planned growth we have in mind for our bank.

This future includes not only a new headquarters building for our bank but also a continued strengthening and expansion of our capabilities. Since year end we have added Mr. Eldon L. Beller as president and chief administrative officer, to head this expansion effort. We feel his many years of banking experience and his former position as executive vice president of Oklahoma's largest bank will be of invaluable assistance to Penn Square Bank in its present phase of expansion.

Bill F. Jennings
Chairman

Left: Penn Square Bank's management team. Seated, left to right: Bill F. Jennings, Chairman and Chief Executive Officer and Eldon L. Beller, President and Chief Administrative Officer. Standing, left to right: Bill G. Patterson, Executive Vice

President and Gas Division; Frank L. Murphy, Vice Chairman; Tony W. Wilkins, Executive Vice President-Operations.



Oil and Gas Lending Division

Oil and gas loans have been a significant factor in Penn Square Bank's growth. This division is now handling nearly \$800 million in oil and gas loans, in participation with five of the largest oil and gas lending banks in the country.

These loans are originated and monitored at Penn Square Bank. Bill G. Patterson, executive vice president, heads a young, aggressive staff of more than 30 people, utilizing the most modern monitoring/

evaluation techniques in the banking industry.

Penn Square Bank serves one of the finest group of independent petroleum operators in the Southwest, providing lines of credit, drilling fund and rig loans, all well secured with oil and gas reserves.

The bank works closely with its oil and gas customers and its correspondent banks to provide the financing needed by these customers in searching out new supplies of energy.

Correspondent Banking

Penn Square Bank corresponds with over 50 banks in Oklahoma and other parts of the country. These correspondent banks include five of the largest banks in the country and the largest oil, gas and coal lender in the world.

Penn Square Bank works closely with these large

banks, reaching dual credit decisions, in many instances, to provide two or three-bank loans to its oil and gas customers.

These close ties to larger banks provide Penn Square Bank's oil and gas customers with access to the capital resources they need for expansion of their activities.

(1) Penn Square Bank makes loans to many of the most active independent oil and gas operators in the Southwest. (2) Visiting a well site are Ken Wilson, Vice President, and Janelle Coles, Assistant Vice President, Oil and Gas Lending. (3) Frequent trips and telephone calls

help Robert Kotanski, Vice President, Correspondent Banking, stay in close touch with affiliated banks. (4) Executive Vice President Bill G. Patterson, right, confers with Ken Wilson and Janelle Coles.



Petroleum Engineering

To help monitor its oil and gas loans, Penn Square Bank has one of the most sophisticated petroleum engineering departments in the state.

Its petroleum engineering department includes two full-time petroleum engineers and two engineering assistants. Both engineers are capable of reservoir estimating and have access to the latest technology to assist them.

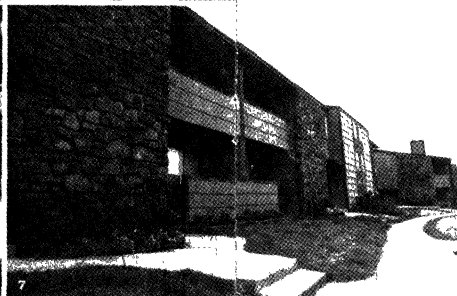
Through a computer timeshare program, the bank has access to a commercial production data base on all producing wells in Oklahoma and 11 surrounding states. The bank also has on microfiche data on every well

drilled in Oklahoma and surrounding states from 1906 to 1980, plus six months of production records on every producing well in Oklahoma.

The engineering department provides constant monitoring of all properties securing oil and gas loans, comparing forecasted revenue to actual reports and sorted listings. Through these reports the department can pinpoint problem wells or problem loans on a timely basis.

(1) The Engineering Department's computer is linked to a commercial production data base covering 12 states, including Oklahoma. (2) The department has access to the latest technology and industry data in monitoring all properties

securing oil and gas loans. (3) Petroleum engineers Mike Gilbert (pictured here) and Jeff Callard have many years of actual experience in the field, both in this country and abroad.



Commercial and Consumer Lending

Helping businesses grow is a large part of Penn Square Bank's business — not only in the oil and gas industry, but in retail, real estate and industrial enterprises.

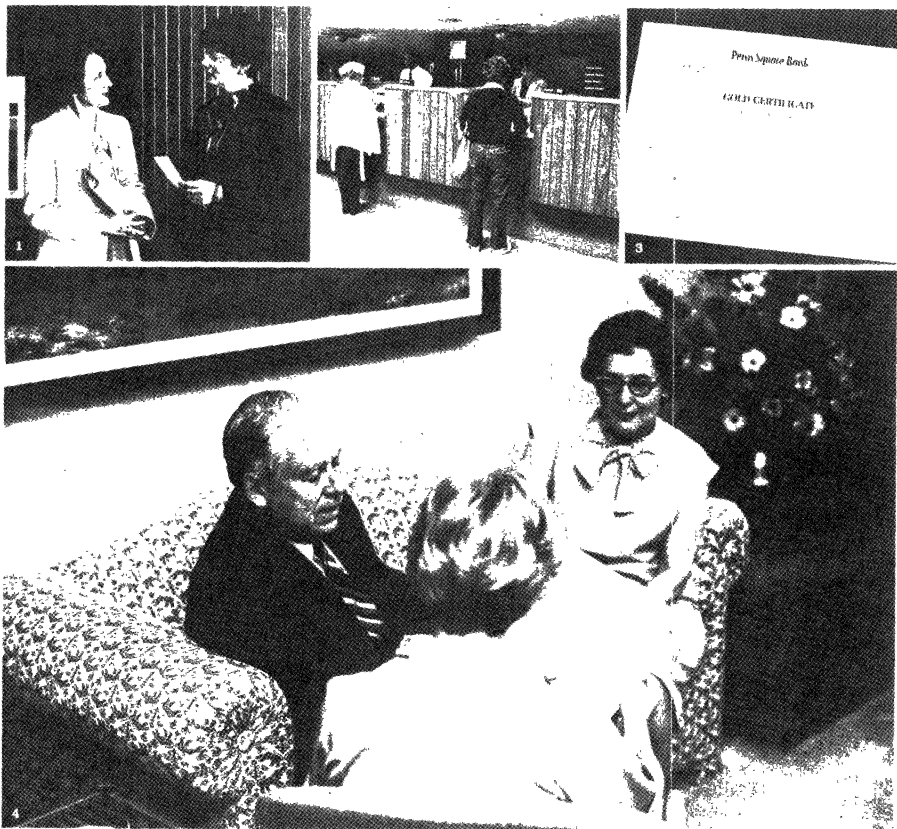
The bank's commercial loan staff includes loan officers experienced in real estate, commercial and industrial lending. The bank serves a number of medium sized manufacturing and commercial accounts, providing equipment, accounts receivable and inventory loans.

Some of the companies we have helped to grow are pictured on these pages. We're proud to be a "silent partner" in the success of our business customers.

Consumer lending is also an important aspect of the bank's business, and one of the many family-oriented services we provide our individual customers.

Penn Square Bank helps provide financing for a wide variety of businesses. These are typical: (1) Irving Rosowitz, co-owner of Callie, one of the city's finest restaurants, and Cyrk & Co., unique women's fashion shop; (2) Jim Vulliamy, The Fire & Flowers, and Greenhouses; (3) Dub Ross and son

Mike, Dub-Ross Company, manufacturer of ornamental steel pipe; (4) Wayne McPhail, Air Center aircraft chartering and maintenance; (5) L. to L. Hill Cig. Kent Packens and Diane Jacobson of the Consumer Lending Department; (6) Robert L. Horn, Horn Seed Company; (7) Quail Run Apartments.



Trust and Financial Advisory Services

Aid in financial planning is one of the most valuable services Penn Square Bank provides its customers. We do this in many ways.

One way is through the services rendered by our Trust Department, under John H. Miller, one of Oklahoma's most highly respected professionals in the field of personal and corporate trusts.

This department offers a full range of trust and financial advisory services, including financial and estate planning, investment and management of funds, the establishment and management of many different types of trusts, estate management, and many more. The bank can serve as executor or co-executor, administrator or co-administrator, trustee or co-trustee of estates and trusts. For corporations, the bank can and does act as trustee for pension trusts

or profit sharing plans, as escrow agent, or as trustee under bond issues.

Another way the bank helps in financial planning is by providing a wide variety of investment opportunities for individuals and businesses, ranging from interest bearing NOW accounts, Keogh and IRA accounts, to money market certificates, certificates of deposit and gold and silver certificates.

A third way is through its annual program of financial planning seminars keyed to the needs of various groups served by the bank. These have ranged from seminars addressing the needs of today's businesswoman to sessions on tax shelters aimed at physicians or other professional groups.

(1) Seminar on asset management with Linda Bell, Vice President of Marketing (2) Trudy Bell, Vice President of Marketing (3) and (4) other professionals assist customers in financial planning (5) John H. Miller, Trust Department provides a wide variety of financial

advisory services and trust administration services for individuals, corporations and estates. John H. Miller, Vice President of Marketing, is a member of the Oklahoma Bar Association and has extensive experience in the field of corporate and personal trusts.



Our Wide Range of Banking Services

Convenience is a vital element in providing good service. In recent years Penn Square Bank has expanded its banking services, always with customer convenience in mind.

We've expanded our motor bank to provide not only drive-through service but also a lobby teller area with parking at the door. The latest expansion, this past year, added a commercial lobby to speed service not only to our business customers but for our individual customers as well.

Our Beep Machine provides automated teller service 24 hours a day, seven days a

week, allowing customers to withdraw cash or make deposits or other transactions by computer.

Penn Square Bank provides its customers with a full range of checking and savings accounts and certificates, including the new NOW accounts, a type of checking account paying 5 1/4% interest. Safe deposit boxes and consumer loans are other services provided for our individual customers.

(1) The Motor Bank's Consumer Lobby is popular with individual customers. (2) Operations Division staff meeting. L. to R: Tom Harrison, Jenn Shannon, Dan Thompson, Tony Williams, Executive Vice Presidents-Operations, Jim Pitta, Elaine Duke, Bob Barton. (3) The Beep Machine

provides 24 hour automated teller service. (4) and (5) The Motor Bank provides drive-in windows as well as lobby areas convenient to parking. (6) The new Commercial Lobby speeds service to commercial customers at the Motor Bank. (7) Data Processing/Proof Department



Planning for the Future

A period of rapid change lies ahead for the banking industry, as new forms of competition develop and new types of financial services come into being. Penn Square Bank is actively planning for change through expansion of our capabilities, our services and our facilities.

Soon to take shape at North Blackwelder and Northwest Expressway is Pennbank Tower, a 20-story office building and two-story parking facility. Penn Square Bank has made application to banking authorities to relocate its headquarters to the new location, approximately three blocks east of our present main bank building. Our motor bank will remain at its present location. The bank will be the major tenant of the office tower;

being built by Pennbank Tower Investors, a limited partnership.

Initially the bank will occupy four floors of the new office tower, in addition to the operational facilities presently occupied in Penn Square. This will enable us to expand many of our services. One planned expansion is availability of safe deposit space for valuables such as artwork or silver pieces.

Penn Square Bank also continues to strengthen and broaden the capabilities of its operational staff in every aspect of banking services.

Details of Penn Square Bank's new headquarters building are discussed by (left to right) Bill P. Jennings, Leon Huff (standing), Ronald H. Burks and Frank L. Murphy. Burks is general partner of Pennbank Tower Investors, developers of

the office tower. (Inset photo) Site work is now under way on the tract to be occupied by Pennbank Tower.

Statement of Condition

At the Close of Business December 31

(December Daily Averages)

	1980	1979
ASSETS		
Cash and due from banks.....	\$ 32,065,000	\$ 17,664,000
U. S. Treasury securities.....	8,661,000	3,181,000
State and municipal securities.....	30,124,000	18,743,000
Stock in federal reserve.....	235,000	60,000
Federal funds sold.....	8,082,000	55,000
Loans, net of reserve.....	197,815,000	97,145,000
Bank premises and equipment.....	2,812,000	1,975,000
Other assets.....	8,235,000	2,656,000
Total assets.....	<u>\$286,259,000</u>	<u>\$141,479,000</u>
LIABILITIES		
Demand deposits.....	\$107,238,000	\$ 52,496,000
Time and savings deposits.....	151,485,000	71,847,000
Total deposits.....	258,723,000	124,170,000
Federal funds purchased.....	7,182,000	7,115,000
Other liabilities.....	1,932,000	1,259,000
Total liabilities.....	267,837,000	132,544,000
STOCKHOLDERS' EQUITY		
Capital stock.....	1,000,000	1,000,000
Surplus.....	10,500,000	1,400,000
Retained earnings.....	8,922,000	6,535,000
Total stockholders' equity.....	20,422,000	8,935,000
Total liabilities and stockholders' equity.....	<u>\$286,259,000</u>	<u>\$141,479,000</u>

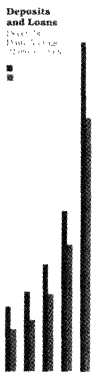
Total Assets
Period: 12/23/80 - 12/23/79



Net Income
Period: 12/23/80 - 12/23/79



Deposits and Loans
Period: 12/23/80 - 12/23/79



Stockholders' Equity
Period: 12/23/80 - 12/23/79



Statement of Income

Years Ended December 31

	1980	1979
REVENUE FROM EARNING ASSETS:		
Interest and fees on loans.....	\$24,650,000	\$11,038,000
Investment securities:		
U. S. securities.....	300,000	277,000
States and municipal subdivisions.....	1,308,000	601,000
Other.....	10,000	6,000
Interest on federal funds sold.....	283,000	15,000
Total revenue from earning assets.....	26,551,000	12,237,000
INTEREST EXPENSE:		
Deposits.....	12,620,000	5,127,000
Interest on federal funds purchased.....	739,000	711,000
Other interest expense.....	135,000	87,000
Total interest expense.....	13,694,000	5,925,000
Net revenue from earning assets.....	12,657,000	6,312,000
Provision for possible loan losses.....	1,408,000	615,000
Net revenue from earning assets after provision for possible loan losses.....	11,449,000	5,697,000
OTHER REVENUES:		
Deposit fees.....	687,000	296,000
Other operating income.....	211,000	156,000
Total other revenue.....	898,000	452,000
OTHER EXPENSES:		
Salaries and employee benefits.....	2,339,000	1,486,000
Occupancy and equipment expense.....	619,000	389,000
Other expense.....	2,383,000	1,171,000
Total other expenses.....	5,341,000	3,046,000
INCOME BEFORE INCOME TAXES AND SECURITIES GAINS OR LOSSES	<u>7,006,000</u>	<u>3,103,000</u>
Provision for income taxes.....	2,721,000	1,064,000
INCOME BEFORE SECURITIES GAINS OR LOSSES	<u>4,285,000</u>	<u>2,039,000</u>
Securities gains (losses) net of related income taxes.....	- 0 -	(9,000)
NET INCOME	<u>\$ 4,285,000</u>	<u>\$ 2,030,000</u>

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Bill P. Jennings



Frank L. Murphy



Eldon L. Beller



Bill G. Patterson



Ronald H. Burks



Elizabeth Merrick Coe



Gary M. Cook



J. C. Cravens



Richard C. Haugland



C. P. "Tag" Kimberling



Marvin K. Margo, M.D.



H. Mead Norton



James G. Randolph



Jerry Richardson



W. A. "Dub" Ross



Gene Smelser



Bill Stubbs



Carl W. Swan

Directors

Bill P. Jennings
Chairman and Chief Executive Officer

Frank L. Murphy
Vice Chairman

Eldon L. Beller
President and Chief Administrative Officer

Bill G. Patterson
Executive Vice President

Ronald H. Burks
Chairman of the Board,
Burks Investments, Inc.

Elizabeth Merrick Coe
President,
The Merrick Foundation

Gary M. Cook
Chairman,
Trend Construction Corporation

J. C. Cravens*
President

Richard C. Haugland
Vice President,
Citizens National Bank, Muskogee

C. P. "Tag" Kimberling
Past Editor

Marvin K. Margo, M. D.
President,
McBride Clinic, Inc.

H. Mead Norton*
President,
Scott Investment Co.

James G. Randolph
President,
Mc-Cee Coal Corporation

Jerry Richardson
President,
Dub Richardson Ford, Inc.

W. A. "Dub" Ross
President,
Dub Ross Company

Gene Smelser
President,
Val Gene's Food Service, Inc.

Bill Stubbs
Real Estate Investments

Carl W. Swan
Independent Oil Producer

*Advisory Director

Officers

Chairman and Chief Executive Officer
Bill P. Jennings

Vice Chairman
Frank L. Murphy

President and Chief Administrative Officer
Eldon L. Beller

Executive Vice President
Bill G. Patterson

Vice Presidents
Keneth R. Wilson
Thomas D. Switeland

Assistant Vice President
Robert E. Williams, Jr.

Banking Officers
Dwayne Horton
Shari Mitchell

Administrative Officer
Frankie Burrows

Engineering Department
Raymond Hicks

Petroleum Engineers
James W. Pitts
Jeff G. Callard

Construction Department
Michael R. Gilbert

Vice President
Robert Kolanski

Assistant Vice Presidents
Randy Allison
Billie J. Dean

Administrative Officer
Michael H. Makorsky
Jan Kiser

Administrative Officer
Shirley Vini

Marketing Officer
Wayne Kuznerman

Security Officer
Jerry Pendry

Commercial Loan Department
Phillip E. Foss
Patrick McCoy

Real Estate Loan Department
Bill Blacksten

Administrative Officer
Charles Galtrey

Installment Loan Department
Bill Coy

Vice President
Don Chappell

Assistant Vice President
Diane Jackson

General Counsel
John R. Preston

President and Chief Administrative Officer
Eldon L. Beller

Executive Vice Presidents
Ray Williams
Bill G. Patterson

Richard T. Dunn

Assistant Vice President
Richard T. Dunn

Assistant Cashier
Cheryl Lennon

OPERATIONS DIVISION
Executive Vice President
Tony Williams

Senior Vice President and Cashier
Daniel W. Thompson

Vice Presidents
M. Robert Horton
Tom Harrison

Raymond Hicks
James W. Pitts
Gelene Shannon

Assistant Vice Presidents
Bill McHain
Cede Owens

Assistant Cashiers
Carol Stewart
Aida Carithers

Operational Officers
Michael H. Makorsky
Shirley Vini

Marketing Officer
Wayne Kuznerman

Security Officer
Jerry Pendry

TRUST DIVISION
Vice President and Trust Officer
John H. Miller

Trust Officer
Carlyn B. Jones

MARKETING DIVISION
Vice President
Linda Belt

AUDITOR
Norma Babb

PERSONNEL DIVISION
Vice President
Elaine Fink

Assistant Vice President
Geraldine Yearby

OFFICIAL RECORD COPY

APPENDIX F

REPORT ITEMS

REC'D IN RECORDS SECTION
 JUN 04 1982
 [Handwritten initials and signatures]

1. Consolidated and Parent Holding Company Financial Statements:

The required financial statements, at year ended December 31, 1981 are attached.

2. Annual Reports to Stockholders and to the Securities and Exchange Commission (SEC):

a. The registrant does not prepare an annual stockholder report. The consolidated financial statements of First Penn Corporation are attached.

b. Neither the registrant nor its subsidiaries file annual reports with the SEC.

3. Information on Subsidiaries

Information on the registrant's subsidiaries is provided in Schedule A of the computer printout.

4. Non-Bank Subsidiary Financial Statements

Information on the registrant's non-bank subsidiaries is provided on Schedule A. Financial statements are not submitted on these non-bank subsidiaries since they are fully consolidated on a line-by-line basis in the registrant's consolidated report of condition.

5. Information on Organizations Other Than Subsidiaries:

The registrant has no direct or indirect interest in any organization other than its wholly owned subsidiaries, Penn Square Bank, n.a. and Penn Realty.

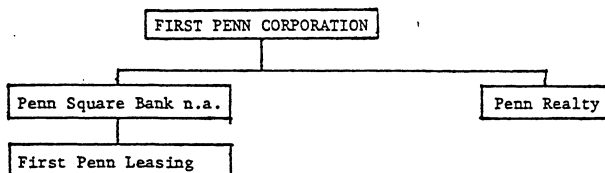
6. Activities of the Parent Bank Holding Company:

The registrant engages in the activity of owning or controlling its wholly owned subsidiaries as set forth in the completed Schedule C (part of the computer printout), and in the distribution of commercial paper.

7. Terminations:

No organization has ceased being a part of the bank holding company organization during the registrant's fiscal year.

DIVISION OF BANKING
 SUPERVISION & REGULATION
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 FEDERAL RESERVE BANK OF ST. LOUIS

REPORT ITEMS--CONT'D8. Organization Chart as of December 31, 1981:

NOTE: All Subsidiaries were wholly owned at December 31, 1981.

9. Amendments to Organizational Documents:

See attachments

10. Shareholders voting 5% or more of total voting stock:

NAME	ADDRESS	NO. SHARES	%
Ronald H. Burks	Oklahoma City, Ok.	13,127	5.9
Bill P. Jennings	Oklahoma City, Ok.	59,649	26.7
Bill G. Patterson	Oklahoma City, Ok.	16,182	7.2
The Rooney Corp.	Tulsa, Oklahoma	15,065	6.7
Carl Swan	Oklahoma City, Ok.	16,879	7.6

NOTE: All are U.S. citizens or U.S. Corporations

REPORT ITEMS--CONT'D11. Directors & Officers:

a. Bill P. Jennings, Oklahoma City, Ok., owns 59,649 shares (26.7%) of First Penn Corporation common stock and serves as its Chairman and President. Mr. Jennings is also Chairman of the Board and Chief Executive Officer of Penn Square Bank n.a and a Director of Penn Realty (both subsidiaries of First Penn Corporation). In addition, he has interests in the following business companies other than First Penn Corporation:

<u>COMPANY NAME</u>	<u>TITLE/POSITION</u>	<u>SHARES HELD</u>
First Healdton Corp.	President & Director	19.7%
First Healdton Bancorp.	Vice Chairman & Director	19.7%
J-Mc Aircraft Corporation		50.0%
S & J Aircraft Corporation		50.0%
Woodlawn Development Co.		33.3%
Peachtree Hospitalities, Inc.		33.3%
Thompson, Tuckman & Anderson	Director	00.0%
Petroleum Building, Ltd.	Partner	25.0%
JJS, A Partnership	Partner	33.3%
Penn-Northwestern Land Development Co.	Partner	25.0%
Chi-Chi's Property Mgmt. of Atlanta	Partner	25.0%
Jack Skaggs Limited Partnership 76-1	Partner	25.0%
Trans-Central Airlines		25.0%

b. Frank Murphy, Oklahoma City, Ok., owns 225 shares (0.1%) of First Penn Corporation common stock and serves as a Director and Vice President. Mr. Murphy is also a Director of Penn Realty, Vice Chairman of Penn Square Bank n.a. (both subsidiaries of First Penn Corporation) and has interests in the following business companies other than First Penn Corporation:

<u>COMPANY NAME</u>	<u>TITLE/POSITION</u>	<u>SHARES HELD</u>
Edgewater Heights Development Co.	Secretary & Director	50.0%
Michael's Service Co.		100.0%

REPORT ITEMS--CONT'D11. Directors & Officers--Cont'd:

c. Eldon Beller, Oklahoma City, Ok., owns 1,000 shares (0.4%) of First Penn Corporation common stock and serves as a Director & Vice President. Mr. Beller is also a Director, President and Chief Administrative Officer of Penn Square Bank n.a. (a subsidiary) and has interests in the following business companies other than First Penn Corporation:

<u>COMPANY</u> <u>NAME</u>	<u>TITLE/POSITION</u>	<u>SHARES</u> <u>HELD</u>
none	none	none

d. W. A. Ross, Oklahoma City, Ok., owns 2,944 shares (1.3%) of First Penn Corporation common stock and serves as a Director. Mr. Ross' principal occupation is as President and owner of Dub Ross Company. He is also a Director of Penn Square Bank n.a. (a subsidiary of First Penn Corporation) and has interests in the following business companies other than First Penn Corporation:

<u>COMPANY</u> <u>NAME</u>	<u>TITLE/POSITION</u>	<u>SHARES</u> <u>HELD</u>
Northwest Investors, Inc.	Partner	10.0%
Skirvin Plaza Investors	Partner	20.0%
Sterling Properties	Partner	20.0%

e. Ronald H. Burks, Oklahoma City, Ok., owns 13,127 shares (5.9%) of First Penn Corporation common stock and serves as a Director. Mr. Burks' principal occupation is as President of Ronald Burks Investments, Inc. He is also a Director of Penn Square Bank n.a. (a subsidiary of First Penn Corporation) and has interests in the following business companies other than First Penn Corporation:

<u>COMPANY</u> <u>NAME</u>	<u>TITLE/POSITION</u>	<u>SHARES</u> <u>HELD</u>
Copeland Energy	Director	5.0%
Richland Resources Corp.	Director	7.0%
Peachtree Hospitalities		33.0%
Northwest Investors		23.5%
Ronald Burks Investments, Inc.	President	100.0%
Skirvin Plaza Investors	General Partner	1.0%
Sterling Properties	Partner	11.0%
Penn Bank Tower Inv.	General Partner	1.0%
First Penn Tower Ltd.	Partner	37.6%

REPORT ITEMS--CONT'D11. Directors & Officers--Cont'd:

f. Carl W. Swan, Oklahoma City, Oklahoma, owns 16,879 shares (7.6%) of First Penn Corporation common stock and serves as a Director. Mr. Swan's principal occupation is as an independent oil producer. He is also a Director of Penn Square Bank n.a. (a subsidiary of First Penn Corporation) and has interests in the following business companies other than First Penn Corporation:

<u>COMPANY NAME</u>	<u>TITLE/POSITION</u>	<u>SHARES HELD</u>
Swan Petroleum	Director & President	100.0%
Swan Aviation	Director & President	100.0%
S & J Aircraft		50.0%
Swan Coal Company	Director & President	100.0%
Swan Cattle Co.	Director & President	100.0%
UTE Energy Co.		49.0%
Swan Silver Corp.	Director & President	100.0%
Henson's Saloon & Restaurant, Inc.		30.0%
UTOK Coal Venture		49.0%
Swan Development Co.		80.0%
Interstate Investment Co.		50.0%
SAN Investment Co.		70.0%
Empire Partnership I	Partner	16.67%
Sooner Partnership	Partner	50.0%
R.C. Partnership	Partner	50.0%
Green-Swan Partnership	Partner	50.0%
JJS Partnership	Partner	33.3%
Chi-Chi's Property Mgmt. of Sunrise		25.0%
Chi-Chi's Property Mgmt. of Atlanta		21.1%
Trans-Central Airlines	Director	25.0%
Peachtree Hospitalities		33.0%
Miller-Plano Joint Venture		53.0%
High Plains Drilling Co.	Director	40.0%
Longhorn Oil & Gas Co.	Director	40.0%
Texas Oilfield Supply	Director	15.0%
Penn Northwestern Land Development Co.		25.0%
Stan West Associates		4.5%
Denton Bros. Drilling		45.0%
World of Travel, Ltd.	Director	80.0%
American Gypsum Co.	Director	16.7%
Continental Drilling Co.	Director	32.0%
Oklahoma Pipeline Construction, Inc.		50.0%
Haymaker Farms, Ltd.		11.0%
Bethel-Radio Road Ltd.		20.0%

CONTINUED ON FOLLOWING PAGE

REPORT ITEMS--CONT'D11. Directors & Officers--Cont'd:

f. Carl W. Swan--Cont'd:

Empire Partnership II	Partner	20.0%
Junior's Inc.		20.0%
Intrepid Services, Inc.		15.0%
Intrepid Drilling Corp.		15.0%

g. John E. Rooney, Tulsa, Oklahoma, owns 1960 shares (.9%) of First Penn Corporation common stock and serves as a Director. Mr. Rooney's principal occupation is as President of the Rooney Corporation in which he has 50% ownership interest. The following are subsidiaries of the Rooney Corporation or subsidiaries of subsidiaries:

COMPANY
NAME

East Side Development Co.
Fleet Finance Company
Lake Country Beverage
Leland Equipment Co.
Leland-Manhattan Joint Venture
Penn Square, Inc.
Manhattan Construction Co.

In addition, Mr. Rooney has interests in the following business companies other than First Penn Corporation:

<u>COMPANY</u> <u>NAME</u>	<u>TITLE/POSITION</u>	<u>SHARES</u> <u>HELD</u>
Hope Lumber & Supply	Secretary & Director	140 shares
Rooney Oil Co.	Partner	33.3%

h. John Preston, Oklahoma City, Oklahoma, owns 120 shares (0.05%) of First Penn Corporation common stock and serves as a Director & General Counsel. Mr. Preston is also a Director, Secretary and General Counsel of Penn Square Bank n.a., and a Director of First Penn Leasing (both subsidiaries of First Penn Corporation). In addition he has interests in the following business companies other than First Penn Corporation:

<u>COMPANY</u> <u>NAME</u>	<u>TITLE/POSITION</u>	<u>SHARES</u> <u>HELD</u>
Circle Glenn Associates*	Partner	50.0%
Partners Investments Ltd.*	Partner	10.0%
Partners Investments Ltd. II*	Partner	.087%

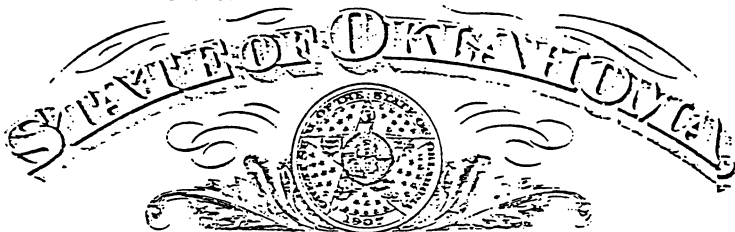
*Ownership in these companies was terminated effective 12/31/81.

REPORT ITEMS--CONT'D12. Insider Loans:

As of December 31, 1981, there were no loans to any insider or his interests aggregating more than 10% of the equity capital accounts of the bank holding company.

Amendments to Organizational Documents

OFFICE OF THE SECRETARY OF STATE



AMENDED

CERTIFICATE OF INCORPORATION*To all to Whom these Presents shall Come. Greetings:*WHEREAS, *Articles of Incorporation* duly signed and verified ofFirst Penn Corporation*have been filed in the office of the Secretary of State, as provided by the Laws of the State of Oklahoma.**NOW THEREFORE, I, the undersigned, Secretary of State of the State of Oklahoma by virtue of the powers vested in me by law, do hereby issue this Certificate of Incorporation.**IN TESTIMONY WHEREOF, I hereunto set my hand and cause to be affixed the Great Seal of the State of Oklahoma.*Filed at the City of ²Oklahoma City, this 7thday of January, A.D. 19 82

J. Bennett B. Edwards
Secretary of State

By *Brinda J. Young*

AMENDED ARTICLES OF INCORPORATION OF
 FIRST PENN CORPORATION
INCREASING AUTHORIZED CAPITAL STOCK

FILED

JAN 7 1992

OKLAHOMA SECRETARY
 OF STATE

STATE OF OKLAHOMA)
) ss.
 COUNTY OF OKLAHOMA)

TO THE SECRETARY OF STATE, STATE OF OKLAHOMA:

We, the undersigned officers of First Penn Corporation, an Oklahoma corporation, being persons legally competent to enter into contracts under the laws of the State of Oklahoma, and having been directed by the shareholders of the corporation to cause to be filed Amended Articles of Incorporation to reflect an amendment properly made and adopted by such shareholders, do hereby, in accordance with such directions, file the following Amended Articles of Incorporation which provide for increasing the authorized capital stock of this corporation:

ARTICLE I

NO CHANGE

ARTICLE II

NO CHANGE

ARTICLE III

NO CHANGE

ARTICLE IV

NO CHANGE

ARTICLE V

CHANGED TO READ AS FOLLOWS:

"This corporation is authorized to issue two (2) classes of capital stock, one to be designated "Common Stock" and the other to be designated "Preferred Stock". The total number of shares of Common Stock which this

corporation shall have authority to allot, the par value of each share of Common Stock, and the amount of total authorized Common Stock are as follows:

<u>TOTAL NUMBER OF SHARES</u>	<u>PAR VALUE OF EACH SHARE</u>	<u>TOTAL AUTHORIZED COMMON STOCK</u>
500,000	\$1.00	\$500,000

The Preferred Stock of the corporation shall be entitled to receive dividends at the annual rate of 6.5%, which dividends shall be cumulative and payable annually on January 30 of each year for dividends accrued as of the end of the preceding year out of the earnings of the corporation and in preference to any dividends upon the Common Stock. No cash dividend shall be paid upon the Common Stock if the payment of dividends on the Preferred Stock shall be in arrears. In the case of liquidation or dissolution of the corporation, the holders of Preferred Stock shall be entitled to be paid in full both the par value of such shares and the dividends accrued but unpaid, before any amount shall be paid to the owners of the Common Stock. Each share of Preferred Stock shall be subject to conversion into one share of Common Stock of the corporation at any time at the option of the holder thereof. The shares of Preferred Stock are subject to redemption at the option of the corporation, in whole or in part, upon payment of the par value thereof and accrued dividends at any time following January 1, 1989. Preferred Stock shall have no voting rights. The total number of shares of Preferred Stock which this corporation shall have authority to allot, the par value of each share of Preferred Stock and the amount of total authorized Preferred Stock are as follows:

<u>TOTAL NUMBER OF SHARES</u>	<u>PAR VALUE OF EACH SHARE</u>	<u>TOTAL AUTHORIZED PREFERRED STOCK</u>
5,000	\$60.00	\$300,000

ARTICLE VI

NO CHANGE

ARTICLE VII

NO CHANGE

ARTICLE VIII

NO CHANGE

Said Amendment was adopted in accordance with the procedures set forth in Title 18 of the Oklahoma Statutes, specifically, as follows:

- (1) Said Amendment was proposed by resolution of the Board of Directions adopted at a meeting of the Board of Directors held on the 19th day of May, 1981.
- (2) The Amendment was adopted by the shareholders of this corporation at a meeting held on the 14th day of July, 1981.

FIRST PENN CORPORATION

By: Bill P. Jennings
Bill P. Jennings, President

ATTEST:

Frank L. Murphy
Frank L. Murphy, Secretary

(SEAL)

ACKNOWLEDGMENT

The foregoing instrument was acknowledged before me this 30th day of December, 1981, by Bill P. Jennings, President, and Frank L. Murphy, Secretary, respectively, of First Penn Corporation, an Oklahoma Corporation, on behalf of the corporation.

[Signature]
Notary Public

My Commission Expires:

January 2 1983

(Seal)

FIRST PENN CORPORATION

MINUTES

SPECIAL SHAREHOLDERS' MEETING

Tuesday July 14, 1981 2:30 P.M.

Minutes of a special meeting of the shareholders of First Penn Corporation held Tuesday, July 14, 1981, at 2:30 P.M. in the Board Room of Penn Square Bank, N.A., 1919 Penn Square, Oklahoma City, Oklahoma.

Bill P. Jennings, Chairman of the Board, called the meeting to order and welcomed the shareholders present. He called for the election of a Chairman and a Secretary for the meeting. Upon motion duly made and seconded, Bill P. Jennings was unanimously elected Chairman of the meeting and John Preston was unanimously elected Secretary of the meeting.

The Secretary read the notice of the meeting (Exhibit A) and presented proof of mailing thereof (Exhibit B).

The Chairman called for a roll call of shareholders. Ronald E. Burks and W. A. Ross presented proxies representing 124,919 common shares (of 162,466 outstanding) and 4,025 preferred shares (of 4,225 outstanding). The Secretary noted that there are 166,691 total shares outstanding (common and preferred) and declared a quorum (128,944 total shares, representing 77% of the shares outstanding) present.

The Chairman appointed Elizabeth Merrick Coe and Marvin Margo as a committee on credentials to review the proxies and report to the Chairman thereon. After review, the credentials committee verified the proxies. The Chairman accepted the committee's report and discharged the committee. He instructed the Secretary to file the proxies with the permanent records of the Corporation. The Chairman announced that a quorum was present and declared the meeting open for business.

The Chairman introduced Eldon L. Beller and John R. Preston and moved their election as Directors of the Corporation. The motion was seconded. There being no discussion, the Chairman called for a vote. The Secretary announced that 128,944 shares present in person or by proxy voted in favor of the election. The Chairman declared Eldon L. Beller and John R. Preston duly elected as Directors of the Corporation.

The Chairman moved the adoption of a resolution authorizing Eldon L. Beller and John R. Preston to sign checks on behalf of the Corporation. The motion was seconded. There being no discussion, the Chairman called for a vote. The Secretary announced that 128,944 shares present in person or by proxy voted for adoption of the following resolution:

RESOLVED, that Eldon L. Beller and John R. Preston, both Directors and Vice Presidents of this Corporation, are hereby authorized and empowered to sign checks on behalf of this Corporation.

The Chairman next moved for the approval of a resolution increasing the number of authorized shares of common stock from 250,000 to 500,000. The motion was seconded. After discussion, the Chairman called for a vote. The Secretary announced that 128,944 shares present in person or by proxy voted for the adoption of the following resolution:

WHEREAS, the Directors of this Corporation have proposed, by resolution, the amendment of the Articles of Incorporation of this Corporation, as provided below,

NOW, THEREFORE, be it resolved, that Article V of the Articles of Incorporation of this Corporation be and the same are hereby amended from the following:

"This corporation is authorized to issue two (2) classes of capital stock, one to be designated "Common Stock" and the other to be designated "Preferred Stock". The total number of shares of Common Stock which this corporation shall have authority to allot, the par value of each share of Common Stock, and the amount of total authorized Common Stock are as follows:

<u>TOTAL NUMBER OF SHARES</u>	<u>PAR VALUE OF EACH SHARE</u>	<u>TOTAL AUTHORIZED COMMON STOCK</u>
250,000	\$1.00	\$250,000

The Preferred Stock of the corporation shall be entitled to receive dividends at the annual rate of 6.5%, which dividends shall be cumulative and payable annually on January 30 of each year for dividends accrued as of the end of the preceding year out of the earnings of the corporation and in preference to any dividends upon the Common Stock. No cash dividend shall be paid upon the Common Stock if the payment of dividends on the Preferred Stock shall be in arrears. In the case of liquidation or dissolution of the corporation, the holders of Preferred Stock shall be entitled to be paid in full both the par value of such shares and the dividends accrued but unpaid, before any amount shall be paid to the owners of the Common Stock. Each share of Preferred Stock shall be subject to conversion into one share of Common Stock of the corporation at any time at

the option of the holder thereof. The shares of Preferred Stock are subject to redemption at the option of the corporation, in whole or in part, upon payment of the par value thereof and accrued dividends at any time following January 1, 1989. Preferred Stock shall have no voting rights. The total number of shares of Preferred Stock which this corporation shall have authority to allot, the par value of each share of Preferred Stock and the amount of total authorized Preferred Stock are as follows:

<u>TOTAL NUMBER OF SHARES</u>	<u>PAR VALUE OF EACH SHARE</u>	<u>TOTAL AUTHORIZED PREFERRED STOCK</u>
5,000	\$60.00	\$300,000"

to the following:

"This corporation is authorized to issue two (2) classes of capital stock, one to be designated "Common Stock" and the other to be designated "Preferred Stock". The total number of shares of Common Stock which this corporation shall have authority to allot, the par value of each share of Common Stock, and the amount of total authorized Common Stock are as follows:

<u>TOTAL NUMBER OF SHARES</u>	<u>PAR VALUE OF EACH SHARE</u>	<u>TOTAL AUTHORIZED COMMON STOCK</u>
500,000	\$1.00	\$500,000

The Preferred Stock of the corporation shall be entitled to receive dividends at the annual rate of 6.5%, which dividends shall be cumulative and payable annually on January 30 of each year for dividends accrued as of the end of the preceding year out of the earnings of the corporation and in preference to any dividends upon the Common Stock. No cash dividend shall be paid upon the Common Stock if the payment of dividends on the Preferred Stock shall be in arrears. In the case of liquidation or dissolution of the corporation, the holders of Preferred Stock shall be entitled to be paid in full both the par value of such shares and the dividends accrued but unpaid, before any amount shall be paid to the owners of the Common Stock. Each share of Preferred Stock shall be subject to conversion into one share of Common Stock of the corporation at any time at the option of the holder thereof. The shares of Preferred Stock are subject to redemption at the option of the

corporation, in whole or in part, upon payment of the par value thereof and accrued dividends at any time following January 1, 1989. Preferred Stock shall have no voting rights. The total number of shares of Preferred Stock which this corporation shall have authority to allot, the par value of each share of Preferred Stock and the amount of total authorized Preferred Stock are as follows:

<u>TOTAL NUMBER OF SHARES</u>	<u>PAR VALUE OF EACH SHARE</u>	<u>TOTAL AUTHORIZED PREFERRED STOCK</u>
5,000	\$60.00	\$300,000"

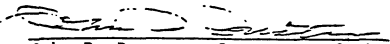
RESOLVED, further, that the Secretary is authorized, empowered, and directed to file the appropriate amendment to this Corporation's Articles of Incorporation to reflect such change in the number of authorized common shares of this Corporation.

The Chairman moved for the approval of a resolution adopting a stock option plan and a stock award plan for a total of 20,000 shares of common stock of this Corporation. The Chairman advised that no shares would be issued to himself or Frank Murphy, Secretary-Treasurer. After discussion, the Chairman called for a vote. The Secretary announced that 128,944 shares present in person or by proxy voted for adoption of the following resolutions:

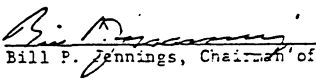
RESOLVED, that this Corporation's Stock Option Plan and Stock Award Plan (Exhibits C and D attached) are hereby adopted, provided that no shares shall be issued to Bill P. Jennings, Chairman of the Board, or Frank Murphy, Secretary-Treasurer.

RESOLVED, further, that the Board of Directors is hereby authorized and empowered to adopt such terms and conditions in relation to the issuance and award of such options and shares, and such amendments of the plans, as the Board determines reasonable and appropriate.

There being no further business, upon motion duly made, seconded, and unanimously adopted, the meeting was adjourned.


John R. Preston, Secretary of the
meeting

APPROVED:


Bill P. Jennings, Chairman of the Board

FIRST PENN CORPORATION
(Consolidated and Parent Company)

and

PENN SQUARE BANK, N.A.

Index to Financial Statements

December 31, 1981

(With comparative figures for 1980)

First Penn Corporation:

Consolidated Balance Sheet

Consolidated Statement of Income

Consolidated and Parent-Only Statement of Stockholders' Equity

Consolidated Statement of Changes in Financial Position

Parent-Only Balance Sheet

Parent-Only Statement of Income

Parent-Only Statement of Changes in Financial Position

Penn Square Bank, N.A.:

Consolidated Balance Sheet

Notes to Financial Statements



Peat, Marwick, Mitchell & Co.

Certified Public Accountants

First Oklahoma Tower
Oklahoma City, Oklahoma 73102

The Board of Directors and Stockholders
First Penn Corporation:

We have examined the consolidated and parent-only financial statements of First Penn Corporation and subsidiaries and the consolidated balance sheet of Penn Square Bank, N.A. and subsidiary as listed in the accompanying index. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The financial statements for the year ended December 31, 1980 for First Penn Corporation as listed in the accompanying index, which are included for comparative purposes, were examined by other auditors whose report, dated March 13, 1981, was qualified because they were unable to satisfy themselves as to the adequacy of the allowance for possible loan losses due to the lack of supporting documentation of collateral values of certain loans. As described in note 4 to the accompanying financial statements, the subsidiary bank, during 1981, formalized its approach to the evaluation of credit risks within the loan portfolio and documentation of the loan files with respect to credit and collateral information. The consolidated balance sheet for Penn Square Bank, N.A. and subsidiary as of December 31, 1980, which is included for comparative purposes, was included in the consolidated balance sheet of First Penn Corporation but was not presented separately and, therefore, not covered by the aforementioned auditors' report dated March 13, 1981.

In our opinion, the aforementioned financial statements present fairly the consolidated and parent-only financial position of First Penn Corporation and subsidiaries at December 31, 1981, the results of their operations and the changes in their financial position for the year then ended, and the consolidated financial position of Penn Square Bank, N.A. and subsidiary at December 31, 1981, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Peat, Marwick, Mitchell & Co.

March 19, 1982

FIRST PENN CORPORATION
Consolidated Balance Sheet

December 31, 1981
(With comparative figures as of December 31, 1980)

<u>Assets</u>	<u>1981</u>	<u>1980</u>
Cash, time deposits and due from banks	\$ 87,465,338	59,625,519
Investment securities (note 2):		
U.S. Treasury securities	13,123,075	10,992,420
Obligations of state and political subdivisions	<u>34,362,974</u>	<u>31,334,926</u>
Net investment securities	<u>47,486,049</u>	<u>42,327,346</u>
Loans (notes 3 and 4)	277,407,896	203,437,140
Less:		
Unearned discount	2,171,330	1,537,889
Allowance for possible loan losses	<u>4,141,447</u>	<u>2,004,587</u>
Loans, net	<u>271,095,119</u>	<u>199,894,664</u>
Federal funds sold	53,000,000	16,000,000
Bank premises, property and equipment, net (note 5)	4,541,937	3,724,388
Accrued interest receivable	20,495,932	7,372,553
Other assets (note 9)	<u>4,432,812</u>	<u>1,513,248</u>
	<u>\$ 488,517,187</u>	<u>330,457,718</u>
<u>Liabilities and Stockholders' Equity</u>		
Deposits:		
Demand	226,626,319	135,029,063
Savings and NOW accounts	18,223,800	13,341,126
Time (note 6)	164,817,006	136,522,794
Total deposits	<u>409,667,125</u>	<u>284,892,983</u>
Federal funds purchased	900,000	650,000
Commercial paper (note 7)	38,674,788	14,640,252
Loans sold under agreement to repurchase	-	2,795,561
Notes payable (note 8)	10,000,000	8,606,800
Accrued interest and other liabilities (note 9)	<u>3,962,669</u>	<u>4,636,579</u>
Total liabilities	<u>463,204,582</u>	<u>316,222,175</u>
Stockholders' equity (note 11):		
Preferred stock, 6.5% cumulative \$60 par value.		
Authorized 5,000 shares; issued 4,225 shares	253,500	253,500
Common stock, \$1 par value. Authorized 500,000 shares; issued 225,326 shares in 1981 and 162,466 shares in 1980	225,326	162,466
Surplus	15,827,993	7,420,753
Retained earnings	<u>9,005,786</u>	<u>6,398,824</u>
Total stockholders' equity	<u>25,312,605</u>	<u>14,235,543</u>
Commitments and contingent liabilities (note 12)		
	<u>\$ 488,517,187</u>	<u>330,457,718</u>

See accompanying notes to financial statements.

FIRST PENN CORPORATION
 Consolidated Statement of Income
 Year ended December 31, 1981
 (With comparative figures for 1980)

	<u>1981</u>	<u>1980</u>
Interest revenue:		
Interest and fees on loans	\$ 50,947,954	24,665,544
Interest and dividends on investment securities:		
U.S. Treasury securities	1,596,992	299,778
Obligations of state and political subdivisions	2,204,267	1,308,326
Interest on Federal funds sold	678,235	282,715
Interest on time deposits	15,732	-
Total interest revenue	<u>55,443,180</u>	<u>26,556,363</u>
Interest expense:		
Interest on deposits (note 6)	28,019,523	12,549,925
Interest on Federal funds purchased	2,949,376	871,220
Interest on commercial paper	4,737,523	1,055,686
Interest on notes payable	1,511,200	791,024
Other	95,805	2,745
Total interest expense	<u>37,313,427</u>	<u>15,270,600</u>
Net interest revenue	18,129,753	11,285,763
Provision for possible loan losses (note 4)	6,343,000	1,407,830
Net interest revenue, less provision for possible loan losses	11,786,753	9,877,933
Other revenue:		
Service charges on deposits	785,012	366,920
Other service charges and fee income	553,958	431,738
Gain on sale of land	401,770	-
Other	175,439	89,312
Total other revenue	<u>1,916,179</u>	<u>887,970</u>
Other expense:		
Salaries	4,521,562	1,997,560
Employee benefits (note 10)	602,703	341,656
Occupancy expense, net	677,197	310,941
Depreciation	698,785	307,887
Other	4,280,768	2,410,459
Total other expenses	<u>10,781,015</u>	<u>5,368,503</u>
Income before income taxes	2,921,917	5,397,400
Income taxes (note 9):		
Current:		
Federal	1,031,000	1,710,000
State	152,000	180,000
Deferred	(901,000)	76,710
	<u>282,000</u>	<u>1,966,710</u>
Net income	\$ <u>2,639,917</u>	<u>3,430,690</u>
Net income per average outstanding common share	\$ <u>14.19</u>	<u>29.23</u>
Average outstanding common shares	<u>183,701</u>	<u>116,794</u>
See accompanying notes to financial statements.		

FIRST PENN CORPORATION

Consolidated and Parent-Only
Statement of Stockholders' EquityYear ended December 31, 1981
(With comparative figures for 1980)

	<u>1981</u>	<u>1980</u>
Preferred stock - balance at beginning and end of year	\$ <u>253,500</u>	<u>253,500</u>
Common stock:		
Balance at beginning of year	162,466	108,311
Shares issued, 62,860 in 1981 and 54,155 in 1980	<u>62,860</u>	<u>54,155</u>
Balance at end of year	<u>225,326</u>	<u>162,466</u>
Surplus:		
Balance at beginning of year	7,420,753	3,142,508
Amount in excess of par value of shares issued	<u>8,407,240</u>	<u>4,278,245</u>
Balance at end of year	<u>15,827,993</u>	<u>7,420,753</u>
Retained earnings:		
Balance at beginning of year	6,398,824	2,984,611
Net income	2,639,917	3,430,690
Cash dividend on preferred stock, \$7.80 per share in 1981 and \$3.90 in 1980	<u>(32,955)</u>	<u>(16,477)</u>
Balance at end of year	<u>9,005,786</u>	<u>6,398,824</u>
Total stockholders' equity	\$ <u>25,312,605</u>	<u>14,235,543</u>

See accompanying notes to financial statements.

FIRST PENN CORPORATION

Consolidated Statement of Changes in Financial Position

Year ended December 31, 1981
(With comparative figures for 1980)

	<u>1981</u>	<u>1980</u>
Funds provided:		
Net income	\$ 2,639,917	3,430,690
Items not using (providing) funds:		
Depreciation and amortization	698,785	307,887
Deferred income taxes	(901,000)	76,710
Provision for possible loan losses	6,343,000	1,407,830
Gain on sale of land	(401,770)	-
Amortization of cost in excess of net assets acquired	<u>21,348</u>	<u>21,348</u>
Funds available from operations	8,400,280	5,244,465
Increase in:		
Deposits	124,774,142	135,213,155
Federal funds purchased	250,000	250,000
Commercial paper	24,034,536	14,640,252
Loans sold under agreement to repurchase	-	2,795,561
Notes payable	1,393,200	5,446,799
Accrued interest and other liabilities	-	2,584,528
Proceeds from sale of bank premises, property and equipment	1,720,538	12,562
Proceeds from issuance of common stock	8,470,100	4,332,400
	<u>\$ 169,042,796</u>	<u>170,519,722</u>
Funds used:		
Purchase of bank premises, property and equipment	2,835,102	2,106,886
Cash dividends	32,955	16,477
Increase in:		
Cash, time deposits and due from banks	27,839,819	33,953,858
Investment securities	5,158,703	19,344,527
Loans	77,543,455	94,817,612
Federal funds sold	37,000,000	14,900,000
Accrued interest receivable	13,123,379	4,877,277
Other assets	2,216,622	503,085
Decrease in:		
Accrued interest and other liabilities	497,200	-
Loans sold under agreement to repurchase	<u>2,795,561</u>	<u>-</u>
	<u>\$ 169,042,796</u>	<u>170,519,722</u>

See accompanying notes to financial statements.

FIRST PENN CORPORATION
(parent company only)

Balance Sheet

December 31, 1981
(With comparative figures as of December 31, 1980)

<u>Assets</u>	<u>1981</u>	<u>1980</u>
Cash on deposit with subsidiary bank	\$ 6,009,164	7,595,651
Time deposits with subsidiary bank	32,000,000	8,300,000
Receivable from subsidiary bank	1,389,774	873,083
Investment in subsidiaries:		
Penn Square Bank, N.A.:		
Equity in net assets	31,597,401	20,422,403
Cost in excess of net assets acquired	<u>725,832</u>	<u>747,180</u>
	32,323,233	21,169,583
Penn Realty Company	<u>1,250,057</u>	<u>-</u>
	33,573,290	21,169,583
Land	664,008	1,242,721
Accrued interest	107,199	44,866
Other assets (note 9)	<u>754,011</u>	<u>3,180</u>
	\$ <u>74,497,446</u>	<u>39,229,084</u>
<u>Liabilities and Stockholders' Equity</u>		
Commercial paper (note 7)	38,674,788	14,640,252
Notes payable (note 8)	10,000,000	8,606,800
Accrued interest and other expenses (note 9)	<u>510,053</u>	<u>1,746,489</u>
Total liabilities	49,184,841	24,993,541
Stockholders' equity (note 11):		
Preferred stock, 6.5% cumulative, \$60 par value.		
Authorized 5,000 shares; issued 4,225 shares	253,500	253,500
Common stock, par value \$1 a share. Authorized		
500,000 shares; issued 225,326 shares in 1981 and		
162,466 shares in 1980	225,326	162,466
Surplus	15,827,993	7,420,753
Retained earnings	<u>9,005,786</u>	<u>6,398,824</u>
Total stockholders' equity	25,312,605	14,235,543
Commitments and contingent liabilities (note 12)		
	\$ <u>74,497,446</u>	<u>39,229,084</u>

See accompanying notes to financial statements.

FIRST PENN CORPORATION
(parent company only)

Statement of Income

Year ended December 31, 1981
(With comparative figures for 1980)

	<u>1981</u>	<u>1980</u>
Income from subsidiary bank:		
Dividends	\$ 1,050,000	300,000
Interest on time deposits	<u>1,823,656</u>	<u>270,375</u>
	2,873,656	570,375
Gain on sale of land	<u>401,770</u>	-
Total income	<u>3,275,426</u>	<u>570,375</u>
Expenses:		
Interest	6,248,722	1,846,710
Amortization of cost in excess of net assets acquired and organization costs	21,348	22,951
Other	<u>42,931</u>	<u>4,305</u>
Total expenses	<u>6,313,001</u>	<u>1,873,966</u>
Loss before income taxes and equity in undistributed earnings (loss) of subsidiaries	(3,037,575)	(1,303,591)
Income tax benefit (note 9)	<u>2,013,000</u>	<u>749,183</u>
Loss before undistributed earnings (loss) of subsidiaries	(1,024,575)	(554,408)
Equity in undistributed earnings (loss) of subsidiaries:		
Penn Square Bank, N.A.	3,674,998	3,985,098
Penn Realty Company	<u>(10,506)</u>	-
	<u>3,664,492</u>	<u>3,985,098</u>
Net income	<u>\$ 2,639,917</u>	<u>3,430,690</u>
Net income per average outstanding common share	<u>\$ 14.19</u>	<u>29.23</u>
Average outstanding common shares	<u>183,701</u>	<u>116,794</u>

See accompanying notes to financial statements.

FIRST PENN CORPORATION
(parent company only)

Statement of Changes in Financial Position

Year ended December 31, 1981
(With comparative figures for 1980)

	<u>1981</u>	<u>1980</u>
Funds provided:		
Increase in:		
Commercial paper	\$ 24,034,536	14,640,252
Notes payable	1,393,200	5,446,799
Accrued interest and other expenses	-	963,863
Proceeds from issuance of common stock	8,470,100	4,332,400
Proceeds from sale of land	1,653,736	-
Decrease in cash	1,586,487	-
	<u>\$ 37,138,059</u>	<u>25,383,314</u>
Funds used:		
Net income	(2,639,917)	(3,430,690)
Items which do not provide (use) funds:		
Equity in undistributed earnings (loss) of subsidiaries:		
Penn Square Bank, N.A.	3,674,998	3,985,098
Penn Realty Company	(10,506)	-
Gain on sale of land	401,770	-
Amortization of organization costs	-	(1,603)
Amortization of cost in excess of net assets acquired of subsidiary bank	(21,348)	(21,348)
Funds used by operations	1,404,997	531,457
Increase in:		
Cash	-	7,588,209
Time deposits	23,700,000	8,300,000
Receivable from subsidiary bank	516,691	171,583
Accrued interest and other assets	813,164	30,867
Additional investment in subsidiaries through capital contributions:		
Penn Square Bank, N.A.	7,500,000	7,500,000
Penn Realty Company	10,000	-
Purchase of investment in Penn Realty Company	1,250,563	-
Purchase of land	673,253	1,242,721
Acquisition of Penn Square Bank, N.A. common stock	-	2,000
Cash dividends	32,955	16,477
Decrease in accrued interest and other expenses	1,236,436	-
	<u>\$ 37,138,059</u>	<u>25,383,314</u>

See accompanying notes to financial statements.

PENN SQUARE BANK, N.A.
(A Wholly-owned Subsidiary of First Penn Corporation)

Consolidated Balance Sheet

December 31, 1981
(With comparative figures as of December 31, 1980)

<u>Assets</u>	<u>1981</u>	<u>1980</u>
Cash, time deposits and due from banks	\$ 87,465,338	59,625,519
Investment securities (note 2):		
U.S. Treasury securities	13,123,075	10,992,420
Obligations of state and political subdivisions	34,362,974	31,334,926
Net investment securities	<u>47,486,049</u>	<u>42,327,346</u>
Loans (notes 3 and 4)	277,407,896	203,437,140
Less:		
Unearned discount	2,171,330	1,537,889
Allowance for possible loan losses	4,141,447	2,004,587
Loans, net	<u>271,095,119</u>	<u>199,894,664</u>
Federal funds sold	53,000,000	16,000,000
Bank premises, property and equipment, net (note 5)	3,877,929	2,481,667
Accrued interest receivable	20,495,932	7,372,553
Other assets (note 9)	<u>1,704,004</u>	<u>762,888</u>
	<u>\$ 485,124,371</u>	<u>328,464,637</u>
<u>Liabilities and Stockholder's Equity</u>		
Deposits:		
Demand	232,636,575	142,624,714
Savings and NOW accounts	18,223,800	13,341,126
Time (note 6)	196,817,005	144,822,794
Total deposits	<u>447,677,381</u>	<u>300,788,634</u>
Loans sold under agreements to repurchase	-	2,795,561
Federal funds purchased	900,000	650,000
Accrued interest and other liabilities (note 9)	4,949,589	3,808,039
Total liabilities	<u>453,526,970</u>	<u>308,042,234</u>
Stockholder's equity:		
Common stock, par value \$10 a share. Authorized and issued 100,000 shares	1,000,000	1,000,000
Surplus	18,000,000	10,500,000
Undivided profits	12,597,401	8,922,403
Total stockholder's equity	<u>31,597,401</u>	<u>20,422,403</u>
Commitments and contingent liabilities (note 12)		
	<u>\$ 485,124,371</u>	<u>328,464,637</u>

See accompanying notes to financial statements.

FIRST PENN CORPORATION

Notes to Financial Statements

December 31, 1981

(With comparative information for 1980)

(1) Summary of Significant Accounting Policies

The accounting and reporting policies of First Penn Corporation, "the Company", and its wholly-owned subsidiaries, Penn Square Bank, N.A., "the Bank", and Penn Realty Company, "Realty", conform to generally accepted accounting principles and general practice within the banking industry. The following represent the more significant of those policies and practices.

Basis of Presentation and Principles of Consolidation

The consolidated financial statements include the accounts of the Company, the Bank and its wholly-owned subsidiary, First Penn Leasing, Inc., and Realty, after elimination of all significant intercompany accounts and transactions. The consolidated balance sheet of the Bank includes the accounts of the Bank and its wholly-owned subsidiary after elimination of all significant intercompany accounts and transactions.

The Company's investment in its subsidiary bank is carried at cost plus equity in the Bank's net income from date of acquisition reduced by dividends received. Included in such investment is cost in excess of net assets acquired (goodwill) which approximated \$725,000, net of amortization, as of December 31, 1981. Such excess cost is being amortized over forty years.

In January 1981, the Company acquired from certain officer-stockholders all of the outstanding stock of Penn Realty Company at their cost of \$1,250,000. Realty's primary asset is a real estate project on which the Bank had previously foreclosed. The Bank's non-interest accruing loan on such project at December 31, 1981 approximated \$2,200,000 and was included in outstanding loans in the accompanying balance sheets. No significant loss is anticipated on ultimate disposition of the project.

Investment Securities

Investment securities are carried at cost adjusted for amortization of premiums and accretion of discounts. Gains and losses on sales of investment securities are recognized on a completed transaction basis. Such gains and losses for 1981 and 1980 were insignificant and have been included in other revenues in the consolidated statement of income. The basis of the securities sold is determined by specific identification of each security.

Loans

Loans are reported on a gross basis before the reduction of unearned discount and the allowance for possible loan losses. Interest income is recorded on discounted loans by use of the "rule of 78" method. Interest income is recorded as earned on non-discounted loans. The recognition of interest income is discontinued when, in management's judgment, the interest will not be collectible in the normal course of business.

(Continued)

FIRST PENN CORPORATION

Notes to Financial Statements, Continued

Allowance for Possible Loan Losses

The Bank maintains its allowance for possible loan losses at levels management considers necessary to reflect the credit risks of the loan portfolio. For financial reporting purposes, the provision to be charged as an operating expense is based on the Bank's past loan loss experience and such other factors which in management's judgment deserve current recognition necessary to maintain the allowance at an adequate level. See note 4.

Bank Premises, Property and Equipment

Bank premises, property and equipment are stated at cost, less accumulated depreciation. Depreciation is charged to operating expense and is computed by the use of the straight-line or the declining balance methods over the estimated useful lives of the assets. Leasehold improvements are amortized over the term of the respective leases. Maintenance and repairs are charged to expense as incurred while improvements are capitalized.

Income Taxes

The Company files a consolidated income tax return with its subsidiaries. Deferred income taxes are recorded for timing differences which result from the recognition of certain income and expenses for income tax purposes in periods different from that for financial statement purposes. In computing the provision for Federal income taxes, investment tax credits are used to reduce the provision in the year the assets are placed in service.

Trust Income

Trust income is reported on a cash basis which does not materially differ from the accrual basis.

Computation of Income Per Share

Income per share of common stock is based on the weighted average number of shares outstanding during the year after considering preferred stock dividends.

Presentation

Certain 1980 amounts have been reclassified to conform with 1981 account classifications.

(2) Investment Securities

A comparison of the recorded value and market value of investment securities of the Bank at December 31 is as follows:

	1981		1980	
	Recorded value	Approximate value	Recorded value	Approximate value
U.S. Treasury securities	\$ 13,123,075	12,490,000	10,992,420	10,643,000
Obligations of state and political subdivisions	<u>34,362,974</u>	<u>29,030,000</u>	<u>31,334,926</u>	<u>26,546,000</u>
	<u>\$ 47,486,049</u>	<u>41,520,000</u>	<u>42,327,346</u>	<u>37,189,000</u>

(Continued)

FRASER BANK CORPORATION

Notes to Financial Statements, Continued

Management believes there has been no permanent impairment in the value of its investment securities and intends to hold them to maturity.

Investment securities having a recorded value of approximately \$24,031,000 and \$18,549,000 at December 31, 1981 and 1980, respectively, were pledged to secure public and trust deposits and for other purposes required by law.

(3) Loans

A summary of loans at December 31 is as follows:

	<u>1981</u>	<u>1980</u>
Commercial loans	\$ 197,579,003	155,798,134
Real estate loans	43,606,909	26,763,002
Installment loans	23,945,308	17,894,678
Other	<u>12,276,676</u>	<u>2,981,326</u>
	277,407,896	203,437,140
Less unearned discount	<u>2,171,330</u>	<u>1,537,889</u>
	275,236,566	201,899,251
Less allowance for possible loan losses	<u>4,141,447</u>	<u>2,004,587</u>
	<u>\$ 271,095,119</u>	<u>199,894,664</u>

Certain of the Bank's officers and directors had transactions with the Bank in the ordinary course of business. At December 31, 1981 and 1980, loans to them and their affiliated interests approximated \$6,800,000 and \$3,900,000, respectively. In the opinion of management, such transactions were made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons or companies and did not involve more than normal risk. Also, the Bank purchases and sells loans to two banks in which an officer-director of the Bank holds an equity interest. At December 31, 1981 and 1980, outstanding transactions with such banks consisted of:

	<u>1981</u>	<u>1980</u>
Loan participations purchased	\$ 1,490,470	1,737,484
Loan participations sold	5,532,369	6,767,646

The Bank's non-accrual loans at December 31, 1981 approximated \$11,800,000. Such loans are considered in the determination of the adequacy of the allowance for possible loan losses. See note 4. The total amount of interest which would have been recorded under the original terms of the loans, had interest been accruing, was approximately \$2,000,000 in 1981.

(Continued)

FIRST PENN CORPORATION

Notes to Financial Statements, Continued

(4) Allowance for Possible Loan Losses

A summary of transactions in the allowance for possible loan losses is as follows:

	<u>1981</u>	<u>1980</u>
Balance at beginning of year	\$ 2,004,587	1,002,097
Recoveries credited to the allowance	629,417	212,061
Provision charged to expense	<u>6,343,000</u>	<u>1,407,830</u>
	8,977,004	2,621,988
Less loans charged off	<u>(4,835,557)</u>	<u>(617,401)</u>
Balance at end of year	<u>\$ 4,141,447</u>	<u>2,004,587</u>

Management's judgment as to the level of future losses on existing loans involves the consideration and related effect of current and anticipated economic conditions on specific borrowers, an evaluation of the existing relationship among loans, examinations by regulatory authorities and management's internal review of the loan portfolio. In determining the collectibility of certain loans, management also considers the fair value of the underlying collateral.

During 1981, the Bank formed a loan review function and adopted a formalized approach to the evaluation and documentation of credit risks within the loan portfolio. The conclusions reached from this systematic analysis of the loans are translated on a quarterly basis to adjustments, if any, which are deemed necessary to maintain the allowance for possible loan losses at an adequate level. Also during 1981, the Bank significantly improved its documentation of the loan files with respect to credit and collateral information.

It should be understood that estimates of future loan losses involve an exercise of judgment. It is the judgment of management that the allowance is adequate at both December 31, 1981 and 1980.

(5) Bank Premises, Property and Equipment

Bank premises, property and equipment at December 31 are summarized as follows:

	<u>Estimated useful lives</u>	<u>1981</u>	<u>1980</u>
Bank:			
Land	-	\$ -	469,426
Buildings and improvements	3-30 years	2,994,203	1,838,075
Furniture, fixtures and equipment	3-12 years	2,740,751	1,268,168
Construction in progress	-	-	118,682
		<u>5,734,954</u>	<u>3,694,351</u>
Less accumulated depreciation		<u>1,857,025</u>	<u>1,212,684</u>
		3,877,929	2,481,667
Company - land	-	<u>664,008</u>	<u>1,242,721</u>
Total consolidated bank premises, property and equipment		<u>\$ 4,541,937</u>	<u>3,724,388</u>

(Continued)

FIRST PENN CORPORATION

Notes to Financial Statements, Continued

During 1981, the Company sold certain of its unimproved land at a gain of \$401,000. Also during 1981, the Company acquired the Bank's land used principally for its drive-in facility at its recorded cost of \$469,426.

(6) Deposits

Included in time deposits of the Bank at December 31, 1981 and 1980 are approximately \$162,400,000 and \$116,473,000 (including \$32,000,000 and \$8,300,000 held by First Penn Corporation), respectively, of certificates of deposit in denominations of \$100,000 or more. Interest expense on such deposits approximated \$20,761,000 and \$8,765,000 (including \$1,824,000 and 270,000 on deposits held by First Penn Corporation), for the years ended December 31, 1981 and 1980, respectively.

(7) Commercial Paper

The Company obtains funds to support its investment activities through the issuance and sale of commercial paper. Commercial paper aggregated \$38,674,788 (with weighted average interest rates approximating 10.94%) and \$14,640,252 (with weighted average interest rates approximating 17.57%) at December 31, 1981 and 1980, respectively.

(8) Notes Payable

The following summarizes notes payable for which the Company is obligated:

	<u>1981</u>	<u>1980</u>
Interest rate floating with Dallas prime, due February 27, 1981, secured by land with a recorded cost of approximately \$1,240,000	\$ -	1,106,800
Interest rate floating with Chicago prime, due on demand, secured by 98,354 shares of Bank common stock	<u>10,000,000</u>	<u>7,500,000</u>
	<u>\$ 10,000,000</u>	<u>8,606,800</u>

The interest at Chicago floating prime will increase by 1/2% in February 1982 with subsequent bi-annual increases of 1/4%. Interest is payable quarterly. Quarterly principal payments of \$250,000 begin March 1982 with final payment in March 1992.

(9) Income Taxes

The consolidated income tax provisions for 1981 and 1980 differ from the normally expected income tax rate of 46% principally because of income from tax-exempt municipal securities and investment tax credits. The income tax benefit for the parent company represents the excess of amounts payable by its subsidiaries in lieu of paying income taxes on a separate return basis over the taxes payable on the consolidated return.

(Continued)

FIRST PENN CORPORATION

Notes to Financial Statements, Continued

Deferred income tax expense (benefit) results from timing differences in the recognition of revenue and expense for income tax and financial statement purposes. The sources of these differences in 1981 and 1980 and the consolidated income tax effect of each were as follows:

	<u>1981</u>	<u>1980</u>
Provision for possible loan losses	\$(1,027,500)	72,400
Other, net	<u>126,500</u>	<u>4,310</u>
	<u>\$ (901,000)</u>	<u>76,710</u>

Income tax accounts included in the balance sheets are summarized as follows:

	<u>1981</u>	<u>1980</u>
<u>First Penn Corporation (consolidated):</u>		
Other assets:		
Income taxes refundable	\$ 155,180	-
Deferred income tax benefit	724,290	-
Accrued interest and other liabilities:		
Income taxes currently payable	-	1,032,859
Deferred income taxes payable	<u>-</u>	<u>176,710</u>
<u>First Penn Corporation (parent-only):</u>		
Other assets - income taxes refundable	155,180	-
Accrued interest and other liabilities - income taxes currently payable	<u>-</u>	<u>977,535</u>
<u>Penn Square Bank N.A.:</u>		
Other assets - deferred income tax benefit	724,290	-
Accrued interest and other liabilities:		
Income taxes currently payable	1,400,556	928,407
Deferred income taxes payable	<u>-</u>	<u>176,710</u>

(10) Retirement Plan

The Bank has a non-contributory retirement plan covering substantially all of its employees meeting certain age and service requirements. Pension expense was approximately \$58,000 for 1981 and \$74,000 for 1980. The Bank's policy is to fund pension costs accrued with past service costs being amortized over ten years. A comparison of accumulated plan benefits and plan net assets as of January 1, 1981, the date of the most recent actuarial valuation, is presented below:

Actuarial present value of accumulated plan benefits:	
Vested	\$ 232,000
Nonvested	<u>91,000</u>
	<u>\$ 323,000</u>
Net assets available for benefits	<u>\$ 422,000</u>

(Continued)

FIRST PENN CORPORATION

Notes to Financial Statements, Continued

The assumed rate of return used in determining the actuarial present value accumulated plan benefits was 7%.

The above data compares the fair value of assets held with the present value of benefits that have been earned based on services rendered and current salary levels. The plan's actuarial accrued liability based on the actuarial cost method used to determine the Bank's retirement expense differs from the actuarial present value of accumulated plan benefits due to the fact that it considers expected future salary increases at a rate of 5% per annum. At January 1, 1981, the actuarial accrued liability under this method was approximately \$516,000.

(11) Common and Preferred Stock

During 1981, the Company approved a plan which reserved 20,000 shares of its common stock for issuance under an employee stock option plan. No options have been granted through December 31, 1981.

Each share of preferred stock outstanding is convertible into one share of the Company's common stock at any time at the option of the holder and is subject to redemption at the Company's option after January 1, 1989 upon payment of the par value of \$60 per share plus accrued dividends. No cash dividends may be paid on the Company's common stock if the dividends on the preferred stock is in arrears.

(12) Commitments and Contingent Liabilities

The Bank has various long-term operating lease agreements under which it makes annual rental payments for the use of certain land and facilities. The lease terms vary but are generally renewable when the respective leases expire. Minimum lease payments for such leases presently approximate \$175,000 annually.

The Bank's intent is to move its principal offices to a new building which is expected to be completed in 1983. Annual rentals for the new space will approximate \$1,500,000 with provision for increases over the lease term.

In the normal course of business, the Bank is involved in various legal actions. In the opinion of management and legal counsel, no material losses from such actions are anticipated.

At December 31, 1981, the Bank had outstanding stand-by letters of credit which approximated \$116,000,000. Should the Bank be required to fund such commitments, approximately \$30,000,000 will be participated to other banks.

The Bank extends lines of credit covering future borrowings of a customer when the customer's financial condition and collateral warrant such extensions of credit. In most instances a maximum amount will be specified and the line may be cancelled at the Bank's option with notice to the customer.

APPENDIX G

(Excerpt from Conduct of Monetary Policy hearing of July 21, 1982)

The CHAIRMAN. Thank you, Chairman Volcker.

Mr. Chairman, the discount window has remained a very mysterious element of the Federal Reserve's operations. Unfortunately, by law it is excluded from even any auditing by the GAO. As I recall, in 1977 when the GAO auditing of portions of the Fed came about, that there were those of us who agreed that we would revisit this exclusion at a later date, and perhaps the time has come for such a revisiting.

However, once again the spotlight is seeking out the discount window operation in the Penn Square Bank failure in Oklahoma. One wonders how much money the Fed put into the bank for the 12 months prior to July 6 when it was declared a failed bank and shut down.

Next, who made the decision to toss a series of liferafts to the bank during those months? Do you think that the Federal Reserve's open window policy gave a false sense of security to private investors who placed money in the bank while your life support systems were in place? Now, of course, we read about another bank, the Abilene National Bank of Texas. There are some news reports that it has received \$30 million, others \$50 million, depending on which news story is to be believed.

Once again, who makes the decision that this is a worthy use of funds dispensed by a public agency? Overall, what does the free use of the discount window do? And this is questionable in the minds of some, what does it do for market discipline, for the market discipline of financial institutions?

So to run through it again, who made the decision? Do you know how much was pumped into, or can you tell us, Penn Square? And do you think that this gave a false sense of security to many of the investors who are caught with their deposits over \$100,000?

Chairman VOLCKER. I don't think there is anything mysterious about the operations of the discount window, Mr. Chairman. I am a little bit disturbed to hear your characterization. We do not, and obviously cannot, comment in terms of our lending to individual, ongoing institutions. But in the case of Penn Square, I think I can tell you there was no borrowing at the discount window in the year prior to the demise of that institution until 3 working days before the actual closure of the bank.

We did lend some money on the Wednesday and the Friday before the closing, \$20 million one day, and after this loan was paid off on Thursday, the next day—Friday—a little under \$6 million. But there wasn't any borrowing in the previous year. There had been some borrowings intermittently in earlier years by that bank but none in the previous year.

The CHAIRMAN. The lending within 3 days of the closure, was that perhaps an effort to see if other arrangements could be made to avoid the drastic action that was eventually taken?

Chairman VOLCKER. There was a run on the bank for a perfectly normal reason. In fact, the basic reason the discount window is there in the first place is to provide credit under those circumstances if that can be done safely and soundly. These loans, of course, were fully secured, and certainly it is preferable to lend money on secured bases in that period, while you see what needs to be done with the bank, indeed whether it has to be closed at all.

We are prepared to lend to banks that are under liquidity pressures in circumstances of that kind; that is our function.

The CHAIRMAN. And in the case of Abilene National Bank?

Chairman VOLCKER. I do not want to comment on individual operating banks. A bank that is in a functioning position, experiencing a loss in deposits, if it has adequate collateral, certainly has the discount window available to it.

The CHAIRMAN. When you say adequately protected, are you stating that in the case of the \$26 million that was lent to Penn Square—

Chairman VOLCKER. That was not the total; it was \$20 million on one day, Wednesday, and \$6 million on Friday.

The CHAIRMAN. Right. So the \$20 million on that occasion right at the very end, but that is secured and have been repaid or will be repaid in full?

Chairman VOLCKER. I do not know just what the situation is now. We will certainly be repaid in full, yes. Whether we have been repaid yet or not, while the thing is in the process of liquidation, I do not know.

The CHAIRMAN. Repaid after liquidation? In other words, do you occupy a preferred position?

Chairman VOLCKER. Yes. We are secured and we have a preferred position.

The CHAIRMAN. Preferred position over depositors who had funds in there over \$100,000?

Chairman VOLCKER. Yes, we have our loans fully secured.

The CHAIRMAN. That means that an institution, whether this \$20 million had gone in 2 days before the failure or 6 months before the failure, nevertheless the moneys are advanced or lent that are fully secured, and then other private investors not aware of—and this is a big problem, the secrecy—not aware of the fact that a particular institution is suffering or is on a problem list or is very close or on the brink of failure. They keep putting money in but they are not protected. Yet the Fed's injection of funds gives the appearance to the public at large that that individual or particular institution is indeed healthy.

Chairman VOLCKER. I don't think—

The CHAIRMAN. Is that not a problematical thing?

Chairman VOLCKER. The public at large would not know about the lending operation at the time.

The CHAIRMAN. Exactly. Therefore, the institution continues to function with an artificial infusion of funds and the public at large is not aware of the fact that that is taking place.

Chairman VOLCKER. You call it an artificial infusion of funds. At its very foundation the Federal Reserve System was designed to assist institutions that are facing a liquidity situation of this sort. I think there is an expectation in the Congress as well as elsewhere that those loans will be secured when we make them.

The CHAIRMAN. Oh, sure.

Mr. Chairman, my time has expired, although my staff did not give me the 5-minute notice, and they better start doing it in all fairness to all the members. I think this is an item that we are going to have to pursue further. I do not want to take up any more of the committee's time on this at this point, but I think that we are not communicating or thinking in the same direction but I think we eventually shall if we were to pursue it a little further.

(Excerpt from Conduct of Monetary Policy hearing of July 21, 1982)

The CHAIRMAN. If we could revisit the use of the discount window in Penn Square, I would like to ask you a few more questions. You decided to allow, \$20 million 1 day and on the following day \$6 million.

Chairman VOLCKER. In round numbers.

The CHAIRMAN. So when the bank closed they owed you \$6 million, is that correct?

Chairman VOLCKER. That is correct.

The CHAIRMAN. Was that decision to lend those funds and allow the use of the discount window made in the regional Kansas City office, or was there any contact with the Fed in Washington?

Chairman VOLCKER. In this particular case they were in contact with the Fed in Washington.

The CHAIRMAN. Was that because the Fed in Washington was aware of the status of Penn Square and the problem loans?

Chairman VOLCKER. We had become aware recently, yes.

The CHAIRMAN. Do you know, was it the Comptroller's Office that informed you of the situation or was it the FDIC?

Chairman VOLCKER. To the best of my knowledge we first learned about this through an inquiry, more or less a routine inquiry that one of our people had made to the Comptroller's Office.

The CHAIRMAN. That one of your people had made of the Comptroller's Office?

Chairman VOLCKER. Yes.

The CHAIRMAN. What gave rise to this individual's making the inquiry of the Comptroller's office?

Chairman VOLCKER. The individual was specifically interested in knowing if there were any problems in the banking industry that he did not know about already.

The CHAIRMAN. OK. Was that a general question, to wit, Mr. Comptroller, what is the status of the problem banks? Or was it specifically directed to Penn Square?

Chairman VOLCKER. No, it was not directed to Penn Square.

The CHAIRMAN. Would it be possible to find out who this persistent individual is?

Chairman VOLCKER. Yes, but I do not know what purpose would be served.

The CHAIRMAN. It might be helpful to us in factfinding as time goes by.

Chairman VOLCKER. I would prefer to discuss that later.

The CHAIRMAN. All right, we can discuss that a little later.

Chairman VOLCKER. That is how we first found out about it; I am not saying that we would not have found out about it in another way subsequently.

The CHAIRMAN. Do you know approximately when this information came to the attention of our persistent individual?

Chairman VOLCKER. Oh, a week or so before.

The CHAIRMAN. About a week prior?

Chairman VOLCKER. Yes.

The CHAIRMAN. If I were you, I would feel hurt about that, because Continental and the bankers had been informed about that same time without the inquiry. They were given the information. You need not comment.

You say those advances, the loans at the discount window, were secured. No. 1, you said that you had preferred status.

Chairman VOLCKER. We have a secured loan.

The CHAIRMAN. But no preferred status?

Chairman VOLCKER. Only in the sense that it's a secured loan.

The CHAIRMAN. Secured by what?

Chairman VOLCKER. It was part of their loan portfolio.

The CHAIRMAN. Loan portfolio?

Chairman VOLCKER. There may have been something else in there, but essentially their loan portfolio.

The CHAIRMAN. OK. Now, in view of the fact that many of those loans were not worth very much, they vary in value, let us say at the close there was a \$6 million advance of loans from the discount window. The loan that you have as collateral is in what amount?

Chairman VOLCKER. Considerably in excess of that. I do not know what the number is.

The CHAIRMAN. Would it be possible to ask that we have what the ratio is? Is that information available?

Chairman VOLCKER. I am sure it was very high on that day, because we made a \$20 million loan 2 days before.

The CHAIRMAN. What I would like is, what was the collateral on the day of their first loan, as well as on Friday?

Chairman VOLCKER. I cannot tell you that offhand.

The CHAIRMAN. I realize you do not have it here at the moment, but I think it would be beneficial for us to know that.

[At the request of Chairman St Germain, the following additional information was submitted for inclusion in the record by Chairman Volcker:]

RESPONSE RECEIVED FROM CHAIRMAN VOLCKER

The first loan was made on June 30. It was a one-day note for \$20 million. It was collateralized by about \$27 million (face value) of customer notes; none of the customer notes were "criticized."

The second loan was made on Friday, July 2, and was to run through the weekend. It was for \$5.7 million due July 6. Collateral of about \$7.5 million was needed for this loan; much more was in fact on hand, including the amount available on June 30 plus an additional \$15 million. Again, these were not "criticized" loans. The second loan was paid off on July 6 by the FDIC.

APPENDIX H

FEDERAL RESERVE BANK OF KANSAS CITY
KANSAS CITY, MISSOURI 64198

August 26, 1982

The Honorable Fernand J. St. Germain
Chairman
Committee on Banking, Finance
and Urban Affairs
U. S. Rayburn House Office Building
Washington, D.C. 20515

Re: Penn Square Bank, N.A.

Dear Mr. St. Germain:

On August 16, 1982 in Oklahoma City, your committee requested that the Federal Reserve Bank of Kansas City produce the following:

- (1) Inspection reports prepared by the Federal Reserve Bank of Kansas City concerning First Penn Corporation, parent company of the Penn Square Bank.
- (2) A copy of the confidential offering circular prepared by First Penn Corporation in May, 1981.
- (3) A list of the notes taken as collateral by the Federal Reserve Bank of Kansas City for the advance made by it to Penn Square on June 30. While you didn't request the same information concerning the July 2 advance, I have assumed that you are interested in that as well.

Enclosed you will find a copy of the private offering circular which was filed with the Federal Reserve Bank by First Penn's management in May, 1981. Also enclosed are copies of the lists of collateral from which the name of the borrower, the customer number, and the note number have been deleted. As counsel for the Reserve Bank, it is my opinion that under 12 CFR section 261.6(c), the Bank is prohibited from furnishing you with the names of the borrowers or with information which would enable you to determine their names.

I have reviewed the list of the names of the borrowers whose notes were furnished as collateral and the list does not include any directors or officers of either the Penn Square Bank or First Penn, nor does it include any notes executed by Mr. Allen, Mr. Hefner or Mr. Hefner's corporation, GHK.

With respect to your request for copies of the inspection reports of First Penn, I must respectfully decline to comply with your request. As I stated in connection with the customer notes, 12 CFR section 261.6(c) prohibits an employee of the Federal Reserve Bank from

FEDERAL RESERVE BANK OF KANSAS CITY

The Honorable Fernand J. St. Germain

Page 2

August 26, 1982

disclosing information such as that contained in an inspection report. I understand that a request for the inspection reports has been made of the Board of Governors by members of your staff. I am advised that the Board is considering that request and will be responding to you in the near future.

In closing, President Guffey has asked that I assure you that the Federal Reserve Bank of Kansas City is most willing to cooperate with your committee to the extent that it is able to do so under existing law and regulation. Should you or a member of your staff have any questions concerning the contents of this letter, please feel free to get in touch with me.

Very truly yours,



Dick H. Woods, Jr.
Vice President, General Counsel
and Secretary

cc: Mr. Michael Bradfield

COLLATERAL FOR JUNE 30 LOAN

<u>Customer Number</u>	<u>Note Number</u>	<u>Name</u>	<u>Maturity Date</u>	<u>Principle Balance As of 6/25/82</u>
			10/24/84	\$ 771,707.30
				188,410.02
			10/28/85	545,267.26
			12/31/85	150,000.00
			9/30/82	350,000.00
			1/31/84	1,500,000.00
			6/ 1/88	1,371,700.00
			7/ 6/82	450,047.72
			9/25/82	140,000.00
			8/10/82	400,000.00
			12/31/82	104,500.00
			11/11/82	116,150.00
			9/ 1/82	300,000.00
			7/29/82	610,000.00
			11/17/82	184,000.00
			5/26/85	310,000.00
			6/ 2/82	860,162.09
			10/12/82	2,518,921.75
			4/19/86	309,353.00
			6/29/86	650,000.00
			8/25/82	2,079,068.50
			8/28/82	371,975.90
			12/31/86	560,666.67
			4/ 1/84	235,000.00
			3/31/83	109,916.31
			1/15/83	1,225,000.00
			8/30/82	2,000,000.00
			5/28/83	1,120,000.00
			7/21/82	1,500,000.00
			10/2/82	138,500.00
TOTAL				<u>\$21,170,346.52</u>

21,170,346.52 * A
 36,162.09 -
 2,431,018.43 * A
 152,000.00 -
 1,278,000.00 * A

6-28-82

The above notes are submitted for collateral to be pledged to Loans and Discount.

Bert Davis, III

Bert Davis, III
 Senior Vice President
 Penn Square Bank, N. A.
 Oklahoma City, OK

July 1, 1982

<u>Customer Number</u>	<u>Note Number</u>	<u>Name</u>	<u>Maturity</u>	<u>Amount</u>
			10/18/82	\$ 500,000.00
			12/31/82	465,000.00
			6/ 1/86	313,806.27
			4/29/85	750,000.00
			1/13/83	387,150.00
			3/31/83	500,000.00
			12/17/82	130,320.50 ⁸²
			2/17/83	295,000.00
			8/ 2/88	708,237.46
			7/15/87	1,085,000.00
			7/15/82	299,309.53
			3/30/88	223,952.99
			7/23/82	400,000.00
			7/ 1/86	557,880.00
			3/ 2/87	110,683.27
			4/ 8/87	602,783.75
			6/25/86	140,000.00
			12/31/82	281,500.00
			3/ 2/86	201,827.87
			4/30/85	134,836.06
			6/25/86	125,000.00
				<hr/>
				\$7,930,787.70 ⁸²

Best Davis
Senior Vice President
Penn Square Bank

OKLAHOMA CITY BRANCH
 FED. RES. BANK OF K.C.

JUL 1 5 28 PM '82

SECURITIES

<u>DEBTOR</u>	<u>NOTE</u>	<u>PRINCIPAL BALANCE</u>	<u>MATURITY</u>
		164,566.91	10/28/82
		119,029.24	1/15/85
		104,733.53	1/05/87
		287,484.00	10/30/85
		425,775.88	7/18/85
		197,378.10	7/19/82
		150,000.00	4/06/84
		557,289.58	5/26/83
		310,068.55	4/02/85
		96,959.05	4/22/83
		905,912.94	4/26/87
		477,578.98	10/02/86
		490,000.00	10/21/82
		572,730.75	11/08/82
		138,675.51	12/15/85
		200,000.00	12/31/82
		174,676.17	4/19/87
		192,880.27	12/15/84
		101,783.97	1/16/83
		679,011.77	5/23/85
		381,923.94	10/25/82
		105,227.40	4/30/85

MAY 27

CONFIDENTIAL OFFERING CIRCULAR

35,000 Shares

FIRST PENN CORPORATION
 1919 Penn Square
 Oklahoma City, Oklahoma 73118

35,000 Shares of Common Stock, \$1.00 Par Value

First Penn Corporation (the "Company") is offering to a limited number of qualified investors who are current shareholders of the Company or substantial clients of Penn Square Bank, 35,000 shares of its common stock, par value \$1.00 per share ("Shares"). The minimum subscription per investor is 2,000 Shares (\$270,000). The offer will expire at 3:00 p.m., local time, on Friday, June 26, 1981.

The Subscription Price for each Share is \$135.00

	Subscription Price	Proceeds to Company (1)
Per Share.....	\$ 135.00	\$ 135.00
Total.....	\$4,725,000.00	\$4,725,000.00(1)

- (1) Before deduction of expenses payable by the Company estimated at \$20,000. No solicitation fee or commission will be paid by the Company to any person for or on account of solicitations or sales made pursuant to this offering. Officers, directors and employees of the Company may in its behalf engage in the distribution of this Confidential Offering Circular and assist in the offer and sale of the Shares. Such persons will not be paid any additional compensation therefor or any solicitation fees or commissions.
-

X THESE SECURITIES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, OR ANY STATE SECURITIES ACT. THE SECURITIES ARE NOT BEING OFFERED OR SOLD TO THE GENERAL PUBLIC BUT ARE PART OF A PRIVATE PLACEMENT TO A RESTRICTED NUMBER OF QUALIFIED INVESTORS. NEITHER THE DELIVERY OF THIS CONFIDENTIAL OFFERING CIRCULAR NOR ANY SALE HEREUNDER SHALL UNDER ANY CIRCUMSTANCES CREATE AN IMPLICATION THAT THERE HAS BEEN NO CHANGE IN THE AFFAIRS OF THE COMPANY OR THE BANK SINCE THE DATE HEREOF.

THE SECURITIES OFFERED HEREBY ARE SUBJECT TO CERTAIN LEGAL RESTRICTIONS. SEE "RESTRICTIONS ON RESALE" WITHIN.

The date of this Offering Circular is June __, 1981.

ACKNOWLEDGMENT OF RECEIPT OF
CONFIDENTIAL OFFERING CIRCULAR NO. _____
OF
FIRST PENN CORPORATION

The original of this Acknowledgment must be signed and returned by each person receiving the attached Confidential Offering Circular of First Penn Corporation (the "Circular"). The securities as set forth in the Circular have not been registered with the Securities and Exchange Commission and the offer described therein is being made pursuant to Section 4(2) of the Securities Act of 1933 and Rule 146 adopted pursuant thereto, which exempts any offering by an issuer not including a public distribution.

As a condition to the receipt of this Confidential Offering Circular, the undersigned represents, on behalf of himself or, if the proposed offeree is a corporation, trust, partnership or other entity, on behalf of the proposed offeree:

(1) that the offeree's financial responsibility measured by annual income and net worth is suitable to a proposed investment in the securities of First Penn Corporation, and that the offeree has (i) a net worth of at least \$500,000 exclusive of home, furnishings and automobiles) or (ii) net worth of at least \$250,000 (exclusive of home, furnishings and automobiles) and taxable income of which some portion is subject to federal income taxation at a rate of not less than 50%;

(2) the offeree recognizes the speculative nature of an investment of First Penn Corporation and the risk of loss from such investment. I also understand that since such an investment is not liquid or readily transferable, the subscriber must be prepared to hold this investment indefinitely. By virtue of the offerees investment acumen, business experience, or independent advice, including that of an offeree representative, if any, the offeree is capable of evaluating the hazards and merits of making this investment.

(3) I acknowledge that:

- (a) I have received the numbered Confidential Offering Circular;
- (b) the Circular will be used only by the offeree;
- (c) I will not further distribute the Circular except to designated representatives of the offeree.

EXECUTION OF THIS DOCUMENT DOES NOT INDICATE ANY INTENT TO SUBSCRIBE TO SHARES OFFERED IN THE CONFIDENTIAL OFFERING CIRCULAR. THE OFFER CONTAINED THEREIN SHALL BE INEFFECTIVE AS TO ANY PERSON WHO DOES NOT SIGN AND RETURN THIS ACKNOWLEDGMENT.

Name

Date: _____

Address

This document must be signed and returned to the person from whom you receive the Confidential Offering Circular at the time you receive it since such person must account for each Confidential Offering Circular.

THE COMPANY

First Penn Corporation (the "Company") was organized as a corporation under the laws of the State of Oklahoma on January 14, 1975, by officers and directors of Penn Square Bank, N.A., of Oklahoma City, Oklahoma (the "Bank"). The Company is a one bank holding company registered under the Bank Holding Company Act of 1956, as amended, and owns 100% of the issued and outstanding shares of Common Stock of the Bank. The Company recently acquired all of the stock of Penn Realty Company from Bill P. Jennings, Chairman and Chief Executive Officer, a Director and a major shareholder of the Company. See "Business - Penn Realty Company", "Officers and Directors of the Company and the Bank - Certain Transactions" and Note 13 to the Notes to the Company's Consolidated Financial Statements, March 31, 1981. The Bank is the sole income generating asset of the Company.

THE BANK

The Bank was organized as a National Banking Association in 1960 in the Penn Square Shopping Center located at the Northeast corner of the intersection of Northwest Highway and Pennsylvania Avenue in Oklahoma City. At December 31, 1980, the Bank ranked fourth among the 31 banks in the City of Oklahoma City in terms of total assets, with total assets of approximately \$326 million. At that date, however, the three largest banks in the City of Oklahoma City accounted for approximately 65% of total deposits in the area. The Bank's share of total deposits in the City of Oklahoma City was 6% at December 31, 1980.

OFFERING

Nature of the Offer

The Company is offering to certain qualified investors at the Subscription Price set forth on the cover page of this Circular, 35,000 shares of Common Stock, par value \$1 ("Shares") of the Company. All offerees are either current shareholders of the Company or are major clients of the Bank. The minimum subscription per investor will be 1,120 Shares (\$151,200).

Time of Expiration

The offer will expire and become void at 3:00 o'clock p.m., Oklahoma City Time, on June 26, 1981 ("Time of Expiration").

Method of Subscribing for Shares

As a precondition to subscription for the Shares offered hereby, offerees must execute and return to the Company the copy of the "Acknowledgment of Receipt" contained on perforated paper at page 3 of this Circular. Shares may be subscribed by removing, completing and signing one copy of the Subscription Agreement attached at the back of this Circular on perforated paper and mailing or delivering it to Penn Square Bank, N.A., Oklahoma City, Oklahoma 73118, Attention: Bill P. Jennings, Chairman of the Board, accompanied by the full payment of the Subscription Price for the Shares subscribed under the offer, so as to be received by the Bank before the Time of Expiration.

Payment of the Subscription Price should be by certified or cashier's check, or bank draft payable in United States dollars to the order of the Company.

The Company reserves the right to reject any subscription which in its judgment is not properly exercised in accordance with this Circular and the subscription instructions contained herein or to waive any deficiencies in connection therewith.

Obligation to Purchase

To the extent Shares are subscribed for prior to the termination of this offering, persons who subscribe for the Shares offered hereby will be obligated to purchase the Shares subscribed for by them even if all Shares offered hereby are not purchased.

Delivery of Shares

The stock certificates evidencing the Shares purchased pursuant to the offering described herein are expected to be issued on or about July 1, 1981.

Investor Suitability Requirements.

The offering is directed only to persons who meet certain net worth requirements and who, or whose offeree representatives (if any), have sufficient knowledge and experience in financial and business matters to be capable of utilizing the information contained herein and of evaluating the risks involved. Generally, subscribers must have: (i) a net worth of at least \$500,000 (exclusive of home, furnishings and automobiles); or

(ii) a net worth of at least \$250,000 (exclusive of home, furnishings and automobiles) and taxable income of which some portion is subject to federal income taxation at a rate of not less than 50%. See the Subscription Agreement.

DILUTION

At March 31, 1981, the Company's common stock had a net tangible book value per share of \$91.04 "Net tangible book value per share" represents the amount of total assets less liabilities, preferred stock and related surplus, divided by the number of shares of common stock outstanding. Giving effect to the sale of 35,000 Shares at the price of \$135 per share, the net tangible book value will be \$98.83 per share, representing an immediate increase of \$7.79 to present shareholders and an immediate dilution (i.e., the difference between the purchase price of shares and the net tangible book value after the offering) of \$36.17 per share to the persons purchasing such shares at the offering price.

The following table illustrates the foregoing:

Offering Price.....	\$135.00
Net Tangible book value per share before offering.....	\$91.04
Increase per share attributable to payments by new investor.....	\$ 7.79
Net tangible book value per share after offering.....	<u>\$ 98.83</u>
Dilution to new investors.....	\$ 36.17

The Company intends to relocate the Bank in a proposed 20-story office tower. See "Business-Bank Premises." The proposed building, to be named "Penn Bank Tower" (the "Tower"), will be constructed and owned by an Oklahoma limited partnership to be named Penn Bank Tower Investors, Ltd. (the "Partnership"). The general partner of the Partnership will be Ronald H. Burks, a Director of the Company and the Bank. In the event the Partnership should contract for the sale of the Tower within four years of the date of formation of the Partnership, the Company will have the option to purchase the interests of the limited partners for cash (equal to the expenses theretofore incurred and charged to the limited partners with respect to the Partnership) and warrants to purchase up to approximately 47,500 shares of the Company's Common Stock. Each warrant will entitle the holder to purchase one share of the Company's Common Stock at the purchase price of \$135 per share. The warrants will be exercisable until the expiration of five years after the date of formation of the Partnership.

Assuming that the Company exercises its option to purchase the limited partners' interest in the Partnership, and assuming that all 47,500 warrants were issued and immediately exercised, the Company would issue 47,500 additional shares of its Common Stock for \$6,412,500. Depending upon the then current net tangible book value of the Company's Common Stock, the sale of additional shares would cause either an increase or decrease in the net tangible book value per share of then existing shareholders of the Company, and a reciprocal dilution or profit to the Partnership's limited partners.

USE OF PROCEEDS

The Company has undertaken a recapitalization plan for the Bank, and in accordance with an agreement reached with the Regional Administrator of National Banks, \$2,000,000 of the proceeds of the offering will be used to increase capital accounts of the Bank. The agreement with the Regional Administrator provides that the capital position of the Bank will be periodically evaluated in the future, and additional capital will be added to maintain the Bank's capital accounts at an adequate level. Management has estimated that the Company will need to provide approximately \$2,000,000 (in addition to \$2,000,000 of the proceeds from this offering) additional capital to the Bank later this year. In addition, proceeds of the offering may be used to service or reduce present debt of the Company or to eliminate the negative cash flow now experienced by the Company on sales of commercial paper. At present, the Company invests the proceeds of sales of commercial paper in deposits in the Bank. Interest paid by the Bank to the Company is less than interest paid by the Company on its commercial paper. Negative cash flow to the Company from this source as of May 1, 1981, is estimated at approximately \$1.5 million. It is anticipated that some of these funds may be obtained from additional borrowings by the Company. The actual amount of additional capital which the Company will need to provide the Bank will be based on the actual asset growth and income of the Bank.

CAPITALIZATION

The following table, which should be read in conjunction with the financial statements, and the notes thereto, of the Company included elsewhere in this Circular, sets forth certain information with respect to the long-term debt, authorized and outstanding capital stock and stockholders' equity of the Company

as at December 31, 1980, March 31, 1981 and as adjusted to give retroactive pro forma effect to the sale by the Company of 35,000 Shares (net proceeds of \$4,705,000 after estimated expenses):

	Amount at December 31, 1980	Amount at March 31, 1981	As Adjusted for Sale of 35,000 Shares
Notes payable and other liabilities(1)	\$8,606,800	\$8,606,800	\$8,606,800
Shareholders' Equity:			
Common Stock, \$1.00 par value (250,000 Shares authorized and 162,466 Shares outstanding at December 31, 1980 and at March 31, 1981; 250,000 Shares authorized and 197,466 Shares outstanding-as adjusted for sale of 35,000 Shares)	162,466	162,466	197,466
Capital Surplus	7,420,753	7,420,753	12,110,753
Undivided Profits	6,398,824	7,220,013	7,220,013
6.5% Cumulative Preferred Stock, \$60 par value (5,000 shares authorized, 4,225 shares issued)	<u>253,500</u>	<u>253,500</u>	<u>253,500</u>
Total Shareholders' Equity	<u>\$14,235,543</u>	<u>\$15,056,732</u>	<u>\$19,781,732</u>
Book Value Per Share of Common Stock	\$85.99	\$91.04	\$98.83

(1) See Note 8 of Notes to the Company's Consolidated Financial Statements, March 31, 1981.

DIVIDENDS AND STOCK REDEMPTIONS

Holders of the shares of Common Stock of the Company are entitled to dividends when, as and if declared by the Company's Board of Directors payable out of funds legally available for dividends in accordance with the provisions of the Oklahoma Business

Corporation Act. However, because the Bank, which continues to be the sole income generating asset of the Company, is subject to the National Bank Act regarding the payment of dividends by the Bank, the Company's ability to pay dividends is dependent upon the Bank's ability to pay dividends. Generally, Section 60 of the National Bank Act limits the amount which a nationally chartered bank can pay as dividends to the sum of its undivided net profits, except that, until the surplus fund of a bank equals its common capital account, no cash dividends may be declared unless there is a transfer to the surplus fund of not more than a one-tenth part of the bank's net profits of the preceding half year in the case of quarterly or semi-annual dividends, or not less than a one-tenth part of its net profits of the preceding two consecutive half-years in the case of annual dividends.

As of the date of this Circular, the Company has not paid any dividends on its shares of Common Stock. There can be no assurance as to the payment of dividends on the Common Stock of the Company in the future since such payment will be dependent upon the earnings and the financial condition of the Bank and other factors.

Holders of the Preferred Stock of the Company are entitled to receive dividends at the annual rate of 6.5%, which dividends are cumulative and payable on January 30 of each year. Payment of dividends are in preference to dividends on Common Stock and no dividend shall be paid on Common Stock if the payment of dividends on the Preferred Stock is in arrears.

Each share of Preferred Stock is subject to conversion into one Share of Common Stock of the Company at any time at the option of the holder thereof. The shares of Preferred Stock are subject to redemption at the option of the Company, in whole or in part, upon payment of the par value thereof and accrued dividends at any time following January 1, 1989. See Note 10 of Notes to the Company's Consolidated Financial Statements, March 31, 1981.

As of the date of this Circular no shares of Preferred Stock had been converted to Common Stock, and no shares of Preferred Stock had been redeemed.

As of the date of this Circular, payment of dividends on preferred stock was not in arrears.

PENN SQUARE BANK, N.A.

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

	(in thousands)				
	Year Ended December 31,				
	<u>1980</u>	<u>1979</u>	<u>1978</u>	<u>1977</u>	<u>1976</u>
Total Interest Income	26,551	12,237	6,676	4,427	3,615
Total Interest Expense	<u>13,694</u>	<u>5,930</u>	<u>2,912</u>	<u>2,009</u>	<u>1,630</u>
Net Interest Income	12,857	6,307	3,764	2,418	1,985
Provision for Possible Loan Losses	<u>(1,408)</u>	<u>(615)</u>	<u>(468)</u>	<u>(167)</u>	<u>(120)</u>
Net Interest Income After Provision for Loan Losses	11,449	5,692	3,296	2,251	1,865
Other Income:					
Trust	19	1	0	0	0
SC Deposit Acct.	367	108	224	237	192
Other SC-Fees	432	337	115	76	60
Other	<u>126</u>	<u>6</u>	<u>2</u>	<u>47</u>	<u>22</u>
Total Other Income	944	452	341	360	274
Total Net Interest and Other Income	12,393	6,144	3,637	2,611	2,139
Other Expenses:					
Salaries & Benefits	2,339	1,481	1,158	945	741
Net Occupancy Expense	619	390	302	154	91
Depreciation and Amortization	0	0	0	90	46
Other	<u>2,429</u>	<u>1,170</u>	<u>875</u>	<u>648</u>	<u>530</u>
Total Expense	<u>5,387</u>	<u>3,041</u>	<u>2,335</u>	<u>1,837</u>	<u>1,408</u>

	(in thousands)				
	Year Ended December 31,				
	<u>1980</u>	<u>1979</u>	<u>1978</u>	<u>1977</u>	<u>1976</u>
Income (Loss) Before Income Taxes	7,006	3,103	1,302	774	731
Securities Gains and Extraordinary Item	0	(16)	(102)	2	303
Income taxes	2,721	1,064	334	220	86
Income (loss) before Securities Gains and Extraordinary Items	4,285	2,039	968	554	645
Security Gains - Net of Tax	0	(9)	(53)	1	152
Income (Loss) Before Extraordinary Item	4,285	2,030	915	555	797
Extraordinary Item	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Net Income (Loss)	<u>4,285</u>	<u>2,030</u>	<u>915</u>	<u>555</u>	<u>797</u>

	Year Ended December 31,				
	<u>1980</u>	<u>1979</u>	<u>1978</u>	<u>1977</u>	<u>1976</u>
<u>Per Share Data</u>					
Income (Loss) Before Securities Gains and Extraordinary Item	\$42.85	\$20.39	\$ 9.68	\$ 5.54	\$6.45
Income (Loss) Before Extraordinary Item	42.85	20.30	9.15	5.55	7.97
Net Income (Loss)	42.85	20.30	9.15	5.55	7.97
Cash Dividends	3.00	2.80	2.80	2.80	2.80
Weighted Average Number of Shares Outstanding	100,000	100,000	100,000	100,000	100,000

BUSINESS

The Company

The Company's business since its acquisition of the Bank has been the oversight of the Bank's operations and the acquisition of Penn Realty Company, which are more fully discussed below.

The Bank

As of December 31, 1980, Penn Square Bank was the fourth largest bank in terms of total deposits of the 31 commercial banks located in Oklahoma City. The three largest banks in the City of Oklahoma City, however, accounted for approximately 65% of total deposits, and the Bank's share of total deposits was approximately 6%.

The Bank is engaged in the general business of commercial banking, and in transacting such business it receives deposits, makes and services secured and unsecured loans, and provides other functions for the benefit of persons, business and corporate customers. The Bank makes various types of loans to businesses and individuals, including the oil and gas industry, and offers various forms of installment credit to consumers and also finances construction of housing and business properties.

Commercial and Personal Banking Activities

The Bank is engaged in a wide range of commercial and personal banking activities, including the usual acceptance of deposits for checking, personal and savings and time deposit accounts, making of secured and unsecured loans to corporations, individuals and others, issuance of letters of credit, foreign exchange transactions, rental of safe deposit boxes and rendering of investment and financial counsel to institutions and individuals.

Correspondent Banking Services

The Bank acts as correspondent for approximately 53 banks throughout Oklahoma, providing such services as transfer of funds, loan participations, and securities custody and clearance.

Trust Services

The Bank, through its trust department, provides a wide range of personal and corporate trust and related services to individuals, corporations and others, including serving as executor

of estates, as trustee under testamentary and inter vivos trust and various pension and other employee benefit plans, as escrow agent under various agreements, and as an investment advisor to individuals, corporations and others. Through its corporate trust department, the Bank serves as transfer agent for corporate securities and as corporate trustee under corporate trust indentures.

Bank Premises

The main building of the Bank is currently located in the Penn Square Shopping Center at the northeast corner of the intersection of Northwest Highway and Pennsylvania Avenue in Oklahoma City. The three story building contains approximately 16,500 square feet, virtually all of which is occupied by the Bank. The Bank has lease agreements for (1) the land under the main Bank, expiring in 2029, (2) the office facilities one of which expires in 1985 with renewal options for three five-year terms, one of which expires in 1981, and two of which expire in 1984 both with renewal options for three one-year terms. Minimum annual rentals under these leases are as follows:

1981	\$118,353
1982-1983	122,752
1984	21,119
1985	7,980
1986-1989	7,200
1990-2029	3,000

In addition to the minimum rental for one of the office facility leases, the Bank also pays additional rental based on a percent of average total deposits as defined for each lease year. The lease covering the land provides for rental payments to be adjusted every 10 years based on a cost of living index. Total rental expense for 1980 amounted to approximately \$99,000.

The Bank has a motor bank located immediately north of the Penn Square Shopping Center along Pennsylvania Avenue. The motor bank has approximately 6,000 square feet in which there are two lobbies, a personal banking lobby with four tellers and a commercial lobby with three tellers. The motor bank also has six full service drive-in lanes. All commercial banking services except loans are offered at the drive-in.

The Bank has filed an application with the Regional Administrator of National Banks to move its main office to a new building which is planned to be located immediately east of the Penn Square Shopping Center on Northwest Highway. The Bank will

have the right to occupy approximately 89,000 square feet in the new building at an annual rent of approximately \$1,450,000. See "Dilution."

Competition

The Bank competes actively with national and state banks and certain other financial institutions in the Oklahoma City metropolitan area for all types of deposits, loans, trust accounts and financial and other services offered by the Bank. In addition, the Bank competes with banks from other metropolitan areas, as well as, with respect to certain of its banking services, insurance companies, savings and loan associations, credit unions and other financial institutions. Many of the banks and other financial institutions with which the Bank competes have capital and resources substantially in excess of the capital and resources of the Bank.

Employees

At May 1, 1981 the Bank has 180 employees. Management considers employee relations to be good. None of the Bank's employees are covered by a collective bargaining agreement.

Penn Realty Company.

In January, 1981, the Company acquired all of the outstanding stock of Penn Realty Company ("Penn Realty"), from Mr. Bill P. Jennings, Chairman and President of the Company. The Company then contributed capital to Penn Realty equal to \$1,250,061.48 which Penn Realty in turn used to repay loans made to it by Mr. Jennings and four other Directors of the Company. See "Officers and Directors of the Company and the Bank—Certain Transactions" and Note 13 of the Notes to the Company's Consolidated Financial Statements, March 31, 1981. Penn Realty was organized in September, 1980, solely for the purpose of acquiring title to the Quail Run Apartment project ("Quail Run") which was in the process of construction with construction financing provided by the Bank. Penn Realty acquired Quail Run upon default on the construction loan to the Bank. Pending receipt of approval from the Federal Reserve for the Company to acquire Quail Run and Penn Realty, Mr. Jennings became the sole shareholder of Penn Realty and other officers and directors of the Company and the Bank loaned funds to Penn Realty to enable Penn Realty to acquire Quail Run. Following the receipt of Federal Reserve approval, Penn Realty was transferred to the Company and Mr. Jennings and the other officers and directors who had provided funds to Penn Realty were reimbursed on a cost basis. As of March 31, 1981, the

investment by the Company in Penn Realty was \$1,248,964 (See the Company's Consolidated Financial Statements, March 31, 1981). It is the intention of the Company that Penn Realty will complete construction of Quail Run and that Quail Run will be sold, thereby avoiding a loss to the Bank on the construction loan. If Quail Run cannot ultimately be sold for an amount sufficient to repay the construction loan and any other costs, it is possible that the Company might not recover its entire investment in Penn Realty.

Supervision and Regulation and Related Matters

The Bank. The Bank is a member of the Federal Reserve System and its deposits are insured by the Federal Deposit Insurance Corporation to the extent permitted by law. As a national bank, the Bank is subject to regular examination by the office of the Comptroller of the Currency, the Federal Reserve Board and the Federal Deposit Insurance Corporation and is also subject to certain laws of the State of Oklahoma, including those which prohibit branch banking. The Company is an affiliate of the Bank within the meaning of the Federal Reserve Act, and, therefore, subject to certain restrictions as to (a) loans by the Bank to the Company; (b) investments by the Bank in the securities of the Company; and (c) the Bank's taking shares of the Company's stock, or other securities as collateral security for loans by the Bank to any borrower. Further, under Section 106 of the Bank Holding Company Act of 1956, as amended (the "Act"), and the Board's regulations, a bank holding company and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit or the provision of any property or service.

The Company. The Company is a bank holding company, is regulated under the Act and is subject to supervision by the Federal Reserve Board. The Company is obligated to file annual reports with the Federal Reserve Board and such other reports as may be required from time to time by the Federal Reserve Board. In addition, the Federal Reserve Board is authorized to make examinations of the Company and each of its subsidiaries with the cost thereof being paid by the Company. In general, the Act limits the business of bank holding companies to owning or controlling banks and engaging in such other activities as the Federal Reserve Board may determine to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. The Company must obtain the prior approval of the Federal Reserve Board before acquiring direct or indirect ownership or control of any voting shares of any bank or other business if after such acquisition it would own or control, directly or indirectly, more than 5% of the voting shares of such bank or other business, before merging or consolidating with another bank holding company, and before acquiring substantially all of the assets of any additional bank or other

of any such interest in any bank or bank holding company located in a state other than Oklahoma unless the laws of the state in which such bank is located expressly authorizes such acquisition, which none presently do. With certain exceptions, the Act prohibits bank holding companies from retaining or acquiring direct or indirect ownership or control of voting shares in any company which is not a bank or bank holding company unless the Federal Reserve Board determines the activities of such company are so closely related to banking or managing or controlling banks as to be a proper incident thereto. In making such determinations the Federal Reserve Board considers whether the performance of such activities by the bank holding company would offer advantages to the public which outweigh possible adverse effects.

Monetary Policy. The business of the Bank and therefore, the Company, is affected in important respects by the policies of monetary authorities, including the Federal Reserve System. An important function of the Federal Reserve System is to regulate the national supply of bank credit in order to achieve, among other things, maximum employment and a stable price level. Among the instruments of monetary policy used by the Federal Reserve to implement these objectives are open market operations in U.S. Government securities, changes in the discount rate on member bank borrowings, changes in reserve requirements against member bank deposits, and limitations on interest rates which member banks may pay on time and savings deposits. These means are used in varying combinations to influence over-all growth of bank loans, investments and deposits, and may also affect interest rates charged on loans or paid for deposits. The monetary policies of the Federal Reserve authorities have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. In view of changing conditions in the national economy, in the money markets and in the relationships of international currencies, as well as the effect of actions by monetary and fiscal authorities, including the Federal Reserve System, no prediction can be made as to possible future changes in interest rates, deposit levels, loan demands, capital requirements or the business and earnings of the Bank.

SELECTED STATISTICAL INFORMATION

Distribution of Assets, Liabilities and Shareholders' Equity

The table on the following page sets forth the condensed balance sheets of the Bank for the periods indicated and, with respect to each period, the percentage of each principal category of liabilities and equity capital to total liabilities and equity capital (dollar amounts in thousands):

(Figures in thousands)

	Three									
	Months Ended		Year Ended December 31,							
	3/30/81		1980		1979		1978		1977	
ASSETS										
Cash & due from banks..	\$30,794	9.75%	\$59,626	18.15%	\$25,672	15.95%	\$10,597	10.67%	\$10,256	14.36%
Investment Securities:										
U.S. Treasury.....	13,041	4.13%	10,992	3.35%	3,181	1.97%	3,979	4.00%	2,689	3.76%
States & political subdivisions.....	34,057	10.79%	31,335	9.54%	19,742	12.26%	13,632	13.72%	8,660	12.13%
Other.....	345	.11%	300	.09%	60	.04%	60	.06%	136	.19%
Total investment securities.....	47,443	15.03%	42,627	12.98%	22,983	14.27%	17,671	17.78%	11,485	16.08%
Federal funds sold....	-0-		16,000	4.87%	1,100	.68%	4,000	4.03%	6,500	9.10%
Bank loans, excluding										
Unearned income.....	224,900	71.25%	201,725	61.40%	107,466	66.75%	64,136	64.55%	40,861	57.21%
Less: Reserve for loan losses..	-2,269	.72%	-2,004	.61%	-1,002	.62%	-627	.63%	-325	.46%
Net bank loans.....	222,631	70.53%	199,721	60.79%	106,464	66.13%	63,509	63.92%	40,536	56.75%
Bank premises and equipment.....	3,192	1.01%	2,482	.76%	1,936	1.20%	1,886	1.90%	1,827	2.56%
Other Assets.....	11,601	3.68%	8,061	2.45%	2,847	1.77%	1,691	1.70%	818	1.15%
Total Assets	\$315,661	100%	\$328,517	100%	\$161,002	100%	\$99,354	100%	\$71,422	100%
LIABILITIES										
Deposits:										
Demand deposits.....	\$ 97,260	30.81%	\$142,682	43.43%	\$ 79,790	49.56%	\$44,093	44.38%	\$28,572	40.00%
Time & Savings deposits.....	182,214	57.73%	158,164	48.14%	69,983	43.47%	46,639	46.94%	36,729	51.43%
Total deposits.....	279,474	88.54%	300,846	91.57%	149,773	93.03%	90,732	91.32%	65,301	91.43%
Federal funds purchased.....	6,200	1.96%	650	.20%	400	.24%	-0-	-0-	-0-	-0-
Accrued expense & other liabilities...	8,404	2.66%	6,599	2.01%	1,892	1.18%	3,432	3.45%	1,560	2.18%
Total Liabilities	294,078	93.16%	308,095	93.78%	152,065	94.45%	94,164	94.77%	66,861	93.61%
Shareholders' equity:										
Common Stock.....	1,000	.32%	1,000	.30%	1,000	.62%	1,000	1.01%	1,000	1.40%
Surplus.....	10,500	3.33%	10,500	3.20%	3,000	1.86%	1,000	1.01%	1,000	1.40%
Retained earnings...	10,083	3.19%	8,922	2.72%	4,937	3.07%	3,190	3.21%	2,561	3.59%
Total shareholders' equity.....	21,583	6.84%	20,422	6.22%	8,937	5.55%	5,190	5.23%	4,561	6.39%
Total Liabilities and Equity	\$315,661	100%	\$328,517	100%	\$161,002	100%	\$99,354	100%	\$71,422	100%

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Asset and Liability Management

As will be noted from examining the statistical data regarding distribution of assets, liabilities and capital included at page 17, deposits of the Bank have decreased from \$300,846,000 at December 31, 1980, to \$279,474,000 at March 31, 1981. On December 31, 1980, demand deposits accounted for 47.4% of total deposits, with time deposits constituting the remaining 52.6%. On March 31, 1981, time deposits accounted for 65.2% of total deposits, with demand deposits constituting the remaining 34.8%. For the first quarter of 1981, net loans have increased to 80% of total deposits. Generally, the increase in interest costs associated with an increase in time deposits would dictate adjustments in the Bank's asset allocations in order to offset the increased interest expense, while an increase in net loans would be accompanied by an increase in deposits. In the case of the Bank, both factors, together with market conditions causing movement from demand deposits to time deposits, have been at work. In connection with the increase in loans, Bank management has adopted a policy of attempting to shorten the average maturities of its municipal bond portfolio in order to improve the ratio of liquid to nonliquid assets. Furthermore, the Bank is in the process of formalizing its procedures relative to asset and liability management, and has, among other things, established an Asset and Liability Management Committee composed of eight officers who report directly to the Board of Directors.

Investment Portfolio

The carrying amounts of investment securities held by the Bank at the dates indicated are summarized as follows (amounts in thousands):

	Three	Year Ended December 31,			
	Months Ended	1980	1979	1978	1977
	<u>3/31/81</u>				
U.S. Treasury Securities...	\$13,041	\$10,992	\$ 3,181	\$ 3,979	\$ 2,689
Obligations of state and political subdivisions....	34,057	31,335	19,742	13,632	8,660
Other investment securities.....	<u>345</u>	<u>300</u>	<u>60</u>	<u>60</u>	<u>136</u>
TOTALS	<u>\$47,443</u>	<u>\$42,627</u>	<u>\$22,983</u>	<u>\$17,671</u>	<u>\$11,485</u>

The approximate market values of the investment securities held by the Bank at March 31, 1981, were \$42,818 million.

At March 31, 1981, investment securities having a recorded value of approximately \$16.4 million were pledged to secure public and trust fund deposits and for other purposes required or permitted by law.

The following table shows maturities at par value of bonds, notes and debentures held by the Bank at March 31, 1981 and the weighted average yields (dollar amounts in thousands):

	Due Within One Year		After One But Within Five Years		After One But Within Ten Years		After Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
U.S. Treasury Securities	1,240	12.13	9,500	13.58	2,450	7.70	-0-	-0-
Obligations of state and political subdivisions(1)	4,530	7.46	13,803	6.3	5,696	5.82	9,790	5.63
Other investment securities(2)	-0-	-0-	-0-	-0-	-0-	-0-	345	6.00

(1) Represents federally tax exempt securities.

(2) Represents investments required by the Federal Reserve Board.

The weighted average yields shown above are calculated on the basis of the book value and effective yields, weighted according to par value, for the scheduled maturity of each security.

Loan Portfolio

The amount of loans of the Bank outstanding at the indicated dates are shown in the following table according to the type of loan (amounts in thousands):

	Three Months		Year Ended December 31,			
	Ended 3/31/81	1980	1979	1978	1977	1976
Real Estate Loans....	\$38,267	\$29,433	\$13,917	\$ 6,294	\$ 4,691	\$ 3,169
Loans to financial institutions.....	-0-	-0-	430	-0-	-0-	-0-
Loans for purchas- ing or carrying securities.....	1,604	1,110	636	1,203	-0-	-0-
Loans to farmers....	546	546	548	625	-0-	-0-
Commercial and industrial loans....	161,372	146,895	74,180	40,495	29,135	24,870
Loans to individuals.	14,751	13,375	17,232	13,733	7,762	6,171
Other Loans (in- cluding overdrafts).	9,753	11,834	2,423	2,976	20	70
Gross Loans.....	<u>226,293</u>	<u>203,193</u>	<u>109,366</u>	<u>65,326</u>	<u>41,608</u>	<u>34,280</u>
Less unearned interest.....	1,393	1,467	1,900	1,190	747	577
Total Loans	<u>224,900</u>	<u>201,726</u>	<u>107,466</u>	<u>64,136</u>	<u>40,861</u>	<u>33,703</u>
Less allowance for possible loan losses	2,269	2,005	1,002	627	325	233
Net Loans	<u>\$222,631</u>	<u>199,721</u>	<u>\$106,464</u>	<u>\$63,509</u>	<u>\$40,536</u>	<u>\$33,470</u>

Due to the very rapid increase in the Bank's loan portfolio over the past several years, the Bank has experienced certain difficulties in documentation of collateral and credit analysis. These problems have resulted in a greater number of loans being criticized during examinations of the Bank than is desirable. To alleviate these problems, the Bank has hired a number of additional personnel, including Mr. Eldon Beller who assumed duties as President of the Bank on April 17, 1981. A large part of the increase in loans of the Bank has been in oil and gas loans and other energy related areas. To further insure quality of loans made in these areas, the Bank has employed two qualified petroleum engineers, three petroleum technicians and one technical assistant on a full time basis to work with oil and gas loans and has established an energy lending department. Richard T. Dunn joined the Bank in May of 1981 as Executive Vice President in charge of credit and collateral.

The following table presents information concerning non-performing loans of the Bank. Nonperforming loans comprise loans which are contractually past due sixty days or more as to interest or principal payments:

	March 31, <u>1981</u>	December 31, <u>1980</u>	<u>1979</u>
Loans contractually past due sixty days or more as to in- terest or principal payments:			
Real estate loans.....	\$ 400,560	\$ -0-	\$162,991
Oil and gas.....	-0-	23,462	221,751
All other loans.....	639,936	1,654,873	151,743
Total.....	<u>\$1,040,496</u>	<u>\$1,678,335</u>	<u>\$536,485</u>

Summary of Loan Loss Experience

As of March 31, 1981 and December 31, 1980, the Bank had total loans outstanding of \$224,900,000 and \$201,726,000, respectively, including consumer loans, to borrowers of all sizes in a wide variety of industries and businesses. Implicit in the lending function is the fact that loan losses will be experienced and that the risk of loss will vary with the type of loan, the credit worthiness of the borrower over the term of the loan and general economic conditions. The Bank's Reserve for Possible Losses (the "Reserve"), which is available to absorb such losses, reflects the currently perceived risks of loss associated with the loan portfolio and assets required through foreclosure.

Loans charged off for the three months ended March 31, 1981 totaled \$942,000. Approximately \$1,000 previously charged off loans were recovered during that period, resulting in net chargeoffs of \$941,000. Loans charged off for the year ended December 31, 1980 totaled \$617,000. Approximately \$212,000 previously charged off loans were recovered during that year, resulting in net chargeoffs of \$405,000. For the year ended December 31, 1979, loans totaling \$259,000 were charged off and \$19,000 was recovered, resulting in net charge-offs of \$240,000. The provisions for loan losses is created by direct charges to operations. Losses on loans and foreclosed assets are charged against the Reserve, and recoveries during the period on any loan or foreclosed asset charged-off in a prior period are added to the Reserve.

The Provision for Possible Losses charged to operations in each period reflects the amount which, in the judgment of management, is required to make the total Allowance adequate. If actual charge-offs should exceed the amount of the Allowance, additional charges to operations sufficient to maintain its adequacy would be required. There is no precise method of predicting loan and other losses and the determination that a loan is likely to become uncollectible in whole or in part, and be charged off, is an exercise in judgment. The adequacy of the Reserve is assessed by management based upon continuing reviews of the loan portfolio and assets acquired through foreclosure and of prevailing economic

conditions. The factors considered in the evaluation of loans include the financial condition of the borrower, the value and liquidity of collateral, delinquency, and, if delinquent, the probability that the loan will be brought to a current status. Inasmuch as many factors relevant to such review are essentially judgmental, there can be no assurance that in any given period the Bank might not sustain charges against operating income which are substantial in relation to the size of the Allowance or that substantial additional charges against operating income may not be required. Management believes that its procedures for administering and reviewing its loan portfolio are effective in identifying loans as to which potential loss may exist, that the Reserve established at December 31, 1980 and March 31, 1981 was adequate on those dates to absorb potential losses in the Bank's then existing loan portfolio, and that provisions for possible loan and other losses under present credit policies of the Bank are sufficient to maintain the adequacy of the Reserve.

The following table summarizes the loan balances of the Bank at the end of each period, changes in the Allowance arising from charge-offs and recoveries by categories, and additions to the Reserve which have been charged to operations (amounts in thousands):

	Three Months	Year Ended December 31,			
	Ended 3/31/81	1980	1979	1978	1977
Balances (thousands):					
Loans:					
Average loans.....	220,342	147,386	77,605	50,701	36,858
Loans at end of period..	224,900	201,725	107,466	64,136	40,861
Actual chargeoffs.....	(942)	(617)	(259)	(314)	(172)
Less recoveries.....	1	212	19	149	50
Net loan chargeoffs.....	(941)	(405)	(240)	(165)	(122)
Reserve for possible loan losses.....	2,269	2,005	1,002	627	325
Provision for possible loan losses.....	1,205	1,408	615	468	167
Ratios:					
Net loan chargeoffs to average loans.....	.427%	.275%	.358%	.325%	.331%
Net loan chargeoffs to loans end of period.....	.418%	.201%	.259%	.257%	.299%
Reserve for possible loan losses to average loans.....	1.030%	1.360%	1.29%	1.24%	.88%

Reserve for possible loan losses to loans end of period.....	1.010%	.994%	.93%	.98%	.795%
Net loan chargeoffs to reserve for loan losses.....	41.470%	20.200%	27.74%	26.27%	37.54%
Net loan chargeoffs to provision for loan losses.....	78.090%	28.760%	45.20%	35.26%	73.05%

Deposits

The average amounts of deposits of the Bank are summarized below (amounts in thousands):

	Three Months	Year Ended December 31,			
	Ended 3/31/81	1980	1979	1978	1977
Demand deposits.....	105,168	72,385	39,432	28,757	21,017
Savings.....	12,948	13,673	14,529	15,624	13,814
Consumer Certificates.....	27,073	23,595	16,290	11,827	-0-
NOW Accounts.....	3,545	-0-	-0-	-0-	-0-
Time certificates of deposit of \$100,000 or more.....	113,547	69,792	22,090	10,779	-0-
Public Time.....	19,325	6,162	6,370	4,117	-0-
Other Time.....	138	53	1,157	154	21,334(1)

(1) The amount shown includes all public time deposits, certificates of deposit of \$100,000 or more, and other time deposits.

Return on Equity and on Assets

Certain ratios of the Bank are presented below:

	Three Months	Year Ended December 31,			
	Ended 3/31/81	1980	1979	1978	1977
Percentages of net income to:					
Daily average total assets.....	.473%	2.07%	1.78%	1.16%	.91%
Daily average stock- holders' equity.....	7.050%	32.99%	34.04%	19.30%	12.80%

Percentage of dividends declared per common share to net income per share.....	23.17%	7.00%	13.79%	30.63%	50.45%
Percentage of daily average stockholders' equity to daily average total assets.....	6.71%	6.27%	5.22%	6.01%	7.08%

Commitments and Lines of Credit

In the normal course of business, the Bank makes contractual commitments to extend credit, including the issuance of foreign and domestic letters of credit. Such commitments may be short-term or long-term (but generally not longer than one year) and have a fixed expiration date. Prior to issuance of a commitment, an analysis of the credit worthiness of the client is made based on historical information and examination of future prospects.

In addition, the Bank extends lines of credit covering future borrowings of a customer after similar analysis of credit worthiness. In most instances a maximum amount will be specified and the line may be cancelled at the Bank's option with notice to the customer. Certain of such lines are available for short-term advances, either secured or unsecured; others may be multipurpose.

Average Balances and Average
Rates Earned and Paid

The following table sets forth each major category of interest-earning assets and interest-bearing liabilities, the average amount outstanding during the period (in thousands), the interest earned on such amount and the average rate:

	(thousands)			(thousands)			(thousands)		
INTEREST BEARING ASSETS	AVERAGE BALANCE 3/31/81	INTEREST EARNED	RATE	AVERAGE BALANCE 12-31-80	INTEREST EARNED	RATE	AVERAGE BALANCE 12-31-79	INTEREST EARNED	RATE
U.S. Treasury Securities	12,438	346,688	11.30	3,661	299,777	8.19	3,542	277,395	7.83
State & Municipal (Tax Exempt)	32,969	535,691	12.20	23,495	1,308,325	10.31	16,763	900,530	9.95
Other Securities	324	4,878	6.11	172	10,491	6.11	60	6,307	10.51
Fed Funds Sold	5,954	282,661	19.25	2,350	282,715	12.03	119	14,933	12.55
Tax Exempt Loans	-0-	-0-	-0-	-0-	-0-	-0-	231	11,634	5.04
Commercial Loans	169,088	8,921,076	19.63	115,414	20,434,457	17.71	57,361	8,537,609	14.88
Real Estate Loans	31,434	1,181,116	15.24	16,294	2,274,435	13.96	8,183	1,021,416	12.48
Installment Loans	16,426	570,022	14.07	14,585	1,940,790	13.31	11,660	1,467,300	12.58
Other Loans	3,395	-0-	-0-	1,092	-0-	-0-	170	-0-	-0-
<u>INTEREST BEARING LIABILITIES</u>									
Savings	12,948	(166,487)	5.21	13,673	722,581	5.28	14,529	734,974	5.06
Consumer Certificates	27,073	(822,014)	12.31	23,594	2,525,938	10.71	16,290	1,262,950	7.75
C.D. Over \$100M	113,547	(4,500,694)	16.08	69,792	8,764,631	12.56	22,090	2,375,569	10.75
Public Time	19,325	(532,476)	11.17	6,162	800,736	13.00	6,370	650,969	10.22
Other Time	138	(6,000)	17.66	53	6,417	12.08	1,157	103,024	8.90
Now	3,545	48,671	5.57	-0-	-0-	-0-	-0-	-0-	-0-
Fed Funds Purchased	9,156	336,766	14.92	5,048	739,354	14.65	5,883	710,846	12.08
Other Borrowed Funds	2,612	149,491	23.21	1,002	134,609	13.43	131	12,460	9.52
Subordinated Notes	-0-	-0-	-0-	-0-	-0-	-0-	975	74,409	7.64

PRINCIPAL STOCKHOLDERS OF THE COMPANY AND THE BANK

The Company is the sole shareholder of the Bank's Common Stock, excluding directors qualifying Shares. At the present time, the Company has issued and outstanding 162,466 Shares of its \$1.00 par value Common Stock. The following table sets forth, as of May 1, 1981, the number of Shares of Common Stock of the Company held by each person who is known by management of the Company to own beneficially more than 5% of its outstanding shares of Common Stock:

<u>NAME OF BENEFICIAL OWNER</u>	<u>NUMBER OF SHARES BENEFICIALLY OWNED</u>	<u>PERCENTAGE OF OUTSTANDING SHARES</u>
Bill P. Jennings Oklahoma City, Oklahoma	59,423	36.58%
The Rooney Corporation(1) Tulsa, Oklahoma	15,065	9.27%
Ronald H. Burkes Oklahoma City, Oklahoma	8,307	5.11%
Carl W. Swan Oklahoma City, Oklahoma	9,819	6.04%

(1) Mr. John E. Rooney, a director of the Company who owns an additional 2,252 Shares, is a principal stockholder and officer of The Rooney Corporation.

Currently, the Company has issued and outstanding 4,225 shares of its \$60.00 par value Preferred Stock. The following table sets forth, as of May 1, 1981, the number of shares of Preferred Stock of the Company held by each person who is known by management of the Company to own beneficially more than 5% of its outstanding Preferred Stock:

<u>NAME OF BENEFICIAL OWNER</u>	<u>NUMBER OF SHARES BENEFICIALLY OWNED</u>	<u>PERCENTAGE OF OUTSTANDING SHARES</u>
Frank L. Murphy Oklahoma City, Oklahoma	2,540	60.12%
Allen B. and Collen Pease Oklahoma City, Oklahoma	931	22.04%
Hazel and J. C. Cravens Oklahoma City, Oklahoma	454	10.75%

OFFICERS AND DIRECTORS OF THE COMPANY AND THE BANK

Set forth below are the names and ages of the directors and executive officers of the Company and the Bank, the year each first became a director of the Company and of the Bank, together with the number of Shares of Common Stock of the Company, and shares of Preferred Stock of the Company owned beneficially on May 1, 1981.

NAME AND PRINCIPAL OCCUPATION	AGE	A DIRECTOR OF	SHARES OF	SHARES OF
		(i) COMPANY AND (ii) BANK SINCE	COMPANY COM- MON STOCK OWNED BENEFICIALLY	COMPANY PRE- FERRED STOCK OWNED BENEFICIALLY
Bill P. Jennings Chairman & Chief Executive Officer of Bank	57	(i) 1975 (ii) 1975	59,423	-0-
Frank L. Murphy Vice Chairman of the Board	60	(i) 1979 (ii) 1964	225	2,540
Eldon L. Beller President of Bank	57	(i) N/A (ii) 1981	1,000	-0-
Elizabeth M. Coe President of Merrick Foundation	57	(i) N/A (ii) 1975	2,800	-0-
C. F. Kimberling Owner, Kimberling Food Markets	62	(i) N/A (ii) 1963	450	-0-
Marvin Margo, M.D. McBride Clinic, Inc.	57	(i) N/A (ii) 1965	400	-0-
Jerry Richardson President of Dub Richardson Ford	39	(i) N/A (ii) 1975	319	-0-
W. A. Ross President of Dub Ross Company	53	(i) 1979 (ii) 1975	2,944	-0-

Richard C. Haugland Vice President Citizens National Bank, Muskogee, Oklahoma	45	(i) N/A (ii) 1981	15	-0-
Gene H. Smelser President of Val Gene's Food Services	62	(i) N/A (ii) 1968	450	-0-
Bill Stubbs Real Estate Investments	59	(i) N/A (ii) 1964	1,765	-0-
Carl W. Swan Independent Oil Producer	55	(i) 1979 (ii) 1976	9,819	-0-
Ronald H. Burks Chairman of the Board Burks Investments, Inc.	39	(i) 1980 (ii) 1980	8,307	-0-
John E. Rooney President Rooney Corporation	--	(i) 1975 (ii) N/A	17,317	-0-
Gary M. Cook Chairman, Trend Construction Corporation	39	(i) N/A (ii) 1980	1,500	-0-
J. C. Cravens Investments	77	(i) N/A (ii) 1960	-0-	454
H. Mead Norton President, Norton Invest- ment Co.	79	(i) N/A (ii) 1974	1,346.5	-0-
James G. Randolph President Kerr-McGee Coal Corporation	51	(i) N/A (ii) 1979	3,000	-0-

Tony W. Williams Executive Vice President, Bank	40	(i) N/A (ii) N/A	-0-	-0-
Bill G. Patterson Executive Vice President, Bank	31	(i) N/A (ii) 1981	8,032	-0-
Bill Coy Senior Vice President, Bank	47	(i) N/A (ii) N/A	-0-	-0-
John H. Miller Vice President and Trust Officer, Bank	64	(i) N/A (ii) N/A	600	-0-
Dan Thompson Senior Vice President, Bank	30	(i) N/A (ii) N/A	150	-0-

Remuneration of Directors
and Executive Officers

The following tabulation shows all direct remuneration paid by the Company and its subsidiaries for the year ended December 31, 1980, for services in all capacities to (i) each director of the Bank whose aggregate total remuneration exceeded \$50,000, (ii) each of the five highest paid executive officers of the Bank whose aggregate total remuneration exceeded \$50,000, and (iii) all directors and executive officers of the Bank as a group.

Cash and Cash-Equivalent
Forms of Remuneration

<u>Name of Individual or Identity of Group</u>	<u>Salaries, Fees, Commissions and Bonuses</u>	<u>Securities or Property, In- surance Benefits or Reimbursement, Personal Benefits</u>	<u>Aggregate of Contingent Forms of Remuneration</u>
Bill P. Jennings President and Chief Executive Officer	75,133.24	1,400	-0- (1)

Frank L. Murphy Secretary-Treasurer Vice Chairman	63,300	1,300	-0- (1)
All Directors and Executive Officers as a group (18) Persons(2)	220,700	5,300	73,512(1)

- (1) During calendar year 1980 the Bank contributed \$73,512 to the Defined Benefit Plan (the "Plan") in which there were 55 active participants (including 6 Executive Officers of the Bank) at December 31, 1980. The amount of the Bank's contribution under the Plan in respect of a specific person is not and cannot readily be separately or individually calculated.
- (2) As used above, the term "Executive Officers" means all Senior Vice Presidents and above.

Certain Transactions

Certain of the executive officers, directors and principal stockholders of the Company, and their related interest have deposit accounts with the Bank, and also have other transactions with the Bank, including loans in the ordinary course of business. See Note 3 to Notes to Financial Statements of the Company at March 31, 1981. A related interest includes any company or other organization of which an executive officer or director of the Bank (i) owns, controls, or has the power to vote 25% or more of any class of voting securities of the company; (ii) controls the election of a majority of the directors of the company; or (iii) has the power to exercise a controlling influence over the management of policies of the company. The Bank does not make loans to its officers in the ordinary course of business; isolated consumer loans have been made to officers in compliance with applicable federal laws and regulations. The aggregate amount of loans to directors and their related interest as a group outstanding at March 31, 1981 was approximately \$2,804,600, representing approximately 13% of the total of the Bank's capital stock, surplus and undivided profits (the "Bank's equity capital accounts") on that date.

In January 1981, the Company acquired Penn Realty from Bill P. Jennings, Chairman and Chief Executive of the Company. Penn Realty was formed in September 1980 for the purpose of acquiring title to the Quail Run Apartment project ("Quail Run") after Quail Run had defaulted on a construction loan to the Bank. Subsequent to acquiring Penn Realty, the Company contributed \$1,250,061.48 to its capital which was used by Penn Realty to repay loans made to it by the following persons (all Directors of the Company):

Bill P. Jennings	\$ 625,030.74
W. A. Ross	104,171.29
Frank L. Murphy	104,171.79
Ronald H. Burks	208,343.58
Carl W. Swan	208,343.58

DESCRIPTION OF CAPITAL STOCK

General

The table appearing under the heading "Capitalization" sets forth the authorized capital stock of the Company at March 31, 1981, and as adjusted to give effect to the sale of Shares offered hereby.

Common Stock

The holders of Common Stock are entitled to receive such dividends as may be declared by the Board of Directors of the Company with respect to the Common Stock out of funds legally available therefor. The payment of dividends on the Common Stock is also subject to limitations contained in the Oklahoma Business Corporation Act. See "Dividends and Stock Redemption."

In the event of liquidation, dissolution or winding-up of the affairs of the Company, the holders of outstanding shares of Common Stock are entitled to share pro rata according to their respective interests in the Bank's assets and funds remaining after payment or provision for payment of all debts and other liabilities of the Bank and after payment in the full amount of the liquidation preference and any class of preferred stock or other equity security senior in right of payment to the Common Stock.

Preferred Stock

The Company has authorized one class of \$60.00 par value 6.5% cumulative preferred stock. Holders of preferred stock are entitled to receive annual cumulative dividends of \$3.90 per share in preference to any dividends upon the Company's common stock. In the event of liquidation, the holders of preferred stock shall be entitled to be paid in full both the par value of such shares and any dividends accrued but unpaid, before any amount is paid to owners of the Company's common stock. Each share of preferred stock is subject to conversion into one share of common stock of the Company at any time at the option of the holder thereof. The shares of preferred stock are subject to redemption at the option of the Company, in whole or in part, upon payment of the par value thereof and accrued dividends at any time following January 1, 1989.

RESTRICTIONS ON RESALE

The shares offered herein have not been registered with the Securities and Exchange Commission or any state regulatory authority, and are offered pursuant to Section 4(2) of the Securities Act of 1933 and Rule 146 adopted pursuant thereto and pursuant to Section 401(b)(9) of the Oklahoma Securities Act, which exempt transactions by an issuer not involving a public offering.

All shares to be issued pursuant to the Offer will bear the following legend:

THE SECURITIES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933 OR THE OKLAHOMA SECURITIES ACT. THE SECURITIES HAVE BEEN ACQUIRED FOR INVESTMENT AND MAY NOT BE TRANSFERRED FOR VALUE IN THE ABSENCE OF AN EFFECTIVE REGISTRATION OF THEM UNDER THE SECURITIES ACT OF 1933 AND/OR APPLICABLE STATE SECURITIES LAWS, OR AN OPINION OF COUNSEL TO THE COMPANY THAT SUCH REGISTRATION IS NOT REQUIRED UNDER SUCH ACT OR ACTS.

LEGAL PROCEEDINGS

The Company is not a party to any legal proceedings. The Bank is a party, both as plaintiff and defendant, to several legal actions arising out of the conduct of its business. In the opinion of management, the ultimate liability, if any, resulting from the legal actions to which the Bank is a party will not

materially affect the financial position or results of operation of the Bank.

LEGAL OPINION

The Company has received an opinion from McAfee & Taft A Professional Corporation, 100 Park Avenue, Oklahoma City, Oklahoma 73102, to the effect that the shares of Common Stock have been duly and validly authorized and, when the Subscription Price therefor has been paid and the shares of Common Stock issued in accordance with appropriate corporate proceedings, will be duly and validly issued, fully paid and nonassessable.

ACCOUNTANTS

The financial statements of the Company included in this Offering Circular with respect to the year ended December 31, 1980 have been examined by Arthur Young & Company, independent certified public accountants, whose report thereon appears elsewhere herein.

FIRST PENN CORPORATION
CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 1981
(UNAUDITED)

FIRST PENN CORPORATION
CONSOLIDATED BALANCE SHEET

MARCH 31, 1981

(UNAUDITED)

ASSETS

Cash and due from banks	\$ 30,794,191
Investment securities (Note 3)	47,442,707
Loans, less reserve for possible loan losses of \$2,269,467 (Notes 4 and 5)	222,795,538
Premises and equipment (Notes 6 and 8)	4,442,608
Investment in Real Estate Project (Note 12)	1,248,964
Accrued interest receivable	10,847,119
Other assets (Note 2)	<u>1,266,161</u>
Total assets	<u>\$318,837,288</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Deposits:	
Demand	\$ 87,826,098
Savings	13,431,058
Time	<u>144,513,478</u>
Total deposits	245,770,634
Federal funds purchased	6,200,000
Other liabilities (Note 7)	4,669,568
Notes payable (Note 8)	8,606,800
Commercial paper	34,845,667
Loans sold under agreement to repurchase	<u>3,687,887</u>
Total liabilities	303,780,556
Stockholders' equity (Note 10):	
6.5% cumulative preferred stock, \$60 par value; 5,000 shares authorized, 4,225 shares issued	253,500
Common stock, \$1 par value; 250,000 shares authorized, 162,466 shares issued	162,466
Surplus	7,420,753
Retained earnings	<u>7,220,013</u>
Total stockholders' equity	<u>15,056,732</u>
Total liabilities and stockholders' equity	<u>\$318,837,288</u>

See accompanying notes.

FIRST PENN CORPORATION
 CONSOLIDATED STATEMENTS OF INCOME
 Three Months Ended March 31, 1981
 (UNAUDITED)

Interest income:	
Interest and fees on loans	\$10,136,890
Interest on investment securities:	
Taxable	346,688
Tax exempt	<u>535,692</u>
Total interest on investment securities	882,380
Interest on federal funds sold	<u>282,662</u>
Total interest income	11,301,932
Interest expense:	
Interest on deposits:	
Savings	166,488
Time	5,227,289
Other	<u>123,356</u>
Total interest on deposits	5,517,133
Interest on commercial paper	1,489,272
Interest on federal funds purchased	414,276
Interest on notes payable	<u>415,329</u>
Total interest expense	7,836,010
Net interest earnings	3,465,922
Provision for possible loan losses	<u>1,205,000</u>
Net interest earnings after provision for possible loan losses	2,260,922
Other income:	
Service charges on deposit accounts	153,829
Other service charges and fee income	669,547
Other	<u>30,726</u>
Total other income	854,102

(Continued on following page)

FIRST PENN CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Three Months Ended March 31, 1981
(UNAUDITED)

Other expense:	
Salaries	\$ 755,485
Employee benefits	107,654
Occupancy and equipment expense	272,534
Other	<u>808,684</u>
Total other expense	1,944,357
Income before income taxes	1,170,667
Provision for income taxes (Note 9)	<u>333,000</u>
Net Income	<u>\$ 837,667</u>

See accompanying notes.

FIRST PENN CORPORATION
(consolidated and parent company)

STATEMENTS OF STOCKHOLDERS' EQUITY
Three Months Ended March 31, 1981

(UNAUDITED)

	<u>Preferred stock</u>	<u>Common stock</u>	<u>Surplus</u>	<u>Retained earnings</u>
Balance at December 31, 1980	\$253,500	\$162,466	\$7,420,753	\$6,398,824
Net income	-	-	-	837,667
Preferred stock dividends	-	-	-	(16,478)
Balance at March 31, 1981	<u>\$253,500</u>	<u>\$162,466</u>	<u>\$7,420,753</u>	<u>\$7,220,013</u>

See accompanying notes.

FIRST PENN CORPORATION
(parent company only)

BALANCE SHEETS

MARCH 31, 1981

(UNAUDITED)

<u>ASSETS</u>	<u>March 31, 1981</u>
Cash on deposit with subsidiary bank	\$ 9,362,728
Certificate of deposit of subsidiary bank	24,269,535
Receivable from Penn Realty	500
Receivable from subsidiary bank	1,141,672
Investment in stock of subsidiary Bank (Note 2):	
Equity in net assets	21,583,035
Cost in excess of net assets acquired	741,842
	<hr/>
	22,324,877
Investment in real estate project (Note 12)	1,250,061
	<hr/>
	23,574,938
Land (Note 8)	1,250,890
	<hr/>
TOTAL ASSETS	<u>\$ 59,600,263</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>	
Liabilities:	
Other liabilities:	
Income taxes payable	855,535
Interest payable	218,664
Other	16,865
	<hr/>
	1,091,064
Commercial paper	34,845,667
Notes payable (Note 8)	8,606,800
	<hr/>
TOTAL LIABILITIES	\$ 44,543,531
Stockholders' equity (Note 10):	
6.5% cumulative preferred stock , \$60 par value; 5,000 shares authorized, 4,225 shares issued	253,500
Common stock, \$1 par value; 250,000 shares authorized, 162,466 shares issued	162,466
Surplus	7,420,753
Retained earnings	7,220,013
	<hr/>
TOTAL STOCKHOLDERS' EQUITY	15,056,732
	<hr/>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$ 59,600,263</u>

See accompanying notes

FIRST PENN CORPORATION
(parent company only)

STATEMENTS OF INCOME

THREE MONTHS ENDED MARCH 31, 1981

(UNAUDITED)

	<u>March 31, 1981</u>
Income from subsidiary bank:	
Dividends	\$ 350,000
Interest on certificates of deposit	<u>631,192</u>
Total income from subsidiary bank	981,192
Other income	<u>497</u>
Total income	<u>981,689</u>
Expenses:	
Interest	1,904,601
Amortization	5,338
Other expenses	<u>4,965</u>
Total expenses	<u>1,914,904</u>
Loss before income tax benefit, equity in undistributed earnings of subsidiary	(933,215)
Income tax benefit (Note 9)	<u>610,250</u>
Loss before undistributed earnings of subsidiary	(322,965)
Equity in undistributed earnings of subsidiary	<u>1,160,632</u>
Net income	<u>\$ 837,667</u>

See accompanying notes

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1981

(UNAUDITED)

1. Summary of significant accounting policies

Principles of consolidation - The consolidated financial statements include the accounts of First Penn Corporation ("the Company") and its subsidiaries, Penn Square Bank, N.A. ("the Bank") and Penn Realty Company. All significant intercompany transactions and accounts have been eliminated.

Investment securities - Investment securities are stated at cost adjusted for amortization of premiums and accretion of discounts on the straight-line method to maturity. Gains and losses on sales of investment securities are computed on the specific cost identification method.

Interest on loans - Interest on commercial and real estate loans is accrued based on the principal amount outstanding. Interest on installment loans is recognized as revenue based on the sum-of-the-months-digits method.

Reserve for possible loan losses - The reserve for possible loan losses is a valuation reserve which has been provided from charges to earnings in the form of provisions for possible loan losses. The provision charged to earnings is the amount which, in the opinion of management, is considered necessary to maintain the balance in the reserve for possible loan losses at a level adequate to absorb potential losses in the loan portfolio. The provision is based on loans specifically identified as probable losses and other factors which, in management's judgment, deserve recognition in estimating possible loan losses.

Premises and equipment - Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line and declining balance basis over the estimated useful lives of the individual assets.

Retirement plan - The Bank has a noncontributory retirement plan covering substantially all full-time employees. The Bank's policy is to fund costs accrued, including amortization of prior service costs.

Income taxes - The Company and its subsidiaries file a consolidated income tax return. Income tax charges are allocated to the subsidiaries on the basis of its taxable income included in the consolidated financial statements.

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1981

(UNAUDITED)

1. Summary of significant accounting policies (continued)

Deferred income taxes are provided on all significant timing differences. These differences relate primarily to (1) the difference between the provision for possible loan losses reported for income tax purposes and that reported for financial statement purposes and (2) amortization over a ten-year period of the effect of the change for income tax purposes in 1978 from the cash basis to the accrual basis of reporting certain revenues and expenses.

Investment tax credits are accounted for on the flow-through method.

2. Investment in subsidiary

During 1976 and 1977, the Company acquired 83,259 shares of the 100,000 outstanding shares of the Bank. This acquisition was accounted for as a purchase and the excess of cost over fair market value of the net assets acquired of \$851,792 is being amortized on a straight-line basis over a period of forty years. The unamortized balance of \$741,842 at March 31, 1981 is included in other assets in the consolidated balance sheet.

During 1979, the Company offered to issue to the minority shareholders of the Bank for each share of the Bank's common stock owned either (1) one and one-half shares of the Company's \$1 par value common stock or (2) one share of the Company's preferred stock.

In September 1979 the following exchanges were effected:

<u>Number of shares of bank stock exchanged</u>	<u>Number of shares of company stock issued</u>	
	<u>Common</u>	<u>Preferred</u>
16,731	18,759	4,225

The additional investment acquired in the Bank was recorded at net book value of the Bank stock which in management's opinion approximated fair market value of the net assets acquired.

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1981

(UNAUDITED)

2. Investment in subsidiary (continued)

In addition, the Company offered to exchange one share of its common stock for each \$40 of principal face value of the Bank's \$1,000,000 subordinated notes. All note holders exercised their options in exchange for 25,000 shares of the Company's common stock. In October, the Company canceled the Bank's liability on these notes resulting in an additional \$1,000,000 investment in the subsidiary bank. In addition, a cash capital contribution of \$1,000,000 was made by the Company to its subsidiary bank in 1979.

In January, 1980, the Company purchased the remaining 10 outstanding shares of the Bank at a cost of \$200 per share. The excess of cost over fair market value of the shares acquired was \$1,206. This amount is included in the unamortized excess cost at March 31, 1981. A cash capital contribution of \$7,500,000 was made by the Company to its subsidiary bank in 1980.

3. Investment securities

The carrying values and estimated market values of investment securities at March 31, 1981 are as follows:

	March 31, 1981	
	Carrying Value	Market Value
United States Treasury securities	\$13,041,279	\$12,484,814
Obligations of states and political subdivisions	34,056,428	29,988,083
Other	345,000	345,000
	\$47,442,707	\$42,817,897

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1981

(UNAUDITED)

3. Investment securities (continued)

At March 31, 1981 investment securities with book values aggregating \$16,400,500 were pledged to secure public funds.

4. Loans

Loans are stated at face value less unearned income. The amount of unearned income at March 31, 1981 was \$1,393,325. Loans at March 31, 1981 are as follows:

	<u>March 31, 1981</u>
Commercial	\$170,373,202
Real Estate	34,783,989
Installment	17,074,083
Other	<u>2,833,731</u>
	225,065,005
Reserve for possible loan losses	<u>(2,269,467)</u>
	<u>\$222,795,538</u>

Included in outstanding loans at March 31, 1981 were loans totaling \$2,804,600 to officers and directors, or their affiliates. Also during 1981 the Bank purchased loans from and sold loans to two banks in which an officer-director of the Company held an equity interest. At March 31, 1981 outstanding transactions with these banks consisted of:

Loan participations purchased	\$1,652,265
Loan participations sold	\$6,496,157

Management believes all such loans are made in the ordinary course of business.

5. Reserve for possible loan losses

Changes in the reserve for possible loan losses were as follows:

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1981

(UNAUDITED)

5. Reserve for possible loan losses (continued)

	<u>March 31, 1981</u>
Balance at December 31, 1980	\$2,004,587
Provision charged to operating expense	1,205,000
Recoveries of loans previously charged off	725
Losses charged off	<u>(940,845)</u>
Balance at March 31, 1981	<u>\$2,269,467</u>

6. Premises and equipment

An analysis of premises and equipment follows:

	<u>March 31, 1981</u>
Land	\$ 1,720,316
Building	1,869,622
Furniture and equipment	1,450,359
Other	<u>719,868</u>
	5,760,165
Less accumulated depreciation	<u>1,317,557</u>
	<u>\$ 4,442,608</u>

The land account is composed of land on which the drive-in facility is located and unimproved land.

7. Other liabilities

Other liabilities consist of the following:

	<u>March 31, 1981</u>
Accrued interest payable	\$ 3,249,648
Income taxes payable	911,859

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1981

(UNAUDITED)

7. Other liabilities (continued)

	<u>March 31, 1981</u>
Deferred federal income taxes	\$ 176,710
Other	<u>331,351</u>
	<u>\$4,669,568</u>

8. Notes payable

Notes payable consist of the following obligations of the parent company:

	<u>March 31, 1981</u>
Demand notes payable secured by 98,354 shares of the Bank's stock: Due February 26, 1982 at Chicago floating prime interest rate	\$7,500,000
Demand note payable, due May 29, 1981 at Dallas prime interest rate, secured by land held by the parent company at cost of \$1,250,890	<u>1,106,800</u>
	<u>\$ 8,606,800</u>

It is the intention of management to seek to renew the debt upon maturity of the demand notes.

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1981

(UNAUDITED)

9. Income taxes

Consolidated income tax expense consists of the following components:

	<u>March 31, 1981</u>
Current tax:	
Federal	\$ 294,000
State	<u>39,000</u>
	<u>\$ 333,000</u>

A reconciliation of the amount computed by applying the federal statutory rate of 46% and the effective income rate follows:

	<u>March 31, 1981</u>
Income tax at statutory rate	\$ 538,507
Tax exempt interest	(213,231)
State taxes, net of federal benefit	21,821
Other	<u>(14,097)</u>
	<u>\$ 333,000</u>

The income tax benefit for the parent company represents the excess of amounts payable by its subsidiary in lieu of paying federal income taxes on a separate return basis over the taxes payable on the consolidated return.

10. Common and preferred stock

On September 6, 1979, the stockholders approved an amendment to the Articles of Incorporation increasing the number \$1 par value common stock authorized to 250,000 shares from the previously authorized 100,000 shares. The stockholders also approved the authorization of 5,000 non-voting preferred shares with a par value of \$60 and with dividends cumulative at the annual rate of 6.5%. Each preferred share is convertible into one share of the common stock of the Company at any time at the option of the holder and is subject to redemption at the option of the Company upon payment of the par value plus accrued dividends at any time following January 1, 1989.

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1981

(UNAUDITED)

10. Common and preferred stock (continued)

No cash dividends may be paid on common stock if the dividends on the preferred stock is in arrears.

11. Commitments

The Bank has lease agreements for (1) the land under the main bank, which expire in 2029, and (2) office facilities one of which expires in 1985 with renewal options for three five-year terms, one of which expires in 1981, and two which expire in 1984 both with renewal options for three one-year terms. Minimum annual rentals under these leases are as follows:

1981	\$118,353
1982-1983	122,752
1984	21,119
1985	7,980
1986-1989	7,200
1990-2029	3,000

In addition to the minimum rental for one of the office facility leases, the Bank also pays additional rental based on a percent of average total deposits as defined for each lease year. The lease covering the land provides for rental payments to be adjusted every 10 years based on a cost of living index. Total rental expense for the three months ended March 31, 1981 amounted to approximately \$27,000.

12. Investment in real estate project in foreclosure

In January, 1981, the Company acquired, from certain officer-stockholders, all of the outstanding stock of Penn Realty for \$1,250,000. Penn Realty's primary asset is an uncompleted real estate development project which is subject to bank debt of \$3,776,044 at March 31, 1981 of which approximately \$1,473,000 is payable to the Bank. The lead lending bank has instituted foreclosure proceedings against this project. In addition, certain suppliers of the project have filed third party claims against the Company's subsidiary bank for materials supplied the project and punitive damages.

The ultimate realization of the Company's investment in the real estate project is dependent upon completion and/or sale of the project in an amount in excess of outstanding liabilities. Under terms of an agreement with the lead lending bank, proceeds, if any, in excess of loan balances will be remitted to the Bank.

Management is of the opinion no significant loss will be incurred in connection with this transaction.

FIRST PERN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1981

(UNAUDITED)

13. Statement of changes in financial position

Under generally accepted accounting principles, a statement of changes in financial position is required for each period for which an income statement is presented. The Company does not prepare such a statement in the normal course of business. Accordingly a statement of changes in financial position for the three months ended March 31, 1981 is not included.

PENN SQUARE BANK N.A.

FINANCIAL STATEMENTS

MARCH 31, 1981

(UNAUDITED)

PENN SQUARE BANK N.A.

BALANCE SHEET

MARCH 31, 1981

(UNAUDITED)

<u>ASSETS:</u>	<u>MARCH 31, 1981</u>
Cash and Due from Banks	\$ 30,794,191
U. S. Treasury Securities (Note 2)	13,041,279
Obligations of States & Political Subdivisions (Note 2) ...	34,056,428
Federal Reserve Stock (Note 2)	345,000
Federal Funds Sold	0
Loans, less Reserve for Possible Loan Losses of \$2,269,467 (Note 3 & 4)	222,630,689
Bank Premises & Other Equipment (Note 5)	3,191,718
Investments in Subsidiary (Note 11)	230,101
Other Assets.....	<u>11,371,438</u>
 TOTAL ASSETS	 <u>\$315,660,844</u>
 <u>LIABILITIES:</u>	
Demand Deposits	97,259,756
Time Deposits	182,214,071
Loans Sold Under Repurchase	3,687,887
Reserve for Interest	3,091,323
Reserve for Taxes	1,339,856
Other Liabilities	284,916
Federal Funds Purchased	<u>6,200,000</u>
 TOTAL LIABILITIES	 <u>\$294,077,809</u>
 <u>EQUITY CAPITAL ACCOUNTS:</u>	
Common Stock, \$10 Par Value: 100,000 Shares Authorized	1,000,000
Surplus	10,500,000
Retained Earnings (Note 7)	<u>10,083,035</u>
 TOTAL EQUITY CAPITAL	 21,583,035
 TOTAL LIABILITIES AND EQUITY CAPITAL	 <u>\$315,660,844</u>

See accompanying notes.

PENN SQUARE BANK N.A.
 STATEMENT OF EARNINGS
 THREE MONTHS ENDED MARCH 31, 1981
 (UNAUDITED)

OPERATING INCOME:	MARCH 31, 1981
Interest and Fees on Loans	\$ 10,131,128
Income on Federal Funds Sold	282,662
Interest on U. S. Treasury Securities	346,688
Interest on Obligations of States & Political Subdi- visions of the U.S.	535,692
Interest on Other Bonds and Notes	4,878
Dividends on Stock	0
Service Charges on Deposit Accounts	153,829
Other Income	699,033
TOTAL OPERATING INCOME	\$ 12,153,910

(Statement of Earnings-Continued on Next Page)

PENN SQUARE BANK N.A.
STATEMENT OF EARNINGS
THREE MONTHS ENDED MARCH 31, 1981
(UNAUDITED)

OPERATING EXPENSE:	MARCH 31, 1981
Salaries and Employee Benefits	\$ 863,139
Interest on Deposits	6,148,325
Expense of Federal Funds Purchased	414,276
Occupancy Expense of Bank Premises	272,534
Advertising	58,501
Outside Services	130,210
Provision for Possible Loan Losses (Note 1)	1,205,000
Other Expense	608,043
	9,700,028
 Income Before Income Taxes & Securities Gains or Losses	 2,453,882
Applicable Income Taxes (Note 6)	(943,250)
Income Before Securities Gains or Losses	1,510,632
 Securities (Losses), Net of Related Income Taxes	 0
 NET INCOME	 \$ 1,510,632

(See accompanying notes)

PENN SQUARE BANK N.A.

STATEMENT OF STOCKHOLDER'S EQUITY

THREE MONTHS ENDED MARCH 31, 1981

(UNAUDITED)

	Common Stock (Par-\$10.00)	Surplus	Retained Earnings
Balance Beginning of Period	\$1,000,000	\$10,500,000	\$ 8,922,403
Net Income (Loss)			1,510,632
Cash Dividends			(350,000)
Other Increases (Decreases)	<u>None</u>	<u>None</u>	<u>None</u>
 Balance End of Period	 <u>\$1,000,000</u>	 <u>\$10,500,000</u>	 <u>\$10,083,035</u>

PENN SQUARE BANK N.A.

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1981

(UNAUDITED)

1. Summary of significant accounting policies

Investment securities - Investment securities are stated at cost adjusted for amortization of premiums and accretion of discounts on the straight-line method to maturity. Gains and losses on sales of investment securities are computed on the specific cost identification method.

Interest on loans - Interest on commercial and real estate loans is accrued based on the principal amount outstanding. Interest on installment loans is recognized as revenue based on the sum-of-the-months-digits method.

Reserve for possible loan losses - The reserve for possible loan losses is a valuation reserve which has been provided from charges to earnings in the form of provisions for possible loan losses. The provision charges to earnings is the amount which, in the opinion of management, is considered necessary to maintain the balance in the reserve for possible loan losses at a level adequate to absorb potential losses in the loan portfolio. The provision is based on loans specifically identified as probable losses and other factors which, in management's judgement, deserve recognition in estimating possible loan losses.

Premises and equipment - Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line and declining balance basis over the estimated useful lives of the individual assets.

Retirement plan - The Bank has a noncontributory retirement plan covering substantially all full-time employees. The Bank's policy is to fund costs accrued, including amortization of prior service costs.

Income taxes - First Penn Corporation, the parent company, and Penn Square Bank N.A. file a consolidated income tax return. Income tax charges are allocated to the Bank on the basis of its taxable income included in the consolidated financial statements.

PENN SQUARE BANK N.A.

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1981

(UNAUDITED)

1. Summary of significant accounting policies (continued)

Deferred income taxes are provided on all significant timing differences. These differences related primarily to (1) the difference between the provision for possible loan losses reported for income tax purposes and that reported for financial statement purposes and (2) amortization over a ten-year period of the effect of the change for income tax purposes in 1978 from the cash basis to the accrual basis of reporting certain revenues and expenses.

Investment tax credits are accounted for on the flow-through method.

2. Investment securities

The carrying values and estimated market values of investment securities at March 31, 1981 are as follows:

	<u>Carrying value</u>	<u>Market value</u>
United States Treasury securities	\$13,041,279	\$12,484,814
Obligations of states and political subdivisions	34,056,428	29,988,083
Other	<u>345,000</u>	<u>345,000</u>
	<u>\$47,442,707</u>	<u>\$42,817,897</u>

At March 31, 1981 investment securities with book values aggregating \$16,400,500 were pledged to secure public funds.

3. Loans

Loans are stated at face value less unearned income. The amount of unearned income at March 31, 1981 was \$1,393,325. Loans at March 31, 1981 are as follows:

Commercial	\$170,373,202
Real Estate	16,909,234
Installment	34,783,989
Other	<u>2,833,731</u>
	224,900,156
Reserve for possible loan losses	<u>(2,269,467)</u>
	<u>\$222,630,689</u>

PENN SQUARE BANK N.A.

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1981

(UNAUDITED)

3. Loans (continued)

Included in outstanding loans at March 31, 1981 were loans totaling \$2,804,600 to officers and directors, or their affiliates. Also during 1981 the Bank purchased loans from and sold loans to two banks in which an officer-director of the Company held an equity interest. At March 31, 1981 outstanding transactions with these banks consisted of:

Loan participations purchased	\$1,652,265
Loan participations sold	\$6,496,157

Management believes all such loans are made in the ordinary course of business.

4. Reserve for possible loan losses

Changes in the reserve for possible loan losses for the three months ended March 31, 1981 were as follows:

	<u>March 31, 1981</u>
Balance at December 31, 1980	\$ 2,004,587
Provision charged to operating expense	1,205,000
Recoveries of loans previously charged off	725
Losses charged off	<u>(940,845)</u>
Balance at March 31, 1981	<u>\$ 2,269,467</u>

5. Premises and equipment

An analysis of premises and equipment follows:

	<u>March 31, 1981</u>
Land	\$ 469,426
Building	1,869,622
Furniture and equipment	1,450,359
Other	<u>719,868</u>
	4,509,275
Less accumulated depreciation	<u>1,317,557</u>
	<u>\$ 3,191,718</u>

PENN SQUARE BANK N.A.
 NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1981

(UNAUDITED)

5. Premises and equipment (continued)

The land account is composed of land on which the drive-in facility is located and unimproved land.

6. Income Taxes

Penn Square Bank and its parent company, First Penn Corporation, file a consolidated income tax return. Income tax charges are allocated to the Bank on the basis of its taxable income included in the consolidated financial statements.

The difference in the expected tax provision computed at the statutory rate and the provision included in the accompanying income statement related primarily to the tax exempt municipal interest income.

7. Stockholders Equity

The Bank is a wholly-owned subsidiary of a one-bank holding company. Debt service requirements of the Bank's Parent company are met primarily through dividends paid by the Bank to its parent. At March 31, 1981, the Parent company's borrowings totaled \$8,606,800 with interest at floating prime of the lending bank. Interest on the outstanding principal of the Parent's debt is due quarterly.

8. Commitments

The Bank has lease agreements for (1) the land under the main bank, which expires in 2029, and (2) office facilities one of which expires in 1985 with renewal options for three five-year terms, one of which expires in 1981, and two which expire in 1984 both with renewal options for three one-year terms. Minimum annual rentals under these leases are as follows:

1981	\$118,353
1982-1983	122,752
1984	21,119
1985	7,980
1986-1989	7,200
1990-2029	3,000

PENN SQUARE BANK N.A.

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1981

(UNAUDITED)

8. Commitments (continued)

In addition to the minimum rental for one of the office facility leases, the Bank also pays additional rental based on a percent of average total deposits as defined for each lease year. The lease covering the land provides for rental payments to be adjusted every 10 years based on a cost of living index. Total rental expense for the three months ended March 31, 1981 amounted to approximately \$27,000.

9. Contingency

At March 31, 1981, the Bank has a participation interest of \$1,473,000 in loans relating to an uncompleted real estate project. The project is in foreclosure and certain suppliers of the project have filed third party claims against the Bank for materials supplied to the project and for punitive damages. Management is of the opinion no significant losses will be incurred in connection with these claims.

10. Statement of changes in financial position

Under generally accepted accounting principles, a statement of changes in financial position is required for each period for which an income statement is presented. The Bank does not prepare such a statement in the normal course of business. Accordingly, a statement of changes in financial position for the three months ended March 31, 1981 is not included.

11. Investment in Subsidiary

The investment in the subsidiary is carried at the Bank's equity in the subsidiary's net assets. The Bank owns 100% of its subsidiary, First Penn Leasing Corporation, which was incorporated on July 11, 1975. Earnings have not been material.

ARTHUR YOUNG

ARTHUR YOUNG & COMPANY
1350 LIBERTY TOWER
OKLAHOMA CITY, OKLAHOMA 73102

The Board of Directors
First Penn Corporation

We have examined the accompanying balance sheets (company and consolidated) of First Penn Corporation at December 31, 1980 and 1979 and the related statements (company and consolidated) of income, stockholders' equity and changes in financial position for the years then ended. Except as stated in the following paragraph, our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

We were unable to satisfy ourselves as to the adequacy of the reserve for possible loan losses at December 31, 1980 due to the lack of supporting documentation of collateral values of certain loans.

In our opinion, except for the effects of such adjustments, if any, on the 1980 financial statements (company and consolidated) as might have been determined to be necessary had we been able to satisfy ourselves as to the adequacy of the reserve for possible loan losses, the statements mentioned above present fairly the financial position (company and consolidated) of First Penn Corporation at December 31, 1980 and 1979 and the results of operations (company and consolidated) and the changes in financial position (company and consolidated) for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

Arthur Young + Company

March 13, 1981

FIRST PENN CORPORATION
 CONSOLIDATED BALANCE SHEETS
 December 31, 1980 and 1979

<u>ASSETS</u>	<u>1980</u>	<u>1979</u>
Cash and due from banks	\$ 59,625,519	\$ 25,671,661
Investment securities (Note 3)	42,627,346	22,982,819
Loans, less reserve for possible loan losses of \$2,004,587 (\$1,002,097 in 1979) (Notes 4, 5 and 12)	199,894,664	106,484,882
Federal funds sold	16,000,000	1,100,000
Premises and equipment (Notes 6 and 8)	3,724,388	1,936,348
Accrued interest receivable	7,372,553	2,495,276
Other assets (Note 2)	<u>1,213,248</u>	<u>1,033,114</u>
Total assets	<u>\$330,457,718</u>	<u>\$161,704,100</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Deposits:		
Demand	\$135,029,063	\$ 79,701,722
Savings	13,341,126	13,261,028
Time	<u>136,522,794</u>	<u>56,717,078</u>
Total deposits	284,892,983	149,679,828
Federal funds purchased	650,000	400,000
Other liabilities (Note 7)	4,636,579	1,975,341
Notes payable (Note 8)	8,606,800	3,160,001
Commercial paper	14,640,252	-
Loans sold under agreement to repurchase	<u>2,795,561</u>	<u>-</u>
Total liabilities	316,222,175	155,215,170
Stockholders' equity (Note 10):		
6.5% cumulative preferred stock, \$60 par value; 5,000 shares authorized, 4,225 shares issued	253,500	253,500
Common stock, \$1 par value; 250,000 shares authorized, 162,466 shares issued (108,311 shares in 1979)	162,466	108,311
Surplus	7,420,753	3,142,508
Retained earnings	<u>6,398,824</u>	<u>2,984,611</u>
Total stockholders' equity	<u>14,235,543</u>	<u>6,488,930</u>
Total liabilities and stockholders' equity	<u>\$330,457,718</u>	<u>\$161,704,100</u>

See accompanying notes.

FIRST PENN CORPORATION
 CONSOLIDATED STATEMENTS OF INCOME
 Years ended December 31, 1980 and 1979

	<u>1980</u>	<u>1979</u>
Interest income:		
Interest and fees on loans	\$24,665,544	\$11,038,809
Interest on investment securities:		
Taxable	299,778	277,397
Tax exempt	<u>1,308,326</u>	<u>908,630</u>
Total interest on investment securities	1,608,104	1,186,027
Interest on federal funds sold	<u>282,715</u>	<u>14,933</u>
Total interest income	26,556,363	12,239,769
Interest expense:		
Interest on deposits:		
Savings	715,844	734,974
Time	11,834,081	4,360,560
Other	<u>2,745</u>	<u>56,650</u>
Total interest on deposits	12,552,670	5,152,184
Interest on commercial paper	1,055,686	-
Interest on federal funds purchased	871,220	710,847
Interest on notes payable	791,024	189,450
Interest on subordinated notes	<u>-</u>	<u>59,656</u>
Total interest expense	15,270,600	6,112,137
Net interest earnings	11,285,763	6,127,632
Provision for possible loan losses	<u>1,407,830</u>	<u>615,000</u>
Net interest earnings after provision for possible loan losses	9,877,933	5,512,632
Other income:		
Service charges on deposit accounts	366,920	108,212
Other service charges and fee income	431,738	279,050
Other	<u>89,312</u>	<u>61,536</u>
Total other income	887,970	448,798

(Continued on following page)

FIRST PENN CORPORATION
 CONSOLIDATED STATEMENTS OF INCOME
 (CONTINUED)

Years ended December 31, 1980 and 1979

	<u>1980</u>	<u>1979</u>
Other expense:		
Salaries	\$ 1,997,560	\$ 1,243,156
Employee benefits	341,656	237,381
Occupancy and equipment expense	618,828	390,363
Other	<u>2,410,459</u>	<u>1,208,478</u>
Total other expense	<u>5,368,503</u>	<u>3,079,378</u>
Income before income taxes, minority interest and securities losses	5,397,400	2,882,052
Provision for income taxes (Note 9)	<u>1,966,710</u>	<u>969,675</u>
Income before minority interest and securities losses	3,430,690	1,912,377
Minority interest	<u>-</u>	<u>232,112</u>
Income before securities losses	3,430,690	1,680,265
Securities losses, net of related income taxes and minority interest	<u>-</u>	<u>7,111</u>
Net income	<u>\$ 3,430,690</u>	<u>\$ 1,673,154</u>

See accompanying notes.

FIRST PENN CORPORATION
 (consolidated and parent company)
 STATEMENTS OF STOCKHOLDERS' EQUITY
 Years ended December 31, 1980 and 1979

	<u>Preferred stock</u>	<u>Common stock</u>	<u>Surplus</u>	<u>Retained earnings</u>
Balance at December 31, 1978	\$ -	\$ 64,552	\$1,387,918	\$1,311,457
Net income	-	-	-	1,673,154
Exchange of stock for stock of subsidiary bank (Note 2)	253,500	18,759	779,590	-
Exchange of stock for subordinated notes of subsidiary bank (Note 2)	-	25,000	975,000	-
Balance at December 31, 1979	253,500	108,311	3,142,508	2,984,611
Net income	-	-	-	3,430,690
Common stock issued	-	54,155	4,278,245	-
Preferred stock dividends	-	-	-	(16,477)
Balance at December 31, 1980	<u>\$253,500</u>	<u>\$162,466</u>	<u>\$7,420,753</u>	<u>\$6,398,824</u>

See accompanying notes.

FIRST PENN CORPORATION
 CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

Years ended December 31, 1980 and 1979

	<u>1980</u>	<u>1979</u>
Source:		
Net income	\$ 3,430,690	\$ 1,673,154
Charges against (credits to) income not involving funds in the current period:		
Depreciation and amortization	307,887	187,858
Excess of provision for possible loan losses over net loan charge-offs	1,002,490	374,606
Amortization of premiums on securities	129,209	57,303
Accretion of discounts on securities	(36,625)	(16,890)
Deferred federal income taxes	76,710	(26,000)
Amortization of cost in excess of net assets of subsidiary bank	21,348	21,314
Net book value of property dispositions	<u>12,562</u>	<u>-</u>
Funds provided from operations	4,944,271	2,271,345
Decrease in federal funds sold	-	2,900,000
Proceeds of borrowings	5,606,800	1,000,000
Increase in deposits	135,213,155	59,033,185
Increase in federal funds purchased	250,000	400,000
Increase in other liabilities	2,584,528	-
Increase in commercial paper	14,640,252	-
Loans sold under agreement to repurchase	2,795,561	-
Common stock issued in exchange for subordinated notes of subsidiary bank (Note 2)	-	1,000,000
Common stock issued in exchange for subordinated notes of subsidiary bank (Note 2)	-	786,226
Preferred stock issued in exchange for stock of subsidiary bank (Note 2)	-	265,623
Proceeds from the sale of common stock	<u>4,332,400</u>	<u>-</u>
	<u>\$170,366,967</u>	<u>\$67,656,379</u>

(Continued on following page)

FIRST PENN CORPORATION
 CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION
 (Continued)

Years ended December 31, 1980 and 1979

	<u>1980</u>	<u>1979</u>
Application:		
Increase in cash and due from banks	\$ 33,953,858	\$15,075,152
Increase in securities	19,737,111	5,351,876
Increase in loans	94,412,272	43,252,807
Increase in federal funds sold	14,900,000	-
Additions to premises and equipment	2,106,886	236,838
Increase in accrued interest receivable	4,877,277	1,238,279
Increase in other assets	203,085	11,141
Decrease in other liabilities	-	1,390,286
Payments on notes payable	160,001	100,000
Cancellation of indebtedness of subordinated notes of subsidiary bank (Note 2)	-	1,000,000
Preferred stock dividends	16,477	-
	<u>\$170,366,967</u>	<u>\$67,656,379</u>

See accompanying notes.

FIRST PENN CORPORATION
(parent company only)

BALANCE SHEETS

December 31, 1980 and 1979

<u>ASSETS</u>	<u>1980</u>	<u>1979</u>
Cash on deposit with subsidiary bank	\$ 7,595,651	\$ 7,442
Certificate of deposit of subsidiary bank	8,300,000	-
Receivable from subsidiary bank	873,083	701,500
Investment in stock of subsidiary (Note 2):		
Equity in net assets	20,422,403	8,936,511
Cost in excess of net assets acquired	<u>747,180</u>	<u>767,322</u>
	21,169,583	9,703,833
Land (Note 8)	1,242,721	-
Other assets	<u>48,046</u>	<u>18,782</u>
Total assets	<u>\$39,229,084</u>	<u>\$10,431,557</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Liabilities:		
Other liabilities:		
Income taxes payable	\$ 977,535	\$ 766,490
Interest payable	752,089	1,271
Other	<u>16,865</u>	<u>14,865</u>
	1,746,489	782,626
Commercial paper	14,640,252	-
Notes payable (Note 8)	<u>8,606,800</u>	<u>3,160,001</u>
Total liabilities	24,993,541	3,942,627
Stockholders' equity (Note 10):		
6.5% cumulative preferred stock, \$60 par value; 5,000 shares authorized, 4,225 shares issued	253,500	253,500
Common stock, \$1 par value; 250,000 shares authorized, 162,466 shares issued (108,311 shares in 1979)	162,466	108,311
Surplus	7,420,753	3,142,508
Retained earnings	<u>6,398,824</u>	<u>2,984,611</u>
Total stockholders' equity	<u>14,235,543</u>	<u>6,488,930</u>
Total liabilities and stockholders' equity	<u>\$39,229,084</u>	<u>\$10,431,557</u>

See accompanying notes.

FIRST PENN CORPORATION
(parent company only)

STATEMENTS OF INCOME

Years ended December 31, 1980 and 1979

	<u>1980</u>	<u>1979</u>
Income from subsidiary bank:		
Dividends	\$ 300,000	\$ 233,125
Interest on subordinated notes	-	7,533
Interest on certificates of deposit	<u>270,375</u>	<u>-</u>
Total income from subsidiary bank	570,375	240,658
Expenses:		
Interest	1,846,710	189,450
Amortization	22,951	22,946
Other expenses	<u>4,305</u>	<u>13,959</u>
Total expenses	<u>1,873,966</u>	<u>226,355</u>
Income (loss) before income tax benefit, equity in undistributed earnings of subsidiary and securities losses	(1,303,591)	14,303
Income tax benefit (Note 9)	<u>749,183</u>	<u>95,225</u>
Income (loss) before undistributed earnings of subsidiary and securities losses	(554,408)	109,528
Equity in undistributed earnings of subsidiary before securities losses	<u>3,985,098</u>	<u>1,570,737</u>
Income before securities losses	3,430,690	1,680,265
Equity in securities losses of subsidiary, net of related income taxes	<u>-</u>	<u>7,111</u>
Net income	<u>\$3,430,690</u>	<u>\$1,673,154</u>

See accompanying notes.

FIRST PENN CORPORATION
(parent company only)

STATEMENTS OF CHANGES IN FINANCIAL POSITION

Years ended December 31, 1980 and 1979

	<u>1980</u>	<u>1979</u>
Source:		
Net income	\$ 3,430,690	\$1,673,154
Charges against (credit to) income not involving funds in the current period:		
Equity in undistributed earnings of subsidiary	(3,985,098)	(1,563,626)
Amortization of organization costs	1,603	1,632
Amortization of cost in excess of net assets of subsidiary bank	<u>21,348</u>	<u>21,314</u>
Funds provided from (absorbed by) operations	(531,457)	132,474
Proceeds of borrowings	5,606,800	1,000,000
Increase in taxes payable	211,045	600,413
Increase in accrued interest payable	750,818	1,270
Increase in commercial paper	14,640,252	-
Increase in other liabilities	2,000	14,000
Common stock issued in exchange for subordinated notes of subsidiary bank (Note 2)	-	1,000,000
Common stock issued in exchange for stock of subsidiary bank (Note 2)	-	786,226
Preferred stock issued in exchange for stock of subsidiary bank (Note 2)	-	265,623
Proceeds from sale of common stock	<u>4,332,400</u>	<u>-</u>
	<u>\$25,011,858</u>	<u>\$3,800,006</u>
Application:		
Increase in cash	\$ 7,588,209	\$ 7,021
Increase in certificates of deposit	8,300,000	-
Increase in receivable from subsidiary	171,583	623,956
Purchase of land	1,242,721	-
Increase in other assets	30,867	17,180
Additional equity investment in subsidiary bank through (Note 2):		
Capital contribution	7,500,000	1,000,000
Cancellation of indebtedness of subordinated notes of subsidiary bank	-	1,000,000

(Continued on following page)

FIRST PENN CORPORATION
(parent company only)

STATEMENTS OF CHANGES IN FINANCIAL POSITION
(CONTINUED)

Years ended December 31, 1980 and 1979

	<u>1980</u>	<u>1979</u>
Acquisition of subsidiary bank stock	\$ 2,000	\$1,051,849
Payment on notes payable	160,001	100,000
Preferred stock dividends	<u>16,477</u>	<u>-</u>
	<u>\$25,011,858</u>	<u>\$3,800,006</u>

See accompanying notes.

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

December 31, 1980 and 1979

1. Summary of significant accounting policies

Principles of consolidation - The consolidated financial statements include the accounts of First Penn Corporation ("the Company") and its subsidiary, Penn Square Bank N.A. ("the Bank"). All significant intercompany transactions and accounts have been eliminated.

Investment securities - Investment securities are stated at cost adjusted for amortization of premiums and accretion of discounts on the straight-line method to maturity. Gains and losses on sales of investment securities are computed on the specific cost identification method.

Interest on loans - Interest on commercial and real estate loans is accrued based on the principal amount outstanding. Interest on instalment loans is recognized as revenue based on the sum-of-the-months-digits method.

Reserve for possible loan losses - The reserve for possible loan losses is a valuation reserve which has been provided from charges to earnings in the form of provisions for possible loan losses. The provision charged to earnings is the amount which, in the opinion of management, is considered necessary to maintain the balance in the reserve for possible loan losses at a level adequate to absorb potential losses in the loan portfolio. The provision is based on loans specifically identified as probable losses and other factors which, in management's judgment, deserve recognition in estimating possible loan losses.

Premises and equipment - Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line and declining balance basis over the estimated useful lives of the individual assets.

Retirement plan - The Bank has a noncontributory retirement plan covering substantially all full-time employees. The Bank's policy is to fund costs accrued, including amortization of prior service costs.

Income taxes - The Company and its subsidiary bank file a consolidated income tax return. Income tax charges are allocated to the Bank on the basis of its taxable income included in the consolidated financial statements.

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

December 31, 1980 and 1979

1. Summary of significant accounting policies (continued)

Deferred income taxes are provided on all significant timing differences. These differences relate primarily to (1) the difference between the provision for possible loan losses reported for income tax purposes and that reported for financial statement purposes and (2) amortization over a ten-year period of the effect of the change for income tax purposes in 1978 from the cash basis to the accrual basis of reporting certain revenues and expenses.

Investment tax credits are accounted for on the flow-through method.

2. Investment in subsidiary

During 1976 and 1977, the Company acquired 83,259 shares of the 100,000 outstanding shares of the Bank. This acquisition was accounted for as a purchase and the excess of cost over fair market value of the net assets acquired of \$851,792 is being amortized on a straight-line basis over a period of forty years. The unamortized balances of \$747,180 and \$767,322 at December 31, 1980 and 1979, respectively, are included in other assets in the consolidated balance sheet.

During 1979, the Company offered to issue to the minority shareholders of the Bank for each share of the Bank's common stock owned either (1) one and one-half shares of the Company's \$1 par value common stock or (2) one share of the Company's preferred stock.

In September 1979 the following exchanges were effected:

Number of shares of bank stock exchanged	Number of shares of company stock issued	
	Common	Preferred
16,731	18,759	4,225

The additional investment acquired in the Bank was recorded at net book value of the Bank stock which in management's opinion approximated fair market value of the net assets acquired.

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

December 31, 1980 and 1979

2. Investment in subsidiary (continued)

In addition, the Company offered to exchange one share of its common stock for each \$40 of principal face value of the Bank's \$1,000,000 subordinated notes. All note holders exercised their options in exchange for 25,000 shares of the Company's common stock. In October, the Company canceled the Bank's liability on these notes resulting in an additional \$1,000,000 investment in the subsidiary bank. In addition, a cash capital contribution of \$1,000,000 was made by the Company to its subsidiary bank in 1979.

In January, 1980, the Company purchased the remaining 10 outstanding shares of the Bank at a cost of \$200 per share. The excess of cost over fair market value of the shares acquired was \$1206. This amount is included in the unamortized excess cost at December 31, 1980. A cash capital contribution of \$7,500,000 was made by the Company to its subsidiary bank in 1980.

3. Investment securities

The carrying values and estimated market values of investment securities at December 31, 1980 and 1979 are as follows:

	<u>Consolidated</u>	
	<u>1980</u>	
	<u>Carrying</u> <u>value</u>	<u>Market</u> <u>value</u>
United States Treasury securities	\$10,992,420	\$10,643,000
Obligations of states and political subdivisions	31,334,926	26,546,000
Other	<u>300,000</u>	<u>300,000</u>
	<u>\$42,627,346</u>	<u>\$37,489,000</u>
	<u>1979</u>	
United States Treasury securities	\$ 3,181,184	\$ 2,816,000
Obligations of states and political subdivisions	19,741,635	18,013,000
Other	<u>60,000</u>	<u>60,000</u>
	<u>\$22,982,819</u>	<u>\$20,889,000</u>

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

December 31, 1980 and 1979

3. Investment securities (continued)

At December 31, 1980 and 1979 investment securities with book values aggregating \$18,549,000 and \$9,460,000, respectively, were pledged to secure public funds.

4. Loans

Loans are stated at face value less unearned income. The amount of unearned income at December 31, 1980 and 1979 was \$1,537,889 and \$1,903,264, respectively. Loans at December 31, 1980 and 1979 are as follows:

	Consolidated	
	1980	1979
Commercial	\$155,798,134	\$ 83,424,493
Real estate	26,763,002	10,532,265
Instalment	16,356,789	13,263,098
Other	2,981,326	267,123
	201,899,251	107,486,979
Reserve for possible loan losses	(2,004,587)	(1,002,097)
	\$199,894,664	\$106,484,882

Included in outstanding loans at December 31, 1980 were loans totaling \$3,846,129 to officers and directors, or their affiliates. Also during 1980 the Bank purchased loans from and sold loans to two banks in which an officer-director of the Company held an equity interest. At December 31, 1980 outstanding transactions with these banks consisted of:

Loan participations purchased	\$1,737,484
Loan participations sold	\$6,767,646

Management believes all such loans are made in the ordinary course of business.

5. Reserve for possible loan losses

Changes in the reserve for possible loan losses during 1980 and 1979 were as follows:

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

December 31, 1980 and 1979

5. Reserve for possible loan losses (continued)

	Consolidated	
	1980	1979
Balance at beginning of year	\$1,002,097	\$ 627,491
Provision charged to operating expense	1,407,830	615,000
Recoveries of loans previously charged off	212,061	19,038
Losses charged off	(617,401)	(259,432)
Balance at end of year	<u>\$2,004,587</u>	<u>\$1,002,097</u>

6. Premises and equipment

An analysis of premises and equipment follows:

	Consolidated	
	1980	1979
Land	\$1,712,146	\$ 469,426
Building	1,607,244	1,461,562
Furniture and equipment	1,158,227	845,699
Other	459,455	74,259
	4,937,072	2,850,946
Less accumulated depreciation	1,212,684	914,598
	<u>\$3,724,388</u>	<u>\$1,936,348</u>

The land account is composed of land on which the drive-in facility is located and unimproved land.

7. Other liabilities

Other liabilities consist of the following:

	Consolidated	
	1980	1979
Accrued interest payable	\$3,186,239	\$1,012,187
Income taxes payable	1,032,859	821,789

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

December 31, 1980 and 1979

7. Other liabilities (continued)

	<u>Consolidated</u>	
	<u>1980</u>	<u>1979</u>
Deferred federal income taxes	\$ 176,710	\$ 75,000
Other	<u>240,771</u>	<u>66,365</u>
	<u>\$4,636,579</u>	<u>\$1,975,341</u>

8. Notes payable

Notes payable consist of the following obligations of the parent company:

	<u>Parent Company and consolidated</u>	
	<u>1980</u>	<u>1979</u>
Demand notes payable secured by 98,354 shares of the Bank's stock:		
Due February 26, 1981 at Chicago floating prime interest rate	\$7,500,000	\$ -
Due February 26, 1980 at New York prime interest rate not to exceed 8%	-	2,160,001
Due December 28, 1980 at New York prime interest rate	-	1,000,000
Demand note payable, due February 27, 1981 at Dallas prime interest rate, secured by land held by the parent company at cost of \$1,242,721	<u>1,106,800</u>	-
	<u>\$8,606,800</u>	<u>\$3,160,001</u>

Subsequent to year end, the \$7,500,000 demand note was extended to February 26, 1982 and the \$1,106,800 demand note was extended to May 29, 1981. It is the intention of management to seek to renew the debt upon maturity of the demand notes.

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

December 31, 1980 and 1979

9. Income taxes

Consolidated income tax expense, including the tax effects of securities losses, consists of the following components:

	<u>1980</u>	<u>1979</u>
Current tax:		
Federal	\$1,710,000	\$888,400
State	<u>180,000</u>	<u>100,000</u>
	1,890,000	988,400
Deferred	<u>76,710</u>	<u>(26,000)</u>
	<u>\$1,966,710</u>	<u>\$962,400</u>

A reconciliation of the amount computed by applying the federal statutory rate of 46% and the effective income rate follows:

	<u>1980</u>	<u>1979</u>
Income tax at statutory rate	\$2,482,804	\$1,318,468
Tax exempt interest	(585,059)	(392,375)
Investment tax credit	(42,955)	(12,200)
State taxes, net of federal benefit	97,200	54,000
Other	<u>14,720</u>	<u>(5,493)</u>
	<u>\$1,966,710</u>	<u>\$ 962,400</u>

An analysis of the provision (credit) for deferred income taxes follows:

Provision for possible loan losses for income tax purposes in excess of financial provision	\$72,400	\$ 15,400
Amortization of effect of the change for income tax purposes in 1978 from the cash basis to the accrual basis of reporting certain revenues and expenses	(10,800)	(10,800)
Provision for state income taxes for financial purposes in excess of tax provision	-	(32,000)
Other	<u>15,110</u>	<u>1,400</u>
	<u>\$76,710</u>	<u>\$ (26,000)</u>

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

December 31, 1980 and 1979

9. Income taxes (continued)

The income tax benefit for the parent company represents the excess of amounts payable by its subsidiary in lieu of paying federal income taxes on a separate return basis over the taxes payable on the consolidated return.

10. Common and preferred stock

On September 6, 1979, the stockholders approved an amendment to the Articles of Incorporation increasing the number of \$1 par value common stock authorized to 250,000 shares from the previously authorized 100,000 shares. The stockholders also approved the authorization of 5,000 non-voting preferred shares with a par value of \$60 and with dividends cumulative at the annual rate of 6.5%. Each preferred share is convertible into one share of the common stock of the Company at any time at the option of the holder and is subject to redemption at the option of the Company upon payment of the par value plus accrued dividends at any time following January 1, 1989. No cash dividends may be paid on common stock if the dividends on the preferred stock is in arrears.

11. Commitments

The Bank has lease agreements for (1) the land under the main bank, which expire in 2029, and (2) office facilities one of which expires in 1985 with renewal options for three five-year terms, one of which expires in 1981, and two which expire in 1984 both with renewal options for three one-year terms. Minimum annual rentals under these leases are as follows:

1981	\$118,353
1982-1983	122,752
1984	21,119
1985	7,980
1986-1989	7,200
1990-2029	3,000

In addition to the minimum rental for one of the office facility leases, the Bank also pays additional rental based on a percent of average total deposits as defined for each lease year. The lease covering the land provides for rental payments to be adjusted every 10 years based on a cost of living index. Total rental expense for 1980 amounted to approximately \$99,000.

FIRST PENN CORPORATION
(consolidated and parent company)

NOTES TO FINANCIAL STATEMENTS

December 31, 1980 and 1979

12. Participation loans

At December 31, 1980, there were participation agreements in effect with maturity dates prior to that of the underlying loans. Subsequent to December 31, 1980, the majority of the agreements totaling \$18,651,497 were amended to reflect terms that coincide with the terms of the note.

Accordingly, the participation agreements amounting to \$20,969,203 at December 31, 1980 have not been reflected in the accompanying balance sheet as loans outstanding. However, the National Bank Examiners required that certain of these loans be reflected as loans outstanding in reports submitted to their office. After renegotiation of the terms of agreements subsequent to December 31, 1980, these amounts will not be included in such reporting.

13. Subsequent event

Subsequent to December 31, 1980 the Company acquired, from certain officer-stockholders, all of the outstanding stock of a company involved in a real estate development project for approximately \$1,250,000. The acquired company's principal asset is the uncompleted development project which is subject to debt of approximately \$3,000,000. Approximately \$400,000 of this debt, at December 31, 1980, was payable to the Bank. The lead lending bank has filed foreclosure proceedings on the project. In addition, certain suppliers of the project have filed third party claims against the Bank for materials supplied the project and punitive damages. Management is of the opinion that no significant loss will be incurred in connection with this transaction.

SUBSCRIPTION AGREEMENT

First Penn Corporation
 1919 Penn Square
 Oklahoma City, Oklahoma 73118

Attention: Bill P. Jennings

Gentlemen:

The undersigned hereby acknowledges that he has received a copy of the Confidential Offering Circular, dated June __, 1981 (the "Circular").

Subject only to acceptance hereof by First Penn Corporation (the "Company"), the undersigned hereby subscribes pursuant to the terms and conditions as described in the Circular, for _____ Shares of the Company's Common Stock and tenders herewith by certified or cashier's check or bank draft payable in United States dollars to the order of the Company, as the full purchase price thereof the sum of \$135 per Share.

(Minimum subscription is 1150 Shares or \$_____).

Certificates representing the Shares subscribed and paid for are to be delivered to the undersigned at the address set forth below, registered in the following name or names:

 (Please type name in which Shares
 are to be registered exactly as it
 is to appear on the certificate)

Address: _____

In connection with this subscription, the undersigned hereby makes the following acknowledgments and representations, on his own behalf or as the duly authorized representative of the subscriber:

COMPLETE EACH ITEM

(where initials are required, initial if true)

1. If the subscription is to be executed in the name of a corporation, general or limited partnership, trust, or other entity:

(a) I represent that such entity was formed on _____, 19__, in the state of _____.

Initial

(b) I represent that I am authorized to make this investment for and on behalf of the entity, that I have included herewith evidence of such authority (resolution of board of directors, etc.), and that I am sufficiently familiar with the financial resources and investment experience of the entity to accurately answer the questions contained in this Subscription Agreement.

Initial

(c) I represent that such investment is not inconsistent with the appropriate charter documents or other instruments of formation of such entity and that I have attached true and correct copies thereof (i.e. certified copies of the Articles of Incorporation, Partnership Agreement, Declaration of Trust, etc.)

Initial

2. I understand that the offering is being made pursuant to the exemption from registration with the Securities and Exchange Commission (the "Commission") afforded by Section 4(2) of the Securities Act of 1933 and Rule 146 adopted by the Commission relating to transactions by an issuer not involving any public offering. Consequently, the materials submitted have not been subject to the review and comment by the staff of the Commission or the National Association of Securities Dealers, Inc.

Further, I understand that the securities have not been registered for sale in the state of my residence.

Initial

3. I have, and my offeree representative (if any) has, carefully read the Circular and fully understand all matters and terms and conditions set forth therein.

Initial

4. I have, or my offeree representative (if any) has, had an opportunity to question, and receive answers from the officials of the Company and to verify the accuracy of the information contained in the Circular (and any amendments, supplements, or exhibits thereto), or any other supplemental information which I, or my offeree representative (if any), deem relevant to make an informed investment decision as to purchase of the Company's Shares.

Initial

5. I, together with my offeree representative (if any), have sufficient knowledge and experience in matters relating to business and financial matters in general to be capable of utilizing the information contained in the Circular to evaluate the risks involved in an investment in the securities contemplated herein; and I am capable of bearing all economic risks involved in this investment with full knowledge that this investment could result in a total loss to me.

Initial

6. I have a net worth of at least \$500,000 (excluding home, furnishings, and personal automobiles) or a net worth of at least \$250,000 (excluding home, furnishings, and personal automobiles) and had during my last tax year, or will have during my current tax year, taxable income (not taking into account any deductions to be realized as a Participant of the Partnership) some portion of which was, or will be, subject to federal income taxation at a rate of not less than 50%.

Initial

7. The interest which I am purchasing will be acquired solely for my own account for investment and not for the purpose of resale, distribution, subdivision, or fractionalization thereof.

Initial

8. I understand that I must bear the economic risks of the investment for an indefinite period because the Shares have not been registered under the Securities Act of 1933 and, therefore, are subject to restrictions on transfer such that the Shares may not be sold or otherwise transferred unless they are registered and the Company has no intention to file a registration statement under such Act or to comply with Regulation A or any other disclosure exemption under such Act. Securities Act Rule 144 would presently be inapplicable to resales of these Shares. The Shares may not be resold under Securities Act Rule 237 until they have been held by an investor for five years, they may be sold only in negotiated transactions which do not involve a broker dealer, and the transaction must not involve an amount greater than \$50,000 or the proceeds of the sale of 1% of the class of securities outstanding, whichever is lesser.

Initial

9(a) I have employed an offeree representative to assist or advise me in connection with evaluating the risks of the prospective investment.

Yes No

is: (b) If the answer is "Yes" my offeree representative

(Name)

(Address)

(Occupation)

(c) If the answer is "Yes", a copy of a written statement from such offeree representative in which he discloses to me his relationship with Company or its affiliates, now existing or mutually contemplated or which has existed at any time during the past two years and any compensation received or to be received as a result of such relationship is attached hereto.

The investment evidenced by this instrument was offered and purchased in the State of _____, and this instrument was signed the ____ day of _____, 1981.

Checks should be made payable to First Penn Corporation.

(Signature of Subscriber)

(Subscriber's Name and Social Security Number-please type)

(Street Address)

(City, State, and Zip Code)

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