OHIO SAVINGS AND LOAN CRISIS AND COLLAPSE OF ESM GOVERNMENT SECURITIES, INC.

HEARING

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON GOVERNMENT OPERATIONS HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

FIRST SESSION

APRIL 3, 1985

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OHIO SAVINGS AND LOAN CRISIS AND COLLAPSE OF ESM GOVERNMENT SECURITIES, INC.

WEDNESDAY, APRIL 3, 1985

HOUSE OF REPRESENTATIVES,
COMMERCE, CONSUMER,
AND MONETARY AFFAIRS SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 8:30 a.m., in room 2154, Rayburn House Office Building, Hon. Doug Barnard, Jr. (chairman of the subcommittee) presiding.

Present: Representatives Doug Barnard, Jr., John M. Spratt, Jr., Joe Kolter, Ben Erdreich, Albert G. Bustamante, Larry E. Craig, Patrick L. Swindall, and Jim Saxton.

Also present: Representatives Jack Brooks, Thomas N. Kindness, Mary Rose Oakar, Thomas A. Luken, Marcy Kaptur, and Bob McEwen.

Staff present: Peter Barash, staff director; James M. Pates, counsel; Stephen R. McSpadden, counsel; Eleanor M. Vanyo, secretary; Faye Ballard, clerk; Scott Fisher, minority professional staff, Committee on Government Operations; and Dean T. Scott, subcommittee staff, on detail from the General Accounting Office.

OPENING STATEMENT OF CHAIRMAN BARNARD

Mr. BARNARD. The Subcommittee on Commerce, Consumer, and Monetary Affairs will come to order.

On March 4, the Securities and Exchange Commission obtained a Federal court order forcing ESM Government Securities of Fort Lauderdale, FL, into receivership. The collapse of this little-known Government securities dealer precipitated a disquieting chain of events unprecedented in the recent history of our Nation's financial markets.

The crisis began with the insolvency of Home State Savings Bank of Cincinnati, a $1.4 billion thrift institution which had extensive business dealings with ESM; and it ended with nervous international money markets bidding up the price of precious metals and bidding down the price of the dollar.

In between these events, the Governor of Ohio ordered a bank holiday of the State's 70 privately insured thrifts; the Ohio Deposit Guarantee Fund, whose entire reserves of $127 million may have been exhausted by the Home State failure, was placed under the control of a conservator; hundreds of Federal bank examiners were

dispatched to Ohio to prevent the thrift crisis from spreading and to speed the conversion of S&L's from private to Federal deposit insurance; the FSLIC and FDIC were swamped with calls from anxious S&L officials in other States seeking information on how to apply for Federal deposit insurance; and, dozens of municipalities and financial institutions across the country faced the bleak prospect of combined losses totaling $350 million or more.

Today, the Commerce, Consumer, and Monetary Affairs Subcommittee of Government Operations begins hearings in an effort to determine whether the Ohio thrift crisis and the events that preceded it were avoidable; whether the major private deposit insurance systems in other States are secure; and, whether the Federal apparatus that supervises our Nation's financial and securities markets is sufficiently competent and aggressive to prevent a repetition of the Ohio situation or at least to minimize the damaging consequences of any repetition.

The subcommittee seeks specific answers to the following questions:

What did the Federal banking agencies and the SEC each know about the business conduct of ESM Government Securities and the ethics of its principals and when did they know it? Was information developed by one agency regularly shared with other supervisory agencies at the Federal and State levels? Were enforcement responses to ESM's tactics coordinated? If not, why not? What types of changes need to be made in our regulatory structure to assure such cooperative action?

Did the Federal Reserve and the Home Loan Bank Board perform adequately in responding to the Ohio emergency? Should the Federal banking agencies establish, on a permanent basis, a standby rescue program for dealing with any similar occurrences in the future?

Did the Ohio thrift regulatory officials perform their supervisory responsibilities adequately?

Do the major private deposit insurance systems in the various States and elsewhere have the necessary procedures and policies to avoid an Ohio situation? Can these systems, either alone or together with their thrift supervisory agencies, properly monitor and prevent unsafe and unsound banking practices? And do these private systems need to be strengthened, and if so, how?

The collapse of ESM Government Securities and the devastating impact of that event on financial institutions and municipalities across the country is a vivid illustration of the fragile interrelationships that exist among providers of our Nation's financial services. A failure on one financial sector can quickly spread to others and the results can be devastating. The failure of a securities dealer or a financial institution because of fraud is not a victimless crime. Just ask the citizens of Ohio, or the taxpayers of Beaumont, TX; Pompano Beach, FL; Toledo, OH, and other cities. Just ask the depositors and the arms-length stockholders of S&L's that did business with ESM.

Last October, this subcommittee issued a report entitled "The Federal Response to Criminal Misconduct and Insider Abuse in the Nation's Financial Institutions." It concluded that one-half of all commercial bank failures and one-quarter of all thrift failures are

caused by insider criminal misconduct. Within the recent past, fraud also appears to have played an important role in the collapse of a number of nonregistered Government securities dealers like Drysdale, Lion Capital Group, Winters Government Securities, and, of course, ESM. Within the past few weeks, a growing number of major banks have admitted to significant violations of the currency reporting requirements of the Bank Secrecy Act. In combination, these events and these admissions raise understandable concerns about our financial system.

While I believe that our Nation's financial markets are vigorous and essentially honest, a repetition of the Ohio episode could deal a crushing blow to the public's confidence in the integrity of those markets. It is essential, therefore, that this hearing lead to a significant strengthening of Federal and State regulatory systems that supervise financial markets.

It has been suggested by some that this committee is playing with a political football in this investigation. Well, let me set the record straight. This committee has a long and excellent record of financial institution and regulatory investigations without the least tint of political association.

Again, we are dealing here today in risky financial transactions over many years, longer than any period of office of most individuals appearing today. Even more importantly, they involve the loss of hundreds of millions of dollars to financial institutions and municipalities, thereby affecting depositors and taxpaying citizens.

Investigations and studies of this committee are independent of any political party or any officeholder.

Let me also note at this time that in yesterday's paper, it was announced that Attorney General Meese had outlined a program to better coordinate criminal prosecution of bank crime. I would like to say that this is directly related to the study that was made by this committee last year and is a typical example of the work that this committee aspires to perform.

This morning we are very fortunate and pleased to have with us, the Honorable Richard F. Celeste, Governor of the State of Ohio.

Governor, at the outset, thank you for taking your time to be with us today. I know it was of some inconvenience to fly in from Ohio today and I know that you are on a limited schedule, but we certainly do appreciate the contribution that you can make to this investigation today. And I would also like to note that there are several distinguished members of the Ohio delegation that are with us today and I want to welcome them to this hearing. Time permitting, I hope that we will be able to accommodate all of you as participants in this hearing.

We will ask if any of you would like to make formal statements, and if so, we would welcome those statements.

Governor, again we welcome you to be with us today and we will accommodate your entire testimony in the record. Without objection, his entire testimony will be entered into the record. If you care to summarize, you may do so at your own discretion. But before you begin, I would like to ask the distinguished senior minority member of this committee for an opening statement.

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

Let me say at the outset a special thanks for the very fair and bipartisan way you have approached this concern and this issue. You are to be commended and your staff is to be commended for the effort you have become involved in.

Once again we enter a new chapter in our book of failed financial institutions in America. As in prior cases, we are faced with similar questions. What happened? Why did it happen? And how did it happen?

Some of those answers will be forthcoming shortly during today's hearings. But another question needs to be asked. When will it stop? If we fail to address this question and soon, the American people will lose any faith they still have in our very important banking system. I fear the days of hiding one's savings under the mattress or 40 paces due north from the south side of the barn will occur once again and that, of course, cannot be tolerated.

Many people would like to point fingers toward deregulation as the reason behind recent bank failures—a notion that I believe is seriously flawed. We are supposed to have a federal system of checks and balances which allows financial institutions to expand in the marketplace while at the same time ensuring stability and public confidence in our banking industry. For some reason, the status quo does not work as well as it should. Unfortunately, the Federal Government's checks and balances is intertwined in a massive layer of bureaucracy. It is this bureaucracy which allows those individuals who want to take advantage of the system to oftentimes do so.

It is now known that several Federal agencies were aware of ESM Government Securities, Inc.'s activities years ago, yet failed to communicate their alarm to other Federal agencies. The State of Ohio was well aware of Home State's financial dealings with ESM and failed to stop them. Deregulation did not prevent the Federal and State governments from acting.

Last week's committee hearings on Vice President Bush's task group report on regulation of financial services proposed ways to improve Federal regulations of financial institutions. I am going to review that report again to see if it contains a proposal requiring all Federal banking and thrift regulators to sit down together once a month, or once every other month, or once quarterly to discuss problem institutions and/or their investments. If they are not required to meet regularly they should be. If they cannot communicate together voluntarily then they should be legislated to do so.

Likewise, the task force report suggests giving States more authority to regulate their State-chartered institutions. Obviously, the State of Ohio will not be used as an example of how well a State can oversee its chartered institutions. Nor should it be said that all State-chartered, private insurance corporations are improperly managed and regulated. Nevertheless, Congress will have to establish stringent guidelines before States take over greater regulatory powers.

Finally, Mr. Chairman, Ed Gray, Chairman of the Federal Home Loan Bank Board, has recently received unfair attacks for the role he and the Federal Savings and Loan Insurance Corporation played in assisting the Ohio thrifts. Newspaper headline seekers have suggested that partisan politics were involved in his decision-

making during the Ohio thrift crisis. I find such remarks incorrect. The members of the subcommittee are well aware of the condition of FSLIC. I believe Chairman Gray acted in a prudent and highly professional manner by not succumbing to the pressures to immediately bring the Ohio thrifts into the FSLIC fund without first doing his required homework on each thrift. His first priority is to ensure financial soundness of FSLIC. Placing more bad apples into a basket that already has its share of bad apples would not be a responsible action. I am sure the thousands of savings and loans associations which are members of the FSLIC also appreciate the manner in which Chairman Gray has responded to this crisis.

Let me thank you, Mr. Chairman, and welcome Governor Celeste before our committee. I look forward to hearing from him.

Mr. BARNARD. Because of the Governor's schedule this morning, we are going to accommodate him first and then we will have questions from the panel and then we would like to have the testimony of Members of Congress who are here today; specifically, the Honorable Chalmers P. Wylie, the Honorable Thomas A. Luken, the Honorable Mary Rose Oakar, and the Honorable Thomas N. Kindness, if they would so like.

Mr. KOLTER. Mr. Chairman.

Mr. BARNARD. Yes, Mr. Kolter.

Mr. KOLTER. May I submit an opening statement for the record, please?

Mr. BARNARD. Without objection, that statement will be entered into the record.

[The opening statement of Mr. Kolter follows:]

OPENING REMARKS FOR
CONGRESSMAN JOSEPH KOLTER
BEFORE THE
GOVERNMENT OPERATIONS COMMITTEE
COMMERCE, CONSUMER AND MONETARY AFFAIRS SUBCOMMITTEE
ROOM 2154 RAYBURN HOUSE OFFICE BLDG.
APRIL 3, 1985 - 8:30 A.M.

Mr. Chairman, the events of the last several weeks, have sensitized the American public to the problems facing the Nation's banking system. The closing of the thrift institutions in Ohio was just another link in what seems to be a long chain of events that have caused the public to ask just what is going on in the Nation's banking system.

While I realize that financial deregulation has brought much change for the better, it has also brought much uncertainty. My deep concern is that people with no real idea of what financial deregulation is all about, will feel less secure about their savings in the future. Confidence in the banking system is paramount to maintaining public trust and faith.

Mr. Chairman, I would like to thank you for calling this hearing today. It is most timely. I am here to learn more about what occurred in Ohio and for a status report from the witnesses scheduled to testify.

Mr. BARNARD. Do any other Members have a statement? Mr. Saxton.

Mr. SAXTON. Thank you, Mr. Chairman. I would just like to note for the record and for the interest of those who are here with us this morning and for the public as well, that the perspective from which I believe this committee comes is not one that we wish to express tremendous immediate concern as to the health and welfare of our financial institutions across this country.

This is one of a series of hearings that we have held relative to this subject. As the background that we set here in Washington for financial transactions relative to banks and thrift institutions has changed, because of deregulation, because of various changes that have happened on the Federal level, it has changed the financial workings of our financial institutions. And because that has happened, it is necessary for Congress to constantly monitor and watch, not only as the situation has developed in Ohio, but all across the country. And I think it is important to point out to the public and to those who are here today that we are not here because we expect some immediate catastrophe to happen with our banking institutions. It is because we are looking down the road and we are here today in a sense in a preventative way, to take whatever action may be necessary so that in the future we do not have to look at these kinds of situations in retrospect but rather we

are here today to look at them in the future in order to prevent these kinds of occurrences from happening again.

And once again, if I can just emphasize that we do not expect, we do not think, in fact, we are sure that FSLIC and FDIC are currently able to handle their intended function.

And so today we are here to look at the Ohio situation, to try and find out what happened in Ohio, to try and determine whether or not we need to make changes in our system so that these occurrences do not happen in the future.

Thank you, Mr. Chairman.

Mr. BARNARD. Governor Celeste.

STATEMENT OF RICHARD F. CELESTE, GOVERNOR, STATE OF OHIO

Mr. CELESTE. Thank you very much, Mr. Chairman, and members of the subcommittee, and particularly Representatives from the State of Ohio.

During the past 4 weeks I have become directly and deeply involved in a crisis which threatened the underpinnings of Ohio's thrift industry, and frankly, part of the fabric of our Nation's highly sophisticated financial system.

Four weeks ago this morning, Cincinnati's morning newspaper headlined the fact that Home State Savings, Ohio's largest privately insured savings and loan institution, had suffered a severe loss in connection with the massive fraud at ESM Government Securities in Fort Lauderdale, FL, compounded by a false audit report.

After 3 days, well over $100 million had been withdrawn from Home State by worried depositors, about a third of the assets of the private Ohio Deposit Guarantee Fund were used up to meet the Home State run, and as officers of Home State and ODGF worked to find a buyer, the institution closed its doors.

On Sunday, March 10, the superintendent of the Ohio Savings and Loan Division in the Department of Commerce, appointed a conservator to protect the more than 70,000 remaining depositors in Home State and the $520 million they still have on deposit there.

The State of Ohio moved as quickly as it could to protect the half million depositors at the 71 remaining privately insured thrifts. By the following Wednesday evening, in record time and with strong bipartisan support, Ohio had passed an emergency appropriation of $50 million as a loan to a new, private insurance fund for those other S&L's, none of which had been tainted with the losses involved in the collapse of ESM.

But depositor fears outran legislative efforts. By Thursday, March 15, runs had spread to a growing number of institutions in Cincinnati and elsewhere. Officials of several thrifts had come to Washington and had pronounced private insurance dead, and Federal officials at this stage indicated that this was, in the first instance, a State problem requiring a State remedy.

At 5:30 a.m. on Friday, March 25, after reviewing a series of options with affected savings and loan executives, State legislative leaders, key administration personnel, and Federal regulatory officials, I determined that there was a high probability that one or

more of the S&L's would not be able to keep open that day and that additional failures would seriously jeopardize at least 70 other institutions.

I ordered a 3-day holiday for the privately insured thrifts so that we could establish an orderly plan for the reopening of all these institutions with sufficient protection to rekindle depositor confidence. I might add that in close cooperation with the Federal Reserve Board and its Chairman, Paul Volcker; and Mrs. Karen Horn, president of the Federal Reserve Bank of Cleveland; the Federal Home Loan Bank Board and its Chairman, Edwin Gray; and Dr. Charles Thiemann, president of the Home Loan Bank of Cincinnati, we are getting these institutions reopened—stronger than ever, and in record time.

As of this morning, 10 working days after passage of special legislation requiring Ohio's S&L's to apply for and qualify for FSLIC or FDIC, we have reopened 29 institutions, representing more than 40 percent of the depositors. And these institutions, I might add, are stronger than ever.

With this brief summary, let me indicate to you four recommendations, Mr. Chairman, that I would draw as lessons from the past 4 weeks for you and members of the committee.

First, the immediate and specific cause of this crisis was large-scale fraud in an unregulated Government securities trading company in Florida. If ESM were healthy today, if its audited statements were accurate, we would not be holding this hearing this morning.

The Federal Government must provide greater oversight of those who make the market for Government securities, a market which I understand from a recent Wall Street Journal article is trading at $70 billion a day.

Second, apparently Ohio's supervision of our privately insured S&L's was sufficient to identify a problem at Home State. "Too many eggs in one basket," according to my commerce director, Ken Cox. But our regulatory process proved insufficient to cure the problem.

I am sharing with you—as attachment A to my testimony—several public accounts which highlight this serious concern, going back over two administrations. I have ordered my director of commerce and my superintendent of savings and loans to review both our procedures and our statutory authority and to recommend changes.

I have also strongly supported the appointment of a special prosecutor, who is now at work, and asked that his original charge be expanded to include a report "of any deficiencies which may have occurred in the State regulation of Home State Savings Bank and recommendations of any changes which ought to be made in State law, regulations, personnel, and practices in order to protect against a situation such as this ever arising again." He has agreed to this further assignment.

The State of Ohio must provide stronger regulation of our State-chartered thrifts and possibly other financial institutions. That is the second lesson I draw from this experience.

Third, despite reassurances by my former superintendent of savings and loans to the contrary, and I have attached as attachment

B his memo to me in early January, the Ohio Deposit Guarantee Fund fell short in two important respects. First, relating to public misperception, and the second, relating to private insufficiency.

On public misperception—most depositors believe that the "Ohio" in Ohio Deposit Guarantee Fund meant that the State of Ohio stood behind the fund. This misperception was so widespread that in the April l issue of Business Week, it is still referred to as a private, State-guaranteed fund. Depositors should know the full and accurate facts about who stands behind such private guarantee funds.

Second, in terms of private insufficiency—even though ODGF enjoyed a capital-to-asset ratio of 2.7 percent, roughly $138 million of capital to $5 billion of covered assets, the fund proved insufficient to withstand the failure of its largest member. Thus, to my understanding the history of Mississippi and Nebraska was substantially repeated.

At a minimum, States with private deposit guarantee funds must assure that their capital and reserves are capable of handling the possibility of failure of their largest member institution. For our part in Ohio, we are insisting on Federal insurance, or an acceptable guarantee from a parent big enough and strong enough to cover every single deposit.

Finally, it was apparent in the days immediately preceding my decision to protect depositors in Ohio's thrifts by closing them that there were no well-charted emergency powers by which Federal regulatory agencies could have helped us to head off the crisis. Closing 71 S&L's, most of them healthy but threatened by a growing loss of confidence, meant that our State's problem became part of a larger set of considerations. Such extraordinary State action should be unnecessary in the future.

As our national and international financial system grows more complex, more fast paced, and more interdependent, I strongly urge not more day-to-day intervention at the Federal level, but more readily accessible emergency powers to intervene directly and early in situations which could, left to run their course, do damage far beyond one thrift or one State.

I want to thank you very much for this opportunity to share the Ohio perspective with you this morning.

[Attachments to Mr. Celeste's prepared statement follow:]

The Columbus Dispatch/Tuesday, March 19, 1985

Home State warned in '82

By Michael Curtin
Dispatch General Assembly Reporter

Who knew what when? And why wasn't something done about it?

Those are the questions state legislators will ask in an investigation of the collapsed Home State Savings Bank, which triggered a crisis of confidence in, and the closing of, 69 privately insured savings and loans.

When legislators ask their questions, they will hear Clark W. Wideman, former superintendent of the Ohio Division of Savings and Loan Associations, say the red flag went up in 1982.

THAT WAS when Wideman's examiners reported that Home State, owned by prominent Democrat Marvin L. Warner, was dangerously overinvested in E.S.M. Government Securities Inc., which failed March 4.

"There was a tremendous amount of hand-wringing at the top levels" of the division, said Wideman, who was appointed by then-Gov. James A. Rhodes and served from September 1978 to February 1983.

Home State's unusually large and risky investments in repurchase agreements — in which cash was borrowed in exchange for securities of greater value — prompted him "to jawbone and armtwist" in an attempt to get the S&L to reduce its dealings with E.S.M. of Ft. Lauderdale, Fla., Wideman said in an interview.

ALTHOUGH THE superintendent has the authority to order divestiture in such cases, Wideman said he feared that forcing Home State out of the transactions too quickly would bring down both the S&L and the Ohio Deposit Guarantee Fund.

Because Home State was the largest member of the fund, its failure would have jeopardized the fund, Wideman said.

"It seemed obvious to me that the amount of required assistance would have been fatal to the fund," he said.

"I was prepared to deal with the loss of one institution," Wideman said. "It was the very significant way the failure of Home State would have affected the guarantee fund" that prevented the intervention, he said.

"I COULD NOT determine anything more appropriate to do than to jawbone and armtwist," Wideman said. "We did the best we could. So far as I can tell, the guys who came in after us did essentially the same thing."

Wideman's successor, C. Lawrence Huddleston, who served from February 1983 to January 1985, said he could not comment.

"The first order of business is to get it (the S&L closings) resolved. I don't want to detract from that effort."

However, other sources with experience in the division confirmed there were continuing efforts — by the division and by the ODGF — to persuade Home State to reduce its dealings with E.S.M.

"WE ENTERTAINED the less-than-well-placed hope that Home State could wind out of those transactions," Wideman said.

Even though Home State directors pledged in 1983 to lessen the S&L's involvement with E.S.M., the transactions instead increased, reaching more than $600 million that year. Home State had $1.4 billion in net worth and assets.

Warren W. Tyler, director of the Ohio Department of Commerce from January 1983 to Feb. 22, 1985, said he was aware Home State had problems, but had no idea they were so large. The Division of Savings and Loan Associations is within the Department of Commerce.

"I CAN'T SAY we were unaware there was attention being paid to Home State," said Tyler, who now is director of the Ohio Environmental Protection Agency. "But there was attention being paid on a regular basis to a number of companies" in a variety of regulated areas.

Tyler said he had no direct knowledge of the communication between the Division of Savings and Loan Associations and Home State, saying it was "the sole authority of the superintendent."

Tyler said he was more than surprised by Home State's failure and the amount and complexity of the E.S.M. transactions. "I thought I understood a repurchase agreement," he said. "It's an amazing story."

THE PLAIN DEALER, SUNDAY, MARCH 31, 1985

Regulators to propose stricter laws for S&Ls

CINCINNATI (AP) — Ohio's savings and loan regulations turned out to be inadequate in the wake of the Home State Savings Bank collapse, and politicians and regulators have decided it is time for changes.

John Mongeluzzo, state Commerce Department staff lawyer, says talks already have begun within the department on drafting new legislation.

Lawrence Kane, a Republican special prosecutor appointed by Attorney General Anthony Celebrezze, has been asked to make recommendations for regulatory procedures while investigating the case.

"One of the problems with the S&L laws as they stand is that we can bark, but we cannot bite," Mongeluzzo said. "The laws, as stated, ... are very vague."

Two former directors of the loan division agreed on the need to strengthen state enforcement laws.

Clark Wideman, superintendent from September 1978 to January 31, 1983, said he and other officials knew years ago that their regulatory powers were not enough.

"But at the same time, we were all cognizant that this was the era of deregulation.

"Proposing tougher laws with more teeth in them was swimming upstream against the tide," Wideman said.

Former Assistant Attorney General Roger Sugarman said it has long been clear that judges frowned if the state threatened to issue a "cease and desist" order to stop a state-chartered thrift from engaging in "unsafe and unsound" activities.

"You have to have more than just suspicions to convince a judge that a cease and desist order is needed," said Sugarman, who served from 1980 to 1982.

'One of the problems with the S&L laws as they stand is that we can bark, but we cannot bite'

Wallace Boesch, S&L superintendent from 1972 to 1974, said today's regulations are better, but not good enough.

"When I was in there, we didn't even have the cease and desist power. That's only about 4 years old. All I could do was browbeat people, or, if their assets were used up to the point where ... the public's money was becoming endangered, I could go to the attorney general and ask for orders to close them down. But there was nothing in between."

Boesch complained that although state examiners can look at thrift records every 18 months, they cannot examine the books of holding companies that own such thrifts. But state bank examiners can.

State Rep. William Batchelder, R-4, of Medina, said, "The superintendent of savings and loans has enough power. All he has to do is exercise his muscle."

Rick Spencer, Commerce Department spokesman, said the division has only 31 examiners, six less than its highest level in recent years.

Salaries range from $16,300 to $30,430 a year, Spencer said.

Commerce Director Kenneth Cox, former Commerce Director J. Gordon Peltier and Wideman all said the state knew Home State had invested a dangerously large amount of money with ESM Government Securities Inc., of Fort Lauderdale, Fla., as early as 1982.

But state officials under former Gov. James A. Rhodes and Gov. Richard F. Celeste took no legal actions to stop Home State. Celeste has said his administration knew of no problems with Home State before 1983.

Wideman said Home State officials promised him in 1983 that they would phase out their ESM dealings. Instead, the Cincinnati thrift doubled its stake in ESM.

Disaster struck after the U.S. Securities and Exchange Commission closed ESM on March 4. The securities firm owed its creditors $300 million.

Home State, which was state-chartered, suffered a $144 million loss from ESM's closing, and a four-day run by depositors in 33 branches removed about $154 million more before the thrift closed March 9.

On March 15, Celeste closed the other state-chartered thrifts when depositor runs started on some of them. Depositors withdrew an estimated $60 million in one day from the thrifts, which were insured by the privately operated Ohio Deposit Guarantee Fund.

Ohio law would have allowed state officials to stop the Home State disaster by ordering directors fired and imposing a cease and desist order after a public hearing, officials said.

The superintendent could fine any thrift officer up to $10,000 for ignoring the orders. The superintendent could also close the thrift and appoint a conservator, which was done.

THE PLAIN DEALER FRIDAY MARCH 29 1985

State S&L chief told Celeste in January all was OK

By MARY ANNE SHARKEY
PD BUREAU

COLUMBUS — Gov. Richard F. Celeste was assured Jan. 7 in a memo from the Ohio Division of Savings and Loan Associations that Ohio's privately insured thrifts were safer than failed state deposit insurance funds in California and Nebraska.

In response to two "60 Minutes" reports on CBS-TV about the Nebraska and California funds, the memo to Celeste said, "The statutory and regulatory shortcomings that existed in these states do not exist in Ohio."

Celeste said last week the memorandum was his first awareness Ohio had a deposit guarantee fund. He called the memorandum "a false prophesy."

Indeed, it was. C. Lawrence Huddleston, former superintendent of Ohio's S&Ls, said in the memorandum Ohio has stringent regulations and annual independent audits to assure the soundness of the system.

Two months later, Home State Savings Bank of Cincinnati closed after ESM Government Securites Inc. in Florida failed. This led to a run on Home State and several other privately insured thrifts in Ohio.

After the Jan. 6 TV segment Huddleston wrote, "I received calls at home from depositors and institution managers. This has never happened in my two-year tenure, and suggests a potentially damaging nervousness may exist. The division received 10 calls between 9 and 9:30 (a.m.) on Jan. 7."

Huddleston explained that California insures thrifts and Nebraska insures industrial banks, "both of which are something of a cross between a credit union and a small loan company, but with fewer restrictions on the types of investments they can make."

The Nebraska fund, Huddleston said, does not have any full-time employees and is run by a volunteer board. "Ohio's Deposit Guarantee Fund has a full-time supervisory staff which monitors the condition and practices of its insured companies."

State officials admit concern was expressed about Home State Savings's extensive investments in ESM Securities. Ohio Commerce Department Director Kenneth Cox said Home State was warned about "having too many eggs in one basket."

Huddleston's January memorandum stated Ohio Deposit Guarantee Fund-backed thrifts, "are more stringently regulated than are industrial banks. The assets to guaranteed savings ratio of the fund is higher than FSLIC (the federally insured system), and the average capital of fund institutions is higher than FSLIC institutions."

The memorandum did not point out federally insured banks and thrifts are backed by the federal government. The Ohio constitution prohibits pledging state money to back private enterprises. The ODGF was created by state law in 1956.

Huddleston described the California and Nebraska funds "as fatally flawed and doomed to failure."

Huddleston accurately declared: "All financial institutions depend on depositor confidence, and could not exist without depositor confidence."

The memorandum said the "60 Minutes" segments revealed depositors lost money in Nebraska and California, "but did not explain why the insurance funds failed.

"It is regrettable that the Ohio Deposit Guarantee Fund is the subject of depositor concerns because of the inadequate structure and supervision of (the Nebraska and California) funds."

Akron Beacon Journal Friday, March 29, 1985

Celeste misled by memo

It said Ohio's S&Ls were safe

Associated Press

CINCINNATI — A Jan. 7 memorandum from a former state savings and loan superintendent assured Gov. Richard F. Celeste that Ohio's privately insured savings and loans were safer than troubled state deposit insurance funds in California and Nebraska.

The memo, made public Thursday, was in response to two *60 Minutes* reports on CBS-TV about the Nebraska and California funds.

"The statutory and regulatory shortcomings that existed in those states do not exist in Ohio," the memo said.

Celeste has said the memo was his first indication that Ohio had a deposit guarantee fund. He called the memo "a false prophesy."

A text of the memo was made public Thursday by Celeste at a conference with newspaper editors in Columbus.

The January memo, by C. Lawrence Huddleston, said, "All financial institutions depend on depositor confidence, and could not exist without depositor confidence."

The erosion of confidence caused the collapse of Home State Savings Bank in Cincinnati, which remains under a conservator, and a run on other savings and loan associations that triggered a statewide closing order by Celeste March 15.

This week, a second savings and loan was placed temporarily under a conservator after reports that some of its officers withdrew their money improperly in the wake of Home State's troubles.

The conservator was called in Wednesday.

Robert B. McAlister, current state superintendent of savings and loans, said the conservatorship of the Oakmont Savings and Loan Co. in Cincinnati ended today.

McAlister allowed Oakmont to reopen Thursday after closing it Wednesday to investigate reports that one or more officers had drawn their own money out in violation of a March 13 state order.

Oakmont president Howard Thiemann said the institution has completed its application for federal insurance and would be open for business today.

"My wife, children and I have our life's savings in Oakmont and we will make no withdrawals," he said in a prepared statement.

Information gathered about the incident has been turned over to the special state-appointed prosecutor looking into Ohio's savings and loan crisis.

Federal and state bank examiners and Thomas Battles, the state's chief deputy superintendent of savings and loans, were back at Oakmont on Thursday to finish reviewing the bank's books. Battles declined to say when the investigation would be completed but said Oakmont would be allowed to stay open and that the savings and loan is able to meet its money demands.

At his daily news briefing on the savings and loan situation, McAlister announced that East Side Building & Loan of Cincinnati has worked out a merger agreement with Mayflower Savings & Loan and thus will meet the requirement for federal insurance, which Mayflower already has. East Side was to reopen for full services today, McAlister said.

He said East Side will be the 27th among the privately insured S&Ls that now have been given conditional approval for federal insurance or have merged with institutions that have federal insurance. These have been allowed to open their doors for unlimited business, he said.

Meanwhile, the owner of Home State, Cincinnati financier Marvin L. Warner, 65, has denied any wrongdoing and claims he is as much a victim as the savings and loan association's depositors.

Warner, who has kept his whereabouts secret since Home State's closing, made a statement Thursday through a public relations firm.

"For 30 years, I have taken pride in Home State Savings, the service it has rendered to its depositors and the community.

"Now, the bank and its depositors, along with my family and myself, have become the victims of what appears to be a massive fraud," he said.

"It is my hope that officials in Ohio will handle this issue in such a way that every depositor and debenture holder will get every penny back," he said.

"The bank's doors have been locked, and my associates and I have not been given the opportunity to help reopen its doors or assist in its sale. I do not know how long this will take, but it is my prayer that this will be soon," Warner said.

Warner is one of 12 Home State officials named in a $432 million civil suit filed by lawyers on Home State conservator Arlo Smith's behalf claiming the savings and loan's problems were caused by their negligence and reckless mismanagment. Warner did not refer to the suit.

STATE OF OHIO
Department of Commerce
Two Nationwide Plaza Columbus, Ohio 43215

MEMORANDUM

January 7, 1985

To: The Honorable Richard F. Celeste
Governor of Ohio
Speaker Vern Riffe
President Paul Gilmore

From: C. Lawrence Huddleston, Superintendent
Division of Savings and Loan Associations

Re: 60 Minutes spots on private insurance of deposit accounts.

Each of the past two weeks, CBS has run investigative spots on "60 Minutes" about the failed state deposit insurance funds in California and Nebraska. The California Fund insures "Thrift and Loans," the Nebraska Fund insures "Industrial Banks." Ohio does not have these types of institutions, both of which are something of a cross between a credit union and a small loan company, but with fewer restrictions on the types of investments they can make.

Last Monday, after the "60 Minutes" piece on California, two institutions reported significant outflows, although neither could be classified as a "run." The Division and many institutions received telephone inquiries.

After the latest piece, aired January 6, I received calls at home from depositors and institution managers. This has never happened in my two-year tenure, and suggests a potentially damaging nervousness may exist. The Division received 10 calls between 9 and 9:30 on January 7.

In the event that you wish to respond to constituent inquiries, we have attached the statements being made by this office, plus a copy of our special edition Newsletter mailed to the institutions after the December 26 "60 Minutes" broadcast.

CLH:gre

Attachments

cc: Warrem W. Tyler

Ohio Savings and Loan Superintendent C. Lawrence Huddleston today issued a statement in response to recent "60 Minutes" investigative reports on the failures of an Industrial Bank in Nebraska and a Thrift and Loan in California, and the "insurance" pools which were to protect depositors.

"Both the Nebraska and California insurance corporations have deficiencies not shared by the Ohio Deposit Guarantee Fund:

- Ohio - Selective underwriting of savings and loans by Fund
  Nebraska/California - must insure Industrial Banks and Thrift and Loans
- Ohio - Fund has full-time professional staff
  Nebraska/California - no staff at all, a mere mail order pool of money.
- Ohio - Fund exercises supervision over member savings institutions
  Nebraska/California - no supervision of any kind over activities of insured banks.
- Ohio - Fund requires monthly report
  Nebraska/California - No reporting required
- Ohio - Fund has more than $40 million in reserves and approximately $130 million available to cover losses
  Nebraska/California - Nebraska fund, according to our information had only $2 million.
- Ohio - Fund insures only savings and loans
  Nebraska/California - Funds insured industrial banks

The Ohio Deposit Guarantee Fund is a mutual deposit guarantee fund authorized by state law in 1956. The Fund and its member institutions are examined at least every 18 months by the Ohio Division of Savings and Loan Associations. The State has required annual independent audits. Ohio's savings and loans are more stringently regulated than are industrial banks. The assets to guaranteed savings ratio of the Fund is higher than FSLIC, and the average capital of Fund institutions is higher than FSLIC institutions.

In short, the Ohio Division of Savings and Loan Associations views the Nebraska and California "insurance funds" as fatally flawed and doomed to failure. The statutory and regulatory shortcomings that existed in those states do not exist in Ohio.

All financial institutions depend on depositor confidence, and could not exist without depositor confidence. "60 Minutes" revealed that citizens lost money in Nebraska and California, but did not explain why the "insurance" funds failed. It is regrettable that the Ohio Deposit Guarantee Fund is the subject of depositor concerns because of the inadequate structure and supervision of the funds.

The Ohio Deposit Guarantee Fund meets the requirements of Ohio law and the regulations of the Division of Savings and Loan Associations.

The Ohio Deposit Guarantee Fund has been in existence since 1956. It is different from the troubled Industrial Bank Fund in Nebraska in several important respects. The Nebraska fund has no full-time employees and is run only by a volunteer board of directors. Ohio's Deposit Guarantee Fund has a full-time supervisory staff which monitors the condition and practices of its insured companies. Ohio's Deposit Guarantee Fund investigates and qualifies those it insures before insurance of accounts is granted whereas the Nebraska fund is obligated to admit all who apply, irrespective of quality.

The Ohio Deposit Guarantee Fund is chartered and examined by the Superintendent of Savings and Loan Associations of the State of Ohio. No depositor has ever lost money in any institution with Guarantee Fund coverage. The Ohio Deposit Guarantee Fund has more than $130 million available to cover depositor losses, and earned more than $10 million dollars on its investments in 1984.

DEPARTMENT OF COMMERCE • DIVISION OF SAVINGS & LOAN ASSOCIATIONS

Rapid Regulatory Review

Richard F. Celeste, Governor | Warren W. Tyler, Director | C. Lawrence Huc, Superintend

Special Edition | An Equal Opportunity Employer | December 1

On the CBS evening news December 26 there was a news story on the failure of the California Thrift Guarantee Fund. The Division has received inquiries from customers of institutions insured by the Ohio Deposit Guarantee Fund, and several Fund-insured companies have also received inquiries about Ohio's Fund as a result of the CBS story.

The Superintendent and the Division have worked diligently in both the General Assembly and the Congress to insure the continued right of states to authorize private insurance of accounts. The Ohio Deposit Guarantee Fund -- and similar funds in North Carolina, Massachusetts and Maryland --differ dramatically from the failed bank fund in Nebraska and the failed Thrift and Loan fund in California. Lest the Ohio Savings and Loan industry be damaged by unsupportable comparisons, we thought it important to share the differences in protection Ohioans enjoy over funds in other states.

The California and Nebraska funds are simply pools of money. We are informed they must insure all who apply, have no full-time employees, exercise no supervision or control over member institutions and have no authority of any kind to take steps to prevent or control problems.

By contrast, the Ohio Deposit Guarantee Fund exercises discretion over who they do and do not insure (having refused insurance to applicants in the past 18 months), has a full-time professional staff, exercise comparatively rigid supervisory controls over selected member institutions, and have virtually unlimited contractural authority over those institutions. In addition, the Fund itself is regulated by the Division of Savings and Loan Associations in roughly the same manner as we would regulate a savings and loan association.

The Ohio Deposit Guarantee Fund has 72 member institutions. The Fund earned in excess of $10 million (net) in the 12 months ended June 30, and now has reserves in excess of $100 million.

In summary, the statutory and regulatory shortcomings that permitted the failure of the California and Nebraska Funds do not exist here in Ohio where the Legislature has provided more authority to the regulatory structure. The savings institution community in Ohio can be helpful to depositors by understanding that, compared to non-supervisory funds in other states, a significantly better operating environment is enjoyed by the Ohio Deposit Guarantee Fund.

Mr. BARNARD. Thank you very much, Governor. Governor, it appears that there are 41 savings and loans that still remain closed in Ohio. What are the prospects for those 41?

Mr. CELESTE. Mr. Chairman, I believe the prospects for those 41 and particularly for the depositors in those 41 institutions, are very good. Most have made application for FSLIC insurance. And we estimate that a good number of them, 10 to 20, are likely to be processed by the same expeditious processing which the Federal Home Loan Bank has been assuring us in the past 2 weeks.

There are a group of them who have indicated the desire to find a strong partner. For them, merger is really important for them to operate safely in the future, and we have retained an investment banker and working with the superintendent of savings and loans to assist in that process and facilitate it.

For the remaining group, which really falls in between the first, relatively easy to process, and the latter, who need a strong partner, we are looking at the possibility of some kind of shared entry into the FSLIC in which the State uses what we now have on the table which is about $60 million. I mentioned $50 million—that has been increased to about $60 million—to see if there is not a way in which we can help them meet the capital requirements, help them maintain the standards which FSLIC expects of them properly so that they can qualify. So it is our hope that we can get all of them open reasonably quickly. It is important to the depositors that they have that access to their funds.

Mr. BARNARD. Governor, there is substantial evidence that the Ohio Thrift Division knew many years ago about the massive unsafe and unsound financial transactions between Home State and ESM, but failed to do anything about it until it was too late.

Do you have any plans to improve your thrift supervisory division so as to minimize the possibility of any future failures?

Mr. CELESTE. Mr. Chairman, as I pointed out in my testimony, I think it is vitally important that we do precisely that. I look forward both to the recommendations of my own director of commerce and of the person I have installed who is fresh and from outside is the superintendent of savings and loans, as the changes we should make, both of a statutory nature and of a procedural nature, possibly including the additional personnel. In addition, I think it is very important to take quite seriously the report of the special prosecutor who will be looking at all of the implications of how this matter was handled, and I intend to do so.

Mr. BARNARD. Have you gotten any indication from your State supervisor—and you mentioned this in your testimony—why it was difficult to determine this connection between Home State and ESM even though you said that it was acknowledged that they knew about it, but it was difficult to disassociate it? Could you elaborate on that to some degree?

Mr. CELESTE. I can tell you what has been reported in the press. I have not had the results of any of the investigative work at this point and in terms of what was reported in the press, on several occasions plans were put in place, and in fact may have been under way to find a way to disinvest in—if that is a proper term—in ESM. The problem was how to manage that in such a fashion that you did not cause a crisis that you sought to avoid. In other words,

whether it was by public exposure of a concern that might cause a loss of depositor confidence through the mechanics available to the superintendent and his staff, or whether it was through substantial losses that might be incurred by a plan that required the sale of their investments in an unfavorable situation.

Mr. BARNARD. The problem is that first of all we are mindful that the supervisory forces of Ohio did make an attempt to separate the two. In other words, that Home State could buy back their repos. But the irony of it was that while a plan was made to decrease the amount, it actually increased.

Mr. CELESTE. You are asking the same questions that I am asking of both my superintendent and of a special prosecutor to examine. I am not sure when a plan was put in place. I am not sure what evidence we have of a commitment on both sides to see to it that that plan was implemented. That is part of what we have to determine.

I come back to this fact. If ESM had not practiced fraud and if the audited statements were accurate, we would not be confronting this issue in this situation today.

Mr. BARNARD. This is what our concern is. Because fraud was evident even back in 1977, and this is where we just——

Mr. CELESTE. There has never been evidence of fraud, Mr. Chairman. Excuse me, Mr. Chairman. There has never been evidence of fraud to my knowledge conveyed to anyone in Ohio's Department of Commerce, Division of Savings and Loan.

Mr. BARNARD. We will be coming back to this time and time again today. Because we can trace the knowledge of ESM through many Federal agencies, as well as State agencies. And credit unions. And it is just hard for us to understand why this information was not considered serious.

Governor, I believe you announced yesterday that an out-of-State purchaser had been found for Home State. Can you provide us with any of the details of this purchase? Or any further information?

Mr. CELESTE. Mr. Chairman I have learned to be very cautious in the last 4 weeks in the matters of banking, as you yourself I am sure are from your own experience in the field. No one is more understandably conservative than are the leaders of the banking community. Let me say this. At the time at which we recognized the dimensions of the crisis at Home State, Home State officers themselves were, and the representatives of the Ohio Deposit Guarantee Fund were in discussions with an Ohio bank about the possibility of a sale. Home State was then also presented to other banks in Ohio and out-of-State banks. In the past week, we have had an indication of substantial interest with the framework for moving forward. For an out-of-State bank to acquire Home State in Ohio and to operate it as a bank would require change in our State law and that matter is now in the hands of more attorneys than I would like to think of this morning to try to work it out.

Mr. BARNARD. But you still have a deposit base at Home State of over $500,000.

Mr. CELESTE. We have a deposit base of about $520 million, in 34 well-located branches and I am happy to say that.

Mr. BARNARD. Are you getting any help in this possible acquisition by the Federal Reserve, the FDIC, or the Home Loan Bank Board?

Mr. CELESTE. Yes. I think we have had very close cooperation by all of the Federal regulatory agencies in the effort to consider a buyer, a purchaser, for Home State.

Mr. BARNARD. Governor, how would you rate the performance of the Federal Reserve and the Federal Home Loan Bank Board in responding to Ohio's thrift crisis?

Mr. CELESTE. Mr. Chairman and members of the committee, I would say that there have been two time periods in which we have dealt. The time period before the declaration of a bank holiday and the time since. I think that the view generally was what we had up until the time I declared the holiday and closed these institutions was a State problem and it required a State remedy. That there was no obvious way in. I think you mentioned some kind of a Federal standby authority. That does not exist today for this kind of a situation. And so I would say as Governor of Ohio I had to seek a remedy on our own terms essentially.

Certainly, there was a recognition of the seriousness of the problem at every stage of the way, and willingness to provide advice and support in trying to understand and get our hands around that problem on the part of the Federal Reserve and the Federal Home Loan Bank.

Since the declaration of the holiday, we have had extraordinary cooperation. In fact, before that I should say we had Federal Home Loan Bank, or Federal Reserve examiners and others in to help. They came in early to take a look at what might be done in order to assure liquidity at the point at which we reopen institutions.

Mr. BARNARD. What has been the response of the financial institutions that were closed in your [bank] holiday? Were they responsive to that affirmatively or did they feel like it was unnecessary?

Mr. CELESTE. Mr. Chairman, two institutions chose to remain open in spite of the superintendent's order on Friday morning that the holiday began. One vice president announced that he knew his customers and he was confident that they could continue to be open. By noon, he had closed his institution and said the Governor was right and he would stay closed as long as the Governor required him to be closed.

I met with about 130 individuals who represented these 71 institutions the Sunday evening in which the holiday was to come to an end, at that point contemplating emergency legislation to require Federal insurance and to keep them closed until we had secured it.

In those conversations which lasted about an hour and a half, there was an opportunity for the executives to speak face to face with me. The vast majority of them expressed appreciation for the fact that they were closed. I said that I would like a written request that I keep them closed. I think understandably they deferred on that matter, but they did offer a rising indication of their opinion. Ninety-five percent of them asked me to keep them closed. But after the meeting about 95 percent of them said that they really would rather be open the next morning.

Now, to me that is perfectly understandable. These are individuals whose business is to be there to do business with their depositors and with their customers. And I think it is very difficult for any of them to go out and say on Main Street, "I do not want to be open this morning." But certainly to the Governor, they indicated

their desire to stay closed, to have a procedure that would expeditiously get them Federal insurance, either FSLIC or FDIC, depending on the circumstances. And that is what we have achieved.

Mr. BARNARD. The fact that so few, comparatively, asked for use of the Fed's discount window, as opposed to the availability of the discount window, does that indicate to you that the management felt confident that they could withstand this crisis?

Mr. CELESTE. I think what happened is that the crisis moved selectively from 1 or 2 institutions to 4 or 5 to perhaps 7 of the 71 that were experiencing severe runs on the day before the institutions were closed. Forty of these institutions were concentrated in a media market in southwestern Ohio where they were being belabored by some who urged them that it was time to panic, take your tents, take your cots, lineup in front of the institutions and there were people sleeping overnight in front of a growing number of institutions as Friday dawned. I think it is fair to say that the circumstance was moving very rapidly, and up to that point in time, no one at the Federal Reserve had really had an opportunity to make a judgment about the quality of assets against which these institutions might borrow at the discount window.

Mr. BARNARD. Governor, let me ask this question. With all of this experience behind you, will you be proposing that your State deposit insurance fund, as well as your State supervisory agency, be strengthened from the standpoint of what it can require of bank management as to management, capital, and other management practices?

Mr. CELESTE. Mr. Chairman, yes, I will. In fact, during the course of this crisis, we issued orders on the kind of trading that could be done, withdrawals, compensation dividends, that might be undertaken by the 71 institutions that were involved. It is my feeling that we have to be more aggressive. I need guidance from those who are investigating exactly what has happened. And the advice of my director of commerce. But I intend to see that strengthened.

Mr. BARNARD. You may check a note from the FDIC and the FSLIC. The Congress gave them the power of cease and desist a number of years ago. We certainly would strengthen their hands.

Mr. CELESTE. Mr. Chairman, we have a cease and desist power in the State law that requires an opportunity for public hearings shortly after the order is imposed and that problem of public hearing is one that raises often the very difficulty that one is trying to avoid.

What I have learned in this is that cash is not the most important ingredient in our banking system. It is confidence. And anything which undermines that confidence is really a greater threat than whether the cash is there at the withdrawal window. And so I am concerned that we reexamine how we strengthen our ability to set standards and enforce them in ways that avoid the danger of undermining confidence.

Mr. BARNARD. I have one final question and that is: What is your best estimate as to when the depositors of Home State will be paid off and whether they will recover all of their deposits?

Mr. CELESTE. My goal has been from the outset to try to make them whole in the Home State situation. I have been reluctant to make a commitment because it may require standing behind our

efforts at sale or something else by the State of Ohio that will be quite likely before the general assembly in the next several days. It is my feeling that we will work urgently in the next few days to have in place a mechanism that gets Home State reopened, gets the depositors protected 100 cents on the dollar, but that is probably a matter of a couple of weeks, not a couple of days, to be done.

Mr. BARNARD. How would you recommend, based upon this very difficult episode, that the Federal supervisory agencies can do a better job of protecting those who deal with Government securities dealers?

Mr. CELESTE. But surely, Mr. Chairman, if there is information available to Federal regulatory agencies about potential problems at any Government securities dealer, I think that information ought to be available to the State regulatory agencies who deal with financial institutions. I am not familiar enough because my background is not banking and finance to give you a technically strong answer, but as a chief executive officer of a State concerned about a panorama of potential problems, certainly good information about potential difficulties in a timely way is the single most important resource that we can look forward to.

Mr. BARNARD. Thank you. Mr. Craig.

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

Governor Celeste, we appreciate your openness and frankness about this critical issue.

Have any depositors in Ohio lost money yet?

Mr. CELESTE. No depositors in Ohio at this point have lost money.

Mr. CRAIG. There has been no money lost?

Mr. CELESTE. That is right. There may be some, officers and shareholders at Home State——

Mr. CRAIG. I used the word "depositor."

Mr. CELESTE. Who are also depositors——

Mr. CRAIG. I see.

Mr. CELESTE [continuing]. Who may have money at risk.

Mr. CRAIG. Would you tell us the relationship the State government has in Ohio with the Ohio Deposit Guarantee Fund?

Mr. CELESTE. Currently, of course, the superintendent has appointed a conservator so that the Ohio Deposit Guarantee Fund is really within the supervision, directly of our division.

Mr. CRAIG. Where was it prior to closing——

Mr. CELESTE. It was a private guarantee fund established under a statute passed in the mid-1950's which was subject to some supervision by the division of savings and loans but which operated independently and by virtue of bylaws adopted by the participating institutions. And operated with an assessment from them. I believe that one of its officers will be here shortly and probably could give you a better evaluation or description of that relationship.

Mr. CRAIG. There was no State regulatory responsibility or direct oversight of this fund?

Mr. CELESTE. I believe that the superintendent could exercise a regulatory authority——

Mr. CRAIG. But I mean there was no quarterly or monthly or——

Mr. CELESTE. To my knowledge, there was no quarterly or monthly supervisory review of the Ohio Deposit Guarantee Fund. You will see in my testimony a memorandum that was prepared for me

and for legislative leaders about the fund by our superintendent of savings and loans back at a time when public questions were raised because of the Nebraska situation.

Mr. CRAIG. What type of people then made up the advisory board or the control board or what the proper title is of the fund itself?

Mr. CELESTE. You will have to ask the—I apologize.

Mr. CRAIG. You are not aware of that?

Mr. CELESTE. I am not aware of that. I assume it was the officers of some of the participating institutions. But for accurate information I would defer to the officer of the Ohio Deposit Guarantee Fund.

If I may, Mr. Chairman and Mr. Craig, point out again that the "Ohio" in the Ohio Deposit Guarantee Fund was in many respects misleading.

Mr. CRAIG. Apparently misunderstood, too.

Mr. CELESTE. Of course, misunderstood.

Mr. CRAIG. The reason I asked those questions is because our investigation showed the rather notorious dealings of ESM were well known nationwide, in part by a lot of people starting in the late 1970's, by bankers and by savings and loans people. Yet, we seem to have had a phenomenal inability to communicate the Federal involvement and the Federal concern versus knowledge on the part of those who are active at State levels with similar responsibilities to our Federal regulatory groups to understand the magnitude of the problem, and therefore, some continued to do business with this group.

Let me then ask the question, Governor, why did you not place the full faith and credit of the State of Ohio behind the Ohio Deposit Guarantee Fund?

Mr. CELESTE. Under our constitution, on the advice of the Ohio attorney general, we could not do that. We could make a specific commitment to a private, nonprofit fund of an appropriation. We did that in the case of the second fund. There was no willingness on the part of the members of the general assembly—leadership of the general assembly—to undertake that with respect to Home State.

Mr. CRAIG. So in other words, this is why you created the new fund?

Mr. CELESTE. That is exactly right. Because it was not subject to the massive hemorrhage caused by the ESM failure and that was the reason for commitment to a new fund.

Mr. CRAIG. How many supervisors of the Ohio Division of Savings and Loan Association has there been since 1984?

Mr. CELESTE. Since 1984, the superintendent of savings and loan indicated to me his intention to resign in about November 1984, but actually stepped down in mid-January. We appointed an acting superintendent at that time, Thomas Batties, who was a member of the legal staff at the division. He was made superintendent during this crisis because under our law he could not sign any binding document unless he were serving as the superintendent. But the superintendent who I appointed, Robert McAllister, was appointed about 2 weeks ago this time.

Mr. CRAIG. So there have been approximately three during that time?

Mr. CELESTE. There really have been two and an acting person who was made superintendent in order that his signatures have the full power of the office.

Mr. CRAIG. What is the responsibility of that office?

Mr. CELESTE. That office has all of the regulatory authority. As a matter of fact, in terms of examination reports, the ability to act on those examination reports, it is in the hands of the superintendent. Even the director of the department in which that division is placed does not have authority under our statute to review examination reports or to act on those examination reports.

Mr. CRAIG. He does not have authority?

Mr. CELESTE. The director of the department does not have authority.

Mr. CRAIG. But this gentleman does?

Mr. CELESTE. This individual does have that responsibility. That is exactly right.

Mr. CRAIG. Do you know why the first person resigned?

Mr. CELESTE. No. I think part of it may have had to do with a quarrel over that authority in which the director chose to exert his leadership as director in terms of all of the divisions in his department. And on that score, I would support the director, let me say, rather than the superintendents.

Mr. CRAIG. In October of 1983, the superintendent of the division of savings and loan instructed Home State to wind down its transaction with ESM. In January 1984, all the directors of Home State agreed to a program of winding down ESM's relationship. I understand all directors agreed except one. Do you have any idea who that dissenter was?

Mr. CELESTE. No, I do not. The information you are providing me is not information that I have directly. My view, and I would go back to this, is that we must examine every aspect of this transaction to determine what is involved and what the lessons are for our regulatory operations.

Mr. CRAIG. And your supervisor or the superintendent of the division of savings and loan did not communicate those transactions to the Office of the Governor?

Mr. CELESTE. Absolutely not. The first time that the Office of the Governor became familiar with the problem at Home State was the evening before the article appeared in the Cincinnati Inquirer. Four weeks ago last evening. That was the first evidence, the first expression of concern with respect to Home State and its operations period.

Mr. CRAIG. Well, then, who does the superintendent report to?

Mr. CELESTE. The superintendent reports to the director of commerce, but the superintendent has the responsibility to deal with those problems and if he does not of his own accord walk forward and say this is a problem, if he believes he is handling the problem, it would be as in any other agency, his responsibility to do that.

Mr. CRAIG. And then the director of commerce you say is the title that he reports to?

Mr. CELESTE. That is right.

Mr. CRAIG. Ultimately then would report to you?

Mr. CELESTE. That is right.

Mr. CRAIG. And he brought this information to you?

Mr. CELESTE. No. No one—but let me go back. No one brought this information.

Mr. CRAIG. You read it in the newspaper?

Mr. CELESTE. We had a call and I could not tell you exactly from whom—the call to my chief of staff on Tuesday evening, the day after the SEC had closed ESM, saying that there was a serious concern about the impact which the ESM situation would have on Home State Savings because of the extent of Home State's investment. My own personal knowledge of this really began the next morning with the publication of the Cincinnati Inquirer story.

Mr. CRAIG. Thank you. Thank you, Governor. Thank you, Mr. Chairman.

Mr. BARNARD. Mr. Spratt.

Mr. SPRATT. Mr. Chairman, I yield to my distinguished colleague and chairman of the Government Operations Committee, Mr. Brooks, if he would like to proceed ahead of me.

Mr. BROOKS. I will let the members go on and question the Governor. We are glad to have you here, Governor. And I will make a brief statement after you leave.

Mr. CELESTE. Thank you very much.

Mr. BROOKS. I know he has a time problem.

Mr. BARNARD. The Governor does have a time problem and I would like to be able to accommodate that time as much as possible. Mr. Spratt.

Mr. SPRATT. Governor Celeste, thank you for appearing here on rather short notice.

Could you tell us, even though it did not happen on your watch, what motivated the State of Ohio to create the Ohio Deposit Guarantee Fund in 1958?

Mr. CELESTE. Mr. Chairman, I cannot tell you. I think it was probably a determination that these—that there should at least be an alternative for the State-chartered institutions to Federal insurance, but I was not a member of the general assembly at that time, although I am older than I look, and feel older than I look. And I was not—frankly, the first time I heard of the Ohio Deposit Guarantee Fund was when a memo unsolicited came to my office from the superintendent, the January memo which is part of my testimony, saying these are the circumstances involving it. And so I am not familiar with its history.

Mr. SPRATT. Do I understand your testimony correctly to mean that the State, the Governor's office, and the State legislative leaders, are now rethinking that decision? It seems to me that you are saying that you are going to require in the future either a big enough parent for a guaranteed fund to assure adequate coverage, or Federal insurance. Are you abandoning the idea of a mutually held State-administered guarantee fund?

Mr. CELESTE. Mr. Chairman, Mr. Spratt, we have abandoned it. We have passed legislation that requires that these previously insured ODGF institutions, privately insured institutions, must apply for Federal insurance, must show evidence that they would qualify for Federal insurance or must—and then the superintendent can exercise discretion—or must have a parent who can provide a guarantee in proper form to satisfy the superintendent that all depositors are protected.

We, for example, have several loan associations who do not have mortgage portfolios that are not your traditional savings and loan, would not qualify for FSLIC insurance, but have very strong parents and there is a firm guarantee of all of the amounts of the deposits in writing with the superintendents, probably as strong a guarantee as you can get anywhere. But that is the only alternative to Federal insurance as far as this Governor is concerned and as far as our general assembly is concerned for the future, in my judgment.

Mr. SPRATT. Fine. I would like to ask more questions, but in light of the time constraints on all of us, I will pass up. Thank you for being here.

Mr. CELESTE. Thank you.

Mr. BARNARD. Mr. Saxton.

Mr. SAXTON. Governor, in previous hearings this committee has had relative to FSLIC and FDIC, one of the considerations that we have taken note of is proposed regulations by those agencies to regulate the amount of direct investment by thrift institutions and banks of various kinds. I am curious to know if you know offhand what percentage of Home State's net worth was invested in ESM?

Mr. CELESTE. I think that substantially about half of its assets were in ESM at that time. Its net worth was—or equity was very small. I do not have that information in front of me directly, but I think there are people here who could answer that for you.

Mr. SAXTON. Our conversations with FSLIC and FDIC have indicated that a safe level might be 5 or 10 percent of its worth.

Mr. CELESTE. I think that is right.

Mr. SAXTON. And your indication is that Home State had perhaps 50 percent of its net worth invested in ESM?

Mr. CELESTE. Yes, Mr. Chairman. Yes. Of its assets. Actually substantially more than its net worth.

Mr. SAXTON. Does the State audit for this type of information?

Mr. CELESTE. Yes, we do. And, Mr. Chairman, Mr. Saxton, in my testimony I have shared with you some articles that spell out the concerns that have been expressed over a number of years by those involved. I think our examiners flagged this problem. I think that the question was how do you cure the problem and whatever reasons for the failure to cure that problem are now the matter of investigation, an investigation I strongly support.

And we point out also it is not simply Home State that brings us together this morning, but the fact of closing 71 other institutions. None of them invested in ESM. To my knowledge, none of them had this same kind of a problem. And one of the points I would like to emphasize is that unfortunately healthy strong institutions and a very strong thrift industry in Ohio suffered because of the failure at Home State as a result of massive fraud at ESM.

Mr. SAXTON. Then if I am hearing you correctly, you are indicating to us that somehow the State had knowledge that this large amount of investment was directly invested in one firm and either could not or did not do anything to remedy the situation?

Mr. CELESTE. That is exactly right. I think the second lesson I point out is that we were able to identify the problem, but not cure the problem. And that is a matter of serious concern in terms of our regulatory capabilities.

Mr. SAXTON. In light of that, would you say—was anyone in your administration aware of Home State's difficulties before the crisis actually occurred?

Mr. CELESTE. Well, I assume that the superintendent of savings and loan was working with them on that. And I think the record will show that and that is part of what will be examined, both by the new superintendent and my director of commerce, new director of commerce, and by a special prosecutor.

Mr. SAXTON. One final question, Mr. Chairman.

In light of what has happened, do you feel that this subcommittee should make recommendations relative to major changes as they affect private insurance companies?

Mr. CELESTE. Yes.

Mr. SAXTON. Thank you.

Mr. BARNARD. Mr. Kolter.

Mr. KOLTER. Thank you, Mr. Chairman.

Governor, do you and your banking people in Ohio feel that possibly the Home State Bank problems could have been avoided if the Federal securities regulators had been more vigorous, perhaps strong?

Mr. CELESTE. Mr. Chairman, Mr. Kolter, if vigor was the problem, I suppose that will be identified. It may have been communicating information clearly if there were concerns as the chairman and others have indicated about the quality of business practices at ESM. There is no question in my mind that if ESM were healthy today, we would not have had the problem at Home State.

Mr. KOLTER. Do you believe the Federal response to the banking crisis in your State was satisfactory?

Mr. CELESTE. I am having a very satisfactory relationship with all of the Federal regulatory authorities during the last 2 weeks, and I think there is a real question about—let me take it back. Before the bank holiday, there is a real question about how any of the Federal regulatory authorities stepped in to help. And I am not sure there is a clear path for that to happen.

Mr. KOLTER. Thank you, Governor.

Mr. CELESTE. Thank you.

Mr. BARNARD. Mr. Swindall.

Mr. SWINDALL. Governor Celeste, if I understand your testimony correctly, you are stating that in spite of the fact that your capital-to-asset ratio was really not that unlike the capital-to-asset ratio we have with federally insured——

Mr. CELESTE. Better, as I understand it.

Mr. SWINDALL. Better. That the real flaw came in the fact that under your State constitution you are prohibited from really putting the full faith and credit of revenue, tax revenue. Is that essentially correct?

Mr. CELESTE. Mr. Chairman, Mr. Swindall, I think there are two aspects of a problem. The first, that even with a well-capitalized fund in relationship to the largest institution, it was not sufficient to meet that. One of the advantages I think of FSLIC and the rest is that though they may not have the same capital-to-assets ratio, there is no single institution that can put the same kind of call on the fund, if it is in trouble.

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The other aspect of it, of course, is that the State of Ohio—the legislature of the State of Ohio cannot pass a resolution like the one the Congress passed in 1982 saying that the full faith and credit of the U.S. Government, in this case, the government of the State of Ohio, is behind this institution. We have a debt limitation. We balance our budget and we are required to make specific appropriations for specific purposes.

Mr. SWINDALL. But there was no prohibition whatsoever from you as Governor putting into effect some action that would have called on workers' compensation fund, pension funds, revenues from lottery profits, or for that matter any "nontax revenue," to back up and give what was in effect full faith and credit and is it not true that former Gov. Jim Rhodes said that is precisely what he would have done in the same situation?

Mr. CELESTE. Mr. Chairman, as all the Members of Congress know, States have only one Governor at a time, and this Governor did talk to the leaders of the general assembly, both parties, who indicated that they were not prepared to recommend the appropriation of any money at that point in time in connection with the situation at Home State. And so a Governor cannot unilaterally commit funds of the State, nor should a Governor be able to, any more than I think that the President could commit funds of this country.

Mr. SWINDALL. But, Governor, what you are saying to us is that some other solution for future problems needs to be solved. But my point is that under extraordinary circumstances, extraordinary leadership is necessary and had extraordinary leadership been taken in this situation we might well have avoided the panic that occurred from literally weeks of floundering, rather than——

Mr. CELESTE. Mr. Chairman, Mr. Swindall, let me make sure the record is correct here. Extraordinary leadership was exercised, both by the Governor and the Ohio General Assembly. Now, there were no weeks involved. There were 3 days involved between the time in which the story broke and the substantial loss at Home State Savings and the time in which the president of Home State closed his doors on a Saturday morning. We placed Home State into a conservatorship on Sunday. That is less than a week.

During that time, I met with legislative leaders to propose potential remedies. We had two problems. Home State directly, and 71 other institutions which were part of a private insurance fund threatened themselves because Home State's hole was so big it could absorb all of that fund and leave them, for all practical purposes, uninsured. In that time, the Ohio General Assembly at the request of the Governor prepared legislation and within 3 days passed legislation appropriating $50 million, a step which I am told by Chairman Volcker and others was unprecedented by any State in an effort to protect those other institutions.

So I think that before you make a judgment about both the nature of leadership and the causes for panic in Ohio, it would be important to recognize the extraordinary nature of the steps that were taken and the fact that today those depositors are protected and those institutions are reopening stronger than ever.

Mr. SWINDALL. In closing, you do, however, concede that in retrospect it might well have been better to have pledged those nontax

revenue related assets of the State in support of full faith and credit, rather than——

Mr. CELESTE. Mr. Chairman, Mr. Swindall, no, I do not concede that at all.

Mr. SWINDALL. Thank you.

Mr. BARNARD. Time has expired. Mr. Bustamante.

Mr. BUSTAMANTE. Mr. Chairman, let me yield some of my time to my colleagues from Ohio. I would like to yield to the gentlelady from the State of Ohio, Mary Rose Oakar.

Mr. BARNARD. Ms. Oakar is recognized.

Ms. OAKAR. I want to thank the chairman for yielding to me. I want to thank the chairman for allowing us to sit with the committee. The chairman and I serve on the full Banking Committee together and I have great respect for the chairman and my colleagues on this committee.

Governor, I just simply want to compliment you on your statement today. I think that your spirit of openness was very, very important and the leadership you provided in those critical days was important.

You cannot say it, but I later will, and you have stressed that you have gotten tremendous cooperation in the last 2 weeks and I know you got very fine cooperation from the Federal Reserve prior to your decision to close the banks, but I intend to pursue politics involved and I just wanted to make that statement for the record and thank you for being here.

Mr. BARNARD. Mr. Kindness. A member of the overall committee.

Mr. KINDNESS. Thank you, Mr. Chairman, and Governor Celeste, we welcome you here today, but I think you would agree, Dick, that we have got to stop meeting like this.

I am concerned about a phase of the matter that is bound to have been overlooked in the process of quickly responding to the difficult situation with which you and the general assembly were faced, and that is some of the very small savings and loans, to the people who are depositors in those institutions. They have just as much concern about being able to get access to their funds for necessary purposes as do depositors of the larger ones that may qualify for FSLIC coverage, but they are too small. And one of them happens to be the Summerville Savings & Loan in our area, in Preble County, and I believe there may be one or two in that small category.

Is it contemplated by the legislation passed by the general assembly that the only out for those small institutions—that one I mentioned happens only to be open 1 day a week. It is a very small operation. Is the only out for them to merge into another savings and loan?

Mr. CELESTE. Mr. Chairman, Mr. Kindness, I do not know that the only out is for them to do that. There may be other vehicles under discussion. I might say that one of the things I learned in my conversations with Chairman Gray and his staff was that size in and of itself is not a factor in determining eligibility for Federal insurance. There are others with respect to their providing full-time service and things of this sort. But our hope would be to work with those small savings and loans. Again, many of them healthy and many of them providing essential services over several genera-

tions to a community to ensure that their depositors are protected and that that service continues to be available to them in some fashion. Merger may be the only or the best recourse in some areas, but I do not want to make that judgment at this point in time.

Mr. KINDNESS. The door is not closed at any rate to those small ones?

Mr. CELESTE. That is right.

Mr. KINDNESS. In the functioning of the State of Ohio under chapter 135 of the Ohio Revised Code, there is a State board of deposit whose minutes made by the State treasurer's office, I believe it is, are prima facie evidence in any court of what the transactions were that were dealt with by the State board of deposits. In December, there was a deposit or a purchase of a certificate of deposit by the State of Ohio of a million dollars in a transaction with Home State. At that time, according to press reports at any rate, there was knowledge that ESM and Home State were so intertwined that there was great difficulty to be contemplated there. Do you have any information that you could share with the committee as to why the taxpayers' moneys were put at risk in Home State in that critical period of time?

Mr. CELESTE. Mr. Chairman, Mr. Kindness, I do not. No. 1, I am not sure that—again, we are talking about press reports today about a situation in December where that knowledge may or may not have been communicated either formally or informally to the people who had to make the decision.

The Governor does not sit on the board of deposit, as you know, so I have not been involved. I would be happy to try to find out for you what the thinking was in the decision on that deposit, how it was recommended and whether there was any discussion or debate before submitting it to the board of deposit or whatever.

Mr. KINDNESS. And if I as a citizen of Ohio were to request a copy of the records relating to that transaction of the State board of deposit, you would have no objection to my obtaining that information?

Mr. CELESTE. More than that, I would help you and I would pay the postage.

Mr. KINDNESS. I thank you. Thank you, Mr. Chairman.

Mr. BARNARD. Governor, I realize that you are on a tight schedule. We have already exceeded it by 15 minutes. And let me say to the committee that as a part of this official record, if you would furnish us any questions that you would like to ask of the Governor or any of these other witnesses, we will see that those questions are answered at your direction and they will be part of the record as a part of your questioning. And so, without objection, we will do that.

And I want to say at this time we are delighted to have with us Congresswoman Kaptur and also a very important member of the Banking Committee and we appreciate your being here this morning.

Governor, with that we want to again say thank you for being here this morning. Your testimony has been very helpful, and we will very possibly be in touch with your office as to this information.

Mr. CELESTE. Thank you very much, Mr. Chairman and members of the committee. I want to express my appreciation for this opportunity to share this experience with you. I want to emphasize again, if I may, that I believe the financial institutions, including those thrift institutions in Ohio that have been affected, are healthy and they are emerging from the closing stronger than ever. But I think all of us can do a better job and look forward to the results of your recommendations.

Mr. BARNARD. We can all take some very definite lessons from Ohio, both from the Federal standpoint as well as the State standpoint, as well as Congress. So we hope that we can do something. Thank you very much.

Mr. CELESTE. Thank you very much.

Mr. BARNARD. Next I would welcome an opening statement from our very, very distinguished chairman of the Government Operations Committee who has permitted us to have this hearing today. I will now recognize the honorable chairman, Mr. Jack Brooks.

Mr. BROOKS. Thank you very much, Mr. Chairman. I want to take this opportunity to express my appreciation to you and the very able members of the Commerce, Consumer, and Monetary Affairs Subcommittee for undertaking this timely and much needed investigation into the conditions surrounding the collapse of ESM Government Securities and the financial difficulties ESM's failure has brought to public investors throughout our country.

In the past 3 years, six Government securities dealers have failed, costing investors hundreds of millions of dollars. These investors include individuals, municipalities, banks, savings and loan associations, public and private pension funds.

My hometown, Beaumont, TX, lost over $20 million when ESM failed. Later this afternoon we will hear from Beaumont mayor, Bill Neild, and other representatives of organizations victimized by ESM's chicanery.

While the circumstances surrounding the failures of ESM, Drysdale Government Securities, Cosmark, Inc., Lombard-Wall, R.T.D. Securities and the Lion Capital Group differ from case to case, we can observe certain common characteristics. They were all heavily engaged in the growing National Government securities market. They made extensive use of a relatively new financial instrument called the repurchase agreement. And they were not under the active supervision of any Federal regulatory agency. Taken together their failures have had a far-reaching negative impact on the public's confidence in the stability of our capital markets.

It seems to me that part of our job here today is to begin the arduous task of discovering answers to the following questions. What were the causes of ESM's failure? We know they are thieves, but how did we allow them to operate that way? Who is responsible? Who could have avoided with proper Federal regulatory supervision these problems? And what can we do to prevent such failures from occurring in the future, other than everybody being as smart as the Chase National Bank was when they lost their $30 million in one of these same scams?

You know, this does not just happen out in the hinterlands, where the unsophisticated people operate. Oh, those big operators right next to Wall Street, deep pocket boys, they dropped about 32

in one of these operations. Now, hopefully the answers to these and other questions should give us some factual base upon which to construct the system of governing the operations of both the Government securities market and those who would participate in this market. At the very least, such a system should offer the American people and the public investor a guarantee that their Federal Government is doing what it ought to do to ensure that our country's financial markets are fair and efficient and free of obvious fraudulent activities and operations.

Thank you, Mr. Chairman.

Mr. BARNARD. Mr. Chairman, you certainly have set the stage for some very interesting inquiries this afternoon and I hope that you will find time to be back with us so you can hear some of the answers.

Mr. BROOKS. I will be back with you.

Mr. BARNARD. Good. We now have with us Congressman Chalmers Wylie of Ohio. Congressman Wylie is the senior minority member of the Banking Committee and a distinguished member of the Ohio delegation.

Chalmers, we are delighted to have you here with us this morning. And we would like to hear your testimony at this time. I understand that you have a lengthy statement, which we will, of course, without objection make part of the official record, and you may summarize as you desire.

STATEMENT OF HON. CHALMERS P. WYLIE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. WYLIE. Thank you very much, Mr. Chairman, and members of the Subcommittee on Commerce, Consumer, and Monetary Affairs.

I thank you for the opportunity to participate in this important hearing on the collapse of the private deposit insurance fund in Ohio which resulted from the failure of ESM Government Securities, Inc., in Florida, and I appreciate the warm welcome which you have extended to me, Mr. Chairman. The chairman is a very valuable member of our Banking Committee, very knowledgeable on banking matters and what he is doing today is providing an excellent service for all of us. And we thank you for that.

I do have a statement which I would ask to be included in the record, and at this point I would summarize the highlights of that statement.

Whenever a crisis such as the one which occurred in Ohio in the aftermath of ESM debacle takes place, we are reminded of just how important public confidence in the safety and soundness of depository institutions is to the health of the Nation's economy. The depositors have to come first in this instance and to date we have heard that no depositor in the 71 S&L's which were closed by the Governor has lost any money as a result of the crisis affecting State-chartered savings and loans in Ohio. And I hope the same is true for the depositors of the Home State Bank also.

Depositors in institutions insured by the Ohio Deposit Guarantee Fund have suffered great inconvenience as a result of being denied the use of their money for a period of time and some are still re-

stricted in the amount they can withdraw even after the institutions have reopened.

We have a responsibility, Mr. Chairman, not only to our constituents in this country but to everyone who relies on the stability of our Nation's economy, to learn whatever lessons can be learned from the Home State-ESM fiasco and to take the steps that are necessary to maintain public confidence in insured depository institutions.

During my years of service on the Banking Committee, I have participated in many inquiries concerning failures of depository institutions. In my experience the causes of these failures tend to fall into three categories: (1) problems associated with deteriorating "spreads" between the cost of funds and the earnings from sound investments; (2) problems associated with the quality of the assets, as has occurred with mortgage loans, business and agricultural loans, and international loans where the value of the property or the earning ability of the borrower were improperly estimated; and (3) where a dominant individual took advantage of weak or nonexistent internal controls or external supervision to impose an imprudent investment policy on the institution.

A preliminary conclusion can be drawn that the Home State-ESM crisis falls into the third category as have most of the largest failures. To recite the list of large failures which threatened public confidence in depository institutions is also to list those cases in which a dominant individual was able to circumvent internal controls or agency regulations designed to safeguard the assets of the institution. To mention a few, Franklin National, the Texas and Georgia banking scandals, U.S. National Bank of San Diego, Penn Square, Continental, Financial Corp. of America and Empire all fall into this category, Mr. Chairman, and I ultimately suspect that Home State will join them.

The Federal Home Loan Bank Board and the Federal Reserve did yeoman service in making their personnel, right up to the chairmen, available to deal with the situation as it was breaking. And may I say that I was in on this from almost the beginning. And I take this opportunity again to express my gratitude to Chairman Gray and Chairman Volcker and to reaffirm my confidence in their dedication to preserving the safety and soundness of the Nation's financial system.

You asked the question in your hearing today whether the ESM collapse that triggered Home State's insolvency might have been avoided if Federal securities regulators had been more diligent or whether the SEC should have additional supervisory powers to protect investors.

Now, my staff has examined the most recent form 10–Q filed by Home State Savings as a publicly traded company with the Securities and Exchange Commission. It is easy to read this document, Mr. Chairman, and learn that out of $1.4 billion in assets, approximately half were invested in reverse repurchase agreements with a single securities firm and that Home State seemed to have more of the characteristics of a mutual fund than of an institution in the business of making home mortgage loans. It would be interesting to find out how they filed their tax return.

I suspect that many deficiencies will be found in the disclosures made by Home State. Yet enough information was provided that one might expect a regulator or a fiduciary to ask further questions. In fact, we have some information provided by the National Credit Union Administration that indicates that some people did take advantage of the information they were able to obtain about Home State and avoided involvement in the transactions that caused so much grief to so many institutions. Moreover, according to last Sunday's Cleveland Plain Dealer, former Ohio State commerce director, Kenneth Cox; former commerce director, J. Gordon Peltier; and former superintendent of savings and loans, Clark Wideman quote "all said the State knew Home State had invested in a dangerously large amount of money with ESM Government Securities, Inc., of Fort Lauderdale, FL, as early as 1982."

It is certainly appropriate for this subcommittee to consider whether additional measures are needed, but warning signals were not heeded which could have prevented the failure. With the help of the Federal regulators, the damage was contained.

You asked another question. Given the state of the Nation's thrift industry, is there a need to strengthen, modify or replace the current system of State/private deposit insurance? And I think it is fair to say that confidence was restored when FSLIC insurance and FDIC insurance were made available to these institutions in Ohio. But the fact of the matter is, as you know, Chairman Gray, who is here and will testify later, has been saddled with some unprofitable portfolios on residential mortgages vis-a-vis the FSLIC fund. The chairman of the full Banking Committee, Mr. St Germain, and I introduced legislation providing for risk-related insurance to try to assist him in that regard.

Congress I think does need to act and act promptly with regard to the situation as we have found it in Ohio. I think, Mr. Chairman, what I would like to do is to close at that point and suggest that if there are any questions that I would be willing to try to answer them.

Thank you very much.

[Mr. Wylie's prepared statement follows:]

Statement of
Rep. CHALMERS P. WYLIE, Ohio
April 3, 1985
Subcommittee on Commerce, Consumer
and Monetary Affairs
Committee on Government Operations
Hearings on the collapse of ESM Government Securities, Inc., and its
impact on privately insured Ohio thrifts

Mr. Chairman:

Thank you for the opportunity to participate in this important hearing on the collapse of the private deposit insurance fund in Ohio which resulted from the failure of ESM Government Securities, Inc. in Florida. My reason for accepting your invitation to appear today, Mr. Chairman, is stated very succinctly in your own remarks as part of the announcement of these hearings: "The public's confidence in the nation's financial markets could be eroded by a repetition of the Ohio-ESM episode. That must not be allowed to happen."

Whenever a crisis such as the one which occurred in Ohio in the aftermath of the ESM debacle takes place, we are reminded of just how important public confidence in the safety and soundness of depository institutions is to the health of the nation's economy. I am pleased to be able to report that to date no depositors have lost any money as a result of the crisis affecting state-chartered savings and loans. Hopefully, all depositors will be made whole in the very near future. Governor Celeste, state and federal officials, including Members of the Ohio congressional delegation, have worked long hours in order to speed the arrangements for the reopening of as many of the institutions as possible. At this point I must commend Federal Reserve Board Chairman Paul Volcker, Cleveland

Federal Reserve Bank President Karen Horn, Federal Home Loan Bank Board Chairman Ed Gray, for being available and for the long hours they and their able staff put in to contain the Ohio situation. Meanwhile, depositors in institutions insured by the Ohio Deposit Guarantee Fund have suffered great inconvenience as a result of being denied the use of their money for a period of time and restricted in the amount they can withdraw even after the institutions reopen.

As the Chairman knows, because we serve together on the Subcommittee on Financial Institutions of the Banking Committee, the Subcommittee held a hearing last week on regulations proposed by the Federal Home Loan Bank Board concerning direct investments by institutions insured by the FSLIC. Near the conclusion of the hearing Chairman St Germain made a statement that helped to put the Ohio situation in perspective. He noted that fluctuations in the value of the dollar in international money markets have been ascribed to concern over the condition of thrift institutions in Ohio and commercial banks in Texas. Having just returned from Europe I can attest to the fact that people in financial circles there are very much aware of Ohio and Texas. We therefore have a responsibility not only to our constituents in this country but to everyone who relies on the stability of our nation's economy to learn whatever lessons can be learned from the Home State-ESM fiasco and to take the steps that are necessary to maintain public confidence in insured depository institutions.

With that introduction, I will proceed to address the specific questions you set forth in your announcement.

Circumstances surrounding the Ohio thrift situation, adequacy of federal agency responses. During my years of service on the Banking Committee, I have participated in many inquiries concerning failures of depository institutions. In my experience the causes of these failures tend to fall into three categories: 1) problems associated with deteriorating "spreads" between the cost of funds and the earnings from sound investments; 2) problems associated with the quality of the assets, as has occurred with mortgage loans, business and agricultural loans, and international loans, where the value of the property or the earning ability of the borrower were improperly estimated; and 3) where a dominant individual took advantage of weak or nonexistent internal controls or external supervision to impose an imprudent investment policy on the institution.

Every day brings new information on the Ohio situation, and it is certainly too soon to pass ultimate judgment. It certainly is not my purpose to pass judgment on other such private insurance funds in other states. In fact, one of the purposes of this hearing is to collect and evaluate the available information. Still, a preliminary conclusion can be drawn that the Home State-ESM crisis falls into the third category, as have most of the largest failures. To recite the list of large failures which threatened public confidence in depository institutions is also to list those cases in which a dominant individual was able to circumvent internal controls or agency regulations designed to safeguard the assets

of the institution. Franklin National, the Texas and Georgia banking scandals, United States National Bank of San Diego, Penn Square, Continental, Financial Corporation of America and Empire all fall into this category, and ultimately, I suspect Home State will join them.

As for the adequacy of the responses to the crisis by the Federal Home Loan Bank Board and the Federal Reserve, I have already said that these agencies did yeoman work in making their personnel, right up to the chairmen, available to deal with the situation as it was breaking. I take every opportunity to express my gratitude to Chairmen Gray and Volcker and to reaffirm my confidence in their dedication to preserving the safety and soundness of the nation's financial system.

Whether the ESM collapse that triggered Home State's insolvency might have been avoided if federal securities regulators had been more diligent; or whether the SEC should have additional supervisory powers to protect investors. My staff has examined the most recent Form 10-Q filed by Home State Savings Bank as a publicly traded company with the Securities and Exchange Commission. Any number of people could look at this filing and get differing insights as to the nature of Home State, but it is remarkable how much of what eventually turned out to be questionable operations of Home State was set forth right in this publicly available filing. It is easy to read this document and learn that out of $1.4 billion in assets, approximately half were invested in reverse repurchase agreements with a single securities firm and that Home State seemed to have more of the characteristics of a mutual fund than of an institution in the business of making home mortgage loans. The scheme of the

securities regulations has always been based on disclosure and on the assumption that people will have the means to protect themselves if there is adequate disclosure. I suspect that many deficiencies will be found in the disclosures made by Home State.

Yet, enough information was provided that one might expect a regulator or a fiduciary to ask further questions. In fact, we have some information provided by the National Credit Union Administration that indicates that some people did take advantage of the information they were able to obtain about Home State and avoided involvement in the transactions that caused so much grief to so many institutions. Moreover, according to last Sunday's Cleveland Plain Dealer, former Ohio State Commerce Director Kenneth Cox, former Commerce Director J. Gordon Peltier, and former Superintendent of Savings and Loans Clark Wideman "all said the state knew Home State had invested a dangerously large amount of money with ESM Government Securities, Inc., of Fort Lauderdale, Florida, as early as 1982."

It is certainly appropriate for this Subcommittee to consider whether additional measures are needed, but it has been my experience on the Banking Committee that many failures take place not because there is inadequate regulation or disclosure but because regulators and to a lesser extent investors failed to take advantage of the information systems that are in place. I do not mean to say that these systems will prevent failures, but when properly implemented, they can contain the damage caused by failures, so that they do not threaten the financial system as a whole. Warning signals were not heeded which could have prevented the

failure. With the help of the federal regulators, the damage was contained. We look to the regulators to perform the information function. It is our job to oversee their performance on a continuing basis.

Given the state of the nation's thrift industry, whether there is a need to strengthen, modify or replace the current system of state/private deposit insurance. Chairman Gray has testified with remarkable candor before both of our Subcommittees concerning the situation that confronts the thrift industry and its regulator. There is a virtual absence of tangible net worth. The size of the FSLIC as a percentage of deposits is near its all-time low. Some institutions are still saddled with unprofitable portfolios of residential mortgages while others are engaging in new activities and growing at an unmanageable rate. The Bank Board has imposed a quarterly assessment of 1/32% of assets. It has provided additional support staff to the regional Home Loan Banks and has asked Congress for money for more supervisory staff. The Bank Board has adopted a regulation on net worth and the regulation on direct investment that was the subject of the hearing last week before the Financial Institutions Subcommittee. Chairman Gray has submitted a proposal for risk-based insurance premiums, which Chairman St Germain and I have introduced by request as H.R. 1680, The Insured Institutions Improvements Act of 1985. FDIC Chairman Bill Isaac also has devised his own proposal which Chairman St Germain and I introduced at his request as H.R. 1833, The Federal Deposit Insurance Improvements Act of 1985. In short the regulators are doing all they can in my opinion. Now it's time for Congress to act.

The hearing last week, which gave us an opportunity to hear from Chairman Gray, from the S&L Commissioner of Texas, and from representatives of the major trade groups for the thrift industry dramatized the need for Congress to address the issue of deposit insurance reform. We can and should begin by promptly considering the agencies proposals. It is desirable to allow institutions, whether they have state or federal charters, to have enough flexibility to compete in the marketplace. In fact, this is necessary if they are to remain healthy in the long run. It is also desirable for state regulators to have an opportunity to participate in the process of formulating the regulations of the federal agency that insures the deposits of most state-chartered institutions. The crucial issues, however, are who is going to provide the capital to support the portfolios that insured institutions hold and who is going to underwrite insurance to protect the system from the inevitable failures that occur. More than merely desirable, it is necessary, it is imperative, that these issues be resolved, and we never know how much time we have to do it.

What I am suggesting is that we the Congress must ensure that the financial system underlying our Nation's economy is strong and healthy. Public confidence in depository institutions is a key to that strength. Another key is an efficient and smoothly functioning government securities market which is essential both to the Federal Reserve's implementation of monetary policy and to the U.S. Treasury's financing of the Federal Government. Congress needs to act this year to update our banking and deposit insurance laws, which obviously have not kept pace with the marketplace. The deposit insurance reforms proposals from the FDIC and the FHLBB need to be examined carefully by Congress, just as other

modernizing legislation introduced by Chairman Barnard, myself, and many others of our distinguished colleagues ought to be considered fully in this session of the 99th Congress.

I would like to address one other issue before concluding. As most of the financial community is aware, I have sponsored a bill, H.R. 15, which would permit bank and thrift holding companies to underwrite mortgage-backed securities and streamline the procedures for bank holding companies to receive approval to conduct nonbanking activities, within a regulatory framework designed to provide equitable regulation for all financial institutions. I am sometimes asked how I can propose expansion of the range of activities that can be conducted by depository institutions holding companies in light of the ESM incident and the recent disclosure of irregularities in the handling of mortgage-backed securities. The argument is often made that these institutions have enough trouble managing their existing activities that they do not need new powers, and to grant new powers would only be asking for more trouble and more scandals.

The point that I want to make today is that no matter what activities financial institutions engage in, problems will inevitably occur from time to time. There will always be people who will try to take advantage of any system, and there will always be people who will make costly mistakes. The rational response is not to shut down every activity in which problems occur. We could shut down the entire economy that way. Rather, the urgent challenge is to require that the institutions be sufficiently capitalized and that they have adequate systems of internal control. Then, there should be effective supervision to discover problems and deal with them in time to safeguard the financial system as a whole.

I look forward to working with Members of this Subcommittee, with my colleagues on the Banking Committee, with state and federal regulators, with industry representatives, and with anyone else who can help address the pressing issues facing the banking system today.

Thank you again, Mr. Chairman, for the opportunity to testify today.

Mr. BARNARD. Thank you very much, Mr. Wylie. You have certainly enumerated many of the things which are certainly on the minds of this committee and which hopefully, with your leadership, will be on the minds of the Banking Committee. I think we definitely need a much more indepth study of the insurance funds and how we can help them, such as the bill that you introduced on variable-rate premiums, and other legislation.

So we feel like the work of this committee should be very, very helpful to the Banking Committee and we hope that the Banking Committee will certainly utilize our report when it is developed.

And we thank you very much for being here this morning.

Mr. WYLIE. You are welcome.

Mr. CRAIG. Mr. Chairman, Congressman Wylie, one of the questions that I have asked insurance fund regulators that is of concern to me is the inability of the Ohio Deposit Guarantee Fund to respond accordingly. We hear the argument that simply the money was not there to back it up. And yet I am told that in the situation where there was $130 million in the Ohio Deposit Guarantee Fund, that they could have covered the run on the Home State and then required other members of the fund to borrow from the Federal Reserve System to meet any shortfall caused by deposit demand for cash, and in fact, if that had occurred and the fund had responded as funds are designed to respond, that there would not have had to have been a banking holiday, there would have been no great concern or public outcry or run on the banks, and in large part, even Home State, although it would have been taken over by the fund, could have remained open.

Your experience on the Banking Committee—what is your reaction to that general comment?

Mr. WYLIE. I do not think that the Ohio Deposit Guarantee Fund could have in fact covered all the possible losses from Home State. I think that a run, a complete run, by Home State would have depleted the fund. As a matter of fact, the fund had $130 million in it 1 day and about 3 days later, after a run, it had about $90 million.

Mr. CRAIG. I am talking about prerun. With the knowledge that everyone had as to the situation at Home State, if the fund had acted properly preclosure, could that not have been avoided?

Mr. WYLIE. That is hindsight and I do not know. I am not in a position to suggest that something like that could have been done. After it was discovered that ESM Securities in Florida was going belly up, and that most of the assets of Home State were invested in ESM. I think at that point that the fund was clearly inadequate. Now, how you go about shoring up the fund at that point is a question that I am not in a position to answer.

Mr. CRAIG. But it is a procedural question. I was curious to see your reaction to it.

Mr. WYLIE. But I think after it was discovered that Home State had closed that the fund might not be adequate to meet the cashflow demands of the persons who were insured. And this was a private fund. It was not State administered. It was created by a special statute, passed in Ohio in 1955. After that was discovered, the Chairman of the Federal Reserve Board, and I talked to him twice on March 13, was very forthcoming in opening the discount window as an emergency situation to all of these 71 State-chartered S&L's.

Mr. CRAIG. Thank you. Thank you, Mr. Chairman.

Mr. BARNARD. Mr. Spratt.

Mr. SPRATT. I have no questions.

Mr. BARNARD. Mr. Kolter.

Mr. KOLTER. Thank you, Mr. Chairman.

Congressman Wylie, following the interrogation of the Governor, do you feel now that the investors have once again their own confidence in the system, in the banking system of Ohio—do you feel the investors are now sure that their money is safe?

Mr. WYLIE. The investors are now sure that their money is safe. I feel that since they have been given the opportunity to apply for FSLIC insurance. And may I say that the Federal Home Loan Bank Board put a lot of extra examiners on the job. They worked overtime to try to examine the books of some of the companies. Now, I think that there are now 30 S&L's the Governor said which have qualified for either FSLIC insurance or FDIC insurance.

The fact of the matter is that in those institutions it is my information that more money has come in in deposits than has gone out in withdrawals. So this, as far as we in Ohio are concerned, was not as serious as far as the other FSLIC-insured S&L's were concerned. And the assets in these companies represent less than 10 percent of the assets of all of the savings and loans in Ohio.

Mr. KOLTER. Thank you.

Mr. BARNARD. Mr. Saxton.

Mr. SAXTON. Congressman Wylie, as a member of the Banking Committee, let me ask you a question. I have here a copy of the Ohio Deposit Guarantee Fund constitution, and attached to it are the rules and regulations by which it operates. There is a section that deals with investigative authority of the fund. It says "the fund supervisory staff, at the discretion of the executive vice president of the fund, may at any time enter a member institution for the purpose of conducting an investigation or an audit. The members shall be required to furnish upon request all the company's books, records, securities, moneys, and other property needed to complete investigation of an audit."

I guess the question is that it appears to me that the mechanism was set through which the proper types of investigations could have been carried out. The signals were all there to indicate that such an investigation may have been necessary and yet no such investigation seemed to come forward. And I guess my question is from our perspective at the national level, how do we know that private funds carry out those functions? And is there something that we need to do from a legislative point of view to ensure that that happens?

Mr. WYLIE. That is a very good question and it may go back to the question that Mr. Craig asked and maybe I did not respond as well to his as I should have.

The problem with the Ohio statute and the Ohio Deposit Guarantee Fund, and you have put your finger on it, is that the agreement as to responsibility is not clear. And if you read those rules and regulations you will really not find out what the Ohio Deposit Guarantee Fund is supposed to do for its members in an emergency situation. And I guess that is the point you were trying to make, Larry.

But the first response, of course, should have come from the Ohio Deposit Guarantee Funds since they were the insurer. It did not. And it did not come immediately, why I do not know. The Federal Government attempted to intervene through the Federal Reserve 2 years ago to try to find out what the responsibility of the Ohio Deposit Guarantee Fund was to its members, and whether the exposure of the State-chartered S&L's, the 72 State-chartered S&L's, had any impact or effect on the safety and soundness of the banking system. And in the *Dimension* case, the members of the Ohio Deposit Guarantee Fund filed a law suit in which they got an injunction against the Federal Reserve from becoming involved in any way, and the injunction said that the Federal Government had no nexus, that it could not intervene, and that it could not examine as to safety and soundness. As one of the persons said, I think it was a Mr. Griffith from Molitar, at the meeting with the Federal Reserve Board Chairman, "We are sorry we won that case now. It would have been better if we had had somebody sort of examining it."

But the Federal Government at this point, or at that point, had no responsibility, could not have had any responsibility, and it was enjoined from doing anything.

I think that the Ohio Deposit Guarantee Fund's days are numbered. Or they have ended. And I think maybe we ought to look at some of the other so-called State funds. Not State funds, private funds, which insure these State-chartered S&L's.

Mr. BARNARD. Mr. Bustamante.

Mr. BUSTAMANTE. Mr. Chairman, thank you.

Congressman Wylie, my concern was with the initial reaction of the Federal Reserve to the Ohio bank run. Their initial reaction was that it was a State problem. However, this changed very quickly with the fluctuation of the dollar.

Can you tell me why this happened? What caused this reaction or attitude change?

Mr. WYLIE. I really do not think it had anything to do with the fluctuation of the dollar, but it is amazing how much of an impact the closing of 72 small State-chartered—well, some of them are rather large—but State-chartered S&L's in Ohio had on the impact of the dollar in Europe. And I had an opportunity to discuss this situation with the editor of the Financial Times and he said there was not any question but that it had an impact because the headlines in Europe were "banks fail in the United States." It did not identify that they were State-chartered savings and loans in Ohio, and so there was a run on the dollar and maybe it is coming down to a little more realistic level and will help the farmers in the process. Maybe there is some good coming from that.

But you have to understand that the Federal Home Loan Bank Board operates in a fiduciary capacity. It is their obligation to protect the FSLIC fund, and in that regard, they have to guarantee against loss. Now, if there is a new application, and Chairman Gray can answer this better than I can, but if there is a new application for a new charter, they have to have 5½ percent net worth. Most of these State-chartered S&L's did not have 5½ percent net worth. It was suggested that they all be brought in and I was at the meeting—that they all be brought in en masse. I do not think

that the Federal Home Loan Bank Board could do that legally. I think they had to make some examination up front.

Now, after it was determined that some of the State-chartered S&L's had a good asset ratio and had net worth above 5 percent—I think they modified it a little—then they were brought in. But they had an obligation, as I see it, to the other members of the FSLIC fund and they had established rules which provided for a 10-day period of comment. If someone wanted to comment about a new application as to whether that would guarantee against loss, they could do that. Now, they have waived in effect the 10-day rule, but at one point during the negotiations the Federal Home Loan Bank Board was willing to bring in all of the 71 State-chartered savings and loans if they could get a guarantee from the State of Ohio that the full faith and credit of the State of Ohio would be pledged against that. And then it was determined that the State of Ohio could not legally do that, or could not constitutionally do that, so they had to back off of that.

But I would say that I think the Federal Home Loan Bank Board was very cooperative here and I think the Chairman of the Federal Home Loan Bank Board, Mr. Gray, ought to be complimented for his part in it.

Thank you, Mr. Chairman.

Mr. BARNARD. Mr. Swindall?

Mr. SWINDALL. Yes. Following up with the constitutional constraints, that constitution in no way prohibits pledging of nontax revenues, does it? To your knowledge?

Mr. WYLIE. The constitutional provision would not allow the pledging of tax revenues. Is that your question?

Mr. SWINDALL. Right.

Mr. WYLIE. I do not think it would, no. What the constitutional provision provides is that you cannot pledge the full faith and credit of the State of Ohio against the contingent liability. If the money is there in a separate fund I would assume that perhaps the general assembly could act.

Mr. SWINDALL. That is my point. You are a former State legislator.

Mr. WYLIE. Yes, sir.

Mr. SWINDALL. And I would just like to know your opinion as to whether or not the Government——

Mr. BARNARD. I hate to interrupt but we have got a lot of witnesses today and I want him to answer the question. But he is not an official of the State.

Mr. WYLIE. I am glad you added that caveat. That is kind of a 20–20 hindsight call.

Mr. SWINDALL. Fine. I yield. He knows the question.

Mr. WYLIE. He made the point, yes.

Mr. SWINDALL. Thank you.

Mr. BARNARD. I am going to defer any further questions of you at this particular time because we do want to hear from other members of the Ohio delegation and we appreciate your being here and we understand that you have got other things to do.

Mr. WYLIE. Thank you very much for inviting me. I appreciate it.

Mr. BARNARD. We have invited several members of the Ohio delegation to be here this morning, and we certainly welcome them.

And we want them to have an opportunity to have something to say. I would like to encourage all of them though, if they would, to submit to us something for the record and then we would like for them to summarize because we have a little scarcity of time.

We are delighted now to have the distinguished Congressman from Cincinnati, Mr. Thomas Luken. We would like to hear from you at this time.

STATEMENT OF HON. THOMAS LUKEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. LUKEN. Thank you, Chairman Barnard.

I want to sincerely congratulate you in conducting this, calling for this examination, and in the way that the hearing has been conducted. There have been certain issues that have already been raised, but I believe that I have some particular information about the events that have come under question.

What I would like to state first, as Congressman Wylie did initially, that the main consideration is depositor confidence. That is the reason, the lack of depositor confidence, the threatened loss to depositors, that our international situation, our currency, has been threatened—has actually fallen. And this has brought involvement from the President, when he was asked at a news conference, and by the highest Federal officials.

Now, there is a time for questions, time and a place for questions and finger pointing, and I think this is one of those times.

But I would like to take us back to March 13. Those events have been discussed publicly and have been discussed here. And that was when several of us appeared before Chairman Gray, the Federal Home Loan Bank Board, but I will go back the day before. And that was when we appeared before the Federal Reserve and Chairman Volcker. Chairman Volcker at that time told the representatives of the thrifts from Cincinnati that what they were looking for was insurance. That the only thing the Fed could give them was a discount window. And the discount window at that point was like throwing an anchor to a drowning man. Because that would not improve their financial picture, and that is what they would need ultimately to get into FSLIC.

So that was not really any kind of a solution. The Fed had no solution and because of the divisions between the Fed responsibility for FDIC and Federal Home Loan Bank responsibility for FSLIC there was that division. And incidentally, Chairman Volcker has publicly recommended a merger of the Federal Home Loan Bank Board and the Fed. Apparently I only read his statement, but I read his statement in the press to the effect that he recommends consideration of a merger——

Mr. BARNARD. He was talking about the insurance funds, I believe.

Mr. LUKEN. All right. That is what I meant. That is the context——

Mr. BARNARD. The FDIC and FSLIC.

Mr. LUKEN. That is what I was referring to in the context, and that is what I understood, as it has a bearing on this particular situation.

So in any event, we did finally meet with Chairman Gray on the following day, which was March 13, and at that time the reaction of Chairman Gray—and I point out, there is a time and I think at this time what should have been the reaction of the Federal authorities was we have a threatened loss of depositor confidence. We had Home State that was closed. And the runs were occurring and this was described to him, it was described on the front pages of the paper. Pictures in the paper.

The reaction of Chairman Gray was insensitive. This is not a partisan statement. Mr. Gradison and Mr. Wylie so told the Wall Street Journal. I can quote that, but here is the article. Mr. Wylie admitted that there was a stall at that time on the part of—a stall is the way he describes—it on the part of Chairman Gray.

We were advised at that time that there was a 10-day waiting period, a 10-day period of notice that could not be waived. We were advised that the Federal Home Loan Bank Board did not have any extra examiners to send in to Cincinnati or to send in to Ohio. We were advised that it was a State problem, that the savings and loans of Ohio had plenty of opportunity and had resisted the opportunity to come into FSLIC, and that the depositors—when we pleaded based upon the depositors potential loss—we were told by Chairman Gray that the depositors knew that they were investing in an institution which did not have Federal insurance and therefore they had made their own bed and they could lie in it also.

I think we can learn from history here, and that is the reason I bring it up. We did have the division. We went to two different agencies and the buck was passed. And we went to the one agency who could have done something and I want to emphasize in my opinion, and I am not a banking expert. I am not the kind of an expert that some of you may be, but in my opinion if the Federal Government had responded as it did in the Continental case, it could have folded these in on March 13 and that is what we pleaded for, and then examined them and then weeded them out. Nobody has said that there is any of these 71 institutions that were that much worse. As a matter of fact, on the average they are better than the FSLIC. And when we considered what was at risk, depositor confidence throughout this country, I think that the proper reaction—I still think, I said it then and I still think that the proper reaction which would have avoided any closings was to fold them into FSLIC. They knew basically. When we talked to Mr. Raiden, Mr. Gray's counsel, he knew basically what the financial picture was in these savings and loans, just as he does now.

I have told you what the reaction was. I think that in the future we should consider bringing together these two institutions. I think the FDIC and FSLIC—I think as far as the finger pointing is concerned, we had a hearing yesterday in our Energy and Commerce Committee. I am not going to go into the ESM questions. Let me just repeat one of the points though that I made at that time, which has been brought up here, and that is that Mr. Warner was identified by the conservator from Ohio, the conservator of Home State, and by Mr. Tew who is going to testify here today, as the controller of the events at Home State and at ESM. And I think that is very instructive to know that.

So if we could back into that, I think the conservator has already filed suit against Mr. Warner. I think that the receiver here, Mr. Tew, should file suit against Mr. Warner. I think he is clearly the responsible party according to these reports, according to the investigation, according to the investigation of those who looked into it. He is one of the responsible parties.

We could go into that, but I think my time is about expired. And I wanted to particularly shed what light I could upon what happened with reference to extending this coverage so that in the future in my opinion, my recommendation would be, that we look first, as we did in Continental, to depositor confidence and do whatever is necessary to absolutely avoid—do what is necessary. That is my opinion.

Mr. BARNARD. Congressman, you have outlined some of the same concerns that everybody on this committee has, and that is why we are all so anxious to have a very thorough hearing into many of these questions that you have brought out. And hopefully, when this hearing is through and all of our investigations are made, we will be able to answer all of the questions that you have brought up this morning which are very substantive, and I think very appropriate, considering the sequence of events that we have been through since March. So we appreciate your sharing your observations with this committee and I assure you that we are going to look into every aspect of your testimony.

Thank you very much.

Mr. LUKEN. Thank you, Mr. Chairman.

Mr. BARNARD. Again, I want to say I am delighted to have Mrs. Oakar with us this morning, Mary Rose Oakar from Ohio, and also a very prominent member of the Banking Committee and I would like to hear from you at this time.

STATEMENT OF HON. MARY ROSE OAKAR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Ms. OAKAR. Thank you, Mr. Chairman, and distinguished members of the committee.

I want to first of all say that I am grateful for this hearing. I think it is important. You are a very important subcommittee. You have the role, as you know, of being the chief investigative committee for Congress related to banking issues. And I want you to know, Mr. Chairman, and others, that I am working on legislation related to the ESM crisis so that hopefully there will be more scrutiny in the manner in which S&L's and banks invest with some of these securities companies. I think it is very, very important that we really look into that situation.

I also want to say for the record that I believe very strongly as many of us do in Ohio and elsewhere, that anyone who was engaged in any illegal activity whatsoever be prosecuted. And I know that an investigation in my State is going on and I hope it comes—to fruition.

Mr. Chairman, you know and Congresswoman Kaptur, who is also a member of the Banking Committee, and others know that our Banking Committee has seen unbelievable failures in the last few years. I have been on the committee 8 years and in the last 3

or 4 years we have seen enormous failures such as Penn Square. We have seen Continental of Illinois being propped up with billions of dollars and we have seen in the S&L area the federally chartered Financial Corp. of America in California. Their subsidiary American Savings & Loan Co., was given unprecedented borrowing power exceeding normal capitalization and we saw the potential failure even of our major banks in their foreign investments. So this whole subject of what happens in a crisis transcends whether S&L's are insured federally or nonfederally.

I think we really have an obligation to see what is going on in this area in our country.

It should be noted for the record that most of the S&L's in Ohio were federally insured. My own county, Cuyahoga County for example, and in Cleveland, OH—had one S&L that was nonfederally insured. It was not a blanket problem in terms of the Federal insurance versus non-Federal insurance. Seventy-one out of about 205 were nonfederally insured. So that most of our institutions are federally insured, and I think that is important to note.

Mr. Chairman, I do want to raise this issue because you are the chief investigative committee and I think it is very important to clear the air on this issue and it in no way takes away from the scrutiny of what ought to be going on in the Ohio situation. I believe very strongly that Congress created the Federal Reserve System and the Federal Home Loan Bank Board to function as Federal regulators and to objectively monitor the investments and operation of our financial institutions and to make sure that the actions are in accordance with the principles of safety and soundness. They must protect depositors' moneys: it is extraordinarily important. Board members have long terms and they are appointed and they serve as separate entities from Congress and the administration, that the public perceive them, Chairman Volcker, Chairman Gray, and other members of their respective Boards, to be totally objective.

Mr. Chairman, I personally have felt that there were some problems with respect to the manner in which the Ohio S&L's were treated. I think that, and this is just a personal opinion, that Chairman Volcker and Karen Horn of Cleveland's Federal Reserve, acted absolutely expeditiously when they sensed there was an oncoming crisis in Ohio prior to the closing of the privately insured saving and loans. They rolled their sleeves up. They met with various Members of Congress. I was at a meeting that Chalmers Wylie called along with the two Members from Cincinnati, in Chairman Volcker's own boardroom to discuss the S&L's crisis March 13.

Mr. Chairman, I have only praise for their actions. They did nothing that was not in accordance with the law. No one wants any regulator to do anything that is not in accordance with the law. We want them to act in accordance with the law. And I want to make that clear. I personally do not feel that Ohio S&L's should have gotten a blanket insurance without scrutinizing first. But our appeal was to have the actions taken in terms of the possibilities of Federal insurance, to have them taken expeditiously. No more, no less. And I felt very strongly that there was stonewalling going on, and for that reason after the Governor closed the privately insured S&L's on the previous Saturday, I circulated a letter, which I

would like to submit for the record, that a number of Members of Congress from Ohio signed, both Republicans and Democrats, asking the Chairman of the Federal Home Loan Bank Board to judiciously and expeditiously consider the urgent request of the S&L's in accordance with the law. We felt the need to write this letter because we felt that there was this absolute lack of energy going on within that office.

It was not until the following week that the Governor was able to get the appointment with Chairman Gray. Of course, we have all seen the Wall Street Journal article which may or may not be true, but I think it is a very indicting article and I would like to submit that with your permission for the record. The article links our crisis in Ohio with GOP politics. Specifically on Friday, March 8, Treasury Secretary James Baker and other Treasury officials planned a Federal strategy regarding the runs on Ohio thrifts and they decided not to rescue them because we had a Democratic Governor, and informed Chairman Gray of that point.

At the Banking Committee the other day, Mr. Chairman, and you were there, Congresswoman Kaptur was there among others, I asked Chairman Gray two very simple questions: Did you, prior to March 13 or any day thereafter, get any advice on how to handle the situation in Ohio from the Secretary of the Treasury or anybody on the staff at the White House?

The second question: Did you in any way get advice from the White House on how to act before the Governor closed the S&L's in Ohio that were nonfederally insured?

Chairman Gray's answer was that he could not answer it because he did not think they were relevant questions. He refused to answer.

Mr. Chairman, I think that the air has to be cleared on this issue one way or another. I do not know whether this article is true or not, but there are some very serious allegations about the integrity of the Federal Home Loan Bank Board, and its ability to act objectively and nonpolitically.

For this reason, Mr. Chairman, I am asking your committee, because I think it is the proper committee, to investigate the conduct of the Federal Home Loan Bank Board, its Chairman, and the administration and let the chips fall where they may in terms of how that situation was handled. And I think that you are the proper source to do that, Mr. Chairman. I hope you can respond favorably to do the investigation on this situation and I look forward to a reply to my letter to you, Mr. Chairman, which you will be receiving in about 30 seconds.

Thank you, Mr. Chairman.

[Letter and article referred to follow:]

Congress of the United States
House of Representatives
Washington, D.C. 20515

March 18, 1985

The Honorable Edwin J. Gray
Chairman
Federal Home Loan Bank Board
1700 G Street, N.W.
Washington, D.C. 20552

Dear Mr. Chairman:

As you know, some of the state chartered, privately insured Savings and Loans in Ohio have been experiencing a lack of confidence after the failure of Home State Savings Bank.

Last week, the Governor declared an emergency bank holiday. It is our understanding that in the interim, some of the affected Ohio Savings and Loans are applying for federal deposit insurance with the Federal Savings and Loan Insurance Corporation.

We would appreciate your agency's judicious and expeditious consideration of these urgent requests in accordance with the law.

Thank you for your cooperation in this important matter.

Sincerely,

Mary Rose Oakar
Member of Congress

Thomas Luken
Member of Congress

Tony Hall
Member of Congress

Edward Feighan
Member of Congress

Dennis Eckart
Member of Congress

Bill Gradison, Jr.
Member of Congress

John Seiberling
Member of Congress

Bob McEwen
Member of Congress

Louis Stokes
Member of Congress

Bank Board Chairman's Cool Initial Response To Ohio Crisis Linked by Some to GOP Politics

By Monica Langley
Staff Reporter of The Wall Street Journal

WASHINGTON—When a group of nervous Ohio thrift executives flew to Washington three weeks ago, Federal Reserve Board Chairman Paul Volcker put out the welcome mat.

Mr. Volcker immediately took time to meet with the executives, whose thrifts were backed by a newly insolvent insurance fund, and assured them that the Fed would provide cash for runs on their deposits by making loans through the Fed discount window. Then he told the executives to make themselves at home in the board of governors' conference room and his own office.

Mr. Volcker instructed two of his top staff members to help the executives plan a strategy to handle the emerging crisis stemming from the collapse of Home State Savings Bank of Cincinnati, and keep their thrifts open. The executives stayed at the Fed for six hours, using Mr. Volcker's telephones, typewriters and secretaries.

A few blocks away, Edwin Gray, chairman of the Federal Home Loan Bank Board, through whom the executives hoped to obtain federal insurance, refused to meet with them.

The stark difference in the receptions the Ohio thrift executives received in Washington is being blamed by some here on partisan politics. Democratic representatives, in particular, argue that Fed Chairman Volcker understood that a financial crisis was building and treated the executives accordingly. But Bank Board Chairman Gray, a Reagan appointee, was following orders from the Reagan administration not to assist Ohio's Democratic governor, these lawmakers assert.

"The administration must have given instructions to Ed Gray not to rescue the Ohio thrifts," says Rep. Mary Rose Oakar (D., Ohio). "Obviously, it wanted to embarrass the Democratic governor (Richard Celeste) up for reelection soon."

Rep. Thomas Luken (D., Ohio) adds, "It took the dollar falling and questions asked of President Reagan at his press conference before any Bank Board assistance was provided. Ohio thrifts had to become a national problem before party politics were removed."

Mr. Gray, through a spokesman, refused to comment on administration influence on his initial decision not to provide immediate federal insurance to the thrifts. But an official involved in the matter insists the "politics" of it wasn't partisan but federal versus state responsibility. When asked at a congressional hearing last week whether he was told how to react, Mr. Gray wouldn't answer the question.

Executives of privately insured Ohio thrifts wanted federal insurance from the Bank Board to restore depositor confidence in the wake of the Home State failure, which by itself would wipe out the state-sponsored insurance fund. Home State was closed on Saturday, March 8, following runs stemming from heavy losses in its dealings with the failed E.S.M. Government Securities Inc., of Fort Lauderdale, Fla.

The night before, high-level Treasury officials, including Secretary James Baker, met for 1½ hours to decide what the federal response should be if other privately insured Ohio thrifts began experiencing runs. The group concluded that if a crisis developed, it should remain a problem of the Democratic administration in Ohio, according to a Reagan administration official.

A call was then made to Mr. Gray to inform him of the Treasury officials' consensus, this official says, adding, "Ed agreed with us that the Bank Board shouldn't save the thrifts; we didn't decide what he should do."

Thomas Healey, just-departed assistant treasury secretary for domestic affairs, added, "Of course it (the Treasury and Bank Board decisions) was political. But it's the politics of wanting Washington to bail the state out, but our saying no. It has nothing to do with Democrats and Republicans."

A Refusal to Meet With Them

When the thrift executives came to town the following Wednesday, Mr. Gray refused to see them. On Thursday, when he permitted Republican representatives from Ohio to see him, and after some resistance, let Democratic Rep. Luken and one thrift executive join them, Mr. Gray's first comment was: "Why aren't you guys up at the state capitol?"

Mr. Gray then told them he couldn't insure the savings and loans until each institution met a 5⅛% capital-to-assets ratio requirement; was individually examined by the Bank Board, "which could take months," and was subject to a 10-day comment period.

Upon returning to Ohio empty-handed, the executives privately asked Gov. Celeste to close the thrifts to stop the runs on deposits. Publicly these executives were stating they could handle the deposit withdrawals and wanted to stay open, but Mr. Gray's denial of federal backing terrified them, say the Ohio lawmakers who met with Mr. Gray.

So when Gov. Celeste, in a closed meeting with the thrift executives, asked who wanted to reopen, only four of the 71 executives stood up in favor of reopening, Gov. Celeste told the lawmakers.

Even Ohio Republican Rep. Willis Gradison acknowledges that the Bank Board's initial refusal to aid the thrifts seemed particularly harsh, given the Fed's immediate willingness to intervene. "I wonder, too, if political considerations were placed above confidence in and the integrity of the financial system," Rep. Gradison says.

A Reversal by Gray

The Ohio Republican notes that Mr. Gray "reversed himself" the next week when the Ohio thrift crisis frightened the currency markets, causing the dollar to plunge. At about the same time, Mr. Volcker was urging Mr. Gray to expedite the insurance process, even offering information from Fed examiners' reports, and President Reagan was fielding questions about federal assistance to Ohio thrifts.

Mr. Gray suddenly decided that the 10-day comment period could be waived, that the 5⅛% capital requirement could be dropped to 5%, and that examinations could be expedited. Shortly after that, the Bank Board began approving federal insurance for two or three Ohio thrifts a day.

"Ed Gray was helpful before it was all over," says Rep. Chalmers Wylie (R., Ohio), the ranking Republican on the House Banking Committee. "I'm sure his only motivation in stalling at first was to guarantee against loss in the insurance fund."

But questions remain as to what extent political factors delayed the Bank Board's actions, and a House subcommittee hopes to learn more about that at a hearing scheduled tomorrow.

How Washington Got Involved

Thursday, March 7
A run on deposits begins at Home State Savings Bank, which expected heavy losses from its dealings with E.S.M. Government Securities Inc.

Friday, March 8
Treasury Secretary James Baker and other Treasury officials plan a federal strategy if runs begin at other Ohio thrifts. They decide not to rescue the S&Ls, and inform Federal Home Loan Bank Board Chairman Edwin Gray, who agrees with the plan.

Saturday, March 9
Home State closes, citing the run.

Monday and Tuesday, March 11-12
Ohio thrifts begin experiencing runs and call the Bank Board asking how to get federal insurance. They call their congressmen asking for federal help.

Wednesday, March 13
A group of Ohio thrift executives flies to Washington. Fed Chairman Paul Volcker promises loans through the discount window. Bank Board Chairman Gray refuses to meet the executives.

Thursday, March 14
Gray outlines to the delegation requirements thrifts must meet before he will consider granting federal insurance, and says it could take months.

Friday, March 15
Ohio Gov. Richard Celeste temporarily closes the thrifts.

Monday, March 18
The dollar begins falling, largely due to the Ohio crisis.

Tuesday, March 19
The Bank Board agrees to ease requirements for granting insurance.

Thursday, March 21
President Reagan, asked about the federal response to the Ohio thrift woes, calls it an isolated problem and says that beyond Fed loans, "there isn't anything for the federal government to do."

Friday, March 22
The Bank Board begins approving federal insurance for some of the thrifts.

Mr. BARNARD. Thank you, Madam Chairman, and let me assure you that we intend to cover every one of the subjects which you have enumerated in your testimony this morning. They have already been a consideration of this committee but we are delighted to have you here to emphasize your concern about this situation.

Thank you.

Ms. Kaptur, do you have any statement you would like to make at this time? We are delighted to have you with us this morning.

Ms. KAPTUR. Thank you, Mr. Chairman. I do not really have a formal statement except to say thank you so much for allowing me the courtesy to sit in on these hearings. And to encourage you to get to the bottom of this entire matter.

As you know, one of the municipalities that I represent lost $19 million or it appears that it has lost $19 million in this series of events, and there are certainly a lot of unanswered questions on various levels. And I would hope that this committee would use its full powers to bring in the appropriate witnesses and to get the kind of thorough investigation that I think this question needs so we find out who really did what and when.

Thank you, Mr. Chairman.

Mr. BARNARD. Thank you very much.

Congressman Kindness, you are going to be with us today. I did not know whether you wanted to offer any statement at this time.

Mr. KINDNESS. Thank you, Mr. Chairman. I had not planned to make a statement, but I would suggest that if newspaper articles are going to be made a part of the record, I have quite a collection of them from around the State of Ohio that reflect concerns about graft and corruption in the political sphere and its influence upon this whole matter, which I had sought not to get into today, but I would urge upon the chairman that if we are to really investigate fully what this matter is all about, we will find a whole lot more meat in the Governor's office, the various departments and agencies that are affected in the State of Ohio than we will find in the Federal Home Loan Bank Board or the Federal Reserve, and I would hope that perhaps we could confine this to those areas that would be productive in terms of finding what the Federal response really should be.

Thank you, Mr. Chairman.

Mr. BARNARD. Thank you very much.

We are also honored today to have with us Congressman Bob McEwen of Ohio and, Congressman, we would be delighted to hear from you if you have a statement at this time.

Mr. MCEWEN. Mr. Chairman, thank you very much. It is gracious of you to give me this opportunity and I would just quickly say that I join my colleagues in expressing a personal interest in this matter. I too participated in the meetings with the Federal Home Loan Bank Board and I believe that as Congressman Kindness has said that if we can find some way that in the future the Federal Government can participate expeditiously and yet not usurp State authority it would be in the best interests of all of us.

And I thank you very much for the generosity. I would be glad to submit a statement.

Mr. BARNARD. Thank you very much.

Our next witness this morning—our next panel this morning will consist of Mr. Donald R. Hunsche, executive vice president of what was the Ohio Deposit Guarantee Fund, and Mr. Tom Batties, who is chief deputy superintendent and general counsel of the Ohio Division of Savings and Loans. If they would take the podium at this time, the witness stand.

We appreciate you gentlemen being with us today and participating in this hearing. And I would first recognize Mr. Donald R. Hunsche and Mr. Hunsche, if you would like to, without objection, we will submit your entire testimony in the record. If you feel like you would like to summarize, that would be at your desire.

STATEMENT OF DONALD HUNSCHE, EXECUTIVE VICE PRESIDENT, OHIO DEPOSIT GUARANTEE FUND

Mr. HUNSCHE. Thank you, Mr. Chairman. Mr. Chairman, distinguished members of the committee, my name is Donald R. Hunsche. I am the executive vice president of the Ohio Deposit Guarantee Fund. I am accompanied today by David S. Cupps and Roger Yurchuck, my legal counsel.

I have been requested to provide the committee with background information on the Ohio Deposit Guarantee Fund and then discuss the Home State Savings Bank situation in three parts.

The first part, prior to the ESM collapse; second, the events from Saturday, March 2, 1985, the day the fund became aware of the problem involving ESM, through Sunday, March 10, 1985, the day the conservator was appointed for Home State; and third, the events from March 11 through 20, the date the conservator was appointed for the Ohio Deposit Guarantee Fund.

The law authorizing the creation of mutual, nonprofit guarantee associations for Ohio State-chartered savings and loans was passed in 1955. Our fund was incorporated in 1956 and commenced business January 2, 1957, with 69 original members.

The fund was formed because the Federal Savings and Loan Insurance Corporation would not insure companies that were only open for business less than 30 hours a week, did not have ground floor locations, or that had assets of less than $1 million. Many of the initial ODGF members fit into this category.

The original amount of the total deposits guaranteed was about $200 million. This has subsequently grown to over $4.3 billion. The fund generally relied on the experience of Massachusetts whose fund predated Federal insurance.

The fund's assets include a 2-percent deposit from each member based on savings at that institution. In addition, earnings on those deposits are retained by the fund to further strengthen the fund. Members count this 2 percent as a part of their assets.

As of December 31, 1984, the fund had assets of $125,800,000. The total amount of guaranteed deposits was approximately $4.3 billion. The ratio of assets to guaranteed savings amounted to 2.9 percent. The FSLIC's comparable ratio is approximately three-quarters of 1 percent.

The Ohio Deposit Guarantee Fund has cooperated fully with the Ohio Division of Savings and Loans throughout its history. The fund received examination reports of the State as well as quarterly

and other reports from all member companies, including Home State. The reports are reviewed by the fund's department of supervision for the purpose of making recommendations to improve operations of the companies and to assist in the correction of unsafe practices.

However, the fund does not have legal power to effect compliance. It has no cease-and-desist power. It attempts to achieve compliance by working with State officials and the management of member companies to have the officers and directors of member companies agree to make desirable changes.

Beginning on about April 1, 1980, the fund became aware through a review of reports of Home State's involvement with ESM Securities. There were at that time repurchase agreements of about $168 million.

The situation again came to our attention in March 1981. At that time a report revealed an increase to $232 million. That occurred in July 1980. And there was overcollateralization and too much concentration with one dealer, namely, ESM.

As I recall, the State questioned the overcollateralization and claimed there was a violation of borrowing limits; 1982 showed more of the same. The percentage of overcollateralization increased. Letters were written and meetings held expressing our concern, stating that such activities were imprudent. We also told Home State to restructure the transaction.

On February 25, 1983, the fund wrote a letter to Home State strongly suggesting that it reduce the overcollateralization with ESM as soon as possible but not later than June 30, 1983, the date by which the transactions would mature.

A board resolution of Home State agreed to our directive. Later, the fund was startled to learn that contrary to these directions, the transactions were dramatically increased in May and June 1983 up to $550 million.

A meeting was held on October 3 involving representatives of the fund, the superintendent of the division of savings and loans and his staff, officials of Home State, and a representative of ESM. At that point, there was also a significant overcollateralization. We expressed our serious concern. The superintendent, with the fund's full support and concurrence, instructed Home State to wind down the transactions and reduce the substantial overcollateralization.

In January 1984, all of the directors with the exception of two agreed to a program of unwinding the ESM relationship. By July 1984, 60 percent of the transactions had been matched and would mature in May and June 1985 and would thereupon cease. At least that is what Home State agreed to.

On March 2, 1985, at approximately 4:15 in the afternoon, the fund became aware for the first time of a potential problem at ESM and a potential resultant problem with a loss at Home State.

At that time, Mr. Schiebel, president of Home State, advised us that he was concerned because the audit report prepared by Alexander Grant & Co., the auditors for ESM, had been withdrawn on Friday, March 1, approximately 24 hours after it was delivered to him.

We were advised that Home State still had repurchase relationships with ESM and that they were substantially overcollateral-

ized. We responded by requesting that the Ohio Deposit Guarantee Fund be kept fully advised.

On Saturday or Sunday, March 2 or 3, I discussed the matter with Thomas Batties, as the acting superintendent of the division of savings and loans.

On March the 5th, the depositors of Home State started a run on the institution.

On March the 6th, the State of Ohio announced that it was prepared to safeguard the interests of the depositors of Home State and of all depositors whose funds were guaranteed by the Ohio Deposit Guarantee Fund and that the system in place provided adequate safeguards for depositors at its State-chartered savings and loans.

The run at Home State continued on Thursday and Friday, March the 7th and 8th, in spite of the State's announcements. By Friday evening, March 8, an estimated $154 million had been withdrawn. By the close of business on March 8, the Ohio Deposit Guarantee Fund had advanced $45 million in cash to Home State for the benefit of its depositors.

From approximately Wednesday, March 6, through Saturday, March 9, the ODGF was aware of negotiations involving a potential merger or purchase and assumption involving Home State.

On Saturday, March 9, the ODGF had representatives present as observers at a meeting in Cleveland where bankers throughout the State of Ohio were informed of the situation and of Home State's availability as a merger partner.

On Sunday, March 10, the State of Ohio announced the appointment of a conservator and the closing of Home State. Subsequent to Sunday, March the 10th, the Ohio Deposit Guarantee Fund has not been kept informed of the events surrounding Home State or its potential sale.

The fund was not allowed to review the books and records of Home State so as to make its own independent assessment of the parameters of the potential loss.

On about March 13, runs began at a few fund-member companies, particularly in the Cincinnati area, creating long lines which were dramatically played up by the media.

On or about March 13, the State legislature passed legislation authorizing the creation of a separate deposit guarantee fund and providing for a loan to that fund. The ODGF was not consulted about the content or the advisability of the legislation.

On March 15, the Governor visited Cincinnati and announced the closing of all Ohio Deposit Guarantee Fund companies statewide, even though the problem of runs was confined to the general Cincinnati area.

Members of the fund were forced to remain closed on March 18 and 19. Institutions which were and are totally uninsured were allowed to remain open throughout this crisis.

On Monday, March 21, the Ohio Deposit Guarantee Fund received notice that the superintendent of savings and loans had appointed or purported to appoint a conservator for it on the evening of March 20.

As you might guess, I have not yet had time or sufficiently complete information to reflect thoughtfully on the lessons on the

events or to formulate definitive recommendations. Since the appointment of the conservator for Home State on March 10, the Ohio Deposit Guarantee Fund has been denied access to the records of Home State. Consequently, it is impossible for me to answer certain questions as raised in your letter of March 22.

It is impossible to discuss comprehensively the ultimate financial impact of Home State's situation on the Ohio Deposit Guarantee Fund and its members. This is due to the fact that, one, as noted, the Ohio Deposit Guarantee Fund has been denied access to the books and records; second, the ultimate loss of Home State is still not quantified to our knowledge; third, no buyer has been found for Home State, so the purchase price cannot be determined and thus the impact on the fund cannot be determined; fourth, it is not yet possible to determine either the collectability of Home State's claim against the ESM estate and the likely defendants in ESM litigation or the collectability of claims against directors, officers, controlling persons and other potentially liable persons involved in the Home State situation; and fifth, until Home State is sold we do not know whether it will be sold in such a way as to preserve the ODGF members' 2-percent deposits with the fund.

It is also impossible to comment responsibly on the response and assistance from the Federal Home Loan Bank or the Federal Reserve. The ODGF does not know what the response from the Federal Home Loan Bank Board or the Federal Reserve has been since it has not been asked for its advice or assistance nor has it been informed directly as to what steps have been taken.

The relationship and interaction with the Ohio Division of Savings and Loans and the Ohio Deposit Guarantee Fund was excellent prior to the Home State Savings Bank closing. Up to March 10, 1985, the fund and the division worked closely to try to resolve problems of Home State. After March 10, when the conservator was appointed for Home State, there has been little if any interaction. Subsequent to March 10, no information has been shared.

In summary, as soon as the Ohio Deposit Guarantee Fund became aware of what it considered to be an inadvisable practice at Home State, it attempted to cause Home State to cease the practice. Contrary to those directions, Home State increased the dollar amounts of the transactions and increased the overcollateralization.

Finally, Home State and its directors agreed in writing to stop the transactions. The fund has no legal power to author or enforce a cease-and-desist order. It could counsel restraint, but could not compel it.

A tragic aspect of the situation which is still unresolved is the fate of the approximately 70 members of the fund. Some are now insured by the FSLIC. Others will be shortly. But there remain a significant number of sound, well-managed companies that have provided good service to their communities and neighborhoods, some for 100 years, whose fate is in doubt. The key to their future is to ensure that the Home State matter is settled promptly and in a way that protects the members' 2-percent deposit in the fund.

While I believe that, if handled differently, the Home State situation could have been solved through a quick sale or merger and depositors immediately protected, the problem we now face is to

ensure prompt reopening of the remaining fund-guaranteed companies in such a way that they and their depositors are fully protected.

To that end, the fund pledges its full support and cooperation.

Mr. BARNARD. Thank you very much.

Mr. HUNSCHE. Thank you, Mr. Chairman.

[Mr. Hunsche's prepared statement follows:]

STATEMENT OF DONALD HUNSCHE, AN OFFICER OF THE
OHIO DEPOSIT GUARANTEE FUND,
BEFORE SUBCOMMITTEE ON
COMMERCE, CONSUMER AND MONETARY AFFAIRS
OF THE COMMITTEE ON GOVERNMENT OPERATIONS
UNITED STATES HOUSE OF REPRESENTATIVES
WASHINGTON, D.C.

APRIL 3, 1985

Chairman Barnard:

My name is Donald Hunsche. I am the Executive Vice President of the Ohio Deposit Guarantee Fund ("ODGF").

I would like to provide the Committee with background information on the ODGF and then discuss the Home State Savings Bank ("Home State") situation in three parts: (1) prior to the ESM Securities collapse, (2) the events from Saturday, March 2, 1985, the day the Fund became aware of a problem involving ESM, through Sunday, March 10, 1985, the day a conservator was appointed for Home State, and (3) the events from March 11, through March 20, the date a conservator was appointed for ODGF. I will conclude with a summary and some observations.

Background

The law authorizing the creation of mutual nonprofit guarantee associations for Ohio chartered savings and loans was passed in 1955. The ODGF was incorporated in 1956 and began business on January 2, 1957. There were 69 original members.

The Fund was formed because the Federal Savings and Loan Insurance Corporation ("FSLIC") would not insure companies that were opened for business less than thirty (30) hours per week, did not have ground-floor office space or had less than

$1,000,000 in assets. Many of the initial ODGF members fit those categories. Today, many of those members continue to operate in a similar fashion and serve their neighborhoods, particularly in the Hamilton County area, as well as small towns throughout the State of Ohio. Other original members believed they could jointly do as good a job as the FSLIC in guarding savers deposits.

The original amount of total deposits guaranteed was about $200,000,000. This has subsequently grown to over $4,300,000,000. The fund generally relied upon the experience of Massachusetts, whose fund predated federal insurance, and Connecticut in establishing the rules and operations of the fund.

Then and now there are several totally uninsured companies in Ohio. These have not been closed and have not generally, to my knowledge, been adversely affected by the Home State crisis.

The Fund's assets include a 2% deposit from each member, based on savings at that institution, which is adjusted semi-annually each year. In addition, earnings on the deposits of members are retained by the Fund to further strengthen the Fund. No dividends have been paid for 25 years. The members count this 2% deposit as part of their net worth.

As of December 31, 1984, the Fund had assets of $125,800,000. The total amount of guaranteed deposits was approximately $4,300,000,000. This is a ratio of approximately 2.9%. The FSLIC's comparable ratio is approximately 0.75%.

The Home State Situation

Prior To ODGF's Knowledge of the Collapse of ESM

By way of additional background, ODGF has cooperated fully with the Ohio Division of Savings and Loan Associations throughout its history. ODGF receives examination reports of the State, as well as quarterly and other reports from all fund companies, including Home State. The reports are reviewed by the Fund's Department of Supervision toward the end of making recommendations to improve operations of the companies and to assist in the correction of unsafe practices. However, the Fund has no legal power to effect compliance. It has no cease and desist power. It attempts to achieve compliance by working with the the State and management of insured companies to have the directors of a company agree to make desireable changes.

Beginning in about 1980, the Fund became aware, through its review of reports, of Home State's involvement with ESM Securities. There were at that time repurchase agreements of about $100,000,000. There was also a modest over-collateralization and non-uniform maturities.

The situation came to our attention next about March of 1981. At that time a report revealed over-collateralization and we noted that there was too much concentration with one dealer, namely, ESM. There was, however, no explicit lending violation. Letters were written to and meetings held with officers of Home State concerning the problem, particularly the over-collateralization.

1982 reports showed more of the same. Although the amounts involved would increase and decrease, the trend was upward. Again, we were concerned with over-collateralization and concentration of activities with ESM. Meetings were held with officials at Home State which were also attended by representatives of the State Superintendents Office.

On February 25, 1983, the Fund wrote a letter to Home State strongly suggesting that it unwind the transactions with ESM and reduce the over-collateralization as soon as possible, but not later than June 30, 1983, the date the transactions would mature.

Later, the Fund was startled to learn that, contrary to these directions, the transactions were dramatically increased in May and June of 1983. A meeting was held in October, 1983, involving representatives of the Fund, the Superintendent of the Division of Savings and Loans and his staff, officials of Home State and a representative of ESM. At that point there was also significant over-collateralization. The Superintendent, with the Fund's full support and concurrence, instructed Home State to wind down the transactions and reduce the substantial over-collateralizations. In January, 1984, all the directors of Home State, with one exception, agreed to a program of unwinding the ESM relationship, with a particular emphasis on over-collateralization, and the concentration of transactions with one thinly capitalized dealer.

It is our understanding that by July, 1984, the various transactions had been matched, would mature in June and July of 1985 and would thereupon cease. At least that is what Home State agreed to.

The Events of March 2-10

On Saturday, March 2, 1985, at approximately 4:15 p.m., the Fund became aware for the first time of the potential collapse of ESM and the resultant potential loss to Home State. We learned this at a meeting which I and the Fund's counsel attended. Also present were David Schiebel, President of Home State, Nelson Schwab, Jr., attorney for and a director of Home State, and Marvin Warner. At that time, Mr. Schiebel advised us that he was concerned because an audit report prepared by Alexander Grant & Company, the auditors for ESM, had been withdrawn approximately 24 hours after it was delivered to Mr. Schiebel earlier that week. We were also told that the withdrawal of the auditor's opinion caused Mr. Schiebel to engage legal counsel, whom he authorized to institute an immediate investigation of ESM. We were advised that Home State still had a repurchase relationship with ESM that was substantially over-collateralized. We responded by requesting that ODGF be kept fully advised of the results of the investigation Home State had undertaken in Florida.

On Saturday, March 2 or Sunday, March 3, I discussed the matter with Thomas Batties, at that time acting Superintendent of the Division of Savings and Loans of the State of Ohio.

Thereafter, ESM's financial posture became the subject of extensive news coverage in Cincinnati due to the impact it might have on Home State.

On March 5, the depositors of Home State started a run on the institution.

On March 6, the State of Ohio announced that it was prepared to safeguard the interests of the depositors of Home State and of all depositors whose funds were guaranteed by the ODGF and that the system in place provided adequate safeguards for depositors at its State chartered savings and loan associations. The run at Home State continued on Thursday and Friday, March 7 and 8, in spite of the State's announcements. By Friday evening, March 8, an estimated $154,000,000 had been withdrawn. By the close of business on March 8, the ODGF had advanced $45,000,000 in cash to Home State for the benefit of depositors. On its own initiative, Home State announced that it would not be open for business on Saturday, March 9, a normal day of business for the Company, pending resolution of its pursuit of a merger.

From approximately Wednesday, March 6 through Saturday, March 9, the ODGF was aware of negotiations involving a potential merger or purchase and assumption involving Home State. The negotiations earlier in the week where with the First National Bank of Cincinnati. On Saturday, March 9, the ODGF had representatives present as observors at a meeting in Cleveland where bankers from throughout the State of Ohio were informed of the situation and of Home State's availability as a merger partner. Representatives of the Department of Commerce and the

Superintendent were also present as were attorneys for the State and the Superintendent of Banks. Representatives of the Federal Reserve Board were also present. The bankers stated that they were unable to make a rational offer because of the lack of definitive financial information.

On Sunday, March 10, the State of Ohio announced the appointment of a conservator for and the closing of Home State.

The Events of March 11 through March 20

Subsequent to Sunday, March 10, the ODGF has not been kept informed of events surrounding Home State or its potential sale. Even though a request was timely made, the Fund was not allowed to review the books and records of Home State so as to make its own independent assessment of the parameters of the potential problem.

On Monday and Tuesday, March 11 and 12, the media continued to publicize the difficulty Home State was having as a result of the dealings with ESM. On Tuesday, March 12, 1985, the Fund retained Mr. John Lyons of a New York firm specializing in sale of troubled financial institutions. The Fund then made the services of Mr. Lyons and his firm available to the State. On Wednesday the Fund was informed that the services of Mr. Lyons were not needed at that time. Later, we learned that on Saturday, March 16, Mr. Lyons' firm was retained by the State to assist in the preparation of a bid package. We have not been furnished with a copy of the bid package or bidding instructions,

if any, and the Fund has not been involved in any efforts to sell Home State since the Saturday meeting on March 9 in Cleveland.

On or about March 13, runs began at a few Fund member companies, particularly in the Cincinnati area, creating long lines which were dramatically played up by the media.

On March 15, Governor Celeste announced the closing of all ODGF companies statewide, even though the problem of runs was confined generally to the Cincinnati area.

On or about March 13, the State Legislature passed legislation authorizing the creation of a separate deposit guarantee fund and providing for a loan to that fund. The Fund was not consulted about the content or advisability of the legislation.

On March 15, an organization meeting was held for the organization of the new deposit guarantee fund, specifically excluding Home State, based on a deposit of 1% of member savings and the lending of $50,000,000 by the State of Ohio. To this date, to our knowledge, the State of Ohio has not placed its $50,000,000 in the new fund.

On March 15, the Governor visited Cincinnati and announced the closing of all ODGF companies statewide, even though the problem of runs were confined to the general Cincinnati area. Members of the Fund were forced to remain closed on March 18 and 19. Institutions which were and are totally uninsured were allowed to remain open throughout the crisis. To our knowledge, they have had no runs to date.

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On March 19, the Ohio Legislature passed additional legislation providing for the reopening of ODGF associations on a limited basis in some cases and on a full basis in others.

On the morning of March 21, ODGF received notice that the Superintendent of Savings and Loan Associations had appointed or purported to appoint a conservator for it on the evening of March 20.

Summary and Conclusions

As you might guess, I have not yet had time or sufficiently complete information to reflect thoughtfully on the lessons of the events or to formulate definitive recommendations. Since the appointment of a conservator for Home State on March 10, 1985, the ODGF has been denied access to the books and records of Home State. Consequently, it is impossible for me to answer certain questions as raised in your letter of March 22.

It is impossible to discuss comprehensively the ultimate financial impact of the Home State situation on the ODGF and its members. This is due to the facts that: (1) as noted ODGF has been denied access to the books and records of Home State, (2) the ultimate loss at Home State is still not quantified to our knowledge, (3) no buyer has been found for Home State, so the purchase price cannot be determined, and thus the impact on the Fund cannot be determined, (4) it is not as yet possible to determine either the collectability of Home State's claims against the ESM estate and the likely defendants in ESM litigation or the collectability of claims against the directors,

officers, controlling persons and other potentially liable persons involved in the Home State situation and (5) until Home State is sold we do not know whether it will be sold in such a way as to preserve the ODGF members' 2% deposit (2% of savings) with the Fund. If a sale can be arranged which protects that deposit, it would be of great benefit to the members of the Fund and their depositors.

It is also impossible to comment responsibly on the response and assistance from the Federal Home Loan Bank Board or the Federal Reserve System. Since March 10, the ODGF has basically been without communications or information relating to Home State. ODGF does not know what the response of the Federal Home Loan Bank Board or the Federal Reserve System has been since it has not been asked for its advice or assistance nor has it been informed directly of what steps have been taken. Therefore any comments would be based on hearsay, and I do not believe such a response would be appropriate.

In response to one of your questions in your letter of March 22, the relationship and interaction with the Ohio Division of Savings and Loan Associations and the ODGF was excellent prior to the Home State Savings Bank closing. Up to March 10, 1985, the Fund and the Division worked closely to try to solve the problem of Home State. After March 10, when the conservator was appointed for Home State, there has been very little, if any, interaction. Pursuant to Section 1155.16 of the Ohio Revised Code, examination reports prepared by the Ohio Division of

Savings and Loan Associations were shared with the ODGF. Subsequent to March 10, no information has been shared.

Summary

In summary, as soon as ODGF became aware of what it considered to be inadvisable practices at Home State, it attempted to cause Home State to cease the practices. Contrary to those directions, Home State apparently increased the dollar amounts of the transactions and increased the over-collateralization. Finally, Home State and its directors agreed in writing to stop the transactions. The transactions still went on. However, the Fund had no legal power to author or enforce a cease-and-desist order. It could counsel restraint, but could not compel it.

As soon as the Fund became aware of the ESM collapse, it began working with the State Superintendent. After the March 10, 1985 appointment of a conservator for Home State, the Fund has been kept out of all negotiations relating to Home State. In fact, even today, it does not know the true financial condition of Home State.

A tragic aspect of the situation which is still unresolved is the fate of the other approximately 70 members of the Fund. Some are now insured by the FSLIC. Others will be shortly. But there remain a significant number of sound, well-managed companies that have provided good service to their communities and neighborhoods, some for a 100 years, whose fate is in

doubt. The key to their future is to insure that the Home State matter is settled promptly and in a way that protects the members' 2% deposit in the Fund.

While I believe that, if handled differently, the Home State situation could have been solved through a quick sale or merger and depositors immediately protected, the problem we now face is to insure prompt reopening of the remaining Fund-insured companies in such a way that they and their depositors are fully protected. It will take the cooperation of the State, the FSLIC and the Fund to insure this result. To that end, I am sure the Fund would pledge its support and cooperation.

NAME OF DEPOSIT INSURANCE FUND: OHIO DEPOSIT GUARANTEE FUND (the "ODGF")

I. General Information

1. Type(s) of Financial Institution(s) whose deposits you insure: Ohio chartered savings and loan associations.

2. In which state(s) do you insure: Ohio only.

3. A. Cost of initial membership in your fund, if any: 2% of withdrawable savings, rounded to the nearest $100, adjusted semi-annually as of June 30 and December 31 of each year, plus pro rata share of accumulated earnings at date of acceptance into fund membership.

B. Annual premium: None.

C. Continuing equity contribution or membership deposit: 2% of withdrawal savings, rounded to the nearest $100, adjusted semi-annually as of June 30 and December 31 of each year.

4. Maximum coverage per account or per depositor: 100%.

5. Do you insure brokered deposits: Yes, but members are controlled by the OGDF Rules and Regulations as to amounts they can take in brokered deposits (See Item II(k) the ODGF Rules and Regulations (the "Rules").

6. Number of insured institutions, by type:

A.	Under $100 million:	61
B.	$100 million to $500 million:	7
C.	$500 million to $1 billion:	1
D.	Over $1 billion:	1 (Home State)

	December 31, 1984	
	Assets	Deposits
A.	$1,833,006,000	$1,699,704,000
B.	$1,175,396,000	$1,119,130,000
C.	$ 914,551,000	$ 823,675,000
D.	$1,440,608,000	$ 668,005,000

7. Aggregate amounts of deposits insured, by type of institution: $4,310,514,000 at December 31, 1984.

8. Your fund's total usable assets: $126,912,430 at December 31, 1984 (market value)

9. Ratio of usable insurance fund assets to deposits insured: 2.94% at December 31, 1984

II. Background:

1. Are you a governmental or private agency and are you a creation of state law? Please provide a text or description of your basic statutory authority.

   The ODGF is a non profit, private mutual corporation created pursuant to Ohio Revised Code Section 1151.80-92, as repealed by Amended Substitute Ohio Senate Bill 119.

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

   Ohio Division of Savings and Loans.

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute:

a. Access to the treasuries of the state(s) in which you operate; and/or

No

b. Authority to assess other insured institutions enough to cover the losses?

Not by statute; however, Article V of the ODGF Constitution and Item III(A) of the ODGF Rules provides a method for an assessment.

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

No

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

The ODGF has a $1,000,000 line of credit at the Bank for Savings & Loan Associations, Chicago, Illinois

6. Do you reinsure your risks with any other insurance carriers? Please provide details.

$2,000,000 Insurance Company of North America. $25,000,000 retention rider

7. Regarding your board of directors:

a. How is your board of directors selected:

Selected by Nominating Committee and/or representatives or members at ODGF Annual Meeting. See Article VIII of the Constitution.

b. What rules govern the size and composition of the board?

See Article VIII of the ODGF Constitution.

c. Who are the present members of your board? (Please provide names and principal affiliations.)

Name	Affiliation
Charles A. Brigham, Jr.	President and Director, Federated Savings Bank, Lockland, Ohio
John A. Dreyer	Director, Baltimore Savings and Loan Company, Cincinnati, Ohio
Richard D. Hoffman	Chairman of the Board, The City Loan & Savings Company, Lima, Ohio
Vernon W. McDaniel	Assistant Treasurer and Director, Anderson Ferry Building and Loan Company, Cincinnati, Ohio
John R. Perkins	President and Director, The Metropolitan Savings Bank, Youngstown, Ohio
Eleanor J. Remke	President and Director, Madison Saving Bank, Cincinnati, Ohio
Joseph D. Rusnak	President and Director, Mentor Savings Bank, Mentor, Ohio
David J. Schiebel	Chairman of the Board, Home State Savings Bank, Cincinnati, Ohio
Harold R. Swope	President and Director, Independent Savings Association, Euclid, Ohio
Charles F. Tilbury, Sr.	Executive Vice-President and Director, The Clermont Savings Association, New Richmond, Ohio
Jack R. Wingate	Executive Vice-President and Director, Heritage Savings Bank, Cincinnati, Ohio

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and

soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

Yes. See Item II of the ODGF Rules.

2. Please respond separately for each state in which you insured deposits: Ohio only

   a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

      Yes--See:

      (1) Article IX, Section 6(a) of the ODGF Constitution;

      (2) Item IV(A) of the ODGF Rules provides for at least two months of continued insurance;

      (3) Item VI of the ODGF Rules requires Notice of Termination to be given to depositors.

   b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

      By resolution of the Board of Trustees for due cause. See Article IX, Section 6(a) of the ODGF Constitution.

   c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

      None.

3. Please respond separately for each state in which you insure deposits: Ohio only

   a. Do you have <u>authority</u> to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

      Yes. See Item VI(F) of the ODGF Rules. Also see Article IX, Section 6(b) of the ODGF

Constitution and Item VI(C) of the ODGF Rules concerning additional directors.

b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have? What is your examination operating budget?

Member institutions are examined as deemed necessary by the Department of Supervision of the ODGF. Policies and procedures vary with the type of information desired. The Department of Supervision consists of three persons capable of examining and auditing with an unlimited budget.

c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

Yes, the ODGF receives copies of all examination reports of its member institutions as prepared by the Division of Savings and Loan Associations, State of Ohio.

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

No.

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

The ODGF has no direct authority to correct problems; however, the ODGF closely supervises problems through the Department of Supervison which works with the member institution to resolve its problems. If the problem cannot be resolved by the Department of Supervision, the ODGF works with the Division of Savings and Loans, State of Ohio, to seek to effect a merger with another financially viable institution. The Advisory Committee of the ODGF can make recommendations to

the Board of Trustees with respect thereto.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

No. By agreement with member institutions, the ODGF has replaced management and directors in the past with ODGF employees and Trustees, corrected problems and then effected a merger with a financially viable association. The ODGF has never been a receiver/liquidator.

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?

The ODGF has never experienced a closing of a financial institution due to insolvency.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

No. See Ohio Revise Code §1151.87(H). Pursuant to the ODGF Rules and general authority, the ODGF can attempt to effect mergers or provide other assistance.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

No, not without the complete, full knowledge and approval of the Superintendent of the Division of Savings and Loan Associations, State of Ohio, and the ODGF member institutions.

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

Yes, but the OGDF needs the approval of the member institution and the Superintendent to provide assistance.

4. Please provide a listing showing, for each insolvency covered by your fund from January 1,

1980, to date:

The only situation to date is Home State Savings Bank, Cincinnati, Ohio, which is now in the hands of a state appointed conservator.

V. Insured Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year date for 1981, 1982, 1983, and 1984.

Fiscal Year Ended June 30

1981	$50,182,978	1982	$59,269,202
1983	$88,354,862	1984	$108,413,800

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury Securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

At March 23, 1985

U.S. Government Securities	$33,848,375
U.S. Government Agency Bonds	39,472,914
U.S. Government Treasury Bills	2,243,760
Cash and Federal Funds	2,968,157
Bank Certificate of Deposits	450,000

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

ODGF deposits are made in member institutions only in the event of an assisted transaction. At present, $6,955,311 is on deposit in a savings account at City Loan & Savings Co. pursuant to a contractual agreement arising out of an acquisition of Central Savings Association, Blue Ash, Ohio.

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

Fiscal Year Ended June 30

1981	9.98%
1982	11.36%
1983	11.30%
1984	11.32%

5. Please provide a copy of your latest annual report.

(Amended Substitute Senate Bill Number 119)

AN ACT

To ensure the orderly reopening of building and loan associations and to provide for the protection of depositors, to terminate the authority for deposit guaranty associations except for certain functions, to repeal sections 1151.80, 1151.81, 1151.82, 1151.83, 1151.84, 1151.85, 1151.86, 1151.87, 1151.88, 1151.89, 1151.90, 1151.91, 1151.92, and 1151.99 of the Revised Code, and to declare an emergency.

Be it enacted by the General Assembly of the State of Ohio:

SECTION 1. (A) No building and loan association the deposits of which on the effective date of this act are insured by any deposit guaranty association shall be open for business unless deposits in such association are insured by the Federal Savings and Loan Insurance Corporation (FSLIC) or the Federal Deposit Insurance Corporation (FDIC), or unless the findings in division (B), (C), or (D) of this section have been made.

(B) Notwithstanding division (A) of this section, a building and loan association which has made an application for insurance to FSLIC or FDIC that is substantially complete shall be permitted to open for business by the Superintendent of Building and Loan Associations if the Superintendent finds, upon application by such association to the Superintendent, that such association probably should qualify for such insurance under the applicable standards of FSLIC or FDIC, as the case may be. If such association is other than a permanent stock company, and, in addition to an application for insurance to FSLIC or FDIC, it has submitted an application for reorganization under section 1151.61 of the Revised Code, the Superintendent shall include and consider such application in making his finding.

(C) Notwithstanding division (A) of this section, if a building and loan association has made application to the Superintendent pursuant to division (B) of this section and such application has been denied or not been approved within fifteen days from the date such application was submitted to the Superintendent, such building and loan association may make application to the Director of Commerce. The Director shall hold a

hearing based upon rules promulgated by the Director within fifteen days at which evidence may be presented. A building and loan association shall be permitted to open unless the Director finds, based upon such factors as the liquidity of the building and loan association as demonstrated by its levels of cash, cash items and readily marketable securities, and the ability of such association to immediately preserve or increase the liquidity in response to depositor demands and the net worth of such association, and that such opening is not in the best interests of the depositors of such association or is detrimental to the interests of building and loan associations generally. The procedures provided by this act are not subject to Chapter 119. of the Revised Code.

(D) Notwithstanding division (A) of this section, a building and loan association may open if it demonstrates to the satisfaction of the Superintendent one of the following:

(1) Its deposits are guaranteed by a corporation, organization, or other person, which corporation, organization, or person owns, directly or indirectly, a majority of such association within 120 days of the effective date of this act, and which corporation, organization, or person meets such financial and other qualifications as may be established by the Superintendent;

(2) It is owned or controlled, directly or indirectly, by an institution insured by FSLIC or FDIC and such institution guarantees its deposits, or has entered into an agreement to be acquired by or be merged with such institution, or enters into such an agreement within fifteen days of the effective date of this act.

(3) The Superintendent determines that the interests of the depositors will not be jeopardized.

(E) In addition to the causes stated in section 1157.01 of the Revised Code, the Superintendent may order a building and loan association to liquidate its business and property pursuant to section 1157.23 of the Revised Code whenever either:

(1) The Superintendent has denied its application to open for business under division (B) of this section and there is no appeal from that denial pending pursuant to division (C) of this section or an appeal has been denied and the Superintendent determines that the interests of the depositors will be jeopardized if the association is not liquidated;

(2) After being permitted to open for business under division (B) or (C) of this section, its application for deposit insurance has been denied or the Superintendent finds that any other condition upon which opening was permitted is not in existence and the Superintendent determines that the interests of the depositors will be jeopardized if the association is not liquidated;

(3) The association has not qualified to open for business 120 days after the effective date of this act, and the Superintendent determines that the interests of the depositors will be jeopardized if the association is not liquidated.

(F) During the period in which a building and loan association is not open for business pursuant to division (A) of this section, such association may set aside and make available in its discretion for withdrawal by all depositors during any period of thirty consecutive days an aggregate amount not exceeding the balance of such depositors' account or accounts,

but in no event more than an aggregate of seven hundred fifty dollars in each thirty-day period; provided, however, that such association shall keep an account of the withdrawals made and such withdrawals shall be deemed to be credits against the withdrawing depositor's pro rata dividend in the event such association is liquidated. Such association may receive deposits, but the deposits received during such period are not subject to any limitation as to payment or withdrawal, and such deposits shall be segregated and shall not be used to liquidate any indebtedness of such association existing on the effective date of this act or any subsequent indebtedness. Such deposits received while the association is not open for business shall be kept on hand in cash, invested in the direct obligations of the United States or the State of Ohio, or deposited with a financial institution in Ohio designated by the Superintendent.

(G) Nothing in this section shall preclude the Superintendent from exercising his powers and discharging his duties and responsibilities as set forth in the Revised Code.

(H) The powers of the Superintendent under this act and Sub. S. B. 113 of the 116th General Assembly after December 31, 1985, shall be limited to the fulfillment of commitments made under such acts, expressly or by reasonable implication, on or before that date and shall not include the initiation of any additional proceedings not so required.

(I) There shall be no liability imposed on the part of, and no cause of action of any nature arises against, the savings association guaranty fund created pursuant to Sub. S. B. 113 of the 116th General Assembly, its board of trustees, officers, agents, or employees, the superintendent of savings and loan associations or his authorized representatives, for any statements made in good faith by them in any reports or communications concerning risks insured or to be insured by the association, or for any administrative actions conducted in connection therewith.

SECTION 2. That sections 1151.80, 1151.81, 1151.82, 1151.83, 1151.84, 1151.85, 1151.86, 1151.87, 1151.88, 1151.89, 1151.90, 1151.91, 1151.92, and 1151.99 of the Revised Code are hereby repealed effective sixty days from the effective date of this act. Notwithstanding this section, a deposit guaranty association has all power and authority necessary to accomplish complete winding up of its business, including, but not limited to, the defense to judgment, with right of appeal as in other cases, of any claims asserted against any such deposit guaranty association, and the prosecution to judgment, with right of appeal as in other cases, of claims, whether arising by subrogation or otherwise, presently held by, or hereafter arising or accruing to, any such deposit guaranty association.

SECTION 3. Notwithstanding any other provision of the Revised Code to the contrary, if any such building and loan association or building and loan association or building and loan associations insured by a deposit guaranty association elects to convert to a bank and if following such conversion the institution should be eligible for FDIC insurance, upon application the Superintendent of Banks shall forthwith issue an authorization for the applicant to commence business as a bank and thereafter the institution shall be a bank.

SECTION 4. Notwithstanding any other provision of the Revised Code to the contrary, if any such building and loan association or building and loan associations insured by a deposit guaranty association, elects to

convert to a bank, the association or associations shall file an application with the Superintendent of Banks. The Superintendent of Banks may, without being subject to the publication, notice and hearing requirements of section 1103.07 of the Revised Code, approve such application and may condition such approval to provide for the orderly transition from the business of a building and loan association to the business of the bank. The Superintendent of Banks shall have full authority to enforce compliance with such conditions and to regulate the resulting bank pursuant to Chapters 1101. to 1129. of the Revised Code. Upon receipt of evidence satisfactory to the Superintendent of Banks that the resulting bank will be insured by the Federal Deposit Insurance Corporation at the time it commences business as a bank, the Superintendent shall issue a certificate of authority to commence business as a bank.

Notwithstanding any other provision of the Revised Code to the contrary, if any building and loan association or building and loan associations insured by a deposit guaranty association elects to merge or consolidate with a bank or to transfer assets and liabilities to a bank, upon receipt of evidence satisfactory to the Superintendent of Banks that the resulting bank of such reorganization will be insured by the Federal Deposit Insurance Corporation upon consummation of the reorganization, the Superintendent of Banks shall approve the merger, consolidation or transfer of assets and liabilities.

The Superintendent of Banks may waive, in whole or in part, fees required by section 1125.16 of the Revised Code for any transaction made pursuant to this section.

SECTION 5. A special prosecutor shall be appointed by the attorney general as described in section 2939.10 of the Revised Code to investigate and prosecute any criminal violations that may have been committed in connection with any events and circumstances that caused any savings and loan association to be placed in the possession of a conservator as of March 15, 1985, and any criminal activity by any depositor, investor, director, officer, or employee of any savings and loan association, any unlawful activity in the operation of any savings, and loan association, or any unlawful activity by any state officer or employee in connection with the regulation, examination, inspection, or operation of any savings and loan association or any deposit guaranty fund or any person with whom an association had any contractual relationship.

SECTION 6. All assets, deposits or loans received by the deposit guaranty fund for state chartered building and loan associations, as created by Sub. S. B. 113 of the 116th General Assembly less any deposits by building and loan associations denied membership by the Federal Savings and Loan Insurance Corporation are hereby pledged to indemnify the corporation for any losses incurred by the corporation through defaults through June 30, 1987 of formerly privately insured state chartered associations accepted for membership by the corporation. In addition, the General Assembly shall appropriate $10,000,000, not withstanding the net amount provided by the deposit guaranty fund for these same purposes to the extent these funds are required.

SECTION 7. Within two working days of a privately insured state chartered building and loan association receiving notification that it has been denied insurance from the Federal Savings and Loan Insurance Corporation, the deposit guaranty fund as created by Sub. S. B. 113 of

the 116th General Assembly, shall pay to the association any funds on deposit by the association to the guaranty fund less any withdrawals by the association and plus interest earned on the net balances by the association on deposit with the guaranty fund. Interest earned shall be calculated on the daily interest received by the guaranty fund as determined by the funds' management.

SECTION 8. This act is hereby declared to be an emergency measure necessary for the immediate preservation of the public peace, health, and safety. The reason for such necessity lies in the fact that this action is essential to the best possible conclusion to a serious problem affecting public confidence in building and loan associations whose deposits are insured by deposit guaranty associations. Therefore, this act shall go into immediate effect.

_____

Speaker_____of the House of Representatives.

_____

President_____of the Senate.

Passed _____, 19___

Approved _____, 19___

_____

Governor.

The section numbering of law of a general and permanent nature is complete and in conformity with the Revised Code.

_____

Director, Legislative Service Commission.

Filed in the office of the Secretary of State at Columbus, Ohio, on the _____ day of _____, A. D. 19__.

_____

Secretary of State.

File No._____ Effective Date _____

[DEPOSIT GUARANTY ASSOCIATIONS]

§ 1151.80 Definitions.

As used in sections 1151.80 to 1151.92, inclusive, of the Revised Code:

(A) "Building and loan association" means a corporation organized for the purpose of raising money to be loaned to its members or to others; and includes "savings association";

(B) "Deposit guaranty association" means an association organized under the provisions of sections 1151.81 to 1151.86, inclusive, of the Revised Code;

(C) "Superintendent of building and loan associations" means the superintendent of building and loan associations in the state of Ohio created

by the provisions of section 121.04 of the Revised Code.

HISTORY: 126 v 94, § 1. Eff 10-11-55.

Cross-References to Related Sections

Fiduciary—
Deposit of funds, RC § 2109.41
Investment by, RC § 2109.37
Investment of funds by trustees of police and firemen's disability and pension fund, RC § 742.11.
Investment of surplus or reserve of state insurance fund, RC § 4123.44.2.
Investments by domestic life insurance company, RC § 3907.14.
Investments by public employees retirement board, RC § 145.11.
Investments by state teachers retirement board, RC § 3307.15(F)(1).

See RC § 1107.16 which refers to RC §§ 1151.80 to 1151.92.

CASE NOTES AND OAG

1. A deposit guaranty association organized under RC § 1151.80 et seq is not empowered to guaranty the permanent stock of member building and loan associations: 1956 OAG No.6299.

2. A deposit guaranty association organized under RC § 1151.80 et seq is empowered to guaranty withdrawable shares, stock deposit accounts or running stock of member building and loan associations: 1956 OAG No.6299.

3. A deposit guaranty association organized under RC § 1151.80 et seq is empowered to guaranty moneys on deposit with member building and loan associations pursuant to the pertinent provisions of RC § 1151.19, whether evidenced by passbook or certificate of deposit: 1956 OAG No.6299.

§ 1151.81 Incorporation of mutual deposit guaranty association.

Any number of building and loan associations incorporated pursuant to sections 1151.02, 1151.03 and 1151.04 of the Revised Code, not less than twenty-five, may become incorporated under the general corporation laws of this state as a mutual deposit guaranty association without capital stock subject to the limitations prescribed in sections 1151.80 to 1151.92, inclusive, of the Revised Code.

Articles of incorporation of a deposit guaranty association shall be filed in the office of the secretary of state. The secretary of state shall, upon receipt of such articles, transmit a copy of them to the superintendent of building and loans and shall not record them until authorized to do so by the superintendent.

HISTORY: 126 v 94, § 1. Eff 10-11-55.

§ 1151.82 Examination and certification by superintendent.

Upon receipt from the secretary of state of a copy of the articles of incorporation of a proposed deposit guaranty association the superintendent of building and loans shall at once examine into all the facts connected with the formation of such proposed corporation. In the event such articles of incorporation are correct in form and substance and the examination shows that such corporation, if formed, would be entitled to commence the business of a deposit guaranty association, the superintendent shall so certify to the secretary of state.

The superintendent may refuse to make such certification if upon examination he has reason to believe the proposed corporation is to be formed for any business other than assuring the liquidity of member building and loan associations and guarantying deposits therein, if he has reason to believe that the character and general fitness of the incorporators are not such as to command the confidence of the general public or if the best interests of the public will not be promoted by its establishment.

HISTORY: 126 v 94, § 1. Eff 10-11-55.

CASE NOTES AND OAG

1. The sole purpose of the legislature in making possible a deposit guaranty corporation is to guaranty the liquidity of its member associations: Ohio Deposit Guarantee Fund v. Dziamba, 60 OO 426, 137 NE(2d) 905 (CP).

2. The refusal of the superintendent of building and loan associations to certify the articles of incorporation of a deposit guaranty association because of certain provisions or lack of provisions in a proposed constitution and by-laws constitutes an arbitrary and discriminatory act: Ohio Deposit Guarantee Fund v. Dziamba, 60 OO 426, 137 NE(2d) 905 (CP).

§ 1151.83 Recording of articles of incorporation; certified copies.

Upon receipt of the certificate provided for in section 1151.82 of the Revised Code, the secretary of state shall record the articles of incorporation of such deposit guaranty association and furnish a certified copy thereof to the incorporators and to the superintendent of building and loan associations. All papers thereafter filed in the office of the secretary of state relating to such corporation shall be recorded as provided by law and a certified copy forwarded to the superintendent.

HISTORY: 126 v 94 (95), § 1. Eff 10-11-55.

§ 1151.84 Proposed amendments transmitted to superintendent.

When any proposed amendments to the articles of incorporation of a deposit guaranty association are filed in the office of the secretary of state, the secretary of state shall transmit a copy thereof to the superintendent of building and loan associations and shall not record such amendments until authorized to do so by the superintendent.

HISTORY: 126 v 94 (95), § 1. Eff 10-11-55.

§ 1151.85 Examination and certification of amendments.

Upon receipt from the secretary of state of a copy of proposed amendments to the articles of

incorporation of a deposit guaranty association the superintendent of building and loan associations shall at once examine the proposed amendments to determine their effect on the operation of the deposit guaranty association.

In the event such proposed amendments are correct in form and substance and the examination shows that if adopted they would not change the character or principal business of the deposit guaranty association, the superintendent shall so certify to the secretary of state.

The superintendent may refuse to make such certification if upon examination he has reason to believe the proposed amendments would change the character of the business of the guaranty deposit association or the best interests of the public will not be promoted by their adoption.

HISTORY: 126 v 94 (96), § 1. Eff 10-11-56.

§ 1151.86 Recording of amendments; certified copies.

Upon receipt of the certificate provided for in section 1151.85 of the Revised Code, the secretary of state shall record the amendments to the articles of incorporation and furnish a certified copy thereof to the corporation and to the superintendent of building and loan associations.

HISTORY: 126 v 94 (96), § 1. Eff 10-11-56.

§ 1151.87 Powers of associations.

A deposit guaranty association incorporated in accordance with sections 1151.81 to 1151.86 of the Revised Code, may:

(A) Assure the liquidity of member building and loan associations;

(B) Guaranty moneys on deposit, but not the permanent stock of associations;

(C) Loan money to a member building and loan association for the purpose of assuring its liquidity and deposits therein;

(D) Buy any assets owned by a member building and loan association for the purpose of assuring its liquidity and deposits therein;

(E) Invest any of its funds in:

(1) Bonds or interest bearing obligations of the United States or for which the faith and credit of the United States are pledged for the payment of principal and interest;

(2) Bonds or interest bearing obligations of the District of Columbia, of this state, of any county, township, school district, or other political subdivision of this state, or of any municipal corporation in this state;

(3) Farm loan bonds issued under the "Federal Farm Loan Act," 39 Stat. 360, 12 U.S.C. 641 (1916), and amendments thereto;

(4) Notes, debentures, and bonds of the federal home loan bank issued under the "Federal Home Loan Bank Act," 47 Stat. 725, 12 U.S.C. 1421 (1932), and any amendments thereto;

(5) Bonds or other securities issued under the "Home Owners Loan Act of 1933," 48 Stat. 128, 12 U.S.C. 1461, and any amendments thereto;

(6) Securities acceptable to the United States to secure government deposits in national banks;

(7) Certificates of deposit of any financial institution that is subject to inspection by the United States or by this state.

(F) Issue its capital notes or debentures to member building and loan associations provided the holders of such capital notes or debentures shall not be individually responsible as such holders for any debts, contracts, or engagements of the deposit guaranty association issuing such notes or debentures;

(G) Borrow money;

(H) Exercise any corporate power or powers not inconsistent with, and which may be necessary or convenient to, the accomplishment of its purposes of assuring liquidity of member building and loan associations and guaranteeing deposits therein.

HISTORY: 139 v S 426. Eff 12-9-82.

Ohio Administrative Code

Negotible order of withdrawal account. OBL: OAC 1301: 2-5-21

Law Review

Developments in Ohio savings and loan law: 1980. Ronald E. Alexander. 17 AkronLRev 357 (1981).

Regulating State Chartered Savings Associations: An Introduction to the Ohio Scheme. Ronald E. Alexander. 11 AkronLRev 399 (1978).

The Ohio deposit guarantee fund—the Ohio alternative to FSLIC. Ronald Alexander. 15 AkronLRev 431 (1982).

§ 1151.88 Filing of semiannual financial reports.

Each deposit guaranty association shall on the thirtieth day of June and the thirty-first day of December of each year, or within forty days thereafter, file with the superintendent of building and loan associations a report for the preceding half year, showing its financial condition at the end thereof.

Such reports shall be in such form and contain such information as prescribed by the superintendent.

HISTORY: 126 v 94 (96), § 1. Eff 10-11-56.

§ 1151.89 Annual examination of building and loan associations.

At least once each year the superintendent of building and loan associations shall make or cause to be made an examination into the affairs of each deposit guaranty association doing business in this state. The expenses of such yearly examination shall be paid by the state.

HISTORY: 126 v 94 (97), § 1. Eff 10-11-56.

CASE NOTES AND OAG

1. The statute (RC § 1151.89 et seq) gives the absolute right of the superintendent to make investigations and examinations and inspections of any

deposit guaranty company in the same manner as he is empowered to supervise and control the operation of all member building associations. Any abuse of authority, power or discretion on the part of such guaranty association may be dealt with as completely and adequately as with any member building and loan association: Ohio Deposit Guarantee Fund v. Dziamba, 60 OO 426, 137 NE(2d) 905 (CP).

§ 1151.90 Special examinations.

Whenever the superintendent of building and loan associations deems it necessary he may make or cause to be made a special examination of any deposit guaranty association doing business in this state in addition to the regular examination provided for by section 1151.89 of the Revised Code. The expense of a special examination shall be paid by the association. Such expenses shall be collected by the superintendent and paid into the state treasury to the credit of the general revenue fund.

HISTORY: 125 v 94 (97), § 1. Eff 10-11-53.

§ 1151.91 Right to enter and conduct investigations.

The superintendent of building and loan associations or any examiner appointed by him shall have access to and may compel the production of all books, papers, securities, moneys, and other property of a deposit guaranty association under examination by him. He may administer oaths to and examine the officers and agents of such association as to its affairs.

HISTORY: 125 v 94 (97), § 1. Eff 10-11-53.

§ 1151.92 Fees.

Each deposit guaranty association doing business in this state shall pay to the superintendent of building and loan associations, at the time of filing each semiannual report required by section 1151.88 of the Revised Code, five dollars plus a sum equal to one one-hundred-sixtieth of one per cent of the assets of such association as shown in such report. All such fees shall be paid into the state treasury to the credit of the division of building and loan associations special account.

*HISTORY: 136 v S 447 (Eff 5-19-76); 137 v S 221. Eff 11-23-77.

The provisions of § 12 of SB 221 (137 v —) read as follows:

SECTION 12. Services rendered by the unclaimed funds section of the Department of Commerce shall include the necessary costs of making publications required by Chapter 169. of the Revised Code and of paying other operating and administrative expenses. Adjustments to the Unclaimed Funds rotary fund appropriation shall be made to cover the actual expenses of this section. The amounts appropriate to the Department of Commerce in Am. Sub. H.B. 191 of the 112th General Assembly for appropriation item 800-613 Building and Loan Rotary shall be con-

Ohio Deposit Guarantee Fund

Constitution

CONSTITUTION

OF THE

OHIO DEPOSIT GUARANTEE FUND

ARTICLE I
NAME

The name of the corporation shall be: "OHIO DEPOSIT GUARANTEE FUND."

ARTICLE II
LOCATION

The principal office of the corporation shall be located in Cincinnati, Hamilton County, Ohio.

ARTICLE III
PURPOSE

The purpose of the corporation shall be to use the full extent of it powers, authority and resources to provide for the liquidity of its members and to guarantee the moneys on deposit in member associations, whether evidenced by passbook, or certificates of deposit, withdrawable shares, stock deposit accounts, or running stock of member building and loan associations and savings associations, but not the permanent stock, debentures or similar stock accounts.

ARTICLE IV
POWERS

The corporation shall have all of the powers granted by Sections 1151.80 to 1151.92 inclusive of the Ohio Revised Code to mutual deposit guarantee associations and as may be hereafter provided by law; and shall have the powers granted by the general corporation laws of Ohio to non-profit corporations.

ARTICLE V
DEPOSITS

Each member shall maintain a deposit with the corporation in such amount and under such terms and conditions as shall be determined by the Board of Trustees, not to exceed two percent (2%) of the deposit liability of such member, which shall be uniformly applied to all members. Such deposit shall be evidenced by certificates of deposit of the corporation. No additional deposit will be required except on an affirmative vote of members having deposit liabilities aggregating more than sixty percent (60%) of the total deposit liability of all members at a regular meeting or a special meeting called for the purpose. All deposits and certificates issued therefor shall be rounded off to the nearest Hundred Dollars. Members may carry such certificates on their books as assets and these may be considered as a liquid asset by the member. Members may not, without the consent of the Board of Trustees, use such certificate or certificates as collateral for loans. Deposits of members shall be adjusted semi-annually to conform to changes in deposit liability, as shall be determined by the Board of Trustees.

In addition to the above deposit, a new member shall, upon admission, contribute to the accumulated reserves of the corporation a sum equal to the accumulated reserves at the end of the calendar quarter immediately preceding such admission multiplied by the

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ARTICLE V
DEPOSITS
(continued)

fraction whose numerator shall be the required deposit of such new member and the denominator shall be the aggregate of deposits of all members.

ARTICLE VI
MEMBERS

SECTION 1

Only companies organized under Sections 1151.02, 1151.03 and 1151.04 of the Ohio Revised Code may be members of the corporation. On or before the 31st day of July each year, each member, by action of its Board of Directors, shall appoint one of its officers or directors to be its Representative, and one of its officers or directors to be its Alternate Representative who shall serve in the absence of the Representative, and shall thereafter notify the corporation of its appointment. On October first of each year following such notification, each Representative and Alternate Representative shall be the Representative and Alternate Representative of the member appointing them until October first of the following year or until their successors are chosen and qualified. At all meetings of members, the vote of each Representative or Alternate Representative shall be the vote of the member association which appointed him.

ARTICLE VI
MEMBERS
(continued)

SECTION 2. Vacancies

Whenever a vacancy occurs in the office of Representative or Alternate Representative of any member, by reason of death, resignation or failure to continue in office as an officer or director, such member, by action of its Board of Directors, shall appoint a successor to fill such vacancy for the unexpired term and shall notify the corporation of its appointment.

ARTICLE VII
MEETINGS AND
NOTICES

SECTION 1. Annual Meeting of Members

The Annual Meeting of members shall be held in October of each year, not earlier than the fifteenth (15th) day thereof, for the purpose of electing the Trustees and conducting such other business as may properly come before the meeting. The Board of Trustees shall designate the time and the place of said meeting and the Secretary shall notify the Representatives at least fourteen (14) days in advance of said meeting by mail. Said notice shall contain the time, place and purpose of the meeting.

Section 2. Special Meetings of Members

Special meetings of members shall be held whenever called by the Board of Trustees, the President, or by at least five (5) Representatives or

ARTICLE VII
MEETINGS AND
NOTICES
(continued)

twenty percent (20%) of the Representatives, whichever is larger, joined together for such purpose. The President, or such group of Representatives, shall notify the Secretary of the purpose of the meeting in writing. The Secretary shall notify all the Representatives of the call, time, place and purpose of said meeting, in writing, at least fourteen (14) days in advance of said meeting.

Section 3. Notices

All notices for Annual or Special Meetings shall be mailed to the address given by the member in its notice of appointment or such other address as the Representatives or Alternate Representatives shall designate.

Section 4. Quorum

Fifteen (15) Representatives or twenty percent (20%) of the Representatives, whichever is larger, shall constitute a quorum of members, and at each meeting of members, whether Annual or Special, said quorum may act by and through a majority of Representatives in attendance, and the act and deed of such majority shall be binding and conclusive as the action of all of the members in all respects.

ARTICLE VIII
BOARD OF
TRUSTEES

Section 1. Number of Trustees

The Board of Trustees shall consist of not less than nine (9) nor more than fifteen (15) Trustees. Only an officer or a director of a member shall be eligible to serve as a Trustee. The terms of office of elected Trustees shall not be less than one (1) year nor more than three (3) years. Representatives may increase or decrease the number of Trustees, within the limits herein prescribed, at any Annual or Special Meeting called for that purpose. A decrease will not affect the term of a Trustee then in office.

Trustees shall be elected by the Representatives at the Annual Meeting in such numbers and to serve for such terms that an equal number of Trustees, as nearly as possible, will expire each year. Elections shall be by ballot if more candidates are nominated than number of Trustees to be elected. Trustees shall be limited to two (2) consecutive terms of office, but may be eligible to serve after one (1) full year's absence on the Board.

The Board of Trustees may make recommendations to the membership as to the number of Trustees and may nominate a duly qualified person as Trustee.

Any five (5) Representatives may also nominate a Trustee by written nomination, provided such nomina-

ARTICLE VIII
BOARD OF
TRUSTEES
(continued)

tion is made in writing and addressed to the Executive Vice-President and received by him at least five (5) days prior to the Annual Meeting.

Section 2. Compensation

The Trustees shall serve without compensation as Trustees, but may be reimbursed for expenses as may be required from time to time in the performance of their duties as Trustees.

Section 3. Termination of Office and Vacancies

The office of a Trustee shall be terminated by reason of death, resignation, failure to continue in office as an officer or director of a member or failure to attend three (3) consecutive meetings. Whenever such vacancy occurs, the remaining members of the Board of Trustees shall appoint a successor to fill such vacancy for the unexpired term.

Section 4. Meetings of Board of Trustees

The Board of Trustees shall meet at least once every three (3) months, and may, from time to time, by action of the Board of Trustees, establish additional regular meetings of the Board of Trustees. The President may call a special meeting of the Board of Trustees at any time and the Executive Vice-President shall notify the members of the Board of

ARTICLE VIII
BOARD OF
TRUSTEES
(continued)

Trustees by notice, in writing, at least five (5) days prior to said meeting.

Section 5. Quorum

A majority of the Board of Trustees shall constitute a quorum at any meeting of the Board of Trustees. At any meeting of said Board, at which a quorum is present, said Board may act by and through a majority of the Trustees in attendance and the act and deed of such majority shall, in all respects, be binding and conclusive as the action of the whole Board.

ARTICLE IX
OFFICERS AND
COMMITTEES

Section 1.

The officers of the corporation shall be elected annually by the Board of Trustees at an organizational meeting to be held following the Annual Meeting of the corporation or at a regular or special meeting of the Board, if necessary, and shall consist of the following: President, and a Vice-President, all from its own number; one or more Vice-Presidents; a Secretary and a Treasurer. The Board shall elect an Executive Vice-President who shall not be an officer or director of any building and loan association, who shall administer the policies of the Board. The Board will appoint

ARTICLE IX
OFFICERS AND
COMMITTEES
(continued)

an attorney or attorneys and an auditor or firm of auditors, who shall be certified public accountants. The Executive Vice-President, attorney or attorneys, and auditor or firm of auditors, will all serve at the pleasure of the Board. The Board may employ such other persons as it deems necessary. No full time employee may be a director or officer of any building and loan association. Officers so elected shall take office immediately and shall hold office for a term of one year or until their successors are elected and qualified. The office of President shall not be held for more than two (2) consecutive terms by the same person.

Section 2.

The President shall appoint an Executive Committee of five (5), with the approval of the Board of Trustees, all of whom shall be Trustees, who shall act for the Trustees of the corporation in the interim between the meetings of the Board of Trustees and have such duties and powers as is delegated to them by the Board of Trustees. The President shall appoint an Advisory Committee of seven (7), with the approval of the Board of Trustees, all of whom shall be officers or directors of members, who shall have such duties and

ARTICLE IX
OFFICERS AND
COMMITTEES
(continued)

authority as shall be delegated to them by the Board of Trustees. The Executive Vice-President shall be the Executive Secretary of both committees without vote.

Section 3.

The Board of Trustees shall have the power to adopt, amend, repeal and enforce such By-Laws, resolutions, rules and regulations and orders as they may deem necessary to enable them to properly manage and control all the business, property and rights of the corporation.

Section 4.

The officers shall have the powers and duties as may be prescribed by the By-Laws.

Section 5.

The Board of Trustees may elect such other officers and provide for such committees, either temporary or permanent, as it deems necessary.

Section 6.

In addition to the powers granted heretofore, the Board of Trustees is charged with the following specific responsibilities:

ARTICLE IX
OFFICERS AND
COMMITTEES
(continued)

(a) The Board of Trustees shall have the sole right to admit additional members to membership in the corporation on such terms and conditions as the Board may prescribe, and for due cause shall have the sole right to revoke membership in the corporation.

(b) The Board of Trustees may require regular and special reports, statements and audits of its members.

Section 7.

Any rule and regulation or order may be amended or repealed by a vote of the members at a duly constituted meeting called for that purpose.

ARTICLE X
AMENDMENTS

The Charter and Constitution of the corporation may be altered, amended, repealed, or superseded either in whole or in part by the affirmative action of a majority of the members, at any meeting of members called for that purpose.

ARTICLE XI
DISSOLUTION

The corporation may be merged or dissolved or otherwise terminate its existence, in accordance with the General Corporation Act of Ohio, with the provision that any action of the members to bring about a dissolution or termination of the existence of the corporation shall require the affirmative vote of not less than eighty percent (80%) of the members.

Notwithstanding the provisions of Article X of this Constitution, this Article XI may be amended only by the affirmative vote of not less than eighty percent (80%) of the members.

Ohio Deposit Guarantee Fund

By-Laws

BY-LAWS

OF THE

OHIO DEPOSIT GUARANTEE FUND

SECTION I
DUTIES OF
OFFICERS

A. President

The President shall preside at all meetings of the corporation, and of the Board, and shall have such authority and perform the duties as they pertain to said office as may be required of him.

B. First Vice-President

The First Vice-President, who is a Trustee, shall perform the duties of the President in the event of his absence.

C. Secretary

The Secretary shall keep a complete record of all the proceedings of all meetings of members and of the Board and shall perform the duties as shall pertain to said office and such other duties as may be required of him.

D. Treasurer

The Treasurer shall perform the duties usually incident to the office of the Treasurer and such other duties as may be required of him.

E. Executive Vice-President

The Executive Vice-President shall be a salaried officer who shall devote his entire business

SECTION I
DUTIES OF
OFFICERS
(continued)

time to the affairs of the corporation. He shall administer the policies of the Board, and, as such, he shall be the general receiving, disbursing, and managing officer of the corporation under the Board and the Executive Committee, and, with the assistance of such employees as the Board may provide, shall have the care and management of all the corporation's business, rights, and affairs for which there is no other provision in the Constitution or By-Laws of the corporation. In the performance of his duties, he shall exercise such authority over the subordinate officers and employees as shall be necessary or appropriate. He shall receive notice of and attend all meetings of the members of the corporation, of the Board, of the Executive Committee, and of the Advisory Committee, and may act, if chosen, as secretary of any committee.

SECTION II
ATTORNEY

The Attorney shall represent the corporation in all legal proceedings; he shall draw all necessary legal papers, give his advice and counsel whenever requested, and render such other services as may be required by the Board.

SECTION III
AUDITOR

The Auditor shall annually examine the books and records of the corporation and render an opinion of same and perform such other duties as are required by the Board.

SECTION IV
COMMITTEES

A. Executive Committee

The President shall appoint the Chairman of the Executive Committee who shall preside at all meetings of the Committee. The Executive Vice-President shall be ex-officio the secretary of the Committee without vote. Members of the Committee shall hold office until the next Annual Meeting following their appointment and until their successors are appointed and qualified. A majority of members of the Committee shall constitute a quorum for the transaction of business.

The Committee shall establish the policy for investment of funds within the limitations prescribed by Section 1151.87 of the Revised Code and shall establish the policy regarding the sale of investments or other assets, real or personal, of the corporation. The Committee may borrow money and secure loans so made by a pledge or mortgage of any of the property, real or personal, of the corporation.

If, in the opinion of the President, or of the Vice-President acting in the capacity of President, an emergency exists and it is impossible to get a quorum to act at once, he may appoint one or more members of the Board to act temporarily as a

SECTION IV
COMMITTEES
(continued)

member of the Executive Committee to provide a quorum so that the Committee may function during the emergency. Minutes of meetings of the Executive Committee shall be submitted to the Board at its next regular meeting.

B. Advisory Committee

The Committee shall, at its first meeting, organize by electing one of its members as its Chairman who shall preside at all meetings of the Committee.

The Executive Vice-President shall be ex-officio a member of said Committee without the power to vote. The Advisory Committee may inquire into the financial condition and management policies of each member of the corporation and shall recommend to any member actions or policies it considers necessary or advisable for such member to take to adopt in order to place or preserve such member in a condition to safeguard properly the interests of its depositors. If its recommendations are not complied with within a reasonable time to the complete satisfaction of the Committee, it shall so report to the Board at its next meeting, including in its report its recommendations with respect to the action to be taken by the Board.

SECTION IV COMMITTEES (continued)

Said Committee shall have authority to counsel with the Board of Directors of members.

All applications for membership in the corporation shall be submitted to the Advisory Committee for its review and recommendation to the Board. The Advisory Committee shall meet at least quarterly and special meetings may be called at any time by the Executive Vice-President or the Chairman of the Committee. Minutes of all meetings of the Advisory Committee shall be submitted to the Board.

SECTION V WAIVER

Members of the Board may waive notice of a meeting required to be given by law or by the Constitution of the corporation, and, by attendance at a meeting, shall be deemed to have waived such notice.

SECTION VI AUTHORIZED SIGNATURES

All certificates of deposit, notes, deeds, mortgages, contracts, and all instruments in writing not herein specifically enumerated other than checks for the disbursement of money, shall be signed by any two (2) of the following officers: President; First Vice-President; Executive Vice-President; Secretary or Treasurer, or such officers as shall be designated by

SECTION VI AUTHORIZED SIGNATURES (continued)

the Board of Trustees to sign on behalf of the corporation. No officer shall sign in more than one capacity.

SECTION VII DEPOSITORIES AND DISBURSEMENTS

All funds shall be under the control of the Board of Trustees, who shall cause them to be deposited in the name of the corporation with its designated depository or depositories, and such funds shall be withdrawn from such depository only on check of such depository or depositories, to be signed by such officer or officers as designated by resolution of the Board.

SECTION VIII INDEMNITY BOND

All officers and employees of the corporation, before entering upon the discharge of their duties, shall be covered by an individual, schedule or blanket fidelity bond in favor of the corporation in an amount required by, and with the terms and surety approved by, the Board. The Trustees, as such, shall not be required to give bond.

SECTION IX PARTICIPATION BY TRUSTEES IN MATTERS BEFORE BOARD

Any member of the Board of Trustees who represents, as counsel, director or other officer, a member of the Fund which has a matter before the Trustees, which may require action by the Trustees, may present to the Trustees the case of the member which he represents, but such member of the Trustees shall not participate any further in the deliberation of the Trustees or the action of the Trustees with respect to such matter.

SECTION X PARTICIPATION BY ADVISORY COMMITTEE MEMBERS IN MATTERS BEFORE COMMITTEE

Any member of the Advisory Committee who represents, as counsel, director or other officer, a member of the Fund which has a matter before the Committee which may require a recommendation by the Committee, may present to the Committee the case of the member which he represents, but such member of the Committee shall not participate, any further, in the deliberation of the Committee of the recommendation of the Committee with respect to such matter.

SECTION XI
AMENDMENTS

These By-Laws may be altered, amended, repealed, or superseded either in whole or in part by the affirmative action of a majority of members of the Board at any meeting of the Board called for that purpose. A proposal to amend shall be filed with the Executive Vice-President at least two (2) weeks prior to the meeting at which said amendment is to be considered, and the Executive Vice-President shall include said proposal with the notice of the meeting. Any amendment so adopted must be substantially the same as proposed.

Ohio Deposit Guarantee Fund

Rules and Regulations

INDEX TO RULES AND REGULATIONS

OF THE

OHIO DEPOSIT GUARANTEE FUND

RULES AND REGULATIONS
OF THE
OHIO DEPOSIT GUARANTEE FUND

ITEM I.
APPLICATION FOR MEMBERSHIP

(A) ELIGIBLE

Any building and loan association of this state which is not a member of the Fund may, upon compliance with such conditions as may be prescribed by the Board, become a member of the Fund.

(B) RECORDS AND FILES

Applicants for membership in the Fund and members of the Fund agree to authorize the Superintendent to make available to the Fund the records and files in his office as to the management and condition of each member. Said authorization shall be in the form agreed upon by the Fund or the Superintendent.

(C) ADVERTISING MEMBERSHIP

A member may advertise itself as a member of the Fund and may use the symbol in its advertising as long as it is a member. The Fund reserves the right to prescribe the form in which the guarantee of deposits may be advertised.

ITEM 11.

STANDARDS AND QUALIFICATIONS

The following standards and qualifications shall be required of all members of the Fund and their maintenance shall be a condition of continuous membership or admittance to membership in the Fund.

(A) LIQUIDITY

Each member shall establish and maintain unpledged liquid assets equivalent to 7% (or such other percentage as determined by the Board of Trustees) of its net deposit liability and borrowed money. However, a member shall not be required to maintain the required percentage on borrowed money that is collateralized by a liquid asset as hereafter defined.

For purposes of this regulation, the following items shall be considered as liquid assets:

1) Cash.
2) U.S. Treasury Bonds, Notes or Bills.
3) Municipal obligations and federal funds, as prescribed in Section 1151.34(B), Ohio Revised Code.
4) Investments in any of the following:
   a) Stock in Federal Home Loan Bank.
   b) Deposit in Ohio Deposit Guarantee Fund.
   c) Bank for Cooperatives Bonds.
   d) Federal Land Bank Bonds.
   e) Federal Intermediate Credit Bank.
   f) Federal International Credit Banks Consolidated Systemwide Bonds.

ITEM II

STANDARDS AND QUALIFICATIONS

(A) LIQUIDITY (continued)

g) Federal Home Loan Bank Bonds.

h) Federal National Mortgage Association Bonds.

i) Government National Mortgage Association Bonds.

j) Bankers acceptances of a bank insured by Federal Deposit Insurance Corporation.

5) Deposits in Federal Home Loan Bank -- both demand and time.

6) Deposits in Bank for Savings & Loan Associations.

7) Certificates of Deposit in any financial institution subject to inspection by the United States or by the State of Ohio.

8) Any other type of investment similar to those listed that may be approved from time to time by the Board of Trustees.

That portion of any liquid asset that is pledged or used as collateral for public deposits or used in reverse repo transactions cannot, at the same time, be construed as a liquid asset.

In the event that liquid assets are used as collateral for borrowed money, public deposits, or reverse repo transactions, only the amount of the liquid assets equal to the amount of the borrowed money, public deposit or reverse repo transaction need be deducted from the book value of the liquid assets in determining the 7% liquidity requirement. However, in the event the lender, etc. specifically requires liquid collateralization on a greater basis than one for one, the additional amount required shall also be deducted.

ITEM II

STANDARDS AND QUALIFICATIONS

(A) LIQUIDITY (continued)

Specifically excluded as liquid assets are all mortgage backed securities and revenue bonds.

If, for any consecutive seven (7) business days, the liquid assets of the member remain less than the fixed requirement and, during that period, the member makes loans, the member may be assessed a fine of not more than $500.00 for each day when loans were made. The amount of the fine shall be determined by the Board of Trustees, upon reviewing the facts disclosed to them by the Supervisory Section of the Fund.

At its discretion, the Board of Trustees may waive any fine or penalty assessed.

# # #

ITEM II. STANDARDS AND QUALIFICATIONS (continued)

(B) LOSS RESERVE AND OTHER NET WORTH ACCOUNTS

Each member or applicant for membership shall maintain or show reasonable ability to maintain, a Loss Reserve and other net worth accounts in accordance with the requirements of the Ohio Revised Code and the Superintendent, Division of Building and Loan Associations, State of Ohio.

(C) REAL ESTATE OWNED

No member or applicant for membership shall hold real estate, acquired through mortgage foreclosure or deed in lieu thereof, the aggregate value of which is in excess of three percent (3%) of its total assets.

(D) SLOW LOANS

No member or applicant for membership shall permit the aggregate of its slow loans, as defined by the Division of Building and Loan Associations, to exceed a sum equal to two percent (2%) of its total assets.

(E) TAXES AND INSURANCE

Each member or applicant for membership shall maintain office records which show payment or non-payment of taxes and insurance premiums upon all property upon which the member or applicant holds

ITEM II. STANDARDS AND QUALIFICATIONS (continued)

a mortgage, and upon real estate owned.

(F) SHAREHOLDERS' APPROVAL

Each member or applicant for membership shall obtain the approval by its shareholders of its membership or application for membership in the Fund, and shall, within sixty (60) days following its admittance to membership, present to the Fund a certified copy of minutes of the meeting at which such approval was given.

(G) HOLDING COMPANIES

Each member, the records of which disclose that more than twenty percent (20%) of its voting stock is owned by a person or corporation not organized under Chapter 1151 of the Ohio Revised Code, shall report this fact promptly to the Fund. The Fund, upon receipt of such notice, or within six (6) months thereafter, may then declare the member to be not eligible for continued membership in the Fund. In such event, said member shall withdraw from the Fund within two (2) months after the Fund has declared it to be not eligible for continued membership. Such member shall be entitled to withdraw from the Fund, in the manner provided in these Rules and Regulations.

ITEM II. STANDARDS AND QUALIFICATIONS (continued)

The Fund may reject any application made for membership in the Fund, if it finds that more than twenty percent (20%) of the voting stock of the applicant is owned by a person or corporation not organized under Chapter 1151 of the Ohio Revised Code.

If, after the receipt of notice that more than twenty percent (20%) of the voting stock of a member or applicant for membership is owned by a person or corporation not organized under Chapter 1151 of the Ohio Revised Code, and the Fund decides to retain such member or admit such applicant for membership, such member and the person or corporation owning in excess of twenty percent (20%) of the voting stock may, at the discretion of the Board of Trustees, be required to comply with the following regulations:

1. No dividends may be declared or paid when the aggregate of the subject member's statutory reserves and undivided profits are less than five percent (5%) of its withdrawable money.

ITEM II.

STANDARDS AND QUALIFICATIONS (continued)

2. The Fund shall have the right to audit or review the records of the person or corporation owning in excess of twenty percent (20%) of the voting stock of a member and any other subsidiary owned or controlled by such person or corporation whenever the Fund considers such audit or review necessary for its best interest.

3. A member whose voting stock is owned, as stated above, shall have its stockholder or corporation, at its expense, submit copies of all reports requested by the Fund which it considers necessary for the protection of its interest. Such reports shall include, but not be limited to, copies of annual audits performed by certified public accountants and copies of reports filed annually with the Securities and Exchange Commission.

4. Transactions and dealings between a member and any person owning more than twenty percent (20%) of the voting stock of such member, and any other corporations, partnerships, trusts, or similar organizations in which said person or his family has an interest, is prohibited, without the prior approval of the Fund.

ITEM II. STANDARDS AND QUALIFICATIONS (continued)

5. Transactions and dealings between a member and its parent corporation, or any subsidiaries of the parent corporation or major stockholder of the parent or any of the subsidiaries, wherein the proceeds of any transaction or dealing made by such member inure to the benefit of any of the above, is strictly prohibited without the prior approval of the Fund.

(H) TEST APPRAISALS

Whenever a member is in violation of Subsections (C) or (D) of this section and an examination made by the Division of Building and Loan Associations, or an audit conducted by the Fund's staff discloses that the member company is or has been engaged in unsound, unsafe or imprudent lending practices, it shall be reported to the Board of Trustees. Under such circumstances, the Board of Trustees has the authority to cause test appraisals to be made of the real estate owned by such member and the real estate securing its loans, by an independent appraiser selected by the Fund. The cost of such test appraisals will be borne equally by the member and the Fund.

In the event the test appraisals indicate that the member is or has been engaged in unsound, unsafe or imprudent lending practices, the Board of Trustees

ITEM II. STANDARDS AND QUALIFICATIONS (continued)

may require the member to set up a Specific Reserve in the amount by which the balance of the loan exceeds the appraised value of the real estate security and also, to have all future real estate offered as security for loans appraised by an independent appraiser selected by the Fund for such period as the Board may determine.

(I) DEFERRED CHARGES AND INCOME

Each member or applicant for membership shall charge off premiums, on mortgage loans purchased when paid, or may capitalize them. If capitalized, a proportionate amount of the premium shall be charged to expense, at least semi-annually, over the remaining term of the loans or over a period not exceeding the average remaining term of the loans, or seven (7) years, whichever is less.

Each member or applicant for membership shall defer discounts on loans purchased over a period of not less than seven (7) years; the discount shall be credited to income at least semi-annually. Any charge made by the purchaser in connection with the purchase of a loan shall be deducted from the purchase price to determine the amount of the discount.

ITEM II.

STANDARDS AND QUALIFICATIONS (continued)

(Rev. 2/80)

All charges for finder's fees, buying commission, attorney's fees, and brokerage fees in connection with the making or acquisition of a mortgage loan or contract, shall be treated as an expense in the accounting period in which such charges are incurred.

(Rev. 4/25/84)

Each member shall credit to an account descriptive of deferred income any amounts charged in connection with making a loan or contract (other than average interest provided by the loan contract) all amounts in excess of the greater of $50.00, or four and one-half percent (4-½%) of the amount of the loan, if the loan is for the purpose of construction, or four percent(4%) of the loan or contract, if the loan is for any other purpose, plus $400.00 for either type of loan or contract when members utilize employees of the institution to perform appraisal, attorney or loan closing functions. A proportionate amount of this deferred income shall be credited to income, at least semi-annually over a period of not less than seven (7) years. Amounts collected from the borrower and paid out to third parties for necessary initial charges in connection with the mortgage loan or contract transaction are excluded from computing deferred income.

ITEM II. STANDARDS AND QUALIFICATIONS (continued)

On loans sold, by participation or otherwise, capitalized premiums and/or deferred credits or discounts applicable to such loans as of the sale date shall be added to or deducted from (as appropriate) the book value, and the profit or loss thereon shall be recognized as of that date.

On loans paid in full, the above may apply; however, it is not mandatory, as it is on loans sold.

(J). SERVICE CORPORATION ACTIVITIES

A service corporation in which any member has an interest or any subsidiary of a service corporation is prohibited from entering into any transaction wherein a director, officer, employee of the member or corporation, or person or corporation owning or controlling 20% or more of the member's stock has a direct or indirect interest without the prior written approval of the Ohio Deposit Guarantee Fund.

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ITEM II. STANDARDS AND ALIFICA-TIONS (continued)

(Approved by Board of Trustees -- 9/26/84)

(K) BROKERED DEPOSITS AND JUMBO CERTIFICATES OF DEPOSIT

Brokered Deposits are defined as funds received, in which a third party intermediary, acting as a broker, comes between the owner of the money and the depository. This broker represents either party for a fee --- or other consideration --- usually paid to the broker by the depository. A savings promotion by a member, in which the employee receives a bonus for bringing savings into the Association, is not considered brokered savings, provided no one other than the employee is involved in obtaining the savings deposits.

Jumbo Certificates of Deposit are defined as Certificates of Deposit in an amount of $100,000 or more or a combination of amounts exceeding $100,000, which are controlled by the same account holder, and which are specially negotiated as to rate and/or duration.

With respect to the above, a member or applicant for membership shall comply with the following:

1) Brokered Deposits and Jumbo Certificates, in the aggregate, shall not exceed five percent (5%) of a member's current total deposit liability.

ITEM II.

STANDARDS D QUALIFICATIONS (continued)

However, Brokered Deposits and/or Jumbo Certificates may be accepted in excess of the 5% limit, if such excess is invested in a liquid instrument that matures within seven (7) days of the maturity date of the Brokered Deposit or Jumbo Certificate.

Mortgage loans, construction loans, and other forms of loans will not be considered as liquid investments.

2) Any tie-in of Brokered Deposits or Jumbo Certificates to the granting of credit is prohibited.

3) In the event the Board of Trustees determines that a member is a supervisory problem, it may, by action taken at any regular or special meeting, prohibit any future acceptance of Brokered Deposits or Jumbo Certificates by said member until such time as the Board of Trustees, in its opinion, no longer considers said member to be a supervisory problem.

4) A member shall have the right to submit to the Board of Trustees a written request for authorization to exceed the percentage

ITEM II.

STANDARDS A. QUALIFICATIONS (continued)

limitation in 1) above. Such request shall set forth the reasons for additional authorization, together with supporting documentation. The Board of Trustees shall have the sole right to approve or disappprove such request.

5) Brokered Deposits and Jumbo Certificates, held as of May 31, 1984, that exceed the percentage limit in 1), may not be renewed without the specific approval of the Fund, except that Jumbo Certificates existing in member institutions as of May 31, 1984, are "grandfathered" and may be continuously renewed.

ITEM III. DEPOSITS AND PENALTIES

(A) DEPOSITS

1. If additional deposits are voted, in accordance with Article V of the Constitution, any member not voting in favor of such call may resign from membership by filing with the Fund, within thirty (30) days after such a vote is taken, a written notice of its intention to resign. Such resignation shall become effective upon compliance with and in accordance with the provisions of the Rules and Regulations. The member so resigning shall be entitled to receive from the Fund the same portion of its assets, and in the same manner, as it would be entitled to receive under Item IV, Section B, of these Rules and Regulations.

No member which has filed a notice with the Fund of its intention to resign under this Sub-Section shall be required to make any additional deposits, required by the Fund of its members pursuant to Article V of the Constitution, after receipt by the Fund of such notice.

The assent of each member to the vote for additional deposits shall be conclusively presumed to have been given unless a member, within thirty (30) days after the vote thereon was taken, files a notice with the Fund of its intention to resign.

ITEM III.
DEPOSITS AND PENALTIES (continued)

Any member, having given notice of its intention to resign, may withdraw such notice by written request, at any time before its effective date. Upon payment to the Fund of its full share of the additional deposit required, such notice of intention to resign shall be void.

2. Upon admission to the Fund, the amount required to be contributed to the accumulated reserves and to the deposit of the Fund, required by Article V of the Constitution, may be paid at once, or in such manner as may be determined by the Board of Trustees.

3. Deposits with the Fund, prescribed by Article V of the Constitution, and the amount required to be paid pursuant to Sub-Section 2 of this section, are prerequisite to membership.

4. "Deposit liability," as used in this section, means the deposit liability of a member as of December 31st or June 30th, immediately preceding the date of the action taken or required to be taken.

5. There shall be an adjustment of the deposit requirements of members semi-annually, beginning January 1st and July 1st, based upon the increase or the decrease of the deposit liability of each member.

ITEM III.
DEPOSITS AND PENALTIES (continued)

For each semi-annual period beginning January 1st, the deposit of each member shall equal that portion of the member's deposit liability as reported on December 31st, immediately preceding and for each semi-annual period beginning July 1st, the deposit of each member shall equal that portion of the member's deposit liability as reported on June 30th immediately preceding, as prescribed in percentage by Article V of the Constitution. If the required deposit of a member is thus found to have increased over the preceding semi-annual period, it may deposit the difference due from time to time, provided the entire difference shall be paid in full not later than February 10th and August 10th of the period for which the adjustment was made. Refund due to members on decrease shall be made by February 10th and August 10th of the period for which the adjustment is made, provided the Certificate of Deposit is presented for such change. At the time of each semi-annual adjustment of deposits, and after payments in accordance with such adjustments have been made, the Fund shall enter on each of the Certificates of Deposit the amount then on deposit. All deposits made with the Fund pursuant to this Sub-Section shall be rounded off to the nearest hundred dollars.

ITEM III. DEPOSITS AND PENALTIES (continued)

(B) PENALTIES

Each member accepts the obligation to make all payments due pursuant to Sub-Section 5 of Section A of this Item, on or before the date due. Failure to do so on the part of any member renders such member subject to suspension or expulsion. While under suspension, or after expulsion, for failure to make deposits when due, the Fund recognizes no obligations to such member to exercise any of the powers set forth in Item VI hereof, and such member is not entitled to any of the benefits of membership in the Fund, including display of the symbol, other than those granted by Item IV, Section B, with respect to withdrawal of assets.

Failure to make deposits on or before the date due shall subject the member to a penalty. The penalty shall not exceed ten percent (10%) of the amount due. The Fund may institute an action at law for the collection of the deposits or the penalty or both.

ITEM IV. WITHDRAWAL FROM MEMBERSHIP

(A) NOTICE

Any member which is not, either at the time of giving notice of intention to withdraw or at the time of withdrawal, in default in any of its obligations to the Fund, including calls made before the date of withdrawal, or which has repaid any advance or loan made to it by the Fund, and has carried out the terms of any repurchase agreement made with the Fund, may withdraw from membership in the Fund upon giving to it twelve (12) months' notice in writing, of its intention to withdraw. The Fund may, upon a vote of two-thirds (2/3) of its Board of Trustees, at a meeting called to consider such notice, or upon a vote of the members whose deposit liabilities aggregate not less than seventy-five percent (75%) of the total deposit liabilities of all members (including those of the withdrawing member) at a meeting of the members called to consider such notice, permit such member to withdraw at the end of two (2) months from the date of giving such notice or at the end of such period less than twelve (12) months from the date of giving of such notice as may be approved by the Board, if no meeting of the members is called to consider such notice. Upon the written request of the withdrawing member, the meeting of the Board to consider the notice as above provided shall be held

ITEM IV.

WITHDRAWAL FROM MEMBERSHIP (continued)

within five (5) weeks from the date such notice was given. If the Board, at such meeting, has fixed the effective date of withdrawal at a date more than two (2) months from the date the notice was given, then, upon the written request of the withdrawing member, the meeting of members to consider such notice, as above provided, shall be held within eight (8) weeks from the date such notice was given.

B) AMOUNT ENTITLED TO

(Approved by Board of Trustees - 9/26/84)

Any member withdrawing from the Fund pursuant to the provisions of Section A above shall be entitled to withdraw from the Fund's assets only in the manner hereinafter stated, its proportionate share of the Fund's net assets on the date its withdrawal becomes effective. Such proportionate share shall be calculated in the following manner:

1) The amount of the deposit in the Fund by the member, (representing the percentage of the deposit liability of the member); plus

2) the amount of the payment, if any, made by the member upon admission to the Fund, representing its proportionate interest in the accumulated reserves of the Fund (the equalization payment); plus or minus

ITEM IV. WITHDRAWAL FROM MEMBERSHIP (continued)

3) The member's proportionate interest in the net earnings or losses of the Fund between the date such member was admitted to membership and the date of such member's withdrawal, calculated as hereinafter stated.

A member's proportionate interest in the earned reserves or losses of the Fund will be calculated in the following manner:

1) For each six-month period, or fraction thereof, (January to June, and July to December), of membership, the net earnings or losses of the Fund less any dividends paid to members shall be allocated to each member based upon the ratio of each member's deposit in the Fund to the total deposits in the Fund of all members, based upon the deposits required at the beginning of each period.

2) As of the withdrawal date, the withdrawing member shall be charged with its proportionate interest (based upon the ratio of the withdrawing member's deposit in the Fund to the total deposits in the Fund of all members at that date) in the following manner:

ITEM IV.

WITHDRAWAL FROM MEMBERSHIP (continued)

a) the amount, if any, by which the market value of the Fund's assets is less than their amortized cost (book value);

b) the amount of any reserve, as determined by the Board of Trustees but not recorded in the financial statements of the Fund, to provide for existing or potential losses existing at the withdrawal date.

3) If the total of the amounts calculated in 1) and 2) above shall be an increase in the amount due to the withdrawing member, there shall be deducted from such amount, twenty-five percent (25%) of such amount to be retained by the Fund.

The amount due to a withdrawing member shall normally be paid in cash. However, in the event that the Board of Trustees, in its judgment, determines that certain assets of the Fund are not readily marketable, then a percentage of such amount shall be paid by the issuance of a certificate or certificates of fractional participation. Such certificate or certificates of fractional participation shall entitle the holder thereof to its proportionate share of any proceeds resulting from the liquidation of such remaining assets as they are liquidated by the Fund. Such certificates

ITEM IV. WITHDRAWAL ROM MEMBERSHIP (continued)

shall describe the assets to which it relates only by symbols, and the Fund shall, after the issuance of such certificate or certificates, designate such assets on its records, by like symbols. Such certificate or certificates shall not entitle the holder thereof to any control over the manner, amounts, or time of liquidation of any of such assets.

The Fund shall not reveal any information related to such remaining assets other than the extent of liquidation of the assets to which such certificate or certificates relate. The Fund, in final settlement of such member's proportionate share, either may pay to the withdrawing member, in lieu of such certificate or certificates, such sum in cash as may be agreed upon as the reasonable value thereof, or at any time after the issuance of such certificate or certificates, may purchase the same for such sum in cash as may be then agreed upon as the reasonable value thereof.

In the event that a withdrawing member's proportionate interest in the earned reserves or losses of the Fund was reduced by a reserve as provided in 2) b), the following shall apply. If the ultimate aggregate loss incurred by the Fund is less than the amount of the reserves provided at the withdrawal date, then the withdrawing member shall be entitled to its propor-

ITEM IV. WITHDRAWAL FROM MEMBERSHIP (continued)

tionate share of any such amount (less the 25% to be retained by the Fund, if applicable). In this event, the determination of any amounts due to withdrawn members, as well as the time and method of payment, shall be made by the Board of Trustees, in their judgment, based upon a review of all the facts and circumstances relating to the loss or potential loss.

ITEM IV. WITHDRAWAL FROM MEMBERSHIP (continued)

(C) MERGER

Any member, or members, proposing to merge with any other association or associations, shall immediately upon adoption of a plan of merger by the Board of Directors of such member, or members, notify the Fund of such action and provide the Fund with a detailed copy of the proposed merger. Such proposal shall include a proposed adjustment of its deposit and premium payment with the Fund based upon its deposit liabilities after such merger. The Fund may approve such proposal with or without modification or it may disapprove if the merged association fails to meet the standards adopted by the Fund. A decision to approve with or without modification or disapprove shall be made within sixty (60) days after receipt of the copy of the proposal. Upon request of the member, the Board of Trustees shall extend the sixty-day (60) period. Upon the final disapproval by the Fund of such merger, the membership of such member, or members, shall terminate upon the effective date of such merger. Any such member, or members, thus terminating membership shall be entitled to withdraw from the Fund's assets, in the same manner provided in Section B of this Item, its proportionate share of the Fund's net assets on the effective date of such merger.

ITEM IV. WITHDRAWAL FROM MEMBERSHIP (continued)

(D) REORGANIZATION

Any member proposing to reorganize pursuant to Section 1151.61 of the Ohio Revised Code shall notify the Fund immediately upon adoption by its Board of Directors of a plan of reorganization. The Fund may approve such plan with or without modification or it may disapprove, if the reorganized association fails to meet the standards adopted by the Fund. A decision to approve with or without modification or disapprove shall be made within sixty (60) days after receipt of the copy of the proposal. Upon request of the member, the Board of Trustees shall extend the sixty-day (60) period. Upon the final disapproval by the Fund of such plan, the membership of such member shall terminate upon the adoption of the plan by the shareholders and such member shall be entitled to withdraw from the Fund's assets, in the same manner provided in Section B of this Item, its proportionate share of the Fund's net assets on the date of the adoption of such plan by the shareholders.

ITEM IV. WITHDRAWAL FROM MEMBERSHIP (continued)

(E) DISSOLUTION

Any member which has filed an application to dissolve with the Superintendent of Building and Loan Associations and received his consent in writing to such dissolution, pursuant to Section 1151.45 of the Ohio Revised Code, shall be entitled to withdraw from the Fund's assets, in the same manner provided in Section B of this Item, its proportionate share of the Fund's net assets on the date such consent of the Superintendent is given. The Fund shall deduct from the proportionate share of such member any obligation of such member to the Fund and may require the fulfillment of any repurchase agreement made with the Fund. Such member shall keep on deposit with the Fund such percentage of its current deposit liabilities as is required of members pursuant to Article V of the Constitution, until such time as such member shall have paid all of its depositors and the guarantee by the Fund of the deposits of such member's depositors shall have terminated.

ITEM V.

NOTICE OF TERMINATION OF MEMBERSHIP

Any member, whose membership in the Fund is terminated at any time, shall notify each of its depositors of such termination of membership, and shall set forth in the notice the date upon which the Fund will cease to guarantee such deposits.

The Fund shall determine the date upon which it will cease to guarantee such deposits and the time and manner of giving and content of such notice.

In no event shall the Fund permit the withdrawal of any assets of the Fund by such member until such member has delivered to the Fund proof of the giving of such notice.

ITEM VI.

POWERS DEFINED

For the purpose of guaranteeing the deposits and assuring the liquidity of its members, the Fund shall have the following powers:

(A) LOANS TO MEMBERS

The Fund may loan money to members with or without security. Such loans shall bear such rate or rates of interest and be on such terms as the Board of Trustees may determine. If and when bonds,

ITEM VI.
POWERS DEFINED (continued)

mortgages or mortgage notes secured by mortgages on real estate shall be taken as security for any such loan, the value of the bonds, mortgages or mortgage notes and the title of the mortgagor may be ascertained at such time and in such manner as shall be satisfactory to the Board, and it shall not be necessary to record the assignment of any such bonds, mortgages, or mortgage notes to the Fund.

(B) PURCHASE OF MEMBER'S ASSETS

The Fund may buy any assets owned by any member at the book value thereof, or at such other value as the Board of Trustees may determine, notwithstanding that such value may exceed the market value thereof, either with or without an agreement providing for the repurchase of such assets, or any of them, at such price or prices, and at such time or times, and subject to such conditions, as are determined by the Board.

(C) AUTHORITY TO FILL VACANCIES ON BOARD

Whenever the Superintendent of the Division of Building and Loan Associations shall notify the Fund that any member has committed such an act or acts or is in such condition that he might take possession of the business of such member, pursuant

ITEM VI.

POWERS DEFINED (continued)

to law or when the Superintendent shall so request, the Fund may require the Board of Directors of such member to appoint one or more persons, recommended to it by the Board of Trustees, to attend all meetings of the Board of Directors and such committee meetings as the Fund shall deem necessary and also to fill any vacancy or vacancies on the Board of Directors, to remain and retain such rights until such conditions shall have been corrected to the satisfaction of the Superintendent and/or the Fund. Each building and loan association, upon becoming a member, agrees, under the foregoing circumstances, to make such changes in its condition or in its Constitution or By-Laws or in the membership of its Board of Directors as may be required of it by the Fund and to retain such changes in the Constitution and By-Laws for the duration of its membership or until authorized by the Fund to do otherwise.

ITEM VI.

POWERS DEFINED (continued)

(D) LIQUIDATION BY SUPERINTENDENT

Whenever the Superintendent shall determine that a member is in such condition that he may be required to exercise any of his statutory powers to restrict such member in the carrying on of its business, or whenever he has, in fact, exercised any of such statutory powers, the Superintendent may notify the Fund. The Fund shall thereupon, or within a reasonable time, either restore such member to a financial condition satisfactory to the Superintendent, or it shall make available to the Superintendent, as receiver or liquidating agent, such funds as may be necessary to pay each of the depositors in such member the full amount of his deposit as credited to his account on the books of the member, and such funds shall be used only for the purpose of paying the depositors of such member. The Fund shall thereupon be subrogated to the rights of such depositors against such member.

(E) TRUSTEES' AUTHORITY TO REQUIRE AMENDMENTS

The Board of Trustees may require the Constitution and By-Laws of members and of applicants for membership to be amended for the sole purpose of providing uniformity of the provisions affecting the liability to their depositors and, consequently, the

ITEM VI.

POWERS DEFINED (continued)

liability and responsibility of the Fund to its members, and may require members to supply a copy of each state examination which is made from time to time. The Board may supply personnel to assist the Superintendent of Building and Loan Associations to make special examinations of its members.

(F) INVESTIGATIVE AUTHORITY

The Fund's Supervisory staff, at the direction of the Executive Vice-President of the Fund, may, at any time, enter a member institution for the purpose of conducting an investigation or audit. The member shall be required to furnish, upon request, all of the company's books, records, securities, monies, and other property, needed to complete the investigation or audit.

ITEM VII.

INTEREST AND RETURN OF DEPOSITS

(A) At the discretion of the Board of Trustees, the Fund may pay interest when the deposit liability ratio exceeds one and one-quarter percent (1-1/4%) and may return deposits to members, to the extent of the excess, when the deposit liability ratio exceeds two percent (2%).

(B) The Fund shall pay interest or return deposits to members when the deposit liability ratio exceeds three percent (3%) to the extent of such excess.

(C) The interest paid to any member shall be computed upon its deposits with the Fund, at the immediate preceding adjustment date or in such other manner as may be determined by the Board of Trustees.

(D) Any interest or return deposits may, at the discretion of the Board of Trustees, be paid to a member by applying such interest or return of deposits to the reduction of any advance made to such member by the Fund or any other liability of such member to the Fund, including any amounts due to the Fund as an adjustment of deposit requirements pursuant to Item III, Section A, Sub-Section 5, hereof.

ITEM VII. INTEREST AND RETURN OF DEPOSITS (continued)

(E) Whenever the Fund returns deposits to members pursuant to Sections A, B, or D of this Item, the Fund shall enter on each of the certificates of deposit the amount then on deposit.

ITEM VIII. INFORMATION AND STATISTICS OF MEMBERS

The Fund may require from its members information and statistics, in addition to information which it may have received from the Superintendent, Division of Building and Loan Associations, or otherwise, with respect to their condition and investments, and upon consideration thereof may make such written recommendations as, in the judgment of the Board of Trustees, shall tend to place or preserve members in condition to properly safeguard their depositors. If a member to which such a recommendation has been made refuses to comply therewith, within a reasonable time, then the Board may, after hearing the member at a meeting of the Board called for that purpose, and upon the affirmative vote of three-fourths (3/4) of the entire Board, expel or suspend such member from membership in the Fund. Such member shall thereupon have, pursuant to Item IV (B), the same rights with reference to withdrawal of assets as a member which has withdrawn from the Fund, except that the Fund may set off against the member's proportionate share of the assets any obligation of the member to the Fund, including advances, loans or repurchase agreements.

ITEM IX. REQUIRED NOTIFICATION

Any member proposing to take any action for which statutes require that application be filed with or notice be given to the Superintendent of Building and Loan Associations, shall, at the time of filing such application or giving such notice, transmit a copy thereof to the Fund.

ITEM X. INCREASE IN INTEREST OR DIVIDEND

Any member intending to increase its rates of interest to be paid on deposits, or its dividend rates to be paid its withdrawable shareholders, shall immediately notify the Executive Vice-President of the Fund of such increase.

ITEM XI. ADVERTISING RATES OF RETURNS

Every advertisement, announcement or solicitation relating to the interest or dividends paid on savings accounts in member institutions shall be governed by the following rules:

(a) Annual rate of simple interest. Interest or dividend rates shall be stated in terms of annual rates of simple interest or dividends.

ITEM XI.

ADVERTISING RATES OF RETURN (continued)

(b) Percentage yields based on one year. Where a percentage yield achieved by compounding interest or dividends during one year is advertised, the annual rate of simple interest shall be stated with equal prominence, together with a reference to the basis of compounding. No member shall advertise a percentage yield based on the effect of grace periods permitted such members.

(c) Percentage yields based on periods in excess of one year. No advertisement shall include any indication of a total percentage yield, compounded or simple, based on a period in excess of a year, or an average annual percentage yield achieved by compounding during a period in excess of a year.

(d) Time or amount requirements. If an advertised rate is payable only on savings accounts that meet time or amount requirements, such requirements shall be clearly and conspicuously stated. Where the time requirement for an advertised rate is in excess of a year, the required number of years for the rate shall be stated with equal prominence, together with an indication of any lower rate or rates that will apply if the savings account is withdrawn at an earlier maturity.

ITEM XI.
ADVERTISING RATES OF RETURN (continued)

(e) Profit. The term "profit" shall not be used in referring to interest or dividends paid on savings accounts.

(f) Accuracy of advertising. No member shall make any advertisement, announcement, or solicitation, which is inaccurate or misleading or which misrepresents its savings accounts contract.

(g) Solicitation of savings accounts for member institution. Any person or organization which solicits savings accounts for a member shall be bound by the rules contained in this section with respect to any advertisement, announcement, or solicitation. No such person or organization shall advertise a percent yield on any savings account it solicits for a member institution which is not authorized to be paid and advertised by such member.

(h) "Savings Accounts," as aforementioned, are defined as all types of savings accounts, whether evidenced by passbooks or certificates.

ITEM XII. PROMOTIONAL OPERATIONS

A member may use give-aways in connection with a promotional campaign to increase savings accounts.

The value of the give-away (any premium whether in the form of merchandise, credit, or cash) shall be its cost to member institution (excluding shipping and packaging costs, if applicable), and shall not exceed:

1. $10.00 for the opening of a new account, or for an addition to an existing account of less than $1,000.00.

2. $20.00 for the opening of a new account, or for an addition to an existing account of $1,000.00 or more.

ITEM XIII. AMENDMENTS

These Rules and Regulations may be altered, amended, repealed, or superseded, either in whole or in part, by the affirmative action of a majority of members of the Board at any meeting of the Board. A proposal by the Board to amend shall be submitted to the membership for review and comment thirty (30) days prior to final adoption by the Board of Trustees, except that, in any emergency, as determined by the Board of Trustees, temporary action, not to exceed ninety (90) days, may be taken to alter, amend, repeal or supersede the above regulations pending final adoption.

OHIO DEPOSIT GUARANTEE FUND

DEFINITIONS AS USED IN THE CONSTITUTION, BY-LAWS AND RULES AND REGULATIONS

1. "Fund" means the Ohio Deposit Guarantee Fund, a corporation organized under the provisions of Section 1151.80 to 1151.92, inclusive, of the Revised Code of Ohio.

2. "Superintendent" means the Superintendent of the Division of Building and Loan Associations, an office created by Section 121.04 of the Revised Code.

3. "Building and loan association" means a corporation organized under Sections 1151.02, 1151.03 and 1151.04 of the Revised Code, for the purpose of raising money to be loaned to its members or to others, and "building and loan association" includes savings association.

4. "Member" means a building and loan association which has become a member of the Fund.

5. "Depositor" means any person, firm or corporation who has placed withdrawable funds in a member.

6. "Deposit liability" means the aggregate of all withdrawable funds credited to the accounts of all depositors of a member.

(more)

DEFINITIONS (CONTINUED)

7. "Certificate of deposit" means the capital note which the Fund is authorized to issue to its members pursuant to Section 1151.87, subsection (F), of the Revised Code.

8. "Deposit" means the money which a members has deposited with the Fund as a capital asset for which the Fund has issued a certificate of deposit.

9. "Deposit ratio" means, expressed in percentage, the deposit liability of a member divided into the face value of the certificates of deposit of a member.

10. "Deposit liability ratio" means, expressed in percentage, the aggregate deposit liability of all members divided into the aggregate of all cash and the value of marketable securities of the Fund.

OHIO DEPOSIT GUARANTEE FUND

1001 Tri-State Building
Cincinnati, Ohio 45202

STATEMENT OF CONDITION

June 30, 1984

TWENTY-EIGHTH ANNUAL REPORT

of the

OHIO DEPOSIT GUARANTEE FUND

A mutual deposit guaranty association of state-chartered savings and loan companies organized under the laws of the State of Ohio.

Report For The Fiscal Year Ended
June 30, 1984

Submitted To The Members
October 18, 1984

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OHIO DEPOSIT GUARANTEE FUND
BOARD OF TRUSTEES

THREE YEARS

Charles A. Brigham, Jr.
President and Director, Federated Savings Bank, Lockland

Eleanor J. Remke
President and Director, Madison Saving Bank, Cincinnati

John R. Perkins
President and Director, The Metropolitan Savings Bank, Youngstown

Joseph D. Rusnak
President and Director, Mentor Savings Bank, Mentor

TWO YEARS

John A. Dreyer
Director, Baltimore Savings and Loan Company, Cincinnati

David J. Schiebel
Chairman of the Board, Home State Savings Bank, Cincinnati

Harold R. Swope
President and Director, Independent Savings Association, Euclid

ONE YEAR

Robert D. Maher
Secretary and Director, The Ottawa Home and Savings Association, Ottawa

Vernon W. McDaniel
Assistant Treasurer and Director, Anderson Ferry Building and Loan Company, Cincinnati

Charles F. Tilbury, Sr.
Executive Vice-President and Director, The Clermont Savings Association, New Richmond

Jack R. Wingate
Executive Vice-President and Director, Heritage Savings Bank, Cincinnati

OFFICERS AND COMMITTEES

OFFICERS

President	**Charles F. Tilbury, Sr.**
Executive Vice-President	**Donald R. Hunsche**
Vice-President	**Vernon W. McDaniel**
Secretary	**David J. Schiebel**
Treasurer	**Joseph D. Rusnak**

EXECUTIVE COMMITTEE

Vernon W. McDaniel — **Joseph D. Rusnak**

John R. Perkins — **Charles F. Tilbury, Sr.**

Jack R. Wingate

ADVISORY COMMITTEE

Wallace E. Evans
Executive Vice-President, American Savings Bank
Upper Sandusky

Richard D. Hoffmann
Chairman of the Board, The City Loan & Savings Company,
Lima

August Hoffman
Executive Vice-President, Midwest Savings Association,
Silverton

Michael O. Roark
President, Scioto Savings Association, Columbus

Arthur W. Wendel, Jr.
Executive Vice-President, Seven Hills Savings Association,
Cincinnati

Jerry D. Williams
Secretary, People's Building, Loan and Savings Company,
Lebanon

Robert M. Williams
President, Union Savings, Building and Loan Company,
Loveland

ANNUAL REPORT OF THE PRESIDENT

Members of the Ohio Deposit Guarantee Fund:

Your Fund concluded a very successful twenty-eighth year of operation. The performance of your Fund is noteworthy in that new highs have once again been achieved. These achievements include topping $100 million in Assets and $10 million in Earnings. Also an achievement, during the fiscal year, is our losses, due to default prevention activities, which were less than one quarter of a million dollars.

Your Fund had some other noteworthy achievements during the fiscal year, which were related indirectly to its financial success:

1) The filing of a successful lawsuit against the Federal Reserve Board, challenging the Board's redefinition of Regulation Y. If the Fund had not been successful in winning this case, twelve of our members, with Assets aggregating $2,854,000,000, would have been forced to terminate their membership in the Fund and apply for FSLIC or FDIC coverage.

2) NASSALS, on behalf of your Fund and the Superintendent, was also successful in Washington, D.C. in lobbying amendments to Senate and House Bills which would have given the federal government considerable control over state-chartered privately-insured savings and loans. However, it is imperative that, in the future, constant vigilance be exercised.

We owe a debt of gratitude to a number of enlightened United State Senators, Congressmen and Congresswomen.

We also owe a debt of gratitude to the Division of Savings and Loan Associations and its able Superintendent, C. Lawrence Huddleston, for having the State of Ohio join us in our suit against the Federal Reserve Board, as well as their efforts in Washington, D.C. in protecting the dual system of chartering.

This fiscal year has seen the savings and loan industry in Ohio emerging from the chaos of 1981 and 1982 with many additional powers. These powers are designed to enhance the profitability of the industry to enable it to better withstand the economic instability in which it has been forced to operate. If used properly, these new powers should increase profitability and enable all of us to better serve the housing needs of Ohioans.

I would like to extend my gratitude to the Board of Trustees, members of the various committees, management and staff for their cooperation. The Ohio Deposit Guarantee Fund has enjoyed another very successful year due to their dedication and unselfish service.

Sincerely,

Charles F. Tilbury
President

OHIO DEPOSIT GUARANTEE FUND

Consolidated Financial Statements of Membership Adjusted to Reflect Current Membership Growth

(000 OMITTED)

ASSETS

	June 30, 1984	June 30, 1983	Increase or Decrease
Cash	$ 78,180.	$ 67,607.	$ 10,573.
U. S. Govt. Obligations	782,184.	565,248.	216,936.
Other Investments	427,076.	514,068.	(86,992.)
Ohio Deposit Guarantee Fund	73,808.	55,577.	18,231.
Federal Home Loan Bank Stock	2,474.	2,981.	(507.)
First Mortgage Loans	2,875,435.	2,545,573.	329,862.
Other Loans	707,028.	472,672.	234,356.
Real Estate Owned	21,486.	12,385.	9,101.
Office Bldg., Leasehold Improvements & Equipment	47,086.	38,462.	8,624.
Other Assets	110,709.	73,372.	37,337.
TOTAL ASSETS:	$5,125,466.	$4,347,945.	$777,521

LIABILITIES AND NET WORTH

Withdrawable Savings *	$4,103,030.	$3,373,350.	$729,680.
Borrowed Money	728,578.	717,116.	11,462.
Other Liabilities	81,020.	42,090.	38,930.
Permanent Stock	22,766.	20,664.	2,102.
General Reserves	77,145.	76,599.	546.
Undivided Profits	112,927.	118,126.	(5,199.)
TOTAL LIABILITIES AND NET WORTH:	$5,125,466.	$4,347,945.	$777,521.

* includes $5,541,000 in 1983 insured by FSLIC.

Liquidity Ratio:	14.11%	12.61%
Net Worth to Savings Ratio:	5.19%	6.39%

Peat, Marwick, Mitchell & Co.
Certified Public Accountants
800 Walnut Street
Cincinnati, Ohio 45202

The Board of Trustees and Members
Ohio Deposit Guarantee Fund
Cincinnati, Ohio:

We have examined the statements of financial condition of the Ohio Deposit Guarantee Fund as of June 30, 1984 and 1983 and the related statements of operations, changes in deposits and reserve fund and changes in financial position for the years then ended and the schedule of investments at June 30, 1984. 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.

In our opinion, the aforementioned financial statements present fairly the financial position of the Ohio Deposit Guarantee Fund at June 30, 1984 and 1983 and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis; and the schedule of investments at June 30, 1984, in our opinion, presents fairly the information set forth therein.

Peat, Marwick, Mitchell & Co.

July 27, 1984

OHIO DEPOSIT GUARANTEE FUND

Statements of Financial Condition
June 30, 1984 and 1983

ASSETS	1984	1983
Cash	$ 122,064	75,920
Time and overnight deposits	2,968,904	3,400,000
U. S. Government and agency obligations, approximate market $96,387,000 in 1984 and $74,961,000 in 1983	99,580,636	74,088,089
Accrued interest receivable	3,112,322	1,884,169
Note receivable from member, net (note 3)	6,955,311	7,225,581
Equalization contributions due from new members (note 2)	6,700	362,900
Prepaid insurance and other assets	13,989	11,821
	$ 112,759,926	86,968,460

LIABILITIES, DEPOSITS AND RESERVE FUND		
Allowance for estimated losses (note 3)	150,000	120,000
Accrued expenses and other liabilities	33,182	34,708
Deposits and reserve fund (note 2):		
Members' deposits	74,778,500	57,952,000
Reserve fund	37,798,244	28,861,752
Total deposits and reserve fund	112,576,744	86,813,752
Contingencies (note 4)		
	$ 112,759,926	86,968,460

See accompanying notes to financial statements.

OHIO DEPOSIT GUARANTEE FUND

Statements of Operations

Years ended June 30, 1984 and 1983

	1984	1983
Interest income:		
U. S. Government and agency obligations	$ 10,116,338	6,938,012
Time and overnight deposits	409,310	521,806
Notes receivable from members	765,115	913,648
Other	11,953	12,202
Total interest income	11,302,716	8,385,668
Office operating expenses	754,947	481,097
Operating income	10,547,769	7,904,571
Other income (expense):		
Provision for losses-member associations (note 3)	(225,269)	(176,369)
Other, net	34,976	6,072
Other income (expense), net	(190,293)	(170,297)
Net income	$ 10,357,476	7,734,274

See accompanying notes to financial statements.

OHIO DEPOSIT GUARANTEE FUND

Statements of Changes in Deposits and Reserve Fund

Years ended June 30, 1984 and 1983

	Members Deposits	Reserve Fund
Balance at June 30, 1982	$ 45,986,300	21,312,956
Net income for the year ended June 30, 1983	—	7,734,274
Increase in members' deposits (note 2)	12,475,700	—
Payments to withdrawing members	(510,000)	(185,478)
Balance at June 30, 1983	57,952,000	28,861,752
Net income for the year ended June 30, 1984	—	10,357,476
Increase in members' deposits, including equalization contributions (note 2)	19,371,200	14,718
Payments to withdrawing members	(2,544,700)	(1,435,702)
Balance at June 30, 1984	$ 74,778,500	37,798,244

See accompanying notes to financial statements.

OHIO DEPOSIT GUARANTEE FUND

Statements of Changes in Financial Position

Years ended June 30, 1984 and 1983

	1984	1983
Sources of funds:		
Net income	$ 10,357,476	7,734,274
Increase in accrued interest receivable	(1,228,153)	(710,810)
Funds provided from operations	9,129,323	7,023,464
Decrease in cash and time and overnight Deposits	384,952	2,075,433
Decrease in notes receivable from members	270,270	5,396,381
Increase in members' deposits, including equalization contributions	19,385,918	12,475,700
Other, net	382,506	606,546
	$ 29,552,969	27,577,524
Use of funds:		
Increase in U. S. Government and agency obligations	25,572,567	26,882,046
Payments to withdrawing members	3,980,402	695,478
	$ 29,552,969	27,577,524

See accompanying notes to financial statements.

OHIO DEPOSIT GUARANTEE FUND

Notes to Financial Statements
June 30, 1984 and 1983

(1) Summary of Significant Accounting Policies

The Following items comprise the significant accounting policies which the Ohio Deposit Guarantee Fund (Fund) follows in preparing and presenting its financial statements:

U. S. Government and agency obligations are recorded at amortized cost. The obligations are not carried at the lower of cost or market because they are generally held until maturity. Gains or losses on the sale of securities are recognized upon realization and are included in the statements of operations.

Where the Fund anticipates losses will be incurred in fulfilling its guarantee of deposits in certain members, the Fund's policy is to provide allowances for losses and for liquidation expenses by charging operations for all anticipated losses in the period in which the losses become evident and can be reasonably estimated. Such allowances are recorded as asset valuation accounts where the Fund acquires assets at costs in excess of appraised values and where the Fund pledges certain assets to guarantee against losses to other parties. The costs of these assets which, in management's opinion, have no value are written down to a nominal value of $1. When losses and liquidation expenses are anticipated, but do not relate to specific assets of the Fund, the allowances are shown as liabilities. Income is credited for the reduction of estimated loss provisions when losses realized in the period are less than the allowances provided. In the opinion of management, adequate provision has been made for all known or probable losses and expenses of liquidation to be incurred.

(2) Description of the Fund

The Fund, a corporation exempt from Federal income taxes, was incorporated under Ohio law as a mutual deposit guaranty association for the purpose of assuring the liquidity of and guaranteeing the deposits of its members.

OHIO DEPOSIT GUARANTEE FUND
Notes to Financial Statements, Continued

Each member maintains on deposit with the Fund 2% of its savings balances, adjusted semi-annually. Based on net growth in savings deposits of members during the six months ended June 30, 1984, the Fund expects to receive approximately $7,283,000 in additional members' deposits. Members joining since the inception of the Fund are required to make an equalization contribution, which is credited to the reserve fund, to establish their interest in the fund balance at the date of entry on a par with other members. These deposits are invested primarily in United States Government and agency obligations and serve as the central fund to fulfill the guarantee of the Ohio Deposit Guarantee Fund.

(3) Provision for Losses

During the year ended June 30, 1983, the Fund, in its default prevention activities, assisted the merger of a member institution into another member institution by placing a deposit with the acquiring institution at a below market interest rate and by agreeing to indemnify the acquiring institution for losses on certain mortgage assets. The Fund previously recorded a provision of $720,000 for estimated loss based upon management's evaluation of this situation and the status of negotiations at June 30, 1982. In the years ended June 30, 1983 and 1984, the Fund recorded additional provisions for estimated loss based upon management's continuing evaluation of the provisions of the assistance agreement.

The note receivable is due in annual installments of $250,000, with the balance due in December, 1986. The balance at June 30, 1984 has been reduced by approximately $425,000 ($600,000 at June 30, 1983), representing the difference between imputed interest at the rate of 10.5% and the stated interest rate of 7.713% over the term of the note.

(4) Contingencies

The savings and loan industry in general (including many members of the Fund) is experiencing unfavorable operating results and declining net worth as a result of high and volatile rates. This operating

environment has affected savings and loans more severely than many other sectors of the economy because of the mismatch between the yield and maturities of their assets and liabilities.

Given the state of the economy and present condition of the industry, it is possible that the Fund could sustain additional losses in subsequent accounting periods due to its default prevention actions. Because many of the causes for default are beyond management's control, the amount of these losses cannot be determined. However, the Fund believes that its resources are sufficient to absorb any such losses over the foreseeable future.

Schedule

OHIO DEPOSIT GUARANTEE FUND

Investments

June 30, 1984

U. S. TREASURY BILLS

Maturity	Discount Rate	Equivalent Bond Yield	Par Value	Amortized Cost	Approximate Market Value
7/05/84	9.19%	9.80%	$ 100,000	99,877	99,877
7/12/84	9.10	9.67	100,000	99,686	99,686
7/19/84	8.92	9.50	100,000	99,522	99,522
7/26/84	9.01	9.60	100,000	99,362	99,362
8/02/84	8.97	9.55	100,000	99,155	99,155
8/09/84	9.11	9.71	100,000	98,940	98,940
8/16/84	9.16	9.77	100,000	98,755	98,755
8/23/84	9.28	9.90	100,000	98,569	98,569
8/30/84	9.33	9.93	100,000	98,387	98,387
9/06/84	9.37	9.97	100,000	98,156	98,156
9/13/84	9.51	10.14	100,000	97,960	97,960
9/20/84	9.79	10.44	100,000	97,770	97,770
9/27/84	9.88	10.54	100,000	97,548	97,548
10/04/84	9.83	10.49	100,000	97,320	97,320
10/11/84	9.82	10.48	100,000	97,116	97,116
10/18/84	9.92	10.59	100,000	96,932	96,932
11/01/84	9.88	10.54	100,000	96,490	96,490
11/23/84	10.38	11.11	100,000	95,794	95,794
11/29/84	10.62	11.38	100,000	95,613	95,613
12/06/84	10.57	11.32	100,000	95,416	95,416
12/13/84	10.66	11.42	100,000	95,181	95,181
12/20/84	10.49	11.23	100,000	94,959	94,959
12/27/84	10.49	11.23	100,000	94,770	94,770
			$ 2,300,000	2,243,278	2,243,278

U. S. TREASURY BONDS AND NOTES

Maturity	Interest Rate	Approx. yield To Maturity	Par Value	Amortized Cost	Approximate Market Value
7/31/84	13⅛%	11.78%	$ 2,500,000	2,514,062	2,504,667
10/31/84	9¾	9.52	1,500,000	1,501,339	1,492,969
11/30/84	9¼	9.58	2,000,000	2,002,589	1,988,125
12/31/84	14	14.03	1,000,000	999,687	1,011,875
12/31/84	9⅜	9.48	1,500,000	1,499,297	1,464,531
1/31/85	9¼	9.67	1,000,000	996,916	986,250
2/28/85	9⅜	9.71	1,000,000	999,300	985,625

Schedule, Continued

OHIO DEPOSIT GUARANTEE FUND

Investments

U. S. TREASURY BONDS AND NOTES, Continued

Maturity	Interest Rate	Approx. Yield To Maturity	Par Value	Amortized Cost	Approximate Market Value
5/15/85	10⅜%	9.85%	$ 1,000,000	1,005,250	987,500
6/30/85	10	10.24	1,000,000	996,719	978,437
7/31/85	10⅜	11.19	2,750,000	2,731,309	2,699,297
8/15/85	8¼	8.37	1,500,000	1,498,268	1,441,875
11/15/85	9¾	9.82	2,750,000	2,747,852	2,647,734
11/30/85	10½	10.57	3,000,000	2,997,124	2,913,750
2/15/86	9⅛	9.80	1,400,000	1,401,854	1,337,000
2/28/86	10⅛	10.96	3,000,000	2,995,312	2,909,062
3/31/86	14	14.03	1,500,000	1,499,496	1,521,094
3/31/86	11½	11.55	1,000,000	999,130	975,312
4/30/86	11¼	12.27	2,000,000	1,983,437	1,955,000
8/15/86	11⅜	11.42	3,600,000	3,596,892	3,483,000
9/30/86	12¼	11.48	3,000,000	3,045,912	2,945,625
12/31/86	10	10.00	2,000,000	2,000,000	1,863,750
2/15/87	9	9.03	1,500,000	1,499,028	1,380,312
2/15/87	10⅛	11.10	3,000,000	2,982,880	2,840,625
3/31/87	10¼	10.26	4,000,000	3,998,792	3,715,000
5/15/87	12	12.02	1,000,000	998,932	970,312
5/15/87	12½	12.62	2,000,000	1,995,270	1,956,250
5/15/87	14	14.08	1,500,000	1,497,967	1,519,687
6/30/87	10½	10.95	1,000,000	989,219	928,125
12/31/87	11¼	11.35	1,000,000	997,252	938,750
3/31/88	12	12.21	2,000,000	1,986,875	1,908,125
8/15/88	10½	11.16	3,000,000	2,933,234	2,705,625
11/15/88	11¾	11.61	3,000,000	3,009,407	2,813,437
			$ 63,000,000	62,900,801	60,768,746

AGENCY BONDS

Federal Farm Credit Bank

3/04/85	11.95%	11.95%	$ 1,000,000	1,000,000	999,375
1/20/86	10.90	11.20	750,000	746,625	726,562
9/02/86	13.35	12.36	1,000,000	1,018,750	997,812
12/01/86	10.00	10.08	1,000,000	998,389	931,562
1/20/87	9.90	10.31	1,875,000	1,861,524	1,730,859
10/20/88	11.50	11.60	1,000,000	996,766	925,000
			$ 6,625,000	6,622,054	6,311,170

(Continued)

Schedule, Continued

OHIO DEPOSIT GUARANTEE FUND

Investments

U. S. TREASURY BONDS AND NOTES, Continued

Maturity	Interest Rate	Approx. Yield To Maturity	Par Value	Amortized Cost	Approximate Market Value
Federal Home Loan Bank					
1/25/85	13.55%	12.20%	$ 2,500,000	2,527,155	2,521,094
7/25/85	12.80	13.34	2,000,000	1,989,955	2,004,375
8/26/85	9.35	9.35	1,000,000	1,000,000	964,062
9/25/85	14.15	14.15	3,000,000	3,000,000	3,045,937
12/26/85	14.70	14.70	1,500,000	1,500,000	1,533,750
2/25/86	15.30	15.30	2,000,000	2,000,000	2,061,250
4/25/86	10.25	10.13	2,750,000	2,755,402	2,612,500
8/25/86	14.60	14.60	1,000,000	1,000,000	1,021,250
11/25/86	11.30	12.30	1,000,000	983,333	958,125
2/25/87	10.45	10.22	1,000,000	1,006,211	933,125
3/25/87	11.10	10.25	1,875,000	1,913,672	1,774,219
6/25/87	10.30	11.13	2,000,000	1,967,946	1,841,250
7/27/87	11.35	11.72	3,500,000	3,469,648	3,308,594
11/25/87	10.65	10.51	1,700,000	1,704,836	1,562,937
10/25/88	11.40	11.53	1,000,000	996,345	921,562
			27,825,000	27,814,503	27,064,030
Total U.S. Government and agency obligations			$ 99,750,000	99,580,636	96,387,224

ROSTER OF MEMBERS

BELLAIRE
Buckeye Savings and Loan Company

BETHEL
Bethel Building and Loan Company

BLANCHESTER
Peoples Building and Loan Company

CINCINNATI
Addison Savings and Loan Company
American Savings and Loan Company
Anderson Ferry Building and Loan Company
Baltimore Savings and Loan Company
Century Savings Bank
Charter Oak Savings Association
Cherry Grove Savings and Loan Company
Columbia Savings and Loan Company
Delta Savings and Loan Association
East Side Building and Loan Company
First North West Savings and Loan Company
Heritage Savings Bank
Home State Savings Bank
Madison Savings Bank
Molitor Loan and Building Company
New Foundation Loan and Building Company
The Oakley Improved Building and Loan Company
Oakmont Savings and Loan Company
Seven Hills Savings Association
Sycamore Savings and Loan Company
The Tri-State Savings and Loan Company
West Northside Loan and Savings Company
Woodward Savings and Loan Company

COLDWATER
Home Building and Loan Company

COLUMBIANA
Home Savings & Loan Company

COLUMBUS
Scioto Savings Association

DAYTON
Home State Savings Bank of Dayton

DEGRAFF
People's Building and Loan Company

DOVER
Surety Savings and Loan Company

DRESDEN
Savings One Association

ELMWOOD PLACE
Inter-Valley Savings Association

EUCLID
Independent Savings Association

FRANKLIN
Miami Valley Building and Loan Association

GALION
Galion Building and Loan Company

GALLIPOLIS
Buckeye Building and Loan Company
Gallipolis Savings and Loan Company

GEAUGA
Geauga Savings Association

GREENFIELD
Home Building and Loan Company

HAMILTON
Permanent Savings and Loan Association

HILLSBORO
Anchor Savings Association

LEBANON
People's Building, Loan and Savings Company

LIMA
The City Loan and Savings Company

LOCKLAND
Federated Savings Bank

LONDON
Home Savings Bank

LOVELAND
Union Savings, Building and Loan Company

MAINEVILLE
Cardinal Savings Bank

MENTOR
Mentor Savings Bank

MIAMITOWN
Miami Savings and Loan Company

MONTGOMERY
Unity Loan and Building Company

MT. HEALTHY
Mt. Healthy Savings and Loan Company

MT. VERNON
The Citizens Building, Loan and Savings Association

NEW ALBANY
Investor Savings Bank

NEW PARIS
New Paris Loan and Building Company

NEW RICHMOND
The Clermont Savings Association

OTTAWA
The Ottawa Home and Savings Association

OXFORD
Oxford Savings Association

SABINA
Sabina Building and Loan Company

ST. BERNARD
Southern Ohio Savings Association

ST. MARY'S
The Community Savings and Loan Company

SILVERTON
Midwest Savings Association

SOMERVILLE
Somerville Building, Loan and Savings Association Co.

STEUBENVILLE
Jefferson Building and Savings Company

UPPER SANDUSKY
American Savings Bank

VERSAILLES
Versailles Savings and Loan Company

WEST UNION
Adams County Building and Loan Company

WHITEHALL
First State Savings and Loan Association

WILLIAMSBURG
Williamsburg Building and Loan Company

WOODSFIELD
Woodsfield Savings and Loan Company

YOUNGSTOWN
The Metropolitan Savings Bank

Mr. BARNARD. We will now hear from Mr. Tom Batties, chief deputy superintendent and general counsel of the Ohio Division of Savings and Loans.

Mr. Batties.

STATEMENT OF TOM BATTIES, CHIEF DEPUTY SUPERINTENDENT AND GENERAL COUNSEL, OHIO DIVISION OF SAVINGS AND LOANS

Mr. BATTIES. Thank you, Mr. Chairman. I am here at the invitation of Chairman Barnard. I am pleased to be here to have the opportunity to answer the questions of the committee regarding the impact of the closing of Home State Savings Bank and what we are doing in Ohio to resolve this problem.

Unfortunately, I learned late afternoon of yesterday that I would be appearing before the committee to testify, so I do not have a prepared text. However, I was in receipt of a letter approximately March 22 or 23 by the chairman which listed a number of questions that would possibly be asked of me. And I have had an opportunity since yesterday afternoon to basically review those questions and prepare some answers.

I think it is important at this time for me to fill the committee in on my background and my relationship with the division. I joined the division on April 23, 1984, as counsel to the superintendent and chief of supervision.

On January 19, 1985, Mr. Larry Huddleston, who had been the superintendent, resigned on that day and I assumed the role as acting superintendent. On March 8, 1985, I assumed the role or was appointed to the role as superintendent of the division of savings and loan, and on March 22 I resigned this position and Mr. Robert McAllister was appointed the position of superintendent.

I guess in lieu of a prepared text, as I mention again, I have answered basically or reviewed the questions that were submitted to me and would like to share my comments with you now, Mr. Chairman.

In question No. 1 through 2, there are various informational data that was requested. I do have that information. I do not know whether you want me to recite that information now.

Mr. BARNARD. If you could just furnish it and we will, without objection, include it in the record, but if you will give us the bare statistics that would be fine.

Mr. BATTIES. Do you want me to recite that now, sir?

Mr. BARNARD. No. Let us skip over that. We might need to come back to it, but——

Mr. BATTIES. OK. Fine. I think one of the most important things is to note here in question 2A is how many Ohio federally insured and nonfederally insured thrifts were on your problem list prior to the insolvency of Home State? And I would like to answer that question by stating that there was actually no problem or watch list maintained by the Ohio Division of Savings and Loan. However, different types of lists were maintained for a variety of reasons. Some of these lists were to more closely supervise institutions as a result of their various violations of statutory laws. Other lists were kept for supervisory concerns as a result of operating losses sus-

tained by the institutions. Other lists were kept because of the high level of scheduled items incurred by an institution or delinquency rates. Also by management weakness and/or underwriting practices or a lack of continuity of management and other areas such as the amount or level of real estate owned by an institution and other related problems.

Mr. BARNARD. Can you tell us whether or not Home State was on that list?

Mr. BATTIES. Yes, sir.

Mr. BARNARD. It was on the list?

Mr. BATTIES. Yes, sir.

Mr. BARNARD. For any particular reason?

Mr. BATTIES. Yes, sir. It was on that list as a result of a low net worth with respect to its asset size.

Mr. BARNARD. How long had it been on that list?

Mr. BATTIES. My personal knowledge of that list was created once I had arrived at the division.

Mr. BARNARD. Which was——

Mr. BATTIES. In April 1984.

Mr. BARNARD. April 1984?

Mr. BATTIES. Yes, sir.

Mr. BARNARD. But it was on the list since April 1984?

Mr. BATTIES. Yes, sir.

Mr. BARNARD. Thank you.

Mr. BATTIES. Question 3A asks to describe as completely as possible the results of the last two examinations of Home State Savings Bank. "In your response, include specifically the supervisory rating accorded Home State, any examination, criticism, or mention of Home State's financial dealings with ESM Government Securities and any other unsafe or unsound conditions or operations at the association."

My answer to this is that I respectfully decline to answer on the basis that to provide any of the requested information would require me to violate the provisions of section 1155.16 of the Ohio Revised Code, which states, in part, "The Superintendent of Building and Loan Associations and its deputies, assistants, clerks and examiners shall keep secret the information obtained in an examination or by reason of their official position except in connection with criminal proceedings or when it is necessary for them to take official action regarding the affairs of the Building and Loan Association and examine."

I might add that a violation of this statute would result in a fourth degree felony for anyone who violates this.

Mr. BARNARD. Does your department have any intention at this time to file any criminal actions?

Mr. BATTIES. Sir, the Governor in recent legislation has appointed a special prosecutor to investigate wholly the transactions of Home State Savings Bank as well as the operations of the division prior to this situation. And we are working in cooperation with them and have submitted all our records to the special prosecutor.

Mr. BARNARD. When do you think there will be a report from the prosecutor?

Mr. BATTIES. Mr. Chairman, I believe that as expeditiously as possible. I could not give a date certain at this time, but as a result

of the public interest that I would believe that that would be done as expeditiously as possible. Question 3B asks:

Whether or not related to the examination findings on what date did the Savings and Loan Division first become aware of Home State's financial relationship with ESM? Please describe the formal and informal supervisory actions, if any, taken by your division with respect to Home State's financial dealings with ESM. In this connection, please provide copies of any supervisory letters or memorandums involving Home State and ESM and describe all meetings with Home State and/or ESM employees.

My answer to this question is to the extent that I am required to examine the records of the division, in order to answer this question, I have not done so because of section 1155.16 of the Ohio Revised Code. I have no personal knowledge of any action taken by any former superintendent in connection with prior examinations. To my personal knowledge, no actions not within the scope of section 1155.16 of the Ohio Revised Code were taken concerning Home State's dealings with ESM since I was employed by the division in April 1984.

Mr. BARNARD. Mr. Batties, is there any possibility that this information could be furnished to us privately?

Mr. BATTIES. I am sorry. Someone is coughing behind me.

Mr. BARNARD. Is there any possibility that we could get this information privately? You know, we could get it by subpoena.

Mr. BATTIES. I am well aware of that, sir. I would be more than happy to discuss that with the attorney general on what information we could disclose, and I would work with full cooperation to provide you with whatever we could under the law.

Mr. BARNARD. If you would look into that, because we think that this information is very important to our ongoing study of this problem.

Mr. BATTIES. Yes, sir. Question 4A—

At what point did the Ohio Savings and Loan Division first make known to, one, the Federal Home Loan Bank Board, and two, the Federal Reserve System the situation at Home State and its potential impact on Ohio Deposit Guarantee Fund?

My answer—I first learned of the potential problems at ESM and the consequences of those problems for Home State from Mr. Don Hunsche of the ODGF on Sunday, March 3, 1985. After stories concerning ESM appeared in the Cincinnati newspapers on Tuesday, March 5, 1985, I contacted the Federal Home Loan Bank at its Cincinnati office that same day to discuss the impact that this might have on Home State, on the ODGF funds, and for verification of the Cincinnati reports.

To the best of my recollection, my first discussions with the representatives of the Federal Reserve bank were on a Wednesday, March 6, 1985. Those discussions were confined primarily to the questions concerning the liquidity of Home State and the Federal Reserve Board's ability to help Home State respond to depositors' demands.

Question 4B—

Were copies of or information from your Division's examinations of Home State made available to the Federal Home Loan Bank Board prior to the events of last week? If so, when? Please enumerate.

Section 1155.16 of the Ohio Revised Code permits reports of examinations to be shared with representatives of the Federal Home

Loan Bank Board. A copy of the 1983 report of examination of Home State Savings Bank was provided to the Federal Home Loan Bank Board at its request on or about March 13, 1985.

Question 5—

Describe your Division's dealings with the Federal Home Loan Bank Board and the Federal Reserve System once it was determined that Home State would have to be closed because of insolvency. Were these dealings satisfactory? If not, why not? How could they have been improved?

First of all I would like to note that the division did not close Home State Savings Bank. Home State Savings Bank officers closed Home State effective Saturday, March 9, 1985. I appointed a conservator on Sunday, March 10, and the conservator decided not to reopen Home State in light of the depositor run which Home State had experienced from the previous week and the illiquidity of the institution.

The Federal Reserve Bank of Cleveland attempted to provide assistance to the division and to the conservator based upon past experiences including suggestions as to the solutions for Home State and the use of the discount window.

The Federal Home Loan Bank Board's fifth district's office in Cincinnati attempted to respond to inquiries and provide suggestions as to the Home State situation. I had no direct contact with the Federal Home Loan Bank Board of Washington and therefore am not in the position to comment on any dealings with them.

Obviously, in hindsight, I wish that it had been possible to find a way to reopen Home State with Federal insurance and adequate liquidity on Monday, March 11, 1985, with the assistance of the Federal Reserve Board and the Federal Home Loan Bank Board. Unfortunately, it was not possible to do so. Both institutions have been extremely helpful in assisting the State of Ohio with solutions and potential solutions for Home State and the other ODGF-insured institutions since that time.

As to the question of how the system could have been improved—obviously time was a crucial factor for us. I would like to suggest that there needs to be some sort of expedited process to get to the decisionmakers at the Federal Reserve Board and also the Federal Home Loan Bank Board. Procedures which lie outside of the normal operating channels.

I also believe that there needs to be a greater cooperation among financial institution regulators on both the State and Federal levels, and that there possibly is a centralized crisis center or something established so that situations that occur that we have the opportunity to deal with them directly and immediately. And to operate in a more coordinated fashion.

Question 6—

On what date did your Division first notify the Ohio Deposit Guarantee Fund of; one, the financial relationship between Home State and ESM, and two, your conclusion that Home State would have to be closed? Please elaborate.

My answer is that if your question goes to the losses actually suffered by Home State as a result of its dealing with ESM, I did not notify the Ohio Deposit Guarantee Fund. Don Hunsche, the executive director of the ODGF, called me late on Sunday night, March 3, 1985, to advise me that there was a concern that substantial

losses could be incurred by Home State as a result of an alleged fraud at ESM. I have no personal knowledge concerning discussions by prior superintendents with representatives of the Ohio Deposit Guarantee Fund as to the relationship between Home State and ESM other than those within the scope of section 1155.16 of the Ohio Revised Code.

As to question B, as I indicated earlier, the division did not close Home State Savings Bank. The officers of Home State made that decision to close its doors on Saturday, March 9, 1985. The conservator and the superintendent since that time have explored a variety of alternatives which would permit the reopening of Home State on a safe and sound basis, including the purchase of assets and the assumption of liabilities as well as other alternatives. But as of this date, no successful result has been concluded.

Question 7—

What specific lessons have been learned and what recommendations are you prepared to make to Congress regarding recent events in Ohio, including the relationship between Home State and out-of-State Government securities dealers and the financial crisis that developed therefrom?

I respectfully suggest that is more appropriate for the Governor of Ohio and the present superintendent to respond to this question with specificity. Since March 4 my activities have been solely centered around finding solutions to the problems of Home State and the other 71 savings and loan associations.

My concern at this point is directed primarily to needed changes in Ohio law concerning the powers of the superintendent to regulate financial institutions and the creation of more effective powers for the superintendent to utilize.

Obviously, I have not had time to focus upon Federal solutions or alternatives in the midst of this crisis and therefore have only a limited number of recommendations to offer at this time.

Once again, I would like to refer back to an answer to a previous question that I think there needs to be some sort of centralized crisis clearing house involving all the Federal financial institution regulators. The second recommendation is that I think that the Government securities area obviously needs to be highly regulated by the Securities and Exchange Commission, and I would like to defer any other recommendations until I have had a time to reflect upon the events that have taken place in the last month or so.

I had some other comments that I would like to make right now, Mr. Chairman, if I could.

I would like to applaud the efforts of the Federal Reserve Bank which has been helpful from the very beginning throughout this process not only in dealing with Home State but in dealing with the other 71 institutions as runs occurred throughout the State. They have provided examiners to ascertain the liquidity position and open the discount window to the various institutions and I think that they have been involved in an unrelentless effort in providing assistance.

I think that with respect to the Federal Home Loan Bank Board, once Chairman Gray made a decision to be of assistance in this problem that the fifth district of the Federal Home Loan Bank Board as well as Chairman Gray has acted in an expeditious

manner in providing assistance in getting these institutions open on a timely basis.

And I would like to take this opportunity to pay special attention to the president of the Federal Reserve Bank of Cleveland and to President Chuck Thiemann of the fifth district of the Federal Home Loan Bank Board and of Mr. Larry Muldoon for their assistance throughout this crisis.

And that is the end of my testimony, Mr. Chairman.

Mr. BARNARD. Thank you very much.

Mr. Hunsche, what is your official status at this particular time? I mean, the Ohio Insurance Fund is no longer a fact of life, is that——

Mr. HUNSCHE. It has been taken over by conservators, so I have no status.

Mr. BARNARD. But are there any funds left in the deposit fund at all?

Mr. HUNSCHE. Yes. There is about $87 million.

Mr. BARNARD. $87 million. What will happen to that?

Mr. HUNSCHE. That is a question only the conservator can answer, since he has total power over it.

Mr. BARNARD. But there is a new fund that the State legislature has appropriated. Is that true?

Mr. HUNSCHE. To the best of my knowledge, it has never got off the ground.

Mr. BARNARD. I thought the Governor said that the State legislature had started a new fund with about $50 million or $60 million.

Mr. HUNSCHE. To the best of my knowledge, they have not placed one penny in any new fund as yet.

Mr. BARNARD. Mr. Hunsche, you stated in your testimony on page 6 that on March 6 the State of Ohio announced that it was prepared to safeguard the interests of the depositors of Home State and of all the depositors whose funds were guaranteed by the ODGF and that the system in place provided adequate safeguards for depositors at its State-chartered savings and loan associations. What does that mean?

Mr. HUNSCHE. I was under the impression that the $50 million that they were talking about was going to be put into the Ohio Deposit Guarantee Fund. And that we would then go to our members for an additional 1 percent on top of that, which would have given us approximately $220 million at which time we could have gone into the newspaper and said that no matter what the loss is at Home State, it can be covered.

Mr. BARNARD. Well, why was that not done?

Mr. HUNSCHE. That I have to defer to the State legislature and the Governor. I do not know why it was not done.

Mr. BARNARD. Mr. Batties, can you answer that question? I mean, I was under the impression this morning that there had been an additional fund created for this purpose.

Mr. BATTIES. Mr. Chairman, there has been legislation providing for a new fund, a new position guarantee fund. The moneys have been appropriated for that fund and the attorneys of the State are working on the mechanics in terms of opening up that fund. The moneys have been appropriated and——

Mr. BARNARD. But it is not operational?

Mr. BATTIES. No. It is not operational at this time. It has been incorporated if that answers your question. It has been incorporated, and the moneys have been appropriated for it.

Mr. BARNARD. But does that mean that the State of Ohio plans to stand behind that new fund?

Mr. BATTIES. Mr. Chairman, they have appropriated $50 million to inject on a loan basis to be repaid back over a period of a number of years for the new fund.

Mr. BARNARD. What happens to the reserve in the present fund?

Mr. BATTIES. I can only speculate on that. And I might have to defer to the Governor to provide that answer for you. I believe the funds of the Ohio Deposit Guarantee Fund are frozen as they have been basically placed on call by the result of the losses at Home State.

Mr. BARNARD. Mr. Batties, it is obvious from the information available to the subcommittee that beginning in 1980 the Ohio Thrift Division and the Deposit Guarantee Fund had serious concerns about Home State's exposure with ESM. Why did the thrift division not take more aggressive action to force an unwinding of that relationship?

Mr. BATTIES. Mr. Chairman, I have to defer to the fact that I arrived at the division in 1984. It is my understanding as a result of hearing testimony today and reading certain things in the papers that there had been agreements made between the Ohio Division of Savings and Loan and the Ohio Deposit Guarantee Fund with respect to Home State and its dealings with ESM and that there was an agreement to unwind those transactions on a timely basis to be completed I believe some time in 1985.

Mr. BARNARD. Can you answer that question, Mr. Hunsche?

Mr. HUNSCHE. Yes. In January, I believe, of 1984 or so.

Mr. BARNARD. What about 1983?

Mr. HUNSCHE. I believe it was 1984. The board had gone into an agreement, a drafted agreement, whereby the——

Mr. BARNARD. Now, this is a supervisory board, not the insurance fund?

Mr. HUNSCHE. No. This was Home State's board.

Mr. BARNARD. Home State's board and who?

Mr. HUNSCHE. Had entered into an agreement that it was going to wind down the reverse repo transaction.

Mr. BARNARD. Was that agreement with the Ohio Thrift Division or was it with the Deposit Guarantee Fund? Well, it must have been with the Ohio Thrift Division, because you had no jurisdiction evidently to supervise Home State, right?

Mr. HUNSCHE. Right. We have no cease-and-desist powers.

Mr. BARNARD. OK.

Mr. HUNSCHE. And that was being done, Mr. Chairman. In fact, in July 1984, $400 million of the $670 million became Treasury bills that were going to mature in May and June 1985. I think both the division and the fund felt a sigh of relief knowing that 60 percent of the transaction was going to be completed by May and June 1985.

Mr. BARNARD. Your testimony indicated that these transactions would have actually matured on June 30, 1983. The question is if they had matured, all these transactions, why did not Home State

at that time—when they could have very appropriately disassociated themselves from ESM—did they not do that? And instead, it looks like to me that they increased the fund from $200 million to $700 million.

Mr. HUNSCHE. We were astonished at it. Why that was not done, we do not really know.

Mr. BARNARD. Now, Mr. Batties, surely your acquaintances in the department would give you some information about that, would they not?

Mr. BATTIES. Please?

Mr. BARNARD. I mean, would not your experience in this division, would you not have some knowledge of why this was not done?

Mr. BATTIES. When I arrived at the division of savings and loan——

Mr. BARNARD. Now, when was that?

Mr. BATTIES. I arrived, Mr. Chairman, on April 23, 1984.

Mr. BARNARD. OK.

Mr. BATTIES. As counsel to the superintendent and chief of supervision—prior to that time, there had not been a separate division or separate section within the division for supervisory matters. As providing a dual role within the division as counsel to the superintendent and chief of supervision, I was stepping up my activities in the supervisory area. During the course of my tenure there with the division, the superintendent himself dealt with supervisory matters as it related to Home State.

Mr. BARNARD. But would not the records that you have assumed since taking on your new role, would they not give you the benefit of this information?

Mr. BATTIES. Yes.

Mr. BARNARD. This has been over nearly a year ago and of course this subject has been, you know—I know that this has been a matter of concern with the State of Ohio.

Mr. BATTIES. Right. When I assumed the duties of acting superintendent on January 19, those records would have come under my control. On that particular date, I was closing up an institution in eastern Ohio and involved in various runs since that time on some of the other institutions. To answer your question, once again I would have to defer to 1155.16 in terms of providing that information for you, and would like to talk with my attorney general on what information I could provide for you.

Mr. BARNARD. Mr. Batties, the subcommittee has been told informally that your department felt that their hands were tied because the sale of securities in 1983 would have resulted in a $45 million loss to Home State and would have caused its insolvency. Did the department not ask Mr. Marvin Warner, the owner of Home State, to infuse more capital at that time?

Mr. BATTIES. Mr. Chairman, I was not a member of the division at that time and I have no personal knowledge as to whether or not the superintendent or anyone asked Mr. Warner to infuse capital.

Mr. BARNARD. Mr. Batties, when we asked you and Mr. McAllister to testify, we expected that you were going to bring us information from the department which we could use in this hearing. And obviously, you know, we are not getting that information. I mean,

information which we have been able to get from other sources. Surely we feel like you, as a representative of the Office of Ohio Division of Savings and Loan, would have the availability of that information. And you have given us nothing.

Mr. BATTIES. Mr. Chairman, I am not——

Mr. BARNARD. I respectfully appreciate the fact that you got a new position and that you have only been in this position for nearly a year. But a year, considering this transaction, is a long, long, long time. I mean, because we have learned more than we thought we would learn in the last 30 days. So I am just saying that the information—we are not getting the information we need to really find out what your department did, what you felt your responsibilities were, and whether you took just normal appropriate action toward offsetting this calamity which developed between Home State and ESM.

I guess the word is "stonewalling," but hopefully we need to get this information.

Mr. BATTIES. Mr. Chairman, once again I defer to section 1155.16 and I would like to cooperate with you and provide that information——

Mr. BARNARD. That does not protect you from just telling us what you know. We are not asking for the availability of information in examination forms. We are not asking for that. We respect that.

Mr. BATTIES. Yes, sir.

Mr. BARNARD. But on the other hand, we feel that you, as a representative of this department, should tell us what we are trying to find out. In fact, I guess let me clarify. We are trying to ask you what you did. What was done? And that is all we are trying to find out.

Mr. BATTIES. Right. Mr. Chairman, I understand that. And I am trying to cooperate. The confusion is that many of the questions that you are asking me are—the information that I would have would be as a result of my official position. And——

Mr. BARNARD. That is exactly why we have you here.

Mr. BATTIES. Right. And so therefore——

Mr. BARNARD. I mean, we like you, but we are here because of the fact that you represent the Ohio Thrift Division.

Mr. BATTIES. Exactly. And as a result, I am constrained by the section of the Ohio State Code and am personally liable for a fourth-degree felony for exposing some of the information.

Mr. BARNARD. Do you think that the Ohio Thrift Division was negligent in their handling of the connection between Home State and ESM?

Mr. BATTIES. No, sir.

Mr. BARNARD. You do not? Why not?

Mr. BATTIES. Based upon the statutory restrictions that the superintendent had—this is my own opinion. You are asking me for my opinion.

Mr. BARNARD. We are getting somewhere now.

Mr. BATTIES. Right. Based upon my personal opinion, I do not believe that the superintendent was negligent based upon the knowledge that I personally have and his restrictions under the statute as provided by the Ohio Code.

Mr. BARNARD. In your examination of Home State, in just your normal routine examination and what you expect of sound, well-managed financial institutions, you found nothing amiss between Home State and ESM?

Mr. BATTIES. There was concern within the division as to the level of involvement of transactions with Home State and ESM Government Securities. There was no statutory provision that caused a violation of law with respect to those except for the discretion of the superintendent with respect to those transactions.

Mr. BARNARD. In other words, the fact that they had more securities pledged than their loan would require was a discretionary type of decision?

Mr. BATTIES. There was no direct violation of law for their involvement with ESM.

Mr. BARNARD. But it was obvious that that was not very good management.

Mr. BATTIES. Business practice.

Mr. BARNARD. The fact that there were obviously no receipts of safekeeping from a third party with responsibility for these securities. How do you react to that?

Mr. BATTIES. Mr. Chairman, I have no personal knowledge that there were no receipts provided Home State for its transaction with ESM.

Mr. BARNARD. Let me quote from your October 1983 examination:

> The failure to record in the corporate minutes the approvals for security transactions in the millions of dollars the various security brokerage firms used, having a total of $390 million of open contracts in the futures market, and the repeated failure to properly prepare financial reports to the State of Ohio and to the Ohio Deposit Guarantee Fund, indicates a reluctance by management to document and report its actions. It should also be mentioned in this report summary that many of the areas of concern that are included in this examination report were also the subject of comments in previous examination reports.

So here the examination report that your department conducted brings forth the fact that there were real questions as to the management practice of Home State. So what did the department do about that?

Mr. BATTIES. Mr. Chairman, as to my personal knowledge of what the division did, my knowledge is scant. The proper person to ask with respect to that would be the former superintendent. It is my understanding in conversations recently and in testimony provided today as well as in the newspapers, is that there was an agreement struck between the division and Home State, that they were to unwind their transactions—they had matched their transactions is a term in the investment field, as Mr. Hunsche said, with T-bills, which are of a sounder nature than possibly previous investment transactions and that they were to unwind these beginning in May and June 1985.

Mr. BARNARD. Mr. Batties, I hope you can answer this question. That is, when the Home State conservator recently filed a law suit against Marvin Warner and other officers of Home State, the new thrift superintendent, Mr. McAllister, was quoted as saying that "ugly acts by Mr. Warner and others caused the Home State collapse."

Are you familiar with that statement?

Mr. BATTIES. Yes, sir.

Mr. BARNARD. What were those ugly acts?

Mr. BATTIES. I personally do not know what Mr. McAllister totally meant by those ugly acts by Mr. Warner. I can only give you my personal opinion as to what they possibly could have been.

Mr. BARNARD. And what is your association with Mr. McAllister?

Mr. BATTIES. I am his employee. I work for Mr. McAllister. He is superintendent of the division of savings and loan and I am chief deputy superintendent.

Mr. BARNARD. And general counsel.

Mr. BATTIES. And chief counsel, yes, sir.

Mr. BARNARD. So you are speaking from some authority?

Mr. BATTIES. Yes, sir.

Mr. BARNARD. Good.

Mr. BATTIES. I would say that there is some concern. Mr. Warner's obvious involvement with Home State and his control position as being the sole shareholder of Home State, plus being possibly in a control position with American Savings of—I believe it is Miami or Fort Lauderdale—and his obvious personal relationship with Mr. Ewton of ESM, and that there might have been some collusive or alledged misconduct on the part of Mr. Warner with respect to Mr. Ewton and ESM.

Mr. BARNARD. Do you think some of that will be a part of the—will some of this information or your feelings be relayed to the special prosecutor that has been selected?

Mr. BATTIES. Yes, sir.

Mr. BARNARD. Mr. Craig.

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

Mr. Batties, you came to the division when?

Mr. BATTIES. April 23, 1984, Mr. Representative.

Mr. CRAIG. Who hired you?

Mr. BATTIES. Mr. Chairman, Mr. Craig, the superintendent at that time, C. Lawrence Huddleston.

Mr. CRAIG. Is the superintendent's position of that division an appointed position?

Mr. BATTIES. Mr. Chairman, Mr. Craig, yes, sir.

Mr. CRAIG. Who appoints that person?

Mr. BATTIES. Mr. Chairman and Mr. Representative, the Governor.

Mr. CRAIG. Why did that person resign?

Mr. BATTIES. Mr. Chairman and Mr. Representative, I do not have any personal knowledge as to why he resigned, and possibly the Governor might be the best person to answer that question for you. Or Mr. Huddleston.

Mr. CRAIG. Your current boss is whom?

Mr. BATTIES. Robert McAllister, sir.

Mr. CRAIG. And he was appointed by the Governor also?

Mr. BATTIES. Mr. Chairman and Mr. Representative, yes, sir.

Mr. CRAIG. Thank you very much. I have some questions of Mr. Hunsche.

I have before me, sir, the constitution of the Ohio Deposit Guarantee Fund. And on the face of that constitution is a—I assume—a decal or a logo of the fund itself. It says "Ohio Deposit Guarantee

Fund, all savings guaranteed in full." And embossed on the face of that is an outline of the State of Ohio. How is this decal used?

Mr. HUNSCHE. Just as it is presented there.

Mr. CRAIG. Could you come closer to the mike. I could not hear you.

Mr. HUNSCHE. Just as it is presented. It is——

Mr. CRAIG. And how is it presented to the public of Ohio? Does it appear on the windows or doors of the——

Mr. HUNSCHE. It appears on the doors and the windows of the member companies.

Mr. CRAIG. Are there brochures available in each——

Mr. HUNSCHE. There are brochures available in each member institution——

Mr. CRAIG. And what do they say?

Mr. HUNSCHE [continuing]. And——

Mr. CRAIG. Could you come closer to the mike, sir?

Mr. HUNSCHE. The topics first start out with "What is the Ohio Deposit Guarantee Fund? How does the fund operate to protect depositors? Who owns and manages the fund?"

Mr. CRAIG. And what does it say about that?

Mr. HUNSCHE. It says "The Ohio Deposit Guarantee Fund is owned entirely by its member associations which maintain a percentage of their savings deposits adjusted semiannually in the form of cash deposits with the fund."

Mr. CRAIG. Now could you tell me——

Mr. HUNSCHE. There is no indication that it is owned by the State or anything of that nature.

Mr. CRAIG. In other words, it is "depositor beware, do not look at the decal that shows the State of Ohio. Read the brochure."

Mr. HUNSCHE. Right. They should read the brochure.

Mr. CRAIG. OK. Can you tell me who the current board of trustees of that Fund are? Who the board is?

Mr. HUNSCHE. Yes.

Mr. CRAIG. It is a board of trustees, I believe your constitution calls it.

Mr. HUNSCHE. Yes. Charles A. Brigham. Do you want their affiliation as well?

Mr. CRAIG. Yes, please.

Mr. HUNSCHE. Who is also the president and director of Federated Savings Bank of Lockland. John A. Dreyer, director of Baltimore Savings & Loan Co. of Cincinnati. Richard D. Hoffmann, chairman of the board, City Loan & Savings Co., Lima. Vernon W. McDaniel, assistant treasurer and director, Anderson Ferry Building & Loan Co., Cincinnati. John R. Perkins, president and director of the Metropolitan Savings Bank, Youngstown, OH. Eleanor J. Remke, president and director of Madison Savings Bank, Cincinnati, OH. Joseph D. Rusnak, president and director of Mentor Savings Bank, Mentor. David J. Schiebel, chairman of the board, Home State Savings Bank, Cincinnati. Harold R. Swope, president and director, Independent Savings Bank, Euclid, OH. Charles F. Tilbury, Sr., executive vice president and director of the Clermont Savings Association, New Richmond, OH. Jack R. Wingate, executive vice president and director, Heritage Savings Bank, Cincinnati, OH.

Mr. CRAIG. This group, in its overall examination of Home State, had made some determinations as to Home State's relationship with ESM. In that determination, what authority does the guarantee fund have over a member institution? Can it only make recommendations?

Mr. HUNSCHE. To the best of my knowledge, it can only make recommendations.

Mr. CRAIG. It cannot withdraw guarantee?

Mr. HUNSCHE. It can withdraw the guarantee of the member. But then, you know, it is like taking an elephant gun to shoot a flea.

Mr. CRAIG. So it has little to no authority over supervision of a member bank's activity?

Mr. HUNSCHE. No. We can counsel, but we cannot compel. And we have found over the years that normally we have been able to counsel very effectively.

Mr. CRAIG. Were you able to counsel very effectively with Home Savings?

Mr. HUNSCHE. Initially I would say we ran into a problem. Towards the end of the situation, when in July 1984, 60 percent of the ESM transaction was put into Treasury bills that matured in May and June 1985, we felt that we had done an excellent job because they would have rolled out. And there would have only been about $270 million left on some Ginnys that they had at that time. Our position would have been at that time, depending on market, if there were not an enormous loss in the Ginnys, that they roll out of those as well. And that is what we would have tried to get them to do.

Mr. CRAIG. Of the member institutions of the fund, where did Home Savings rank in size and premium payment?

Mr. HUNSCHE. In size it ranked as first; in premium payment, second.

Mr. CRAIG. So in other words, a substantial portion of the fund's assets were derived from Home Savings?

Mr. HUNSCHE. I believe they amounted to approximately 15 percent of the fund.

Mr. CRAIG. Fifteen percent of the total. On January 4, all of the directors of Home State, and I am quoting your testimony, "with the exception of one, agreed to a program of unwinding from ESM's relationship." With a particular emphasis on overcollateralization, and a concentration of transactions with one thinly capitalized dealer, who was the one exception to that board decision? Do you know?

Mr. HUNSCHE. Now, which date were you referring to, Mr. Craig?

Mr. CRAIG. I am referring to page 4, I believe, of your statement. Last paragraph on the bottom of the page.

Mr. HUNSCHE. I believe that one was Nelson Schwab, the company's attorney.

Mr. CRAIG. We were informed otherwise. Do you know that to be a fact?

Mr. HUNSCHE. I am not sure. There are two of these. One of them—both of them have somebody missing. One of them was Stan Brock and the other was the attorney.

Mr. CRAIG. Do you know for a fact or is it a fact that Mr. Warner did not sign the agreement and objected to that decision?

Mr. HUNSCHE. Oh, Mr. Warner, Jr.? I believe this is the one—oh, five out of the seven. This is the one that Mr. Warner, Jr., and Nelson Schwab did not sign.

Mr. CRAIG. Do you know their reason for not signing?

Mr. HUNSCHE. No, we do not. I believe they did not show as being in attendance at the meeting.

Mr. CRAIG. What is your relationship to the State supervisor's office in the collection of information and reports?

Mr. HUNSCHE. Over the years we have worked very effectively together. Anything that comes out of our office, a transmittal copy goes to the division of savings and loans, and conversely, what comes out of their office normally we get a copy of it.

Mr. CRAIG. Is it made available to the fund, to you, all of the supervisorial reports that the supervisor conducts of your member group?

Mr. HUNSCHE. The examination reports?

Mr. CRAIG. The examinations.

Mr. HUNSCHE. Yes.

Mr. CRAIG. Are they adequate reports, do you feel?

Mr. HUNSCHE. Yes.

Mr. CRAIG. Do you base your entire decisions on those reports, or do you do an investigative process yourself?

Mr. HUNSCHE. Sometimes we do. Other times, if we feel something should be expanded, our own people will go out and expand on it.

Mr. CRAIG. You seem to demonstrate a vagueness in knowledge as to the activities of the supervisor's office in your testimony or the division, of at least a knowledgeable relationship through this whole episode. How was the line of communication from the time it became knowledgeable that Home State was in trouble?

Mr. HUNSCHE. Can you repeat that, please? I did not grasp what you were saying.

Mr. CRAIG. You seem to, in your testimony, demonstrate, or at least in the cross examination of the chairman, some lack of knowledge as to the activities of the supervisor's office or the division and so I was curious as to what your relationship with them has been through this whole episode.

Mr. HUNSCHE. That has only taken place since the conservator was placed in Home State. Prior to that, we had a very workable relationship. I think we almost lived together for a solid week in trying to get this thing resolved. Once the conservator was appointed in Home State, we were taken out of the picture totally.

Mr. CRAIG. Do you believe that that is the proper process to go through?

Mr. HUNSCHE. Personally, no.

Mr. CRAIG. Why not?

Mr. HUNSCHE. We felt that we could be helpful.

Mr. CRAIG. In what way?

Mr. HUNSCHE. Well, in one way we brought in a thrift consulting firm out of New York early on to get a bid package together for Home State. Sent them over to counsel's office for the department

of commerce and they were turned away. Then I think that following Saturday we found out——

Mr. CRAIG. Who was turned away from the department of commerce?

Mr. HUNSCHE. The people we brought in from New York, to prepare a bid package.

Mr. CRAIG. In other words, in an attempt to sell Home State?

Mr. HUNSCHE. Right.

Mr. CRAIG. What was the reason for turning them away?

Mr. HUNSCHE. That I do not really know.

Mr. CRAIG. You were not given a reason. Mr. Batties, could you give us a reason?

Mr. BATTIES. Mr. Chairman, Mr. Representative, on the eve that the conservator was appointed and subsequent days thereafter, the conservator was trying to gain control of the Home State Savings Bank situation—books, records. I had enlisted probably 20 to 22 State examiners to provide assistance in gaining control over the institution at that time. We had already gone through some sales activity with respect to Home State in the previous weekend.

To answer your question, it was just not in the best interests of having the conservator gain control over the books and records of Home State to have an additional party or parties clamoring around the books and records at that time.

Mr. CRAIG. If I remember Mr. Hunsche's, either testimony or cross examination, there was a concern though in the capability of the fund to be able to present a valid image that Home State could have been acquired, that the fund could properly have assisted, and that the doors might have remained open in that transaction—or in that period of time.

Mr. HUNSCHE. Well, it is just my personal opinion.

Mr. CRAIG. Well, as the administrator of the fund, your personal opinion ought to have some value.

Mr. HUNSCHE. That had the loan been given to the fund, given to the Ohio Deposit Guarantee Fund, and had we gone to our members for an additional 1 percent, which many of them were agreeable to, it would have increased our assets substantially. So that we could have gone into the newspapers and then made the statement that regardless of how large Home State's loss is, the Ohio Deposit Guarantee Fund can cover it.

We had 30 years of credibility in the Hamilton County area. And I think it would have worked.

Mr. CRAIG. But you were denied that opportunity?

Mr. HUNSCHE. A separate fund was set up.

Mr. CRAIG. All right. Mr. Chairman, thank you.

Mr. BARNARD. Mr. Spratt?

Mr. SPRATT. Thank you, Mr. Chairman.

It would be helpful to me, since we do not have balance sheets before us or attached as any of the exhibits to any of your testimony, if you could just walk us, Mr. Hunsche, through the years and examinations that passed from the time you first detected a problem at Home State in 1980, at which time your statement says there were repurchase agreements of about $100 million and overconcentration with ESM, and an overcollateralization in nonuniform maturities.

Could you first of all tell us what you mean by overcollateralization?

Mr. HUNSCHE. By overcollateralization is when the securities put up with the broker/dealer exceed the amount of the loan against their securities.

Mr. SPRATT. Do you know what the margin on those deals was? The amount of excess collateralization? In rough percentage terms.

Mr. HUNSCHE. There were some of them as high as 25 to 30 percent, as I recall. One of our objectives was to get them down within national ranges of 103 to 105 percent total collateralization.

Mr. SPRATT. Would that not strike an average examiner as an extraordinary situation?

Mr. HUNSCHE. Right. It did and, you know, the examiners did an excellent job on this. The thing that we were told is that the excess overcollateralization enabled them to borrow even at a cheaper rate, initially.

Mr. SPRATT. Did the rate of borrowing—did the rate which they were paying ESM validate that representation?

Mr. HUNSCHE. Yes.

Mr. SPRATT. It was a below-market rate of interest?

Mr. HUNSCHE. Compared to what you would borrow in other areas. To the best of my knowledge.

Mr. SPRATT. And did the Ohio Savings and Loan Department and the guarantee fund accept that explanation at that time?

Mr. HUNSCHE. Yes, I believe we did. However, we still felt that there was too much of a concentration. Our main objective—we had two objectives really—to get the collateralization down within realistic percentages, and second, to reduce the amount of funds that the company had with one securities dealer. In July 1984, when we were advised that the $400 million of the $670 million loan was covered by Treasury bills that matured in May and June 1985, we felt we had won the war. That over 60 percent of this thing would have been washed out come May and June of this year. And then all we would have had to contend with was the remaining $270 million based on their Ginny Mae loans that they had out. And our theory was that if the loss was not substantial, then we would urge them to get out of that as well.

Mr. SPRATT. In July 1984, what did the Home State balance sheet look like? What was on the asset side?

Mr. HUNSCHE. I do not have it with me.

Mr. SPRATT. Was there still an overcollateralization. Did these T-bills belong to Home State? Had they been transferred as collateralization for a loan from ESM?

Mr. HUNSCHE. I believe somehow back then, as I recall, they were switched. They had some Treasury bonds due in 1988, and somehow or another, they managed a switch out of the Treasury bonds and into the Treasury bills, which would have matured then on the year—what they done, their reverse repos were done basically for a year at a time. By switching out of the bonds and into the Treasury bills, it gave us a definite maturity date, when 60 percent of the transaction would have just been paid off.

Mr. SPRATT. What was the net worth, the parent book net worth, of ESM at this time? Excuse me—of Home State at this time?

Mr. HUNSCHE. Probably somewhere in the vicinity of $13 to $15 million. I am not totally sure.

Mr. SPRATT. $13 to $14 million?

Mr. HUNSCHE. I really do not have those figures with me.

Mr. SPRATT. So many times its net worth was in effect being held by a third party well beyond the jurisdiction of the State of Ohio in Fort Lauderdale. What efforts did the Ohio State Savings and Loan Division and the guarantee fund make to determine the validity, the security, of this institution that was holding several times the net worth of the largest institution that they insured?

Mr. HUNSCHE. We insisted on an audit report by Arthur Anderson. We also insisted on an audit report of ESM Government Securities and an attachment on that audit report showing where all of their securities were supposed to be placed.

Mr. SPRATT. And so the audit report you—was the audit report of ESM made by Arthur Anderson?

Mr. HUNSCHE. No. The audit report made on ESM was made by Alexander Grant. But was accepted by Arthur Anderson who is the C.P.A. firm that does the auditing of Home State. And it was accepted by us as well. We did not have any idea that it was an invalid audit report.

Mr. SPRATT. Who was the audit firm for ESM? I am sorry. I did not hear your answer.

Mr. HUNSCHE. Alexander Grant.

Mr. SPRATT. Alexander Grant. What happened to them? Not what is going to happen to them, but what happened to them in their audit practice?

Mr. HUNSCHE. What happened to them? I think they would like to find that out themselves. From what I have read, apparently they had a partner who was taking kickbacks or something.

Mr. SPRATT. It was not a typographical error, was it?

Mr. HUNSCHE. I hope not.

Mr. SPRATT. I am sorry to ask you these elementary questions, and maybe if I had been following the press accounts closely enough I would know this myself. I am just trying to put together a picture of the situation. Were there custodial receipts? Were there documents, safekeeping receipts, indicating these securities were in the hands of a third party somewhere? The T-bills that are the subject of the reverse repo—were these certificates in these vaults?

Mr. HUNSCHE. I cannot answer that totally. At the one meeting I attended where there was a gentleman up from ESM, the story we were given is that the collateral is turned over to the communities that put up the money. The physical collateral. It was always our understanding that ESM was nothing more than a middleman. It went to Toledo and various communities, got the money in, then the institutions would pledge their governments, or Ginnys or whatever it would be, and then those would then be taken and pledged to the communities.

Mr. SPRATT. I see. What in fact happened? Do you know what in fact happened to the securities?

Mr. HUNSCHE. Please?

Mr. SPRATT. Do you know what in fact happened to these securities?

Mr. HUNSCHE. You idea is as good as mine. I have been waiting with baited breath to find out from Florida exactly what happened to the securities. Now, we do know that something like $300 million in Ginnys apparently are still in Home State's name because Home State is getting the interest on them.

Mr. SPRATT. Let me ask you a couple of questions about your insurance fund. One of the reasons for our holding this hearing is that we also have oversight jurisdiction of the FSLIC and the FDIC and there has recently been a proposal made for the reorganization and consolidation of banking agencies. Basically it proposes that the FDIC sort of back out of its examination process and only come into dealing directly with its insured member banks at a time of crisis.

It seems to me that you have been in something of that situation yourself. Would you recommend that other insurance funds operate in the same manner you have with only moral suasion at your disposal?

Mr. HUNSCHE. No. You would be better off to have as much power as you can possibly get. But most of that emanates out of the State law and it is awfully difficult for a private organization to have it.

The ultimate weapon that we have naturally is the expulsion, but when you go through the expulsion, then you have the situation that was initially created by ESM, where you would have a run on it. So——

Mr. SPRATT. Were you hampered by the fact that you did not have routine access to the books of Home State?

Mr. HUNSCHE. No. We always had routine access to the books of Home State.

Mr. SPRATT. Oh, you did have access to the books.

Mr. HUNSCHE. That only stopped after the conservator was appointed.

Mr. SPRATT. I beg your pardon. OK. How have the member institutions of your deposit guarantee fund booked their 2-percent deposit?

Mr. HUNSCHE. They keep it on their books as an asset.

Mr. SPRATT. As an asset?

Mr. HUNSCHE. Yes. That is why it is imperative in the sale of Home State to try and preserve that 2 percent so it does not have to be wiped out against their net worth which will make less of them qualified for Federal insurance.

Mr. SPRATT. I notice in the responses to interrogatories we put to you that you indicated you had $2 million of reinsurance and a $1 million line of credit. In light of your exposure, do you think that is adequate backup liquidity?

Mr. HUNSCHE. Definitely not, although after the Garn-St Germain Act, when the Federal Reserve was made available, it did seem to be adequate.

Mr. SPRATT. You also guarantee deposits over $100,000—all deposits, rather; 100-percent guaranteed. If it were not for that inclusive guarantee, would you still have the same insolvent situation? Would you still have the same problem you have with Home State?

Mr. HUNSCHE. Yes.

Mr. SPRATT. That does not make any difference in terms of exhausting your assets?

Mr. HUNSCHE. The guarantee in full really does not change the portfolio all that much. I mean, you know, under the FSLIC and FDIC, they have a number of ways that you can get up to—I forget how much it is, a quarter of a million or better—guaranteed under their insurance program.

Mr. SPRATT. Thank you.

Mr. BARNARD. Mr. Kolter?

Mr. KOLTER. Thank you, Mr. Chairman.

According to your statement, as early as 1980 and 1981, there was overconcentration with one dealer as you mentioned. And you did have contact with the Home State Bank. Did you in fact also have contact with say the Governor's office, the responsible members of the legislature, the superintendent of banking for the State, and State people? Or were they not notified?

Mr. HUNSCHE. No.

Mr. KOLTER. The reason I ask this question, the Governor today was interrogated as to why he did not move faster. And how could he move faster if he was not notified by somebody?

Mr. HUNSCHE. The information contained in those reports would have been strictly shared between the Ohio Division of Savings and Loans and the Ohio Deposit Guarantee Fund. Now, I cannot speak for Tom. I do not know if he reports to the Governor or not.

Mr. KOLTER. Do you feel if in fact you did notify responsible people at that time at the State level that action could have been taken to avert this crisis?

Mr. HUNSCHE. Back then it really was not all that much of a crisis. A lot of them were matched. They might have been overcollateralized, but they were matched, and they were rolled off every 6 months. There are tremendous numbers of financial institutions who use reverse repos as a borrowing type of instrument. I think the situation involving Home State here was using it on a too large a scale and with a too thinly capitalized dealer.

Mr. KOLTER. Mr. Batties, as regulator, if you would have contacted responsible people at the State level, do you feel this could be averted? Or is this not your responsibility?

Mr. BATTIES. Mr. Chairman, Mr. Representative, no. I do not think that it could have been averted. One thing, I do not think that there is any way that the State in and of itself could have averted the type of alleged fraud activity that took place at ESM. If your question is to the level of involvement of Home State with ESM, in terms of its level of activity, there was concerted effort being taken at that time pursuant to the statutory authority to have them unwind their situation, hopefully without a loss to the institution that would possibly impair the Ohio Deposit Guarantee Fund.

Mr. KOLTER. Thank you.

Mr. BARNARD. In other words, your authority is very limited?

Mr. BATTIES. Mr. Chairman, I might just go through some of the——

Mr. BARNARD. Do you have cease-and-desist powers?

Mr. BATTIES. Yes, sir.

Mr. BARNARD. So in other words, the Ohio Thrift Department could—even as far back as 1977 or 1978, knowing of this involvement with ESM—they could have, at that time, taken regulatory action?

Mr. BATTIES. The Ohio Division of Savings and Loan does possess cease-and-desist powers.

Mr. BARNARD. And they could have taken action to remedy this association if they thought it was unwise banking practices?

Mr. BATTIES. Mr. Chairman, if the superintendent at his discretion thought they were involved in unsafe and unsound practices, he could have instituted a cease-and-desist order.

Mr. BARNARD. Who is the present superintendent?

Mr. BATTIES. Robert McAllister.

Mr. BARNARD. And who was the previous superintendent?

Mr. BATTIES. Myself, for a period of——

Mr. BARNARD. You were the acting superintendent.

Mr. BATTIES. Acting Superintendent.

Mr. BARNARD. But who was your predecessor?

Mr. BATTIES. C. Lawrence Huddleston.

Mr. BARNARD. How long had he been in that job?

Mr. BATTIES. Mr. Chairman, roughly 2 years or more.

Mr. BARNARD. And what is he doing today?

Mr. BATTIES. He is in the investment banking field, Mr. Chairman.

Mr. BARNARD. Mr. Erdreich?

Mr. ERDREICH. Thank you, Mr. Chairman.

I am trying to get a separation between the sharks and the victims. And I think we are all victims here. I think the State of Ohio is obviously a victim. The depositors who are more than inconvenienced and in jeopardy of losing their deposits are victims. But it seems to me we are losing sight of the shark and I am shocked by the memorandum, Mr. Chairman, that I looked at. A 1977 memo—it talks about ESM and the principals and it says and I quote:

> Everyone seems aware of their names and they are known as suede shoe types—slickers, high-pressure salesmen. The usual high-pressure bond salesmen. They are known and feared because they once operated in Memphis and Little Rock as well as Houston, TX, prior to coming to Fort Lauderdale, and are branded as the Memphis bond bandits.

I mean, it sounds like we are dealing with the Bonnie and Clyde of the bond selling business, and this is 1977 when the Comptroller of Currency is telling, at least in a memo that went to all national bank presidents, about ESM. That ESM is a little problem, and is a danger indeed, as this says, is feared by folks in the business. I am just curious to hear that you folks in Ohio, and, yes, you saw that this ESM situation was a problem, but I do not get the impression that either of you, from each agency, had any sense that ESM was some real danger, that you were aware of ESM being a real difficulty or a real financial problem.

Did you have any, Mr. Hunsche, of that?

Mr. HUNSCHE. No, sir. I wish that would have been shared with us. I am sure we would have got them out of that ESM in 1977.

Mr. ERDREICH. Mr. Batties?

Mr. BATTIES. Mr. Chairman, Mr. Representative, we were not aware and to my knowledge any other superintendent or myself was aware that ESM, quote unquote, was a bad actor.

Mr. ERDREICH. It just amazes me, and I think, Mr. Chairman, the further hearings today, what you are doing, is excellent because the obvious lack of communication between all the agencies involved, whether it is at the Federal level or State level, contributed to more victims piling up, and from what I am hearing I see what Ohio had in the level of authority that you had, Mr. Hunsche, what you all could do and where you moved in on the problems at Home State, but looking overall, it just bothers me that an actor like this and more than a bad actor, I would say, could be one of those sharks out there and institutions have not really any sense of it and the State agencies have very little sense of it. What sort of information beyond an audit, that you said you required, Mr. Hunsche, I believe, received an audit on ESM? Anything beyond that is information or disclosure about this particular entity and what it was doing?

Mr. HUNSCHE. As far as ESM is concerned?

Mr. ERDREICH. Yes. As far as ESM?

Mr. HUNSCHE. I think they also required the ESM auditor to indicate where Home State's securities were located. Against which transactions. And they used to compile a list of that every year as well.

Mr. ERDREICH. But no further additional information about ESM itself? And from the State's side——

Mr. HUNSCHE. And the financial statements, you know, made it look like it was making money tremendously. Very profitable corporation.

Mr. ERDREICH. The first that you had—that is, that the State had information, your organization did, your agency, was prior to 1982 the involvement with ESM. Do you have any sense now of the size of ESM, its operations?

Mr. HUNSCHE. Do I have any sense of the size?

Mr. ERDREICH. Have you any further information beyond an audit report on ESM?

Mr. HUNSCHE. I have seen the 1984 audit report. Mr. Scheibel had it. Apparently it was given to him on a Thursday and was asked to be taken back on a Friday, but he kept it. I cannot quote you from it, because I really do not have it. But he did have a physical audit report issued by Alexander Grant & Co., for the year 1984 in his hand and he still has that.

Mr. ERDREICH. And the audit report, you and your agency were satisfied with the audit report on the face of it, I take it?

Mr. HUNSCHE. Right.

Mr. ERDREICH. Thank you, Mr. Hunsche.

Mr. BARNARD. Mr. Batties, one of the strongest—well, excuse me. Let me ask this to Mr. Hunsche. One of the strongest State private insurance funds that we know about indicates that under their system a reverse repurchase borrowing is a separate item on a monthly report, which is flagged on a computer printout, and if it appears like this situation between Home State and ESM, it results in an automatic special inquiry. Now, I will ask both Mr. Batties—Ohio does not have a system like that?

Mr. HUNSCHE. No, sir. We did not.

Mr. BARNARD. From your standpoint, the Ohio Insurance Fund has no system like that. So you do not get these monthly reports?

Mr. HUNSCHE. Yes, sir. We get monthly reports. But I do not believe there is a definitive enough breakdown on that monthly report to show any increase in collateral. Now, it would show an increase in the borrowing, but it does not break down the collateral as to what is truly available right now for liquidity and what is assigned to the other side of the reverse repo transaction.

Mr. BARNARD. Mr. Batties, what type of reports do you get from these institutions? You do not get a monthly report, you get a quarterly report?

Mr. BATTIES. Mr. Chairman, we do receive a monthly report that itemizes the assets and liabilities of the institution. In that monthly report, and I am not an examiner, but in my memory, my recollection of reviewing the reports, that it might take the examiner just a few seconds to figure out that there is an item there that he needs to inquire about, and then he would necessarily phone the institution to determine exactly what that involved. So I believe it is my understanding that that had been tracked on a continual basis about their involvement, their assets and the liabilities. And their relationship.

Mr. BARNARD. But nothing was done about it?

Mr. BATTIES. No, sir.

Mr. BARNARD. Mr. Kindness?

Mr. KINDNESS. Thank you, Mr. Chairman. I will be very quick here.

Mr. Batties, does your division have any cease-and-desist powers to in effect order a savings and loan to change their investment pattern or to take particular actions in order to bring them into compliance with sound practice?

Mr. BATTIES. Mr. Chairman, Mr. Representative, we had cease-and-desist powers to in essence order an institution to cease and desist the activity of which we felt was in violation of either law or safe and sound business practices.

Mr. KINDNESS. Was that used?

Mr. BATTIES. With respect to Home State? No, sir.

Mr. KINDNESS. Is there a reason that is on the record why it was not used?

Mr. BATTIES. I personally have no knowledge as to why it was not used. I can only maybe offer an opinion, but I do not know specifically why it was not used by a previous superintendent.

Mr. KINDNESS. This was in a period of time when the superintendent himself was exercising the supervisory function although your designated responsibility was supervisory as well as being chief counsel; is that correct?

Mr. BATTIES. Mr. Chairman, Mr. Representative, that is correct.

Mr. KINDNESS. So Home State was a special case then aside from your usual caseload, I take it.

Mr. BATTIES. Mr. Chairman, Mr. Representative, correct.

Mr. KINDNESS. And where is Mr. Huddleston now?

Mr. BATTIES. Mr. Chairman, Mr. Representative, he is still in Columbus, if that is your question, working in the investment banking field.

Mr. KINDNESS. Mr. Hunsche, is it your understanding that the Ohio Deposit Guarantee Fund is a corporation? Incorporated under the laws of the State of Ohio?

Mr. HUNSCHE. Right.

Mr. KINDNESS. And it is a separate legal entity and might conceivably have a right to recover from the State of Ohio its losses because of the interference with the ability of the ODGF to minimize or prevent loss of the funds that belonged to its members? Do you have a right to sue as an association?

Mr. HUNSCHE. I would assume we would have a right to sue.

Mr. KINDNESS. And you have indicated to the committee that there were actions taken by the State of Ohio which precluded ODGF from pursuing actions it would normally pursue in a case like Home State in trying to get another purchaser to acquire Home State, and you were precluded from having information and access to the books and records; is that correct?

Mr. HUNSCHE. That is correct.

Mr. KINDNESS. And as a result of that, has ODGF in your opinion suffered any financial loss?

Mr. HUNSCHE. We do not know at this time. We do not know what deal has been put together for Home State. All we have tried to impress upon everybody concerned with it was the extreme importance of saving the 2 percent of the members' deposits.

Mr. KINDNESS. But the members' deposits that were in the ODGF——

Mr. HUNSCHE. That are still in the ODGF.

Mr. KINDNESS [continuing]. Are under the control of a conservator appointed by the superintendent?

Mr. HUNSCHE. The superintendent.

Mr. KINDNESS. And as a result of that conservator's function, the ODGF cannot function at all with respect to its own fund; is that right?

Mr. HUNSCHE. Yes. You are right.

Mr. KINDNESS. And under what authority was the conservator appointed?

Mr. HUNSCHE. Under a bill that was just passed about 2 weeks ago. About 2 weeks ago, they amended the statutes and provided for a conservator over guarantee-fund companies.

Mr. KINDNESS. That was the taking of property without compensation, was it not? Well, that asks for a conclusion. It sounds like a taking of private property without compensation.

Mr. HUNSCHE. I am no lawyer, but I have heard those words used before.

Mr. KINDNESS. Has there been a meeting of the board of trustees of ODGF since the conservator was appointed?

Mr. HUNSCHE. There is no board of trustees. Now we are nothing more than individuals.

Mr. KINDNESS. Did the legislation passed by the general assembly revoke the charter, the corporation papers?

Mr. HUNSCHE. They revoked all the statutes under which we were chartered. And then put us under a conservatorship.

Mr. KINDNESS. The articles of incorporation are still on file in the secretary of state's office?

Mr. HUNSCHE. To the best of my knowledge.

Mr. KINDNESS. But it has been confiscated by the State. Is there any action that you know of personally whereby the State of Ohio has said "You no longer have these assets that belong to private individuals or companies, savings and loans, that are members?"

Mr. HUNSCHE. I would say that that is a question that the conservator has to ask. You know, at this point in time he is the possessor of all the assets of the Ohio Deposit Guarantee Fund.

Mr. KINDNESS. Is the conservator appointed by a court or by the supervisor?

Mr. HUNSCHE. He is appointed by the superintendent.

Mr. KINDNESS. Is there any court proceeding involved?

Mr. HUNSCHE. Not to the best of my knowledge.

Mr. KINDNESS. It sounds as though there ought to be.

Thank you, Mr. Chairman.

Mr. BARNARD. Ms. Oakar, do you and Mr. Luken have any brief questions for this panel?

Ms. OAKAR. No, I think you have dealt with that thoroughly.

Mr. BARNARD. Gentlemen, we appreciate both of you being here today, and offering the testimony.

Mr. Batties, it would be helpful to us if you could, while we have the testimony, you know, the answers to your questions, it might be helpful to us if you could go back and restructure some of those answers now that you have been here today, and if you can fill in some of the vacant aspects after conferring with Mr. McAllister or whoever else you need to confer with. It would be very helpful to us, because at this particular time we feel like we are somewhat lacking as to the intricacies of your examination process.

We know that 148 examiners went into Ohio at the direction of the Federal Reserve, and I guess the reason they did that, they had to find out the stability of the institutions themselves because your records probably did not—I am not saying that, but from what we have learned this morning—that maybe the Ohio Thrift Division was inadequate to give them information as to the strength of these 71 institutions.

But if you can fill in the blanks, we would be very appreciative and likewise, we would like to have the opportunity to ask for further information from the Ohio Department of Thrifts and Supervision.

And with that, we thank you very much for being with us today.

Mr. BATTIES. Mr. Chairman, thank you very much.

Mr. HUNSCHE. Thank you, Mr. Chairman.

Mr. BARNARD. Our next panel consists of the Honorable Edwin J. Gray, Chairman of the Federal Home Loan Bank Board; the Honorable Preston Martin, Vice Chairman of the Federal Reserve Board; Mrs. Karen N. Horn, president of the Cleveland Federal Reserve Bank; and the Honorable H. Joe Selby, Senior Deputy Controller of the Currency. Would you gentlemen please take your positions at the witness stand?

Gentlemen, we certainly appreciate your being with us today and we also appreciate your patience. We are a little bit behind in schedule, but because of the very importance of this subject in this hearing and in this investigation, we certainly do not make any apologies. We feel like all the time that we have used up to now

has been very valuably spent. We appreciate, however, your indulgence with us up to this point.

At this time I would just like to have the testimony of each of you and then we will ask that you respond to questions from the panel. We will begin with Mr. Gray and then Mr. Martin, Mrs. Horn, and Mr. Selby. And the committee will be advised that from this point on, because of the time, we will be imposing the 5-minute rule, including the chairman, and hopefully we will have several rounds of questioning. But we would like for everybody to have an opportunity to offer questions.

So with that, Mr. Gray, we will hear from you, and thank you for being with us today.

STATEMENT OF EDWIN J. GRAY, CHAIRMAN, FEDERAL HOME LOAN BANK BOARD

Mr. GRAY. Thank you very much, Mr. Chairman, and distinguished members of the subcommittee.

I appear before you today in my capacity as Chairman of the Federal Home Loan Bank Board and as Chief Executive Officer of the Federal Savings and Loan Insurance Corporation.

We are here to discuss the nature of the response by the Federal Home Loan Bank Board to the crisis in Ohio which was precipitated by the failure of Home State Savings Bank.

I am pleased to report today that the Federal Home Loan Bank Board has conditionally approved applications for insurance of accounts by the FSLIC from 24 former member institutions of the Ohio Deposit Guarantee Fund—applications which were processed in an historically unprecedented period of time. In addition, two institutions have acquired FSLIC insurance of accounts through merger into already insured institutions. We understand five other institutions intend to apply for FDIC insurance.

As you know, Home State Savings Bank was closed on March 10 1985, following a run on the institution by its depositors. The Home State run spread quickly to other State-chartered institutions insured by the private but State-chartered Ohio Deposit Guarantee Fund, threatening these institutions and the fund that insured them. Faced with this crisis, Governor Celeste declared a bank holiday for the 71 privately insured Ohio thrifts on March 15. I mention these dates because I think they are of interest to you.

On Wednesday evening, March 13, representatives of the Federal Home Loan Bank of Cincinnati examined State reports on Ohio Fund members to make a preliminary estimate of their eligibility for FSLIC insurance. On that same evening, at my request, Bank Board General Counsel Norman Raiden explained the FSLIC's requirements for insurance of accounts at a meeting at the Federal Reserve Board attended by several representatives of a number of Ohio institutions and certain members of the Ohio congressional delegation.

Mr. Raiden extended an invitation at that time to the Members of Congress who were present to meet with me the following day in my office to review the problem. At that time I took the initiative to commit the FSLIC to expeditious processing of applications for FSLIC insurance by members of the Ohio Deposit Guarantee Fund.

Over the next 3 days, from Friday, March 15 through Sunday, March 17, members of the staff of the Federal Home Loan Bank Board had numerous conversations with Ohio officials to discuss related issues.

On Sunday evening, March 17, I and members of my staff met with Federal Reserve Board Chairman Paul Volcker in his office to discuss means of assisting Ohio institutions which the State had closed. I told Chairman Volcker that I had pledged to expedite the processing of applications for FSLIC insurance as quickly as possible. I further explained that because the Bank Board's examination force is severely understaffed—by some 750 positions nationwide—I simply did not have the examination staff required to complete necessary examinations nearly as quickly as I would like. Chairman Volcker responded that evening with a pledge to provide as many Federal Reserve examiners as needed to help the Bank Board fulfill its commitment of rapid processing of insurance of accounts applications.

The following morning I dispatched the Director of the Bank Board's Office of Examinations and Supervision to Cleveland to meet with the staff of the Federal Reserve Bank there to coordinate the deployment of examiners.

Over Monday, March 18, and Tuesday, March 19, telephone calls were made to all Ohio institutions insured by the Ohio Deposit Guarantee Fund requesting them to advise the Federal Home Loan Bank of Cincinnati as to whether they intended to seek FSLIC insurance. In addition, advance application packages were specially mailed to all those institutions so they would be in hand on Tuesday. On Tuesday evening, March 19, examiners were deployed to all those institutions which had indicated their intention to apply for FSLIC insurance of accounts.

On Wednesday, March 20, I met with Governor Celeste in my office at his request. In that meeting I again reiterated my pledge to mount an extraordinary effort to expedite processing of applications for FSLIC insurance by Ohio institutions. Following that meeting I also dispatched the Bank Board's Director of the Office of District Banks to Cincinnati to coordinate the applications process.

Indeed, the Bank Board deployed 71 of its own examiners and, in addition, used some 140 Federal Reserve examiners for the sole purpose of helping to expedite FSLIC insurance of accounts applications by Ohio Deposit Guarantee Fund members.

Examination of the applicant institutions was necessary because the National Housing Act requires that the FSLIC "shall reject the application of any applicant if it finds the capital of the applicant is impaired or that its financial policies or management are unsafe." Indeed, the act requires the FSLIC to quote "give full consideration to all factors in connection with the financial condition of applicants."

I had been advised by staff that a 10-day notice period was required by Bank Board regulations in order to approve applications. The Bank Board's General Counsel explained this during his meeting with the members of the Ohio congressional delegation. Later, after Chairman Volcker pledged examiner support, the staff advised me that the notice period could be waived under the circum-

stances. The Bank Board immediately waived the 10-day notice requirement in order to expedite the applications process.

Frankly, in light of this extraordinary and unprecedented effort and the results it has so far achieved, I am not only pleased by the dedicated work of our staff and the Federal Reserve examiners, but I also cannot be apologetic to those who have chosen to find fault with our effort.

There are several other matters, if time permits, which I would like to address.

Considerable confusion has been generated by some as to the contrasting roles of the Federal Reserve and the Federal Home Loan Bank Board. Under Federal law—specifically the Monetary Control Act of 1980—the Federal Reserve is given specific responsibilities as lender of last resort to depository institutions of any kind. That act requires the Federal Reserve to provide "the same discount and borrowing privileges as members banks" to any "depository institution in which transaction accounts or nonpersonal time deposits are held."

This is why the Federal Reserve was directly involved in providing collateralized credit to member institutions of the Ohio Deposit Guarantee Fund from the earliest beginnings of the Ohio thrift crisis.

On the other hand, the Federal Home Loan Bank Board was not involved in any way with the regulation, examination, supervision, or insuring of member institutions of the Ohio Deposit Guarantee Fund. Our only legal responsibility in this matter was, and is, to deal with applications for FSLIC insurance of accounts and to provide collateralized credit to Federal Home Loan Banks System member institutions. There were 14 non-FSLIC-insured Ohio members of the Federal Home Loan Bank System at the outset of the Ohio thrift crisis. None of them requested Federal Home Loan Bank credit.

Those who have chosen to misconstrue the contrasting nature of the legal responsibilities of the Federal Reserve compared to the Federal Home Loan Bank Board, and have sought to leave the impression, false as it is, that the Bank Board moved slowly or had any role to play other than to deal with applications for insurance of accounts do a disservice to the men and women of the Federal Home Loan Bank System who have acted well above and beyond the call of duty in this matter. For my part, Mr. Chairman and members of the subcommittee, I am very pleased with the Bank Board's historically unprecedented and extremely swift response to the Ohio thrift crisis.

As you know, the Bank Board has the clear duty under the law to protect the safety and soundness of the Federal Savings and Loan Insurance Corporation. Consistent with that solemn responsibility, the Bank Board has chosen as a matter of policy to act prudently and carefully to assess applications for insurance of accounts from uninsured depository institutions. This we have done, and this we intend to continue to do, given the fact that it is the

full faith and credit of the United States which ultimately is called upon to back insured accounts in FSLIC member institutions.

Thank you very much. I will be pleased at the proper time to answer any questions the subcommittee may have.

[Mr. Gray's prepared statement follows:]

STATEMENT OF

EDWIN J. GRAY

CHAIRMAN OF THE

FEDERAL HOME LOAN BANK BOARD

Mr. Chairman and distinguished members of the Subcommittee.

I appear before you today in my capacity as Chairman of the Federal Home Loan Bank Board ("Bank Board"), and Chief Executive Officer of the Federal Savings and Loan Insurance Corporation ("Corporation" or "FSLIC"). You have asked me to discuss the nature of the response by the Federal Home Loan Bank Board to the crisis in Ohio precipitated by the failure of Home State Savings Bank, and to share my thoughts concerning what Congressional response might be appropriate to prevent history from repeating itself.

Home State Savings Bank was closed on March 10, 1985, following a run on the institution by its depositors. That run resulted from a lack of depositor confidence in the institution due to large losses Home State sustained as a result of the collapse of E.S.M. Government Securities, Inc., with which it had a number of complex, and ultimately catastrophic, financial arrangements. The Home State run spread quickly to other state-chartered institutions insured by the private Ohio Deposit Guarantee Fund, threatening both these institutions and the fund that insured them. Faced with this crisis, Ohio Governor Richard Celeste declared a "bank holiday" for these seventy-one privately insured Ohio thrifts on March 15, 1985.

As early as 1982, the Federal Home Loan Bank of Cincinnati was aware of rumors of Home State's massive dealings with E.S.M. The Cincinnati Bank heard that Home State's September 1983 examination report disclosed substantial problems, but

staff at the Bank did not see a copy of that report until the Ohio Division of Savings and Loan Associations made it available to staff on March 8, 1985, after E.S.M.'s collapse. Prior conversations with officials of the Ohio Division and the Federal Reserve Bank of Cleveland during the week of March 4th had confirmed the distinct possibility that E.S.M.'s collapse had not only impaired Home State, but threatened to exhaust the resources of the Ohio Deposit Guarantee Fund as well.

On Tuesday, March 5th, my office received a telephone call from Chairman Volcker's office alerting us to reports that American Savings and Loan Association, based in Miami, Florida, had suffered a major loss in the collapse of E.S.M. On Wednesday, March 6th, the Bank Board's general counsel received a telephone call from the Securities and Exchange Commission noting that public disclosure of the loss would probably be required.

At the request of the Federal Reserve Bank of Cleveland, the Federal Home Loan Bank of Cincinnati sent three experienced senior supervisory staff members to Cleveland over the weekend of March 9th and 10th to assist the Federal Reserve in assessing the financial condition of the state-chartered Ohio thrifts that might need to borrow from the Federal Reserve Bank's discount window.

Following this review, details of the potential loss to Home State were discussed at a meeting on Sunday, March 10th, in Florida among officials of the Securities and Exchange Commission, the Federal Reserve Bank of Cleveland, and the Federal Home Loan Bank of Cincinnati, as well as other Federal Home Loan Bank district officials. At that time it was evident that the Ohio Fund itself was threatened. On March 12th, copies of certain information obtained at the March 10th meeting were sent to the Washington office of the Federal Home Loan Bank Board.

On Wednesday evening, March 13th, representatives of the Federal Home Loan Bank of Cincinnati examined State reports on Ohio Fund members to make a preliminary estimate of their eligibility for FSLIC insurance. That same evening the Bank Board's general counsel explained the FSLIC's requirements for insurance of accounts at a meeting at the Federal Reserve Board attended by several representatives of a number of Ohio institutions and members of Ohio's Congressional delegation. The next day, Thursday, March 14th, I met with four members from Ohio's Congressional delegation to review the problem. At that time I took the initiative to commit expeditious processing on our part of applications for FSLIC insurance by Ohio institutions formerly insured by the Ohio Fund. Over the next three days, from Friday, March 15th, through Sunday, March

17th, officials of the Federal Home Loan Bank Board had numerous telephone conversations with Ohio officials to discuss related issues.

On Sunday, March 17th, my staff and I met with Chairman Volcker to discuss means of assisting the Ohio institutions which had been closed by the State. I indicated that, while the Bank Board would make every possible effort to expedite the processing of FSLIC insurance applications, it did not have the examination staff available to complete the necessary examinations in as short a time as I would like. Chairman Volcker indicated that the Federal Reserve Board had over 100 examiners already in the Ohio institutions for the purpose of reviewing the creditworthiness of those institutions. He pledged to me the use of these Federal Reserve examiners by our staff to assist in expediting the examinations of Ohio institutions applying for FSLIC insurance.

On Monday morning, March 18th, I dispatched the director of the Bank Board's Office of Examinations and Supervision to Cleveland to meet with the staff of the Federal Reserve Bank to coordinate the deployment of examiners. Over Monday, March 18th, and Tuesday, March 19th, telephone calls were made to all Ohio institutions insured by the Ohio Deposit Guarantee Fund, requesting them to advise the Federal Home Loan Bank of Cincinnati whether they intended to seek FSLIC insurance. In addition, advance application packages were specially mailed to

all those institutions so that they would be in hand on Tuesday. On Tuesday evening, March 19th, examiners were deployed to all those institutions which had indicated their intention to apply for FSLIC insurance.

On Wednesday, March 20th, I met with Governor Celeste in my office in Washington. At that meeting, I reiterated my prior commitment directly to the Governor to mount an extraordinary effort to expedite processing of applications for FSLIC insurance by Ohio institutions. I assured Governor Celeste in the strongest possible terms that nothing was more important to me and to the Bank Board than rendering every assistance possible to Ohio institutions seeking FSLIC insurance. Giving this assistance was our number-one priority.

To meet that commitment, I dispatched the director of the Bank Board's Office of District Banks to Cincinnati to coordinate the applications process. I am pleased to report that the staff has performed in an extraordinary manner and, as of April 1, 1985, 60 Ohio institutions applied for FSLIC insurance: 23 of these institutions have been conditionally approved, 2 additional institutions have acquired FSLIC insurance through merger into already insured institutions, and 5 institutions intend to apply for FDIC insurance.

The Ohio crisis shows clearly that persons who place money in a depository institution ought to know the true nature of the insurance backing that institution. That is, disclosure should be made to savers as to whether their deposits are backed by a federal agency, a state agency, or a private company or association.

You have asked whether a standby rescue plan for state or private deposit insurance funds should be put in place. In my opinion, the public would be better protected by requiring federal insurance for all depository institutions. This is so simply because, as the events in Ohio have all too recently reminded us, there appears to be no adequate substitute in the minds of depositors for federal deposit insurance. Nothing gives depositors the same amount of confidence that FSLIC and FDIC insurance do.

Universal federal deposit insurance is preferable to a rescue plan for a number of reasons. We are generally aware of some financial statistics behind the state authorized private deposit insurance funds, but we do not know the true financial condition of the thrift institutions insured by these funds. Privately insured thrift institutions are totally exempted from all federal regulations, and, consequently, they are not required to report their financial condition to federal regulators nor to subject their books and operations to the scrutiny of federal savings institution bank examiners. In

short, these institutions have no connection with the Federal Government, and the Federal Government in turn has no means of assessing the financial viability of these institutions.

I should add that even a formal report on the financial condition of these institutions might not prove sufficient to assess their long-term economic viability. Analyzing financial institutions depends not only on the conditions reflected in pro forma financial statements, but also on the quality of examination and supervision those institutions receive. On a straight accounting basis, Home State Savings Bank appeared to be adequately capitalized. On the other hand, due to what may have been lax supervision, that institution was allowed to take tremendous risk by borrowing almost 50 percent of its funds through a single government securities dealer -- E.S.M. Without our being able to scrutinize the adequacy of the examination and supervision process in states permitting private deposit insurance funds, we have no way at all of determining the soundness or financial integrity of these funds, nor can we vouch for the accuracy of the financial statistics provided by the affected institutions.

H.R. 1564, which Congressman Leach introduced on March 19, 1985, represents an approach for attempting to deal with some of the problems that caused the Ohio crisis. That bill would require all privately insured depository institutions to apply for federal insurance. If they did not qualify, they

would receive interim insurance of individual accounts up to a maximum of $10,000 per account. Institutions insured on an interim basis would have five years to become insurable. Federally insurable institutions could elect to be insured by a state-level program meeting standards set by federal regulators. This proposal is under study by the Bank Board.

Rather than prematurely commenting on this legislation at this time, however, I think it might be more helpful if I were to discuss what needs to be done to strengthen the FSLIC so that the FSLIC's survival is assured. I believe that there are eight general goals whose achievement would significantly strengthen the FSLIC Fund.

I must note, parenthetically, that the achievement of these goals would not necessarily permit the forgiveness of the recent special premium assessment imposed on institutions currently insured by the FSLIC. However, these goals are highly relevant to the formulation of any federal legislation intended to avoid a repetition of the Ohio crisis in another state at some future date.

First, long-term capital adequacy of the FSLIC Fund should be achieved to ensure public confidence in the Corporation's ability to meet present and future obligations.

Second, capital should be infused from insured institutions to the FSLIC to provide it with assets sufficient to resolve problem cases in an expeditious manner.

Third, the FSLIC should be able to require additional deposits or premium assessments from insured institutions in order to replenish the reserves of the Corporation to the extent they fall below acceptable levels.

Fourth, the additional capital infusion from insured institutions to the FSLIC Fund should be structured so that it primarily will be treated as a deposit, or investment in the FSLIC, to be "expensed" when the deposit or investment is paid out by the Corporation or depleted by losses incurred by the Corporation.

Fifth, costs of the risk to the FSLIC should be allocated fairly by requiring those institutions which choose to engage in certain risky activities to bear a higher proportion of FSLIC premiums than institutions not engaging in such activities.

Sixth, the FSLIC should be given explicit statutory authority to limit, on a regulatory basis, losses from excessive risk-taking by the industry.

Seventh, FSLIC insurance should be limited to those institutions that are principally engaged in housing finance and housing-related activities. The FSLIC should not be required to insure all the activities of other companies that choose to designate themselves as savings institutions -- institutions which choose to use the FSLIC seal to attract funds and Federal Home Loan Bank credit to expedite investments which are not reasonably related to economical home financing, including practices by arbitrageurs engaged in greenmail or corporate takeover attempts.

Eighth, the FSLIC should have the authority to classify accounts and to insure only those that are appropriate for insurance by a federal agency, because deposits that are really equity investments should not be federally insured.

Through its special insurance premium assessment and the recent introduction of H.R. 1680, the Bank Board has already begun to move toward the goals I have outlined. I continue to believe strongly that the most important of these goals is the amendment of the National Housing Act to create a "supplementary premium" plan requiring those institutions which choose to engage in activities which go beyond those found suitable for federal deposit insurance for thrifts by the Congress in the Garn-St Germain Depository Institutions Act of 1982 to bear a higher proportion of FSLIC assessments than those institutions

which do not choose to engage in such higher risk activities. The Bank Board included this approach in H.R. 1680, as well as in legislation proposed to the Congress last year.

In Mississippi in 1976 and now in Ohio the FSLIC has responded to a private insurance crisis by making extraordinary efforts to expedite the examination of privately insured thrift institutions and the processing of their applications for insurance. I believe that such efforts are in the public interest. However, they do impose very heavy strains on an already overtaxed examining and regulatory staff. I have repeatedly stressed that the Examinations staff and the FSLIC are severely understaffed, and thus cannot adequately shoulder the monumental burdens being placed on them. Indeed, we have been able to deal with the Ohio situation in an expeditious manner only because of the virtually unlimited staffing assistance provided to us by the Federal Reserve Board.

In my opinion, the Bank Board has moved swiftly and in an historically unprecedented manner to expedite applications for FSLIC insurance from institutions which were formerly members of the Ohio Deposit Guarantee Fund. I am proud of our efforts in this regard. I will be happy to try to answer any questions the Subcommittee may have. Thank you for your thoughtful attention.

Federal Home Loan Bank Board

OFFICE OF CONGRESSIONAL RELATIONS

1700 G Street, N.W.
Washington, D.C. 20552
Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

July 25, 1985

Mr. Peter S. Barash
Staff Director
Commerce, Consumer, and Monetary
Affairs Subcommittee
Committee on Government Operations
House of Representatives
Washington, D.C. 20515

Dear Peter:

In response to your letter of July 17, the Bank Board staff has reviewed the confidential submission in question and finds that we have no objection to any or all of this material being made part of the public hearing record.

If I may be of further assistance please feel free to call me.

Sincerely,

L. Arlen Withers
Director

APPENDIX

Question 1

1. a. Set forth, as comprehensively as possible and in chronological order, the FHLBB's response to the collapse of Home State and its impact on the Ohio Deposit Guarantee Fund and on Ohio's other state-insured thrifts. In this regard, on what date and by whom was the FHLBB first made aware of Home State's financial difficulties (including its dealings with ESM) and their likely impact on the Ohio Deposit Guarantee Fund?

Answer

The Federal Home Loan Bank of Cincinnati was aware of rumors of Home State's heavy dealings with ESM dating back to 1982. (Attached is a copy of Home State's December 1984, December 1983, December 1982 balance sheets from the Annual Reports of the Ohio Division of Savings and Loan Associations.) The Cincinnati Bank heard from various sources that the September 1983 examination report disclosed substantial problems, but it did not obtain a copy of that report until March 8, 1985, after ESM's collapse surfaced. The report came to the Bank from the Ohio Division subsequent to the run on Home State starting on March 5, 1985. Various conversations with Ohio Division and Federal Reserve Bank of Cleveland officials during the week of March 4, 1985, confirmed the distinct possibility that ESM's collapse had not only impaired Home State but that it also could easily exhaust the resources of the Ohio Deposit Guarantee Fund.

On Tuesday, March 5, Chairman Gray's office received a telephone call from Chairman Volcker's office alerting the Chairman that American Savings and Loan Association, based in Miami, Florida, had suffered a major loss in the collapse of ESM. On Wednesday, the Bank Board's general counsel received a telephone call from the Securities and Exchange Commission noting that public disclosure of the loss probably would be required.

At the request of the Federal Reserve Bank of Cleveland, the Federal Home Loan Bank of Cincinnati arranged to send three experienced senior supervisory staff members to Cleveland over the weekend of March 9 and 10 to assist the Federal Reserve Bank in assessing financial conditions and trends of Ohio Fund thrifts that might need to borrow from the Federal Reserve Bank's discount window.

On Sunday, March 10 the president and vice president of the Federal Home Loan Bank of Cincinnati attended a meeting in Florida with SEC, Federal Reserve Bank, and other Federal Home Loan Bank

district officials at which more details of ESM and the potential loss to Home State were discussed, and where it become more evident that the Ohio Fund itself was threatened. On March 12 copies of certain information obtained at the March 10 meeting were sent to the Bank Board.

On Wednesday evening, March 13, representatives of the Federal Home Loan Bank examined Ohio Division reports on members of the Ohio Fund in order to make a preliminary estimate of their eligibility for FSLIC insurance.

On Wednesday evening, March 13, the Bank Board's general counsel explained the FSLIC's requirements for insurance of accounts at a meeting at the Federal Reserve Board attended by representatives of a number of Ohio institutions and members from Ohio's Congressional delegation. The next day, Thursday, March 14, Chairman Gray met with four members of Ohio's Congressional delegation and agreed to expedite FSLIC action on applications for insurance by Ohio institutions formerly insured by the Ohio Fund. Over the next three days, from Friday, March 15, through Sunday, March 17, officials of the Bank Board had numerous telephone conversations with Ohio officials.

On Sunday, March 17, Chairman Gray and his staff met with Chairman Volcker. At this meeting, Chairman Volcker agreed to provide and Chairman Gray agreed to use Federal Reserve examiners to assist in expediting the examinations of Ohio institutions applying for FSLIC insurance.

On Monday morning, March 18, the director of the Bank Board's Office of Examinations and Supervision was dispatched to Cleveland to meet with staff of the Federal Reserve Bank to coordinate the deployment of examiners. Over Monday, March 18, and Tuesday, March 19, telephone calls were made to all 71 Ohio institutions requesting them to indicate whether they intended to seek FSLIC insurance. In addition, advance application packages were specially mailed to all institutions so that they would be in hand on Tuesday. On Tuesday evening, March 19, examiners were deployed to all institutions indicating their intention to apply for FSLIC insurance.

On Wednesday, March 20, Chairman Gray met with Ohio Governor Celeste. At that meeting, Chairman Gray confirmed his commitment to mount an extraordinary effort to expedite processing of applications for FSLIC insurance by Ohio institutions.

On Friday, March 22, the director of the Bank Board's Office of District Banks was dispatched to Cincinnati to coordinate the applications process. As of April 1, 1985, 60 Ohio institutions have applied for FSLIC insurance: 23 of these institutions have been

conditionally approved, 2 additional institutions have acquired FSLIC insurance through merger into already insured institutions, and 5 institutions intend to apply for FDIC insurance.

1. b. Does the FHLBB/FSLIC have copies of the Ohio Division of Savings and Loan's examination reports or other supervisory documents regarding Home State? What do these documents indicate about Home State's dealings with ESM from a safety and soundness point of view? When were these examination reports made available to the Bank Board?

Answer

The Bank Board has a copy of the latest completed examination report (10/15/83) for Home State Savings Bank. The examination report, which was made available to the Federal Home Loan Bank of Cincinnati on March 8, 1985, describes in detail the institution's dealings with ESM. The examiner concluded that management's actions placed the thrift "in a position of possible serious financial loss that could create an extreme indemnification obligation on behalf of the Ohio Deposit Guarantee Fund." The potential loss exposure at September 30, 1983, was estimated to be $158 million if the brokerage firm failed for any reason to perform.

Question 2

2. a. Please describe fully the normal procedures followed and the operating condition required of thrift institutions that seek FSLIC insurance of their accounts. Please provide copies of relevant regulations, statements of policy, or written guidelines applicable to the standards for granting insurance coverage.

Answer

On December 15, 1983, the Bank Board adopted procedures and criteria for evaluating applications for FSLIC insurance by depository institutions currently insured by the FDIC. The Bank Board's procedures for uninsured associations applying for FSLIC insurance have incorporated the same criteria mentioned above (see attached memo dated March 14, 1985). In the case of institutions formerly insured by the Ohio Fund, the Bank Board is using the following three-pronged test: (1) the institution must have net worth of at least 5 percent of liabilities calculated on a regulatory basis and excluding deferred loan losses; (2) the results of a viability analysis run for the institution over a five-year period using the Bank Board standard market rate scenario must show that the institution does not fall below existing regulatory net worth requirements over this period of time; and (3) the institution must pass a standard eligibility examination.

If an Ohio association passes this three-pronged test, it is granted conditional approval subject to an ongoing minimum net worth requirement of 5 percent of liabilities.

2. b. How many of Ohio's nonfederally insured thrifts have applied to date for FSLIC admission? How many do you expect to apply?

Answer

As of April 1, 1985, 60 Ohio institutions have applied for FSLIC insurance: 23 of these institutions have been conditionally approved, 2 additional institutions have acquired FSLIC insurance through merger into already insured institutions, and 5 institutions intend to apply for FDIC insurance.

2. c. Has it been or will it be the Bank Board's policy to expedite the application process or to modify in any way the substantive operating condition or performance requirements necessary for membership in FSLIC? If so, how?

Answer

The Bank Board has committed to expedite the processing of Ohio state-chartered institutions for FSLIC insurance. Through Monday, April 1, 1985, the Bank Board conditionally approved 25 applications for FSLIC insurance (including 2 mergers). To qualify for insurance, all Ohio state-chartered institutions must meet the requirements described in the answer to question 2.a.

2. d. What is the average net worth ratio of federally insured thrifts (i) in Ohio and (ii) nationwide?

Answer

The net worth ratio of FSLIC-insured thrifts in Ohio is identical to the national ratio. The following shows regulatory net worth as a percent of both assets and liabilities for all FSLIC-insured institutions in Ohio and nationwide for December 31, 1984:

	Ohio	U.S.
Regulatory Net Worth:		
Amount (millions)	$1,843	$37,895
Percent of Net Assets	3.87%	3.87%
Percent of Liabilities	4.03%	4.03%

2. e. How many FSLIC insured thrifts in Ohio (i) are presently on your problem list, (ii) could qualify for new admission to FSLIC insurance at this time?

Answer

(i) The Cincinnati Bank has 11 significant supervisory cases in Ohio.

(ii) Ninety-six of the 217 FSLIC-insured institutions in Ohio have a net worth ratio to assets of 5 percent or more.

2. f. In what respects (if any) do the insurance approval standards currently being applied to the Ohio thrifts differ from the standards applied in the past to similarly situated applicants (i.e., nonfederally insured or uninsured applicants already in operation)?

Answer

The Bank Board has reviewed such applications on a case-by-case basis. In all cases, however, the applicant was required to pass an eligibility examination and, if approved, was required to maintain net worth at regulatory levels. Recent cases have applied the formula applicable to FDIC-insured applicants.

The most recent case of privately insured applicants similar to the Ohio situation was the failure of the private insurance fund in Mississippi in 1976. Institutions affected by that failure were required to undergo a standard eligibility examination. Those institutions that passed the eligibility examination were required to maintain net worth and reserves at regulatory levels (5 percent at that time).

At the time of the closing of Home State Savings Bank, several insurance of accounts applications were pending from members of the Ohio Deposit Guarantee Fund. The same criteria were being applied to those applications as are now being applied to the other Ohio applicants.

Question 3

Without identifying associations by name, please provide the following information about the 10 similarly situated institutions (i.e., nonfederally insured or uninsured institutions that have been open and in operation for a significant period of time before making application for Federal insurance) that have most recently applied for and been granted FSLIC insurance: state in which located; year of application; and (as of date of insurance application) (i)

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regulatory capital ratio, (ii) ratios of scheduled items to capital and to assets, and (iii) any other financial ratios and statistics that are being assigned prime importance in evaluating the current applications of the Ohio applicants.

Answer

State	Application Filed	Approval Date	Applicant's Net Worth to Liabilities	Scheduled Items to Net Worth	Scheduled Items to Assets	Net Worth to Assets	Assets (millions)
Conn.	11/4/82	9/29/83	6.10	24.40	1.4	5.70	2,100.4
Ind.	1/22/82	4/8/82	14.90	19.90	2.6	13.00	3.2
Mass.	7/28/83	4/30/84	9.40	17.00	0.5	7.00	39.2
Maine	3/17/78	2/3/83	6.90	15.50	1.0	6.40	59.3
Ohio	6/13/82	4/6/83	12.90	58.70	6.4	10.90	65.1
N. C.	3/15/83	5/29/84	4.42	42.90	1.8	4.19	38.4
N. Y.	11/1/82	5/14/84	5.36	6.70	0.4	5.00	71.0
N. Y.	3/9/82	2/3/83	13.00	7.58	0.8	11.00	1,319.2
N. Y.	6/2/82	5/20/83	6.78	2.50	0.2	6.35	163.2
N. Y.	2/4/82	11/24/82	6.85	20.85	1.3	6.41	1,209.8

Question 4

To what extent have the Home Loan Bank Board and the Federal Reserve System coordinated their responses to the Ohio situation? Please provide specific information on the dates and the substance of communications between the FHLBB and the Federal Reserve System.

Answer

The Bank Board and the Federal Reserve Board coordinated their response to the Ohio situation soon after the problem came to light. The FHLBank of Cincinnati furnished three supervisory agents to the Federal Reserve Bank of Cleveland on March 9 to assist in evaluating the credit of the uninsured institutions. There has been close cooperation between these agencies since that time. Presently about 100 Federal Reserve examiners are assisting Bank Board examiners in conducting eligibility examinations of uninsured Ohio institutions that have applied for FSLIC insurance.

Question 5

5. a. It is the subcommittee's understanding that a number of federally chartered and FSLIC-insured thrift institutions had financial dealings with ESM Government Securities, Inc., including American Savings and Loan Association of Florida, Home Savings Association of Florida, Baraboo Federal Savings and Loan, Sun Federal Savings and Loan. Since 1980, how many FSLIC-insured associations had funds loaned to or invested with ESM? What is the total dollar value of these funds? What is the current FHLBB/FSLIC estimate as to the likely loss to FSLIC-insured institutions from these loans and/or investments? Could there be any FSLIC losses as a result?

Answer

As of December 31, 1984, we know of six FSLIC-insured institutions that had financial dealings totaling about $758.3 million with ESM. Losses are estimated to be $66.8 million, including possible FSLIC losses of $8.0 million. In addition, one institution borrowed $8 million from ESM.

5. b. Please provide the dates of the two most recent FHLBB/FSLIC examinations of each federally chartered or insured thrifts that conducted business with ESM? Did any of the reports of these examinations criticize or mention in any way the dealings between these institutions and ESM? Please be specific. If so, were any formal or informal supervisory actions taken against these institutions? Please enumerate.

Answer

The following summary describes any comments concerning dealings between the institutions and ESM for the two most recent examinations and any supervisory action taken.

INSTITUTION A

5/21/82 Exam: No report comment.

11/30/83 Exam: No report comment.

INSTITUTION B

3/18/83 Exam: No report comment.

9/14/84 Exam: The examiner noted that Ronnie Ewton, a director of American, owned a controlling interest in ESM Group, Inc., the parent company of ESM Government Securities, Inc. The association

engaged in a number of securities transactions with ESM, the largest being a $1 billion leveraged arbitrage transaction. Mr. Ewton presented this transaction to the institution's board and participated in the approval process. A substantial portion of the funds for this transaction were borrowed from various lenders. ESM was responsible for obtaining the borrowings through third parties. The association had no control over who the borrowers were or of any review of their financial strength. ESM refused to provide the institution with information on the commissions involved.

The supervisory letter was written after the demise of ESM. A special examination was ordered to determine the extent of the institution's involvement. The results of that examination have not been received. The Board will conduct an investigation using its powers under the National Housing Act.

INSTITUTION C

10/14/83 Exam: No report comment.

10/15/84 Exam: No report comment.

INSTITUTION D

7/8/83 Exam: Exam report criticized over-collateralization of reverse repos. Supervisory agent requested corrective action. Management agreed to take such action.

9/18/84 Exam: Exam report criticized over-collateralization of reverse repos. Supervisory agent has not yet sent his supervisory letter.

INSTITUTION E

11/21/81 Exam: No report comment.

5/21/83 Exam: No report comment.

INSTITUTION F

7/2/82 Exam: No report comment.

8/16/84 Exam: No report comment.

Question 6

Based on its experience to date with the Ohio crisis, does the FHLBB have any recommendations to Congress regarding the need for strengthening or modifying state/private deposit funds? For example, is there a need to put in place a permanent "standby" rescue plan for state/private deposit insurance funds that may experience extreme difficulty? Any other recommendations?

Answer

Any legislation establishing some sort of "standby" rescue plan for state-authorized private deposit insurance funds could significantly reduce the incentive for a state to responsibly regulate and supervise its insured thrifts. The linkage of responsibility and accountability is essential to the effectiveness of any supervisory program. Even in the absence of any federal "standby" plan, the Ohio events provide evidence that at least some Ohio authorities thought that at the eleventh hour the federal umbrella would be extended to shelter the state-authorized private fund's inadequacies.

CONFIDENTIAL

HOME STATE BANK

Statement of Condition
December 31, 1984

As we begin our 95th year, Home State's Statement of Condition represents a financial institution with over 65% of its assets invested in cash, U.S. Government securities, short term time deposits and mortgages guaranteed by agencies of the federal government.

As of December 31, 1984 total deposits were $667,804,694, which is an increase of $83,952,651, or 14.4% over the preceding year. Total loans grew approximately $38,000,000 to $670,358,560 and total assets reached $1,448,621,505 as of December 31, 1984.

With 33 offices covering Cincinnati, Middletown, Dayton and Columbus and with Home State Savings Bank offering increasing services to our customers, we look forward in 1985 to continued progress and growth.

Sincerely,

President & Chairman of the Board

Assets

Mortgage Loans	
Government Insured	$365,185,204
Privately Insured	115,911,399
Other	160,019,046
Commercial and Consumer Loans	26,601,881
Savings Account Loans	2,641,030
Real Estate Owned	2,445,243
Cash, Government Securities and Other Investments	620,097,603
Ohio Deposit Guarantee Fund	12,238,300
Investment in Real Estate	
Rental Property—Depreciated	28,298,315
Office Buildings—Depreciated	6,466,296
Furniture and Equipment – Depreciated	1,981,416
Investment In and Advances to Subsidiaries	32,927,030
Other Assets	73,808,742
	$1,448,621,505

Directors

David J. Schiebel
Robert J. Weeder
Marvin L. Warner, Jr.
Chmn. Wesselman Farm
Lexington, Kentucky
Nelson Schwab, Jr.
Partner, Langdon, Hood & Bailey
Stanton G. Brock
President, Sycamore Management, Inc.
Robert (Bob) Braun
TV Executive
Arthur C. Elliott
Attorney

Officers

David J. Schiebel
President & Chairman of the Board
Robert J. Weeder
Senior Vice President & Treasurer
Gerald L. Stephens
Senior Vice President
Richard J. Macke
Senior Vice President
Mortgage Loans
Charles D. Stelnau
Vice President
Barry M. Ross
Vice President
Ronald F. Boatman
Vice President
Charles S. Stroup
Vice President
Barry I. Randman
Vice President

Liabilities and Capital

Deposits	$667,804,694
Securities Sold Under Repurchase Agreements	670,356,908
Debentures Payable	26,921,463
Other Borrowed Money	12,064,063
Mortgage Escrow Deposits	1,191,154
Other Liabilities	50,012,013
Income Applicable to Future Operations	506,180
Stock Statury Reserves and Undivided Profits	19,745,030
	$1,448,621,505

CONFIDENTIAL

HERITAGE SAVINGS BANK

3316 GLENMORE AVENUE

CINCINNATI 45211 — *HAMILTON COUNTY*

BRANCH OFFICES: 1

Telephone: 513-481-3481 — Incorporated: 1883

PRESIDENT: WILLIAM T. SHEFFIELD
EXEC. VICE PRES: JACK R. WINGATE (MO)

SECRETARY: STANLEY C. MEININGER, JR.
ATTORNEY: WILLIAM T. SHEFFIELD

ASSETS

Conventional Mtg. Loans	$22,446,931
Non Mortgage Loans	410,587
Cash	394,412
Investment Securities	3,304,341
Fixed Assets-Net	648,627
Other Assets	504,136
Total	$27,909,034

LIABILITIES AND CAPITAL

Withdrawable Savings	$25,676,573
Other Liabilities	84,829
Reserves	930,395
Undivided Profits	1,217,237
Total	$27,909,034

O.D.G.F.

12/31/89

HOME STATE SAVINGS BANK

2727 MADISON RD

CINCINNATI 45209 — *HAMILTON COUNTY*

BRANCH OFFICES: 24

Telephone: 513-871-3400 — Incorporated: 1890

PRESIDENT: BURTON M. BONGARD
EXEC. VICE PRES: DAVID J. SCHIEBEL (MO)

SECRETARY: DAVID J. SCHIEBEL
ATTORNEY: NELSON SCHWAB, JR.

ASSETS

Insured & Guaranteed Loans	$17,022,062
Conventional Mtg. Loans	470,798,769
Non Mortgage Loans	12,282,689
Real Estate Owned	2,751,137
Cash	8,863,216
Investment Securities	596,220,323
Fixed Assets-Net	6,821,917
Other Assets	26,818,513
Total	$1,141,684,626

LIABILITIES AND CAPITAL

Withdrawable Savings	$498,870,739
Borrowed Money	610,051,957
Other Liabilities	16,691,757
Permanent Stock	1,185,000
Reserves	2,727,461
Undivided Profits	12,157,712
Total	$1,141,684,626

O.D.G.F.

CONFIDENTIAL

HERITAGE SAVINGS AND LOAN ASSOCIATION

3316 GLENMORE AVENUE

CINCINNATI 45211 — HAMILTON

BRANCH OFFICES:

Telephone: 513-481-2481

PRESIDENT: WILLIAM T. SHEFFIELD
EXEC. VICE PRES: JACK R. WINGATE (RIO)

SECRETARY: JACK R. WINGATE
ATTORNEY: WILLIAM T. SHEFFIELD

ASSETS

Conventional Mtg. Loans	$20,915,783
Non Mortgage Loans	355,520
Real Estate Owned	39,547
Cash	3,809,894
Investment Securities	100,781
Fixed Assets-Net	873,992
Other Assets	500,601
Total	$26,596,122

LIABILITIES AND CAPITAL

Withdrawable Savings	$24,310
Other Liabilities	[illegible]
Reserves	[illegible]
Undivided Profits	1,180,629
Total	$26,[illegible]

O.D.G.F.

10/31/82

HOME STATE SAVINGS ASSOCIATION

2727 MADISON RD.

CINCINNATI 45209 — HAMILTON COUNTY

BRANCH OFFICES: 2

Telephone: 513-871-3400

Incorporated: 1[illegible]

PRESIDENT: BURTON M. BONGARD
EXEC. VICE PRES: DAVID J. SCHIEBEL (MO)

SECRETARY: DAVID J. SCHIEBEL
ATTORNEY: NELSON SCHWAB, JR.

ASSETS

Insured & Guaranteed Loans	$17,837,319
Conventional Mtg. Loans	277,299,699
Non Mortgage Loans	3,424,792
Real Estate Owned	2,445,886
Cash	4,011,315
Investment Securities	236,142,211
Fixed Assets-Net	4,789,207
Other Assets	32,363,866
Total	$578,414,117

LIABILITIES AND CAPITAL

Withdrawable Savings	$485,182,079
Borrowed Money	66,014,092
Other Liabilities	10,877,874
Permanent Stock	1,185,000
Reserves	2,727,461
Undivided Profits	12,427,611
Total	$578,414,117

O.D.G.F.

CONFIDENTIAL

Federal Home Loan Bank Board

Memo

OFFICE OF DISTRICT BANKS

INTER-OFFICE COMMUNICATION

FROM: S. G. Frank Haas, III
Director

DATE : ~~February 21, 1985~~ March 14, 1985

TO : Chairman Gray

SUBJECT: Ohio Deposit Guarantee Fund

Attached is a copy of the procedures adopted by the Board on December 15, 1983, for evaluating applications for FSLIC insurance by depository institutions insured by FDIC. The Board does not have any procedures for uninsured associations, but we have typically used the same criteria.

An application would have to pass each part of the "three-prong" test before coming to the Board for final action. If an applicant failed a part of the test, it would not go any further in the process.

The three-prong test is as follows:

1. 5% snapshot net worth.

2. Viability analysis - applicant required to meet regulatory net worth requirements over a five year period using the Bank Board's standard market rate scenario.

3. Eligibility examination.

As explained in the June 29, 1984 memo, an exception would be granted on the first prong of the test for associations with net worth of between 4% and 5%, provided that their operating results reflected increasing net worth over the prior two semi-annual periods.

Based on discussions with the Cincinnati Bank, it is estimated that 30 associations with assets of $1.4 billion would meet the first prong of the three-prong test. (Of these 30 associations, the largest is a $914 million consumer loan company with 6% net worth. It has $515 million in consumer loans and as such would not meet a thriftness test.) Assuming that there would be a 50% fallout rate between the next two stages, I would estimate that no more than 15 associations would qualify for FSLIC insurance if we applied the existing FDIC test.

Federal Home Loan Bank Board **Memo**

CONFIDENTIAL

OFFICE OF DISTRICT BANKS

INTER-OFFICE COMMUNICATION

FROM : S. G. Frank Haas, III, Director, ODB
David W. Glenn, Director, FSLIC
Eric I. Hemel, Director, OPER

TO : All Bank Presidents

DATE : January 12, 1984

SUBJECT: Procedures and Criteria for Evaluating Applications for FSLIC Insurance by Depository Institutions Insured by the FDIC

On Thursday, December 15, 1983, the Board formally adopted procedures and criteria for evaluating applications for FSLIC Insurance by depository institutions insured by the FDIC.

The Board considered a memorandum (copy attached) from the Directors of the Office of District Banks, Federal Savings and Loan Insurance Corporation and the Office of Policy and Economic Research, recommending a "three-prong" test as part of the overall evaluation process. The development and formal adoption of this procedure will provide guidance to potential applicants as well as provide the applicant with a realistic indication of whether it can expect favorable action at each stage of the process.

The first step of the "three-prong" test would be to determine whether the applicant had net worth to liabilities equal to or greater than 5%. If the applicant met the first test, it would move to the second step whereby the District Bank would conduct a viability analysis over a 5 year horizon, based upon data obtained from FDIC examination reports and the Board's standard market rate scenario viability test. If the applicant maintains its regulatory net worth (currently 3.0%) during the entire simulation period, it would qualify for the eligibility examination. Upon completion of the eligibility examination the District Banks' digest and recommendation would be prepared and forwarded to Washington, D.C. for review and submission to the Board for action.

It is the opinion of the Board that the adopted procedure will be in the best interest of both the applicant and Insurance Corporation. The procedure will ensure that the corporation will not be exposed to unnecessary risk as well as provide potential applicants with formal procedures.

If there are any questions regarding the above procedures feel free to give any one of us a call. Patrick O. Berbakos of the Office of District Banks (202-377-6712) is also available to answer any specific operational questions.

S. G. Frank Haas, III
Director, ODB

David W. Glenn
Director, FSLIC

Eric I. Hemel
Director, OPER

CONFIDENTIAL

Federal Home Loan Bank Board

1700 G Street, N.W.
Washington, D.C. 20552
Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

MEMORANDUM FOR: Federal Home Loan Bank Board

FROM: S. G. Frank Haas, III, Director, ODB
David W. Glenn, Director, FSLIC
Eric I. Hemel, Director, OPER

SUBJECT: Proposed Procedures and Criteria for Evaluating Applications for FSLIC Insurance by Depository Institutions Insured by the FDIC

DATE:

ISSUE:

Establishment of appropriate criteria for evaluating applications for FSLIC insurance submitted by other depository institutions currently insured by the FDIC.

PREVIOUS AND CURRENT PROCEDURES

By law, the FSLIC must consider the safety and soundness of each applicant when granting insurance of deposits. The exact criteria for judging safety and soundness, however, is a matter over which the Board can exercise wide discretion. Historically, the determination of an institution's safety and soundness was generally made in OES and ODB. However, in December 1982 the Board reviewed the existing approach for evaluating applications and decided that the FSLIC should also have an integral role in the evaluation of an applicant's viability according to a standard set of criteria. Although no formal procedures were developed or issued by the Board, there is general staff agreement that then Chairman Pratt informally directed OPER and FSLIC to apply strict standards for the initial FSLIC evaluation of applicants. This reflected a policy that stressed the minimization of additional risk exposure to the Insurance Corporation.

The standard which governed the initial evaluation of an applicant for conversion to FSLIC insurance required that the institution demonstrate an expected financial performance which would place it in the top 33% of all thrift institutions already insured by the FSLIC. Upon receiving an application for insurance of accounts, the FSLIC would analyze whether the applicant would survive an interest rate scenario that would cause two-thirds of the thrift industry insured by the FSLIC to be insolvent. Only those institutions which remained viable under this scenario were deemed eligible for FSLIC insurance of accounts. While this standard minimized the risk of insuring new members, it was clearly not a realistic scenario nor one which the insurance fund would be likely to survive.

Since January 1983, 15 institutions have applied to convert to FSLIC insurance. Of these applications, 5 were approved, 4 withdrawn, and 6 are currently pending.

This past Spring, OPER and FSLIC were asked to reevaluate the criteria under which applications are considered for FSLIC insurance. Since that time, the Bank Board's core staff has met several times to discuss possible alternatives to the two-thirds rule.

RECOMMENDATIONS

We recommend the adoption of a "three-prong" test as part of the overall evaluation process for institutions currently insured by the FDIC. The initial stage of this test would be the determination of whether the applicant had net worth to assets or net worth to liabilities equal to or greater than the FDIC's current reserve requirement of 5%.

If the applicant met the 5% reserve requirement, it would move to the second stage of the test during which the District Banks would conduct a viability analysis, over a 5 year horizon, based upon data obtained from FDIC examination reports and the Board's standard market rate scenario viability test. If the applicant meets its regulatory net worth requirements during the entire simulation period of the standard market rate scenario, it would qualify for the eligibility examination.

An advantage of this system is that applicants would be "pre-screened" at the District Bank level prior to the eligibility examination; if an applicant is unable to pass the first two stages of the "three-prong" test, it would not qualify for FSLIC insurance and would not incur the expense of the eligibility examination which can be very costly ($304 per day per examiner). If the applicant passes all three stages of the test, the application would be forwarded to Washington D. C. for review and submission to the Board for action.

To ensure that the principal role of FSLIC-insured institutions continues to be that of home finance, it was also recommended that applicants be required to invest a substantial percentage of their assets in mortgage and mortgage-related securities. However, the Office of General Counsel recommended against trying to impose a housing commitment percentage test.

In 1978, the Bank Board attempted to impose a 60% housing commitment test as part of the Committee on Banking, Finance and Urban Affairs, Financial Institutions Regulatory Act (H.R.13471). The Act authorized Federal charters for mutual savings banks. At that time, the Board wanted to ensure that mutual savings banks investments reflected the fact that the Federal Home Loan Bank System remained firmly committed to the housing needs of the country. Although the Board urged the committee to statutorily require a percentage test, it was explicitly rejected by Congress.

CONCLUSION

It is the finding of FSLIC, OPER and ODB that the "three-prong" test is in the best interest of both the applicant and the Insurance Corporation.

The procedure is strict enough to ensure that the insurance corporation will not be exposed to unnecessary risk and it also gives the applicant a realistic indication of whether it can expect approval at each stage of the review process.

Adoption of formal insurance criteria will provide guidance to potential applicants and should help to expedite the processing time.

S. G. Frank Haas, III
Director, ODB

David W. Glenn
Director, FSLIC

Eric I. Hemel
Director, OPER

Mr. BARNARD. Thank you, Mr. Gray.

We will now hear from Vice Chairman of the Federal Reserve Board, Mr. Preston Martin.

STATEMENT OF PRESTON MARTIN, VICE CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. MARTIN. Thank you, Mr. Chairman. We appreciate the opportunity, President Horn and myself, to appear before the subcommittee and briefly to summarize the contribution of the Federal Reserve System to the amelioration of the Ohio privately insured thrift institution situation.

You have already been reminded that the Central Bank has the authority under the Monetary Control Act of 1980 to lend under normal circumstances to nonmember depository institutions, and throughout the Ohio crisis, we have stood ready so to lend, and we have extended credit during the course of events there.

The Federal Reserve has further, as has been indicated, played a role in monitoring events in Ohio, in facilitating cooperative efforts, in counseling the various parties involved to resolve the situation, to reestablish public confidence and to promote the safety of depositors' funds.

In this capacity, as President Horn will detail with you, Federal Reserve officials from the Cleveland Fed and from Washington have held and have participated in numerous meetings with governmental supervisory officials from the State of Ohio, officials from the Federal Home Loan Bank System, Federal Home Loan Bank of Cincinnati, and other Federal regulatory agencies.

As the primary supervisor of bank holding companies, and in response to a request by Governor Celeste, the Federal Reserve, both from the Board and through the efforts of officials of the several Federal Reserve banks, have also been in contact with banking organizations, both from within and from without Ohio, to determine their interest if any in acquiring or merging with ODGF institutions, including those which may be unable to qualify on their own

for Federal insurance or to reopen without additional external support.

To facilitate the Federal insurance requirement of the State government, we have expedited arrangements for review of applications by the Bank Board, as has been commented here, the FDIC, and within our own organization. And in this process, the Federal Reserve will continue to make field examination personnel available to the Bank Board and to Ohio authorities to assist in examinations and to expedite the process of qualifying for Federal deposit insurance.

While a longer range solution with respect to all of the affected thrifts remains to be worked out, we believe the Ohio events underscore the importance of full cooperation among appropriate Federal and State supervisory authorities. And with regard to State banking authorities, the Federal Reserve is well into a new program to work with those State officials and their staffs as they see fit to increase their technical and examinational abilities.

One of your questions of us raised by the recent events in Ohio relates to the role of private deposit insurance funds. Clearly deposit insurance is an important factor in maintaining public confidence in deposit institutions. I believe it is too early to make a definitive judgment about the role of sole-insurer private insurance funds and even of possible State-sponsored funds in our financial system. But you have asked for comments and we appreciate the opportunity to do so.

There may be industry structures which could be adequately supported by private arrangements as sole insurers, structures involving large numbers of small institutions, a substantial reserve fund not dependent upon deposits in a mutual basis by the insured institutions, and featuring adequately strong examination and auditing procedures.

And I would add to that the desirability of geographic dispersion of risk and the further desirability of an independent board, independent of representatives of the mutually insured institutions.

Such an industry structure of small institutions could consist, say, of the smaller credit unions. Any such arrangements suffer from a certain degree of confusion as to whether and to what extent the resources of State government are behind the private sole-insurer's reserves.

However, industry structures consisting in part or in whole of sizable depository institutions, reserve funds dependent upon the deposits of the members exclusively, and with an examination and regulatory procedure, in part justified to its membership as less rigorous than Federal procedures. These raise substantial questions as to whether the public interest is served thereby. And thus the Board supports the movement of several State legislatures away from the presently constituted private insurance funds. Whatever approaches may ultimately prove feasible, the events in Ohio do serve to remind us of the potential consequences of the loss of public confidence in individual depository institutions, and of the celerity with which that loss can spread to other institutions.

In view of these concerns, the Federal Reserve System will continue to cooperate fully with the State and Federal authorities

seeking a longrun solution to thrift industry liquidity problems in Ohio.

Thank you, Mr. Chairman.

Mr. BARNARD. Thank you, Mr. Vice Chairman.

[Mr. Martin's prepared statement follows:]

Statement by

Preston Martin

Vice Chairman, Board of Governors of the Federal Reserve System

I am pleased to appear before this Subcommittee to discuss the Federal Reserve's contribution to efforts to ameliorate the problems of the state-chartered, privately insured thrift institutions in Ohio. The situation in Ohio was touched off by reported losses suffered by Home State Savings Bank (Home State) as a result of transactions with E.S.M. Government Securities, Inc. (ESM), a broker-dealer in government securities, but also was related to more systemic weaknesses in the supervision and insurance of some Ohio savings and loan associations. A detailed chronology of the Federal Reserve System's response to events in Ohio is attached to the statement of President Karen Horn of the Federal Reserve Bank of Cleveland.

As this Subcommittee is aware, reports of losses at E.S.M. precipitated a run on Home State that led to its closing. This development subsequently contributed to more generalized deposit outflows at other ODGF savings and loan associations and savings banks in Ohio, and a number of these institutions experienced heavy depositor withdrawals. Faced with this situation, Governor Celeste of Ohio closed, on a temporary basis, all 70 of the remaining ODGF thrift institutions. Subsequently, the State of Ohio adopted a plan that allows certain institutions found to qualify for federal insurance to reopen on a full service basis. Ohio authorities are pursuing other remedial steps, including the potential merger of weak thrifts with stronger federally insured institutions, designed to resolve the situation and promote the safety of depositor funds. At the present time, all but one of the ODGF thrifts have reopened on either a full or limited service basis; although a permanent solution involving the remaining closed thrift, Home State, and those thrifts that cannot qualify for federal insurance remains to be worked out. The limited service reopenings permit withdrawals of $750 per account per month. The Federal Reserve is lending to the reopened thrift institutions where necessary.

In reviewing this situation, it is helpful at the outset to clarify the Federal Reserve's specific regulatory responsibilities for various types of banking institutions as well as its broader responsibilities as the nation's central bank. The Federal Reserve has primary supervisory responsibility at the federal level for state-chartered banks that are members of the Federal Reserve System and for all bank holding companies. Commercial banks that are members of the Federal Reserve System are FDIC-insured, and commercial banks that are subsidiaries of bank holding companies, regardless of membership status, must by law be federally insured. Of course, the Federal Reserve does not have supervisory responsibility for thrift institutions, and the federal regulatory agencies, including the Federal Reserve, generally do not have direct supervisory or regulatory responsibility for state-chartered, nonfederally insured depository institutions, such as the affected ODGF thrift institutions in Ohio. Normally, such institutions are supervised and regulated by state authorities. It should also be pointed out that the Federal Reserve is not an insuring agency and does not have authority to make direct equity investments in depository institutions. However, the Federal Reserve does have authority to lend through the discount window and, in its role as the nation's central bank, has a fundamental responsibility to foster the stability and orderly functioning of the nation's banking and financial system.

Nonmember depository institutions, including the state-chartered thrift institutions in Ohio, became generally eligible for discount window borrowing in 1980 as a result of the enactment in that year of the Monetary Control Act. Under this legislation, the discount window facilities of the Federal Reserve System were made available to all insured or uninsured depository institutions, throughout the nation, which offer transaction accounts or hold nonpersonal time accounts.

In its capacity as the central bank, the Federal Reserve may assist in efforts to deal with financial disturbances in order to prevent them from becoming generalized financial crises or causing systemic dislocations. An important policy tool to achieve these ends is the discount window through which the Federal Reserve serves as the ultimate source of liquidity.

Throughout this difficult period in Ohio, the Federal Reserve Bank of Cleveland has been prepared to lend and has loaned through the discount window to the affected thrift institutions under terms and conditions established by law for such borrowing. Indeed, on March 6, one day after the public disclosure of possible Home State losses, Federal Reserve examiners were dispatched to Cincinnati to meet with Home State officials, explain borrowing procedures, and begin to review potential collateral. In addition, the eligibility of state-chartered depository institutions, including thrifts, for discount window assistance was stressed in a public statement by the Federal Reserve Bank of Cleveland on March 10. Prior to the temporary ODGF closings, the Federal Reserve Bank of Cleveland provided discount window credit to certain affected institutions, and as the institutions have reopened, they have been eligible for liquidity assistance. The availability of this discount window assistance to reopened institutions was stated publicly by President Horn on March 15 and reiterated by Chairman Volcker on March 20, 1985.

In carrying out its responsibilities as lender of last resort, Federal Reserve System supervisory and examination personnel have worked closely with the affected institutions to inform them of collateral and documentation requirements and to assist them in understanding fully and meeting these requirements. Discount window loans to affected institutions have been made at the regular discount rate, currently 8 percent, and, as required by the Federal

Reserve Act, have been secured by adequate collateral. As is usually the case, this collateral has consisted of government and agency securities, commercial loans, one-to-four family residential mortgage loans, and other loans, and the collateral has been evaluated within normal guidelines. The Federal Reserve has, however, acted in a expeditious manner to facilitate the access of these institutions to the discount window under normal terms and conditions.

In addition to these lender of last resort responsibilities, the Federal Reserve has also played an important role in monitoring events in Ohio and in facilitating cooperative efforts among the various parties involved to resolve the situation, to reestablish public confidence and to promote the safety of depositors' funds. In this capacity, Federal Reserve officials have held or participated in numerous meetings with governmental and supervisory officials from the State of Ohio as well as with officials from the Federal Home Loan Bank Board (FHLBB), the Federal Home Loan Bank of Cincinnati, and other federal regulatory agencies. In order to enhance our understanding of the financial condition of the affected thrifts and to assist the State of Ohio and the FHLBB, the Federal Reserve, within a few days of the temporary closings, provided examiners to participate in on-site examinations and asset evaluations of the ODGF institutions. These examinations have helped to determine the availability of collateral for facilitating access to the discount window and, equally important, they have played a critical role in the process of reopening those institutions found to qualify for federal insurance. The information developed in our on-site visits and otherwise has been made available promptly to other federal and state authorities. We hope these actions have supported and complemented the steps taken by Governor Celeste, the Ohio legislature, and the federal insurance agencies to reopen the affected thrift institutions.

As the primary supervisor of bank holding companies and in response to a request by the State, the Federal Reserve has also been in contact with banking organizations, from both within and outside of Ohio, to determine their interest, if any, in acquiring or merging with ODGF institutions, including those which may be unable to qualify for federal insurance or to reopen without additional external support. The day after the temporary closings, Reserve Bank officials telephoned the senior managements of bank holding companies throughout the country to inform them of imminent State plans to hold meetings to discuss the possible sale or acquisitions of certain thrift institutions.

As the Subcommittee is aware, the State of Ohio has adopted a plan requiring federal insurance for essentially all savings and loans, building and loan associations, and all savings banks in the state. The State has also implemented arrangements to provide ODGF thrift institution depositors limited access to their funds. Further, the Ohio legislature acted promptly to advance $50 million in state funds to shore up the remaining ODGF institutions other than Home State. To facilitate the federal insurance requirement, expedited arrangements have been made for review of applications by the FHLBB, the FDIC, and the Federal Reserve. In this process, the Federal Reserve will continue to make field examination personnel available to the FHLBB and to Ohio authorities to assist in examinations and to expedite the process of qualifying for federal deposit insurance. We have been informed that as of March 29, 1985, the State of Ohio had authorized 26 institutions to reopen on a full service basis. Included in this number is a former thrift institution that has converted to commercial bank status and has reopened with FDIC insurance after our Board acted on a bank holding company application. Also included in this figure is a thrift institution acquired by a bank holding company in a transaction approved on an expedited basis by the Federal Reserve Board.

It may take some time for the thrift situation to return to normal in Ohio. A number of ODGF institutions have obtained federal deposit insurance. Others will, apparently, need an injection of capital from present owners or new investors, and still others may need to be acquired by stronger depository institutions. I assure you that the Federal Reserve will continue to provide assistance through the discount window, the provision of examination personnel to assist the FHLBB and State authorities, and the expeditious review and action on applications for mergers or acquisitions that require our approval.

While a longer range solution with respect to all of the affected thrifts remains to be worked out, the Ohio events underscore the importance of full cooperation among appropriate federal and state supervisory authorities in dealing with any strains or pressures involving depository institutions that could have adverse systemic implications for the banking or financial system. Such adverse developments must be met with timely and effective action to restore confidence and maintain the stability of the financial system. In the case of the thrifts in Ohio, I believe that, in general, the remedial procedures that have been taken should significantly reduce any lasting impacts on financial markets.

One of the questions raised by the recent events in Ohio relates to the role of private deposit insurance funds. Clearly, deposit insurance is an important factor in maintaining public confidence in depository institutions. Indeed, as I have noted, commercial banks that are members of the Federal Reserve System are FDIC-insured, and all commercial banks that are subsidiaries of bank holding companies are required by law to be federally insured. I believe that it is too early to make a definitive judgment about the role of sole insurer private insurance funds and even state sponsored funds in our financial system.

There may be industry structures which could be adequately supported by private arrangements as sole insurers, structures involving large numbers of small institutions, a substantial reserve fund not dependent upon deposits by the insured institutions, and featuring adequately strong examinations and auditing procedures. Such a structure might consist of a large number of smaller credit unions. Any such arrangements suffer from a certain degree of confusion as to whether and to what extent the resources of state government are behind the private sole insurers' reserves. However, industry structures consisting in part or in whole of sizable depository institutions, reserve funds dependent upon the deposits of its members, and with an examination and regulatory procedure in part justified to its membership as less rigorous than federal procedures, raise substantial questions as to whether the public interest is served thereby. The Board supports the movement of several state legislatures away from private insurance funds. Whatever approaches may ultimately prove feasible, the events in Ohio do serve to remind us of the potential consequences of the loss of public confidence in individual depository institutions and of the celerity with which that loss can spread to other institutions. In view of these concerns, the Federal Reserve System will continue to cooperate fully with the State and federal authorities seeking a long run solution to thrift institution liquidity problems in Ohio.

Mr. BARNARD. Ms. Horn, we are delighted to have you with us today, and as president of the Federal Reserve Bank of Cleveland, and we would like to hear from you at this time.

Ms. HORN. Thank you, Mr. Chairman. I would like to submit my full statement for the record.

Mr. BARNARD. Without objection, your full statement will be included.

STATEMENT OF KAREN N. HORN, PRESIDENT, FEDERAL RESERVE BANK OF CLEVELAND

Ms. HORN. I am pleased to appear before the Commerce, Consumer, and Monetary Affairs Subcommittee to discuss the Federal Reserve's response to the recent problems experienced by thrifts insured by the Ohio Deposit Guarantee Fund.

This morning I will be reviewing for you the response of the Federal Reserve Bank of Cleveland. Attached to my statement is a chronology that sets forth the Federal Reserve System's response to the recent events in Ohio.

I would like to begin by stating that the role of the Federal Reserve Bank of Cleveland throughout this period has been to assist the State of Ohio and other Federal regulators in fashioning a solution.

Our initial involvement was to ensure that we could act quickly to provide liquidity assistance at the discount window and to make currency shipments—first, to Home State and subsequently, to the other institutions insured by the Ohio Deposit Guarantee Fund.

We have acted at the request of the State of Ohio, and throughout this period, the Federal Reserve Bank of Cleveland and the Federal Home Loan Bank of Cincinnati have shared information and staff in a cooperative effort to deal with the problems and to fashion solutions. I would also like to recognize the substantial and supportive role of the correspondent banks, the commercial banks, in Cincinnati. I believe the Federal Reserve has been helpful, and we will continue to assist the State of Ohio and other Federal regulators until the problem is solved.

The Federal Reserve Bank of Cleveland first became aware of possible financial difficulties at Home State Savings Bank of Cincinnati on Monday, March 4, 1985, when an official of Home State telephoned the Federal Reserve Bank of Cleveland to inquire about procedures that Home State should follow if it needed to borrow at the discount window.

Although the problems at Home State were triggered by unique events growing out of its transactions with ESM, the severity of public reaction made us concerned about possible deposit withdrawals at other ODGF-insured institutions. As I mentioned earlier, deposits at Home State were insured by the ODGF, a private fund that also insured 70 other State-chartered thrift institutions in Ohio. According to State officials, the insurance fund had assets of about $130 million prior to the run on Home State. Uncertainty regarding other ODGF-insured institutions was increased by reports on the use of ODGF funds to deal with Home State's heavy deposit withdrawals.

Growing concern that other ODGF institutions might confront problems on Monday, led us on Saturday, March 9, to develop a plan to monitor and deal with deposit withdrawals at other ODGF institutions, should they occur.

The plan had several dimensions. One, having a timely and effective mechanism for sensing unusually heavy deposit withdrawals. Two, informing ODGF institutions of collateral and other requirements for borrowing at the discount window. And three, planning and putting into place the logistics necessary to deliver currency, evaluate collateral, and obtain documents for borrowing at the discount window.

The large number of ODGF institutions and the need for prompt and effective action, if action were to be required—at this point we were still in the contingency planning stage—made it imperative that we be prepared to deal with the problem by Monday, March 11, when the ODGF institutions opened. We were fortunate in being able to draw upon the staff from other Federal Reserve banks to assist us in contingency planning and logistics. The weekend planning effort concluded with meetings at 10 p.m. on Sunday, March 10, in both Cleveland and Cincinnati to brief Federal Reserve examiners on their role in the contingency plans. These plans called for examiners to be strategically placed near ODGF institutions throughout the State prepared to deliver borrowing documents upon request.

Our weekend efforts had made it possible to monitor deposit outflows, to lend at the discount window, and to ship cash throughout the weeks that followed to a large number of institutions, most of which had not dealt at our discount window and which normally received their currency from other sources.

Public confidence in ODGF institutions continued to decline. As the financial institutions opened on Monday, March 11, there was evidence of loss of depositor confidence. At first this loss of confidence was largely confined to Cincinnati, where Home State is located. As the week progressed, the number of ODGF institutions suffering heavy cash strains increased and the volume of withdrawals rose sharply. On Thursday, March 15, for example, the seven most affected institutions in the Cincinnati area lost more than $60 million in deposits, almost triple the amount withdrawn on Wednesday, the day before.

Several institutions had lost one-fifth of their deposits between Monday morning and Thursday night, and there was clear evidence that the crisis was spreading to ODGF-insured institutions in other cities as well. The more public confidence fell, the more serious the problem became. Federal Reserve examiners were sent upon request to many institutions to begin reviewing their collateral as their deposit withdrawals increased and the potential for borrowing at the discount window increased. The Federal Reserve and other commercial banks shipped currency to institutions that were experiencing heavy withdrawals, but cash alone was not enough to restore confidence. Without confidence, even the strongest financial institution can be severely impacted.

Our active and visible role was to provide liquidity assistance to ODGF institutions at the discount window. In performing this function, the Federal Reserve Bank of Cleveland has not modified its

normal eligibility requirements for discount window assistance. The Monetary Control Act of 1980, which has already been referred to, made the discount window of the Federal Reserve Bank available to any depository institution that holds transaction accounts for nonpersonal time deposits. This so-called adjustment credit is available on a short-term basis to assist borrowers in meeting temporary requirements for funds while they engage in an orderly adjustment in their asset and deposit liabilities. We set up field warehouses in most of the ODGF institutions where collateral was identified, evaluated, and earmarked for possible use in securing discount window borrowings.

That is our statutory and traditional role. The Federal Reserve played another very important role during the ODGF Savings and Loan problem. We served as a facilitator. During the early morning hours of Friday, March 15, when the full dimensions of the problem became clear, Governor Celeste decided to close all ODGF-member institutions for a 3-day period. Following that decision, the Governor requested that the Federal Reserve assist him in calling a meeting of large Ohio banking and thrift institutions to discuss the situation with them and propose a solution to the problem. The State subsequently decided it would be useful to discuss the situation with out-of-State banks, and two meetings were held with out-of-State institutions at the Federal Reserve Bank of Cleveland.

In the past 2 weeks, some elements of a solution have fallen into place. Each ODGF institution was examined on a case-by-case basis to determine its financial condition and the likelihood of its qualifying for Federal insurance.

The Ohio State Superintendent of Savings and Loan Associations requested assistance from the Federal Reserve, the Federal Deposit Insurance Corporation [FDIC], and the Ohio Division of Banks in conducting these examinations. The results of the preliminary examinations made it clear that a large number of these institutions were well managed, in sound financial condition, and consequently viable candidates for Federal insurance. Others, for a variety of reasons, would have difficulty in qualifying for Federal Deposit Insurance. As of Tuesday, April 2, according to the State of Ohio, 28 of the former ODGF institutions have been reopened for the full range of banking functions, most with Federal insurance.

Confidence in these institutions seems to be restored. And among those fully opened, there has not been evidence of unusual withdrawals or need for assistance through either the credit facilities of the Federal Home Loan Bank in Cincinnati or the Federal Reserve discount window. The Federal Deposit Insurance applications of some ODGF institutions are still being considered, and other ODGF institutions have been informed of the changes and improvements that will be necessary in order for them to be able to obtain Federal insurance.

Mr. BARNARD. Thank you very much.

[Ms. Horn's prepared statement follows:]

Statement by

Karen N. Horn
President, Federal Reserve Bank of Cleveland

I am pleased to appear before the Commerce, Consumer, and Monetary Affairs Subcommittee to discuss the Federal Reserve's response to the recent problems experienced by thrifts insured by the Ohio Deposit Guarantee Fund. This morning I will be reviewing for you the response of the Federal Reserve Bank of Cleveland. Attached to my statement is a chronology that sets forth the Federal Reserve System's response to recent events in Ohio.

I would like to begin by stating that the role of the Federal Reserve Bank of Cleveland throughout this period has been to assist the State of Ohio and other Federal regulators in fashioning a solution. Our initial involvement was to insure that we could act quickly to provide liquidity assistance at the discount window and to make currency shipments -- first to Home State and subsequently to other institutions insured by the Ohio Deposit Guarantee Fund (ODGF). We have acted at the request of the State of Ohio, and throughout this period the Federal Reserve Bank of Cleveland and the Federal Home Loan Bank (FHLB) of Cincinnati have shared information and staff in a cooperative effort to deal with the problems and to fashion solutions. I would also like to recognize the substantial and supportive role of the correspondent banks in Cincinnati. I believe the Federal Reserve has been helpful, and we will continue to assist the State of Ohio and other Federal regulators until the problem is solved.

The Federal Reserve Bank of Cleveland first became aware of possible financial difficulties at Home State Savings Bank of Cincinnati, Ohio on March 4, 1985, when an official of Home State telephoned the Federal Reserve Bank of Cleveland to inquire about the procedures Home State should follow if it needed to borrow at the discount window. The Federal Reserve Bank of Cleveland did not have any financial information on Home

State. It is a state-chartered savings and loan association, regulated and examined by the Ohio Division of Savings and Loan Associations, and prior to this time it had never borrowed at the discount window. We did know that Home State's deposits were insured by the ODGF, but we did not have access to any financial reports on Home State. On March 5, the press reported that Home State might suffer a large loss in connection with the failure of E.S.M. Government Securities, Inc. (E.S.M.), a Florida-based broker-dealer in government securities. The Federal Reserve began an effort to gather information on Home State's situation. Discussions with the FHLB of Cincinnati confirmed that Home State was not a member of the FHLB and that the FHLB also had little financial information on Home State.

Reports from Cincinnati on Wednesday, March 6, indicated a large volume of depositor withdrawals at Home State. On that same day, Federal Reserve examiners entered Home State to examine available collateral in the event that it became necessary for Home State to borrow at the discount window. Depositor withdrawals on Wednesday and Thursday were funded with Home State's own liquidity and lending by the ODGF. The withdrawals on March 6 totaled $55 million. On March 7, a meeting was held at the Cincinnati Branch of the Federal Reserve Bank of Cleveland with representatives from the State of Ohio, ODGF, and Home State to discuss liquidity assistance for Home State from the Federal Reserve Bank of Cleveland. Based on collateral judged to be acceptable by the Federal Reserve Bank, credit was extended on Friday, March 8, and arrangements were put in place to extend further credit. Depositor withdrawals had continued on March 7 and 8, reaching approximately $100 million for those two days. On Saturday, March 9, Home State did not open for business.

Governor Celeste appointed a conservator for Home State and announced on Sunday night, March 10, that Home State would not reopen for business on Monday.

Although the problems at Home State were triggered by unique events growing out of its transactions with E.S.M., the severity of the public reaction made us concerned about possible deposit withdrawals at other ODGF insured institutions. As I mentioned earlier, deposits at Home State were insured by the ODGF, a private fund that also insured 70 other State-chartered thrift institutions in Ohio. According to State officials, the insurance fund had assets of about $130 million prior to the run on Home State. Uncertainty regarding other ODGF insured institutions was increased by reports on the use of ODGF funds to deal with Home State's heavy deposit withdrawals. Financial information on all ODGF insured institutions was made available to the Federal Reserve Bank of Cleveland late Friday, March 8. Federal Reserve examiners and discount window staff reviewed and analyzed this information on Saturday and Sunday, March 9 and 10, with the assistance of senior examination personnel from the FHLB of Cincinnati.

Growing concern that other ODGF institutions might confront problems on Monday led us on Saturday, March 9, to develop a plan to monitor and deal with deposit withdrawals at other ODGF institutions, should they occur. The plan had several dimensions: 1) having a timely and effective mechanism for sensing unusually heavy deposit withdrawals; 2) informing ODGF institutions of collateral and other requirements for borrowing at the discount window; and 3) planning and putting into place the logistics necessary to deliver currency, evaluate collateral, and obtain documents for borrowing at the discount window. The large number of ODGF

institutions and the need for prompt and effective action, if action were required, made it imperative that we be prepared to deal with the problem by Monday, March 11, when the ODGF institutions opened. We were fortunate in being able to draw upon staff from other Federal Reserve Banks to assist in the contingency planning and logistics. The weekend planning effort concluded with meetings at 10:00 p.m. on Sunday, March 10, in both Cleveland and Cincinnati to brief Federal Reserve examiners on their role in the contingency plans. These plans called for examiners to be strategically placed near ODGF institutions throughout the State prepared to deliver borrowing documents upon request.

Also, late Sunday evening, March 10, following the Governor's announcement that Home State would not reopen on Monday, the Cleveland Federal Reserve Bank publicly restated its discount window policy: "State-chartered savings and loans and savings banks, like all depository institutions, are eligible for liquidity assistance through the discount window...under normal terms and conditions." Our weekend efforts had made it possible to implement the policy, to monitor deposit flows, to lend at the discount window, and to ship cash throughout the weeks that followed to a large number of institutions, most of which had not dealt with our discount window and which normally received their currency from other sources.

Public confidence in ODGF institutions continued to decline. As financial institutions opened on Monday, March 11, the evidence of the loss in depositors' confidence was almost immediate. At first the loss of confidence was largely confined to Cincinnati, where Home State is located. As the week progressed, the number of ODGF institutions suffering heavy cash drains increased, and the volume of withdrawals rose

sharply. On Thursday, March 14, for example, the seven most affected institutions in the Cincinnati area lost more than $60 million in deposits -- almost triple the amount withdrawn on Wednesday. Several institutions had lost one-fifth of their deposits between Monday morning and Thursday night, and there was clear evidence that the crisis was spreading to ODGF insured institutions in other cities. The more public confidence fell, the more serious the problem became. Federal Reserve examiners were sent upon request to many institutions to begin reviewing collateral as deposit withdrawals and the potential for borrowing at the discount window increased. The Federal Reserve and other commercial banks shipped currency to institutions that were experiencing heavy withdrawals, but cash alone was not enough to restore confidence; without confidence even the strongest financial institution can be severely impacted.

Our active and visible role was to provide liquidity assistance to ODGF institutions at the discount window. In performing this function, the Federal Reserve Bank of Cleveland has not modified the normal eligibility requirements for discount window assistance in any way. The Monetary Control Act of 1980 made the discount window of the Federal Reserve Bank available to any depository institution that holds transactions accounts or nonpersonal time deposits. Regulation A of the Board of Governors, which prescribes standards for the operation of the discount window, provides for lending to eligible depository institutions under two basic programs. One is the adjustment credit program; the other supplies credit for seasonal and other limited purposes for more extended periods. Adjustment credit is available on a short-term basis to assist

borrowers in meeting temporary requirements for funds while an orderly adjustment is being made in their assets and deposit liabilities.

All Federal Reserve advances must be secured to the satisfaction of the Reserve Bank providing the credit. Satisfactory collateral includes securities of the U.S. government and of federal agencies, and, if of acceptable quality, residential mortgage notes and other assets. Although collateral is generally held in safekeeping at the Federal Reserve Banks or acceptable third-party custodians, in this instance, field warehouses were set up in most ODGF institutions where collateral was identified, evaluated, and earmarked for possible use in securing discount window borrowings.

The Federal Reserve played another very important role during the ODGF savings and loan problem -- we served as a facilitator. During the early morning hours of Friday, March 15, when the full dimensions of the problem became clear, Governor Celeste decided to close all ODGF member institutions for a three-day period. Following that decision, the Governor requested that the Federal Reserve assist him in calling a meeting of large Ohio banking and thrift institutions to discuss the situation with them and propose a solution to the problem. A meeting with representatives of thirteen Ohio depository institutions -- banks and S&Ls -- was convened that morning at the Federal Reserve Bank of Cleveland. At that meeting Governor Celeste explained his decision to close the ODGF institutions and discussed a legislative proposal that would require the ODGF institutions to obtain federal insurance before reopening. He also presented a proposal for dealing with the ODGF institutions that would not qualify for federal insurance. The State subsequently decided it would be useful to discuss the situation with

out-of-state banks, and two meetings were held with out-of-state institutions at the Federal Reserve Bank of Cleveland--one on Saturday, March 16, at 9:00 p.m. and another on Sunday, March 17, at 11:00 a.m.

In the past two weeks, some elements of a solution have fallen into place. Each ODGF institution was examined on a case-by-case basis to determine its financial condition and the likelihood of its qualifying for federal insurance. The State Superintendent of Savings and Loan Associations requested assistance from the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the Ohio Division of Banks in conducting these examinations. This process began on Saturday, March 16, with examiners provided by the Federal Reserve Bank of Cleveland and, eventually, by every other Federal Reserve Bank. Examiners were assigned to each of the ODGF institutions. Virtually all examinations were completed on Sunday, March 17, enabling us to conduct a preliminary review of the condition of each institution to supplement and update the information obtained the previous Friday from the State. The results of the preliminary examinations made it clear that a large number of these institutions were well-managed, in sound financial condition, and, consequently, viable candidates for federal deposit insurance. Others, for a variety of reasons, would have difficulty qualifying for federal deposit insurance. The FHLB Board agreed to review on an expedited basis the Federal Savings and Loan Insurance Corporation (FSLIC) insurance applications of ODGF member institutions. Under this arrangement, FSLIC qualification examinations were expedited, using the resources of the FHLB System and the Federal Reserve. The Federal Reserve offered its assistance to help complete the FSLIC examinations as rapidly as possible. We believed we could facilitate this process because our

examiners were already in place at the ODGF institutions and had gained familiarity with these institutions through the just completed examinations conducted on March 16 and 17.

As of Friday, March 29, according to the State of Ohio, 26 of the former ODGF institutions have been reopened for the full range of banking functions, most with federal insurance. Confidence in these institutions seems to have been fully restored. There has been no evidence of unusual withdrawals or need for assistance through either the credit facilities of the FHLB of Cincinnati or the Federal Reserve discount window. The federal deposit insurance applications of some ODGF institutions are still being considered. Other ODGF institutions have been informed of the changes and improvements that will be necessary to enable them to obtain federal insurance.

The State of Ohio is making intense efforts to develop an orderly plan for those institutions that might not qualify for federal insurance. It is my understanding that a final outline of such a plan is not yet complete. A solution may have to involve the sale of some ODGF institutions to other Ohio financial institutions and, perhaps, also to out-of-state institutions. The Federal Reserve Bank of Cleveland has not participated in the discussions involving plans for any single institution except those for which Federal Reserve regulatory approval was required, such as the sale of Metropolitan Savings Bank of Youngstown to FNB Corporation, a Pennsylvania bank holding company, and the conversion of Scioto Savings Association into a state-chartered FDIC insured commercial bank under the continuing ownership of its parent company, Society Corporation, an Ohio bank holding company.

While this process is underway, the State has authorized the CDGF institutions not yet qualified to reopen for full business to open for the limited purposes of giving each depositor access to a maximum of $750 per month and pledging assets to and borrowing from correspondent banks or the Federal Reserve discount window to fund the limited deposit withdrawals. Complete confidence in the ODGF institutions has not been restored, but the atmosphere is much calmer than it was two weeks ago.

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CHRONOLOGY OF FEDERAL RESERVE RESPONSE TO OHIO S & L SITUATION

(* indicates events not part of the Federal Reserve response but which are important to that day's chronology.)

Monday, March 4

* A receiver is appointed for ESM at the request of the S.E.C.

The Cleveland Reserve Bank's Loan and Discount Department receives what appears to be a routine telephone call from Home State inquiring whether its borrowing documents were in order.

Tuesday, March 5

Cleveland Reserve Bank makes initial inquiries about Home State to the Federal Home Loan Bank of Cincinnati ("FHLB Cincinnati") and the Ohio Deposit Guarantee Fund ("ODGF").

Home State's correspondent bank meets with Cincinnati branch of the Cleveland Reserve Bank ("Cincinnati branch") to discuss Home State situation.

Cincinnati branch makes arrangements for emergency cash shipments to Home State.

Wednesday, March 6

Cleveland Reserve Bank sends examination personnel to Home State and they begin to review collateral.

Home State has estimated deposit outflows of $55 million.

Cincinnati branch makes 39 special cash shipments to various Home State offices.

Thursday, March 7

Meeting at Cincinnati branch is held with representatives of the State, ODGF, Home State, and the Cleveland Reserve Bank to discuss possible discount window loan. Examiners continue reviewing collateral.

Governor Richard Celeste telephones President Karen Horn to discuss Home State matter and to learn what assistance might be available from Federal Reserve.

Cincinnati branch makes 59 special cash shipments to various Home State offices.

Home State has estimated deposit outflows of $45 million.

Friday, March 8

Home State's liquidity position declines throughout the day. Cleveland Reserve Bank monitors the situation with Home State's correspondent bank. Frequent discussions are held by Federal Reserve officials in Cincinnati, Cleveland, and Washington regarding liquidity needs of Home State.

A Cleveland Reserve Bank official attends a meeting in Columbus called by the Superintendent to discuss possible solutions to Home State situation.

Friday, March 8 (Continued)

In late afternoon, Home State directors sign a note to borrow from the Cleveland Reserve Bank. Collateral is segregated by examiners and shipped to the Cincinnati branch. At 4:00 p.m., a discount window loan is made to Home State.

Cincinnati branch makes 76 separate cash shipments to various Home State offices.

Home State has estimated deposit outflows of $54.2 million.

At the Cleveland Reserve Bank's request, the Superintendent agrees to provide financial information for all ODGF institutions in anticipation of borrowing requests from these institutions.

* In late evening, Home State management announces that Home State will be closed on Saturday.

Saturday, March 9

Concerned about the potential spillover effects of the Home State closing, Cleveland Reserve Bank officials begin internal logistical planning for possible cash deliveries and borrowing arrangements for other ODGF institutions.

Cleveland Reserve Bank examination personnel begin analyzing the financial data of all ODGF member institutions for possible borrowings at the discount window. Three representatives from the FHLB Cincinnati assist in this process.

* A conservator, Arlo Smith, is appointed by Governor Celeste to direct the affairs of Home State.

The Superintendent convenes a meeting at a Cleveland bank at 6:00 p.m. with several large bank holding companies in Ohio to discuss the proposed sale of Home State. Representatives from the Federal Reserve are in attendance as observers.

Sunday, March 10

* Governor Celeste announces that Home State will not open on Monday.

Cleveland Reserve Bank issues a statement to the press indicating that state-chartered savings and loans, like all depository institutions, are eligible for liquidity assistance through the discount window under normal terms and conditions.

At the Cleveland Reserve Bank, contingency planning continues and officials from other Reserve Banks arrive to assist.

Monday, March 11

Cleveland Reserve Bank examiners are placed strategically throughout the state and are prepared to deliver borrowing documents to any ODGF institution that requests such information.

Cincinnati Branch officials discuss the Home State situation with local banks.

Estimated net deposit outflows of $6.0 million at ODGF institutions.

Tuesday, March 12

Conservator Smith repays loan from Cleveland Reserve Bank.

Activity at ODGF institutions remains relatively calm. Estimated net deposit outflows for the day approximate $13.4 million at ODGF institutions. Borrowing documents are delivered by Cleveland Reserve Bank examiners upon request.

Wednesday, March 13

Estimated net deposit outflows for the day of $23.4 million at ODGF institutions.

Officials from four ODGF institutions experiencing heavy deposit withdrawals go to Washington, D.C., to meet with members of Congress and officials of the Federal Reserve and the FHLBB.

Several meetings are held at the Cincinnati Branch with individual institutions to discuss borrowing documents.

Thursday, March 14

Major runs occur at six ODGF institutions and cash shipments to these institutions accelerate.

Estimated net deposit outflows of all open ODGF institutions for day approximate $63.9 million.

Seven special cash shipments to five different ODGF institutions by the Cleveland Reserve Bank.

Friday, March 15

At 7:30 a.m. in Cincinnati, Governor Celeste holds a press conference to declare a three-day holiday for the ODGF institutions. President Horn indicates that the Cleveland Reserve Bank stands ready to supply liquidity through the discount window under normal conditions when the institutions reopen.

At 11:45 a.m., a meeting at the Cleveland Reserve Bank is convened at the request of the Governor with representatives of 13 Ohio financial institutions. The Governor requests the institutions to join together to develop a rescue package for those ODGF institutions that would not qualify for federal insurance.

Fifteen special cash shipments are made to 12 institutions.

Saturday, March 16

At 9:00 a.m., a second meeting is held at the Cleveland Reserve Bank with the Ohio financial institutions.

The State also requests Federal Reserve assistance in discussing this situation with out-of-state financial institutions. Two meetings with out-of-state institutions are then scheduled at the Cleveland Reserve Bank--one on Saturday night at 9:00 p.m. and another for Sunday at 11:00 a.m. Representatives from the State requested out-of-state banks to consider acquiring some or all of those ODGF institutions that would not qualify for federal insurance.

Saturday, March 16 (Continued)

Examiners are present at every ODGF institution to review collateral. Examiners from other Reserve Banks arrive to assist. The Superintendent of Savings and Loan Associations requests the Federal Reserve, the FDIC, and the Ohio Division of Banks to assist in learning the current financial condition of all the ODGF institutions. Examinations are then commenced for this purpose.

Fifteen special cash shipments are made to 11 ODGF institutions.

Sunday, March 17

A meeting is held at 11:00 a.m. at the Cleveland Reserve Bank with a second group of eleven out-of-state bank holding companies. (This meeting is also attended by some representatives from the previous meeting.)

Examinations conducted at the State's request are concluded at virtually all ODGF institutions by examiners from the Federal Reserve. Summary results from these examinations are compiled and reviewed.

Monday, March 18

* Governor Celeste signs an executive order requiring ODGF institutions to remain closed for an additional 48 hours.

Examiners insure execution of borrowing documents and control of adequate collateral for all ODGF institutions.

An evening meeting is held at the Cleveland Reserve Bank with officials from the Federal Home Loan Bank System to discuss possible assistance by the Federal Reserve with FSLIC qualification insurance examinations for ODGF institutions.

Eight special cash shipments are made to 7 institutions.

Tuesday, March 19

A second meeting is held at the Cleveland Reserve Bank with officials from the Federal Home Loan Bank System. The Federal Home Loan Bank Board officials accept an offer from the Federal Reserve to assist in qualification examinations.

Governor Celeste meets separately in Washington, D.C., with Chairman Volcker and Chairman Gray. Governor Celeste is assured of expedited processing by FHLBB of FSLIC insurance applications.

As provided in the Cleveland Reserve Bank's check collection operating letter, the Bank sends notice and begins returning checks drawn on the closed ODGF institutions with the stamp "not presentable at this time."

FSLIC qualification examinations begin at ODGF institutions with the assistance of Federal Reserve examiners already present at these institutions.

Two special cash shipments are made to 2 institutions.

Wednesday, March 20

* The State of Ohio legislature approves legislation requiring federal insurance and permitting partial withdrawals ($750 per depositor each 30 day period) for ODGF institutions.

Wednesday, March 20 (Continued)

The availability of discount window assistance to reopened ODGF institutions was restated by Chairman Volcker.

Two special cash shipments are made to 2 institutions.

Thursday, March 21

The conversion of Scioto Savings Association into a commercial bank is approved by the State of Ohio, the FDIC, and the Board of Governors of the Federal Reserve System.

Friday, March 22

A task force is established in Columbus at the office of the Superintendent of Savings and Loan Associations to coordinate communications between the Superintendent, Cleveland Reserve Bank, and the FHLB-Cincinnati.

An application by F.N.B. Corporation in Hermitage, Pa., to acquire Metropolitan Savings Bank in Youngstown, Ohio, is processed and approved on an emergency basis by the Board of Governors of the Federal Reserve System.

Saturday, March 23

As ODGF institutions reopen for limited withdrawal purposes, cash demands are placed on the Cleveland Federal Reserve Bank.

FSLIC qualification examinations continue. In addition, Federal Reserve examiners continue their presence in ODGF institutions to monitor cash situations, and to secure collateral for borrowings where necessary. Staff remains on duty at the Cleveland Reserve Bank to provide assistance and discount window borrowings, answering questions regarding check collection and manage the large numbers of examiners from outside the Fourth Federal Reserve District.

Seven special cash shipments are made to 4 institutions.

Estimated net deposit outflows (aggregate) - $5.4 million.

Sunday, March 24

FSLIC qualification examinations continue.

Monday, March 25

The Cleveland Reserve Bank issues notice that it is presenting checks to those institutions that are fully open.

Six special cash shipments are made to 5 institutions.

Estimated net deposit outflows (aggregate) - $7.7 million.

Tuesday, March 26

Eighteen institutions are now open on a full-service basis. Liquidity and cash situations in these institutions continue to be monitored by Federal Reserve examiners in the field as well as the Cleveland Reserve Bank staff in Cleveland, Cincinnati, and Columbus.

Tuesday, March 26 (Continued)

Five special cash shipments to 2 institutions.

Estimated net deposit outflows (aggregate) - $3.9 million.

Wednesday, March 27

Six special cash shipments to 4 institutions.

Estimated net deposit outflows (aggregate) - $2.9 million.

Thursday, March 28

One special cash shipment.

Estimated net deposit outflows (aggregate) - $4.4 million.

Friday, March 29

Twenty-six institutions are now open on a full-service basis.

FSLIC qualification examinations continue.

Three special cash shipments to 3 institutions.

Estimated net deposit outflows (aggregate) - $2.8 million.

Saturday, March 30

Estimated net deposit outflows (aggregate) - $1.3 million.

Mr. BARNARD. Mr. Selby, we will hear your testimony at this time.

STATEMENT OF H. JOE SELBY, SENIOR DEPUTY COMPTROLLER FOR BANK SUPERVISION, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. SELBY. Thank you, Mr. Chairman, for inviting me, and members of the committee.

On the shortness of the time that I knew I was coming up, I do not have a prepared statement, but if it is appropriate I would ask that my letter to you of March 29 be entered into the record.

Mr. BARNARD. Without objection.

Mr. SELBY. And I will summarize it very briefly.

You requested information from us concerning national bank involvement with ESM Government Securities of Ft. Lauderdale, FL.

National bank examiners first encountered ESM in late 1976 during the examination of the National Bank of South Florida in Hialeah. Our examiners at that time reviewed the bank's new relationship established with ESM Government Securities and reviewed the securities transactions arising out of this relationship.

Our examiners determined that the type of securities trading and the methods of financing provided by ESM were unsuitable for a national bank primarily because they were clearly speculative and the financing arrangement of the equivalent of margin financing.

We also concluded that the securities transactions may have been executed at prices above the prevailing market price. We directed bank management to stop the securities trading activity with ESM, to properly record and unwind outstanding repurchase agreements and to sever their relationship at that time with ESM.

During the examination bank management did follow the examiners' recommendations. They completely unwound the trades and reclaimed the money that had already been sent to ESM. As a result, the bank suffered no loss on the transactions with ESM.

During this examination, it was also evident that there was some massive self-dealing, numerous violation of bank laws as well as possible criminal violations in concentrations of credit which appeared to us to propose a threat to the solvency of the bank.

On February 8, 1977, the bank's directors were served with a notice of charges and a temporary cease-and-desist order. Due to our imposed pressures and limitations particularly through the cease-and-desist order, the controlling shareholder of the bank sought purchasers for the bank and eventually sold it in August 1977.

The examination that we had conducted did result in a number of criminal referrals made to the Department of Justice and Treasury, dealing with a substantial number of banking laws and I might add particularly the Bank Secrecy Act, which did result in some prosecution, but I think it was not a successful prosecution at that time on the bank secrecy.

Information on the dealings between ESM and the bank were first communicated by us to the Office of the State of Florida, that State's securities regulator, in a February 16, 1977, letter, and subsequently referred on April 27, 1977, to the Miami office of the Securities and Exchange Commission.

During this same period of time, we became aware that Robert Seneca and Ronnie Ewton, principals of ESM Government Securities, Inc., were interested in acquiring control of the bank holding company in Florida called the American Bankshares, Inc. [ABI]. I believe at that time we had six national banks under ABI and there were three State banks, also members of the holding company.

To our knowledge, Ewton and Seneca's involvement with ABI had no connection to the situation encountered at the National Bank of South Florida. However, because of our experiences with ESM and their dealings with the National Bank of South Florida, we did deem it appropriate to enter into voluntary written agreements with each of ABI's six national bank subsidiaries which would preclude any business dealings directly or indirectly between ABI's subsidiary national banks and ESM Securities, Inc., its affiliates, its principals, any relative, whether by blood or by marriage of the principals of ESM or any corporation, partnership, or other type of enterprise controlled by these persons.

After Messrs. Ewton and Seneca acquired controlled of American Bankshares, we resisted several attempts by these individuals to subvert the voluntary agreements on the banks.

During 1978, national bank subsidiaries of ABI were converted to State-chartered banks. Eventually Mr. Seneca and Ewton sold their interests in ABI, I believe, to Mr. Marvin Warner.

Prior to the conversion of the banks from national to State, we informed the Florida State banking regulator of our outstanding agreements and concerns. We also met with representatives of the FDIC to provide them background information and assistance with respect to the information. And it is my knowledge that since it was a holding company, we also discussed our agreements with the Federal Reserve.

Contemporaneous with this office's direct dealings with banks doing business with or controlled by ESM and its principals, we published a warning notice to all national banks which contained descriptions of the types of transactions and financing arrangements being offered at that time by ESM as well as by other bond dealers. That was contained in a banking circular dated July 26, 1977.

In your March 22, 1985, letter, you requested information with respect to how many national banks have had dealings with ESM Securities from 1980 to date. At the time of ESM's demise, we have knowledge only of one national bank that had moneys loaned via repurchase agreements collateralized by U.S. Government securities and that bank suffered minimal losses of approximately $250,000.

Mr. BARNARD. Was this account segregated?

Mr. SELBY. I do not know. Yes, it was.

Mr. BARNARD. Did you show any evidence of the securities?

Mr. SELBY. Yes. We have no other evidence of national banks dealing with ESM during the period of your inquiry although I must presume that some national banks did conduct business with ESM during this period.

I must also presume absent any indication to the contrary that no national banks suffered significant losses in connection with its dealings with ESM. Certainly it had not been reported to us by our examiners or by the banks.

Our examiners are well trained in these areas and are extremely sensitive to the unsavory reputations of a number of security dealers doing business with depository institutions. And basically, since 1977, Mr. Chairman, we have intensified our training in the securities dealing practices and have given a great number of training sessions to our examiners as well as other examiners and I am told my staff member that in fact one of the lesson plans contains an example using ESM as the type of example that we teach our examiners.

We are not aware at this time of any other examination criticisms or formal or informal enforcement actions taken against any national bank because of their business dealing with ESM.

Because of the corporate structure of dealer firms trading U.S. Government securities, we must presume each Government or Federal agency securities transaction entered into between a national bank and a dealer involves an unregistered U.S. Government securities dealer. The full extent of those transactions in terms of dollar value or number of transactions is unknown. But as I indicated previously, our supervisory reviews, which are attuned to precisely the kind of transactions undertaken by ESM, disclose very few irregularities. Those irregularities that are disclosed are routinely communicated to the Securities and Exchange Commis-

sion, the National Association of Securities Dealers, and the appropriate State securities regulator.

It is my understanding that these referrals have been the basis for a number of enforcement actions taken by the Securities and Exchange Commission.

Thank you very much.

[Mr. Selby's prepared statement follows:]

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

March 29, 1985

The Honorable Doug Barnard, Jr.
Chairman
Commerce, Consumer, and Monetary
Affairs Subcommittee
Committee on Government Operations
U. S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This is in response to your March 22, 1985 letter requesting information concerning national bank involvement with ESM Government Securities, Inc., of Fort Lauderdale, Florida (ESM).

National Bank Examiners first encountered ESM in late 1976 during an examination of the National Bank of South Florida, Hialeah, Florida (the Bank). Our examiners reviewed the Bank's new relationship established with ESM and securities transactions arising out of this relationship. The examiners determined that the type of securities trading and the methods of financing provided by ESM were unsuitable for a national bank because the trades were clearly speculative and the financing arrangement was the equivalent of margin financing. We also concluded that the securities transactions may have been executed at prices above the prevailing market price. Bank management was directed to stop the securities trading activity, to properly record and unwind outstanding repurchase agreements and to sever the relationship with ESM. During the examination, bank management followed the examiners' recommendations, completely unwound the trades and reclaimed the money already sent to ESM. The Bank suffered no loss on the ESM transactions.

During this examination it also became evident that there was massive self dealing, numerous violations of bank laws as well as possible criminal violations, and concentrations of credit which appeared to pose a threat to the solvency of the Bank. On February 8, 1977 the Bank's directors were served with a Notice of Charges and Temporary Cease and Desist Order. The Bank was ordered to remove the self dealing transactions and to halt further dealings with insiders. The directors were informed that several senior officers of the Bank should be removed. In the days following, the Bank received the

resignations of a number of senior officers and directors. Due to our imposed pressures and limitations, the controlling shareholder of the Bank sought purchasers for the Bank and eventually sold the Bank in August, 1977. The examination resulted in a number of criminal referrals made to the Departments of Justice and Treasury dealing with a substantial number of banking laws and the Bank Secrecy Act.

The specific securities transactions encountered in this examination are detailed in the enclosed February 16, 1977 memorandum authored by Mr. Lou Frank, who was then Deputy Regional Administrator for National Banks in our Atlanta regional office. Information on the dealings between ESM and the Bank was first communicated to the Office of the Comptroller of the State of Florida, that state's securities regulator, in a February 16, 1977 letter and subsequently referred on April 27, 1977 (see enclosures) to the Miami office of the Securities and Exchange Commission.

During this same period of time, we became aware that Robert Seneca and Ronnie Ewton, principals of ESM Government Securities, Inc., were interested in acquiring control of a bank holding company, American Bankshares, Inc. (ABI). To our knowledge, Ewton and Seneca's involvement with ABI had no connection to the situation encountered in National Bank of South Florida. However, because of our experiences with ESM in their dealings with that bank, we deemed it appropriate to enter into voluntary written agreements with each of ABI's six national bank subsidiaries which would preclude any business dealings, directly or indirectly, between ABI's subsidiary national banks and ESM Securities, Inc., its affiliates, its principals, any relative, whether by blood or by marriage, of the principals of ESM or any corporation, partnership or other type of enterprise controlled by these persons. A copy of one of these agreements, dated February 23, 1977, is enclosed.

After Messrs. Ewton and Seneca acquired control of American Bankshares, we resisted attempts by these individuals to subvert the voluntary agreements (see attached correspondence dated September 30, 1977). During 1978, national bank subsidiaries of ABI were converted to state chartered institutions, and Messrs. Seneca and Ewton eventually sold their interest in ABI to Mr. Marvin Warner. Prior to the conversion, we informed the state banking regulator of the outstanding Agreements. Subsequent to the conversion to state charters, we met with representatives of the FDIC to provide them with background and assistance with respect to this matter.

Contemporaneous with this office's direct dealings with banks doing business with or controlled by ESM and its principals, we published a warning notice to all national banks which contained descriptions of the types of transactions and financing arrangements being offered by ESM (see the enclosed Banking Circular No. 2, Supplement No. 4, dated July 26, 1977).

In your March 22, 1985 letter you requested information, from 1980 to date, with respect to how many national banks have had dealings with ESM securities, the total dollar value of these dealings, and if any national bank suffered losses in connection with ESM. At the time of ESM's demise, only one national bank had monies loaned via repurchase agreements collateralized by U. S. government securities. Bank South, Atlanta, Georgia, a relatively large regional bank, had repurchase agreements of $38 million and suffered losses approximating $250 thousand in liquidating these positions. Two regional national banks have reported small gains and losses in closing out forward contracts in GNMA securities against ESM's Memphis, Tennessee, branch office.

We have no other records of national banks dealing with ESM during the period of your inquiry although I must presume that some national banks did conduct business with ESM during this period. I must also presume, absent any indications to the contrary, that no national bank suffered significant losses in connection with its dealings with ESM. Our examiners are well trained in these areas and are extremely sensitive to the unsavory reputations of a number of securities dealers doing business with depository institutions. It is my understanding that examiner criticisms of bank dealings with ESM would be brought to the attention of our Investment Securities Division. No significant criticisms were brought to that division's attention since the original 1977 transaction noted in the National Bank of South Florida examination. We are not aware of any other examination criticisms or formal or informal enforcement actions taken against national banks because of their business dealings with ESM.

Presently, and also during the period covered by your inquiry, our field examiners routinely review transactions between national banks and unregistered government securities dealers. Our examination reviews disclose that the vast majority of such transactions are conducted in a manner which does not expose national banks to losses. In each financial collapse of an unregistered U. S. government securities dealer, apart from the Drysdale Government Securities, Inc. situation, national banks lost very little money because they followed the procedures articulated in supervisory notices of the type previously referred to (see Banking Circular No. 2) and because they exercised banking prudence.

Because of the corporate structure of dealer firms trading U.S. government securities, we must presume each government or federal agency securities transaction entered into between a national bank and a dealer involves an unregistered U. S. government securities dealer. The full extent of those transactions, in terms of dollar value or number of transactions, is unknown. But, as I indicated previously, our supervisory reviews, which are attuned to precisely the kinds

of transactions undertaken by ESM, disclose very few irregularities. Those irregularities that are disclosed are routinely communicated to the Securities and Exchange Commission, the National Association of Securities Dealers, and the appropriate state securities regulator. It is my understanding that these referrals have been the basis for a number of enforcement actions taken by the Securities and Exchange Commission.

I hope this information is useful to the Subcommittee in its investigation. Please let me know if you have further questions in this area.

Sincerely,

H. Joe Selby
Senior Deputy Comptroller
for Bank Supervision

Comptroller of the Currency
Administrator of National Banks

Sixth National Bank Region
Suite 2700, Peachtree Cain Tower
229 Peachtree Street, N.E.
Atlanta, Georgia 30303
404-221-4926

February 16, 1977

PRIORITY

Mr. Tim Rigsby
General Counsel
Office of the Comptroller
State of Florida
Tallahassee, Florida

Dear Mr. Rigsby:

We are investigating a bond transaction involving E.S.M. Government Securities, Inc. This security transaction originated on December 1 and 2, 1976.

We have previously been advised that E.S.M. Government Securities Corporation was not authorized to engage in securities transactions until December 23, 1976.

If our information is correct, E.S.M. Securities Corporation was engaged in an unauthorized and prohibited transaction with one of the banks that we regulate. Our Regional Counsel, H. Gary Pannell, informed me that you intend to investigate the matter and advise us of the results of your investigation.

Very truly yours,

Lou Frank

Lou Frank
Deputy Regional Administrator
of National Banks
Sixth National Bank Region

cc: Comptroller - Attn: Mr. Dunham
Reading File
Priority File
American Bancshares Holding Co. File

LFrank:np

E.S.M. Government Securities, Inc.

INVESTMENT BANKERS

SUITE 1710, ONE FINANCIAL PLAZA, FORT LAUDERDALE, FLORIDA 33394 (305) 764-2600

Corrected from SG1952 as to Price & Figures

CONFIRMATION
SUBJECT TO CORRECTION

SG 200

SALE DATE	SETTLEMENT	REP.	NO.
12/1/76	12/7/76	D. Fromhoff	

SOLD TO
National Bank of South Florida
1001 E. 9th Street
Hialeah, Florida 33011
Att: Henry Heitman, Chairman of Board

PAR AMOUNT	DESCRIPTION OF SECURITIES		PRICE
$500,000.00	Treasury Notes Due 12/31/80 Dated 12/7/76	5 7/8	99.902

PRINCIPAL	INTEREST PERIOD	INTEREST		TOTAL AMOUNT
$499,510.00	-	-		$499,510.00

DELIVER TO
Manufacturers Hanover Trust NY F/A National Bank of South Florida

WE CONFIRM SALE AS PRINCIPAL OF THE SECURITIES DESCRIBED ABOVE WITH ACCRUED INTEREST TO BE ADDED.

WE APPRECIATE YOUR BUSINESS

BY

E. & M. Government Securities, Inc.

INVESTMENT BANKERS

SUITE 1710, ONE FINANCIAL PLAZA, FORT LAUDERDALE, FLORIDA 33394 (305) 764-2600

CUSTOMER FILE COPY
SUBJECT TO CORRECTION

SALE DATE	SETTLEMENT	REP.	NO.
12/2/76	12/9/76	B. Trachoff	

S G [illegible]

SOLD TO
National Bank of South Florida
1001 E. 9th Street
Miami, Florida 33011
Attn: Henry Partman, Chairman of Board

PAR AMOUNT	DESCRIPTION OF SECURITIES		PRICE
$1,000,000.00	G.N.M.A. Fort. Cert. Due 2/1/03 Dated 2/1/76	6.25	[illegible]

PRINCIPAL	INTEREST PERIOD	INTEREST		TOTAL AMOUNT
$[illegible]	1/1/76-12/9/76	$21,343.06		[illegible]

DELIVER TO [illegible]

THIS IS YOUR AUTHORIZATION TO ACCEPT DELIVERY OF THE ABOVE BONDS, AND CHARGE OUR ACCOUNT

Authorized Signature

SIGN AND FORWARD TO BANK ACCEPTING DELIVERY

PRIORITY

April 27, 1977

Mr. Charles Harper
Securities and Exchange Commission
Dupont Plaza Center, Suite 1114
300 Biscayne Boulevard Way
Miami, Florida 33131

Dear Mr. Harper:

During the course of an examination of the National Bank of South Florida in Hialeah, Florida, our examiners uncovered information indicating potential violations of federal laws and regulations coming under the jurisdiction of the Securities and Exchange Commission.

Enclosed herewith is a factual memorandum prepared by Deputy Regional Administrator Lou Frank detailing the transactions which indicate the subject bank may have been defrauded by E.S.M. Government Securities, Inc. Because of the firm's activities, it appears that substantial damage would have been perpetrated on the bank.

Subsequent to our examination, the attorneys for the bank notified E.S.M. Government Securities, Inc., to cancel the transaction. The securities firm complied resulting in no ultimate loss to the bank. Notwithstanding the lack of loss, it is clear from the facts in the attached memorandum that an intent of fraud was perpetrated by the E.S.M. Government Securities, Inc. and, but for the fact that we intervened, substantial loss could have occurred.

Very truly yours,

Donald L. Tarleton
Regional Administrator of National Banks
Sixth National Bank Region

Enclosures

cc: Comptroller - Attn: Mr. Dunham
Comptroller - Attn: Mr. Serino
Reading File
Priority File (National Bank of South Florida)
American Bancshares Holding Company File RS:LF:np

MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Sixth National Bank Region
Suite 2700, Peachtree Cain Tower
229 Peachtree Street, N.E.
Atlanta, Georgia 30303

FRANK

To Mr. Donald L. Tarleton

From Lou Frank

Date February 16, 1977

Subject Your Request to Investigate Messrs. Ewton and Senaca

E.S.M. Government Securities, Inc. was chartered in the state of Florida September 26, 1975 and licensed to do business effective December 23, 1976. Records indicate a technical suspension with reinstatement January 21, 1977 for some type of infraction. Reportedly, this bond broker operates out of One Financial Plaza, Fort Lauderdale, Florida. A parallel company, E.S.M. Securities, Inc., apparently did business prior to the current corporate activities. "E" stands for Ronnie R. Ewton, 7421 S.W. 14th Street, Plantation, Florida; "S" stands for Robert C. Senaca, 3999 Bayview Drive, Fort Lauderdale, Florida; "M" stands for George G. Mead, 2717 NE 35th Drive, Fort Lauderdale, Florida.

Only Ewton and Senaca have stated an interest in purchasing stock in American Bancshares, Inc. Complete financial and biographical forms have been furnished to these individuals; however, because Mr. Slobusky claims the sale transaction will be consummated by Friday, we will have no time prior to their acquisition of the stock to investigate their background. I have therefore made a concerted effort to check their background without source documents.

No record exists with the Justice Department, State of Florida, the SEC, FDIC, FRB or our office. Everyone seems aware of their names and they are known as suede-shoe types, slickers, high pressure salesmen, i.e., the usual high pressure bond salesmen. They are known and feared because they once operated in Memphis and Little Rock, as well as Houston, Texas prior to coming to Fort Lauderdale and are branded as "Memphis Bond Bandits".

While no actual criminal wrongdoing in their past has been found, the relationship of E.S.M. Government Securities, Inc., with the National Bank of South Florida, Hialeah, Florida appears to be a clear case of unsafe and unsound bond transactions. A high pressure bond salesman from the company, Don Fromhoff, duped former Chairman of the Board, Henry Heitman, into taking part in speculative

trading transactions. Mr. Heitman was lured by E.S.M. into various flip-flop bond trades (1) with promises of profits of $150M per year, (2) without use of bank funds, and (3) promises to complete the trades before the settlement date.

Beginning with a "sucker transaction" (see Transaction "A") E.S.M. allowed the bank to make a quick one-day profit of $1,583.75. Greatly impressed by the fast profit, possibly a "set up" transaction involving only $500M, Mr. Heitman apparently authorized two transactions the following day, each for $1MM. E.S.M. "boxed" the bank on these two transactions, artificially overstating the price of the GNMA PC issue by about three points on the buy side, while buying or reporting to buy $1MM in FNMA's at the same time. The next day the FNMA's were sold with a point profit. A one point spread was reported as a profit of $10,000 to Mr. Heitman, who must at this point, have been ecstatic about the bank's good fortune. (See Transaction "B"). The one point profit is possible but since the securities were not delivered or settled for we may assume that the figures were "matched" to provide a profit of $10M. The GNMA's were quoted by Soloman Brothers on December 2, 1976 at 89½ to 91½ with the 93 price paid through E.S.M. appearing to be several points above the spread. With each point representing $10M, it is easy to speculate that the two to three points or $20M to $30M paid over the probable price of the GNMA PC's security included the $10M profit they allowed him to take on the FNMA's transaction. Another transaction begun December 3, 1976 ended December 7, 1976 resulting in a small profit of $1,562.50.

By the settlement date, Mr. Heitman faced a problem, although he must have felt reasonably comfortable with his profits to date. He must come up with $930,000 plus accrued interest of $21,343.06 or book a $30M loss and report it to his board making his $13,146.25 profits prior to this time look small. The net loss after eight days of trading with E.S.M. would have been $16,853.75. To make matters worse, the bank did not have the ready cash available to pay for the GNMA participation certificates. Also, Mr. Heitman had been speculating with these E.S.M. bond transactions without Board approval or their knowledge; a fact he did not want to report to them because of the loss he would have to tell them about.

Mr. Heitman was apparently offered a repo deal which meant that he had to in effect enter into a loan transaction with E.S.M. who in effect lent the money to purchase the bond to the bank, a violation of 12 U.S.C. 82. E.S.M. apparently asked for a $30M "haircut" or made a "margin" call on the bank in order to make their so-called loan secure. This occurred December 8, 1976 and all of these transactions should have been booked at this time. None were booked which resulted in a possible violation of 18 U.S.C. 656 and 1005 by former Chairman of the Board Henry Heitman. Possibly a violation of 18 U.S.C. 1001 as well. E.S.M. might possibly be engaging in a conspiracy to defraud the bank.

The very sad part about the trap is that a very careful check of the prices of the GNMA's on December 2, 1976 showed they were quoted at 89 1/2 - 91 1/2 while on December 8, 1976 they were roughly 91. If he had not been "sandwiched" by E.S.M. and the transaction was clean, he could have gotten out about even because some brokers even indicated a one point profit. Instead E.S.M. shuffled him into a repo transaction. Then the market really did drop to where the bonds are now worth about 87 giving the bank a $60,000 loss if they sell or a $60,000 depreciation in the issue if they take delivery on the February 18, 1977 settlement date.

Several points should be made: the bank had no business engaging in trading activities. They had neither the knowledge or experience but probably the most disgusting fact about E.S.M. involvement is the fact that they put the bank in a GNMA PC which is not a type of security normally used in trading activities for the following reasons: (1) it is thinly traded with very little volume, (2) prices are hard to determine, but probably the most serious reason why GNMA PC's are not traded is that the spreads between bid and asked are usually too large for traders to overcome in a short period of time. Of course, GNMA PC's are U. S. guaranteed obligations and represent good long-term bank investments. However, only a very inexperienced and unlearned banker coerced by an unscrupulous and unethical bond broker would try to trade such issues.

There has arisen the possibility that E.S.M. Government Securities, Inc., was not licensed to do business until December 23, 1976 and yet the invoices indicate that they were doing business with the bank on December 2, 1976 prior to the date they would have been authorized. Today, I am notifying in writing Mr. Tim Rigsby, General Counsel, Office of the Comptroller, State of Florida, Tallahassee, Florida, who has advised telephonically that he will investigate the matter.

Through Mr. Slobusky, I requested an explanation from Messrs. Ewton and Senaca of how they could do business when they were not authorized. He reported that they claimed that they did business as E.S.M. Securities, Inc., prior to December 23, 1976. The advices attached clearly state E.S.M. Government Securities, Inc., and cast serious questions in regard to their personal integrity, not to mention their moral and business ethics in these unsavory bond transactions. Their actions contributed to Mr. Heitman's loss of his position and the possibility of a substantial loss if the bank should sell the GNMA PC's in the near future.

I trust this material is sufficient to provide you with the grounds necessary to protect the banking subsidiaries of American Bancshares, Inc., from Mr. Ewton and Mr. Senaca.

cc: Comptroller - Attn: Mr. Dunham
Comptroller - Attn: Mr. Serino
Reading File
Priority File
LNBE Owen Carney

cc: NBC James Jones
Miami Subregion
BC-5
LFrankum

AGREEMENT BY AND BETWEEN THE
SECOND NATIONAL BANK OF NORTH MIAMI
NORTH MIAMI, FLORIDA
AND
THE OFFICE OF THE COMPTROLLER
OF THE CURRENCY

WHEREAS, The Second National Bank of North Miami, North Miami, Florida (hereinafter the "BANK"), and the Comptroller of the Currency (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 law;

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 and acting Representative, that commencing no later than the effective date of this Agreement, or as shall otherwise specified within the Articles of this Agreement, the BANK shall operate 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 the Financial Institutions Supervisory Act of 1966, 12 U.S.C. §1818(b)(1).

ARTICLE II

(2) As of and after the date of this AGREEMENT, the BANK shall not knowingly purchase, assume, or acquire in any manner, directly or indirectly, in its own capacity or as a fiduciary or nominee, or through its subsidiaries or affiliates, any loan, loan participation, or any other obligation or asset in any form whatsoever, FROM; nor shall the BANK knowingly extend, endorse, guarantee, or in any manner provide any extension of credit whatsoever, TO or FOR, any of the following:

(a) E.S.M. Securities, Incorporated, Fort Lauderdale, Florida;

(b) any affiliate, as that term is defined in the Banking Act of 1933 [12 U.S.C. §221a(b)], of E.S.M. Securities, Incorporated, Fort Lauderdale, Florida;

(c) Robert Charles Seneca;

(d) Ronnie Restine Ewton;

(e) George Gordon Mead;

(f) Alan Richard Novick;

(g) any relative, whether by blood or by marriage, of the above named individuals, including, but not limited to, spouse, sons, daughters, sons-in-law, daughters-in-law, and parents;

(h) any corporation, partnership, joint endeavor, or other enterprise or undertaking whatsoever, controlled by or operated substantially in the interest of any of the above named individuals; where "control" shall be defined as ownership, whether direct or indirect, of ten percentum (10%) or more of the stock or other evidence of capital or equity ownership of any such organization; and where "substantial interest" shall be defined as derivation, in any manner whatsoever, of income amounting to more than ten thousand dollars (10,000.) ~~($10,000,000)~~ per annum as a result of the operation of any such organization.

ARTICLE III

(3) As of and after the effective date of this Agreement, the Board of Directors of the BANK shall not pay any sum as management fees or other charges whatsoever to its parent holding company, American Bancshares, Incorporated, North Miami, Florida, without the prior written approval of the

Regional Administrator of National Banks for the Sixth National Bank Region, Atlanta, Georgia (hereinafter the "REGIONAL ADMINISTRATOR"). It is expressly understood that no contemplated payment of such management fees or charges shall be approved by the REGIONAL ADMINISTRATOR, unless same shall represent payment for services actually performed, or for goods actually provided, in the calendar year for which payment is sought.

ARTICLE IV

(4) Within five (5) days of the effective date of this Agreement, the Board of Directors of the BANK shall appoint a committee to supervise the BANK's investment portfolio. No person shall be appointed to that committee who shall not have been a Director of the BANK on or before February 23, 1977, and no officer or director of the BANK's parent holding company, American Bancshares, Incorporated, North Miami, Florida, shall be elligible to serve on the committee.

(5) The committee, acting for the Board of Directors of the BANK, shall review any existing investment policy of the BANK, and shall, within fifteen (15) days of the effective date of this Agreement, adopt a written resolution incorporating a written investment policy of a safe and sound nature, to which the BANK shall strictly adhere. Such resolution shall be submitted to the REGIONAL ADMINISTRATOR for approval, prior to adoption.

(6) Said written investment policy shall include, but not necessarily be limited to, the following:

(a) a strict definition of the type or kind of security to be purchased and held;

(b) limits upon the concentration of credit in the investment portfolio;

(c) a schedule of desired maturities;

(d) specification of the minimum quality of security to be purchased and held.

ARTICLE V

(7) No officer of the BANK ~~who shall be employed, appointed or otherwise retained~~ whose employment or appointment as such an officer shall commence after February 23, 1977, shall be vested with any authority to:

(a) loan money or otherwise extend the credit of the BANK;

(b) authorize or otherwise approve or supervise loans or other extensions of credit;

(c) purchase or sell any security or other instrument of investment on behalf of the BANK; or

(d) authorize or otherwise approve or supervise the purchase or sale of any security or other instrument of investment on behalf of the BANK;

UNLESS the prior approval of the REGIONAL ADMINISTRATOR shall have been first obtained. When the BANK shall seek such approval, a written request shall be submitted to the REGIONAL ADMINISTRATOR, which request shall particularly name the officer, his rank, and the authority for which such approval is sought, including a specification of any lending limits and/or investment restrictions intended to be imposed upon such officer(s).

ARTICLE VI

(8) It is expressly and clearly understood that if, at any time, the COMPTROLLER, in his sole discretion, deems it appropriate in fulfilling the responsibilities placed upon the COMPTROLLER 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.

ARTICLE VII

(9) The provisions of this Agreement shall continue in full force and effect until, unless, or inasmuch as 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.

Donald L. Tarleton
Regional Administrator of National Banks
Sixth National Bank Region
Atlanta, Georgia

2-25-77
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.

Thomas C. Bennett	2/23/77 Date
C. J. Blumenthal	2-23-77 Date
William H. Carr	2-23-77 Date
Anthony P. Cassinelli	2-23-77 Date
James D. Evans	Date
Ralph D. Hollander	2-23-77 Date
~~Julian Wheel~~ DAVID BERGER	2-23-77 Date
David M. Starke	Date
Beth M. Thompson	2-23-77 Date
Ludwig M. Ungaro	Date
L. G. Whatley	Date

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

September 30. 1977

Mr. Ronnie R. Ewton
Mr. Robert C. Seneca
c/o E.S.M. Securities, Inc.
One Financial Plaza, Suite 1710
Fort Lauderdale, Florida 33394

Dear Messrs. Ewton and Seneca:

I am writing this letter in response to your letter of September 19, 1977, to Regional Administrator Donald Tarleton in our Atlanta office. Shortly after receiving your letter Mr. Tarleton transmitted it and its attachments to our Washington office for an appropriate response. I am advised that while your letter was undergoing review in our Law Department Mr. Tarleton received a telegram stating that you intended to pursue the matter with his Washington superiors if he did not respond to your demand by a date specified. I believe it appropriate, therefore, that I personally respond to your letter of September 19, since, as First Deputy Comptroller for Operations, I am Mr. Tarleton's Washington superior.

In February of this year, information came to our attention which we believe to be relevant to the performance of our statutorily mandated duties and responsibilities. In one instance, the information came to our attention in the course of a general examination of a national bank. In another, it was derived through confidential communications with another federal regulatory agency. Our review of the information thus elicited was conducted both in Washington as well as in Atlanta.

On the basis of our evaluation of the information confidentially derived, we considered it appropriate to advise the boards of directors of the six national bank subsidiaries of American Bancshares, Inc., of such of the information as we properly could. At that time, we requested those banks to agree to certain precautionary measures on a voluntary basis. The directors of the six banks deemed it appropriate to enter into the voluntary Agreements we proposed and with which we have reason to believe you are familiar.

Please be advised that we approached the involved banks with the opportunity to enter into voluntary agreements in the exercise of our statutorily mandated responsibility to ensure their safe and sound operation. The action taken by this Office in executing its statutory responsibilities was fully considered and authorized both by myself and the then Acting Comptroller of the Currency.

As we advised the subject national banks at the time the voluntary agreements were executed, we neither intend nor anticipate that the agreements will remain effective in perpetuity. In this regard, any national bank with whom we have an agreement is free at any time to request the modification or termination of the agreement should the board of directors believe it unduly burdensome or otherwise inappropriate. You realize, of course, that such matters are properly conducted between the parties to the agreement, and not their affiliates.

Please be advised that we shall devote our most careful consideration to any modification of an existing agreement which the involved board of directors may propose.

Sincerely,

H. Joe Selby
First Deputy Comptroller
for Operations

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

Banking Circular No. 2
Supplement No. 4

July 26, 1977

To: Presidents of All National Banks

Subject: Improper Securities Practices

The unusually high proportions of liquid assets held by banks in recent times have provided a tempting target for high-pressure salesmen offering questionable securities transactions. This circular contains examples of transactions which our examiners have found in increasing numbers in recent months. The list is not all-inclusive, but merely representative of high risk situations which have resulted in significant losses or illiquid situations for the banks involved. The list includes offers of:

- Municipal bonds having partial federal subsidies as fully U. S. Government guaranteed issues.
- Thinly traded federal agency and government guaranteed issues at prices in excess of current market prices.
- Informal repurchase arrangements as a price guarantee mechanism used to promote the sale of thinly traded securities or as a means of financing the dealer's securities inventory.
- Repurchase agreements which do not require proper evidence of collateral securities or which do not specifically identify the security held as collateral thus making it possible for the dealer to obtain funds without adequate collateral support and impossible for the bank to perfect a collateral lien.
- To purchase a bank's existing portfolio securities under a reverse repurchase agreement (securities purchased under an agreement to resell) if the banker is willing to reinvest the cash proceeds in long term government or municipal securities purchased from the dealer, thus transfering the more pronounced long term interest rate risk from the dealer to the bank. If interest rates rise during the term of the repurchase agreement, the longer term securities or other holdings must be liquidated in declining market to refund the maturing repurchase agreement.

- Reverse repurchase or securities borrowed agreements with inadequate collateral. The dealer will price collateral securities in excess of their current market values, often pricing issues at par when they are selling at a discount.

- "When issued", "forward placement" and "delayed delivery" securities contracts to prospective purchasers with the verbal assurance that a buyer would not have to accept delivery of the securities. These types of commitments require no investment on the part of a purchaser. In a rising market the commitment can generally be sold at a profit. However, in a declining market banks acquiring such open contractual commitments have in several instances become liable for the purchase of considerable amounts of securities at prices substantially in excess of prevailing market value at settlement date.

- To arrange reverse repurchase agreements to finance payment for securities delivered under the types of contractual commitments referred to above. This procedure allows the dealer to convert an unsettled sale transaction to a secured receivable due from a bank. The dealer will require cash and delivery prices, plus a comfortable collateral margin. This type of re-po financing generally creates immediate liquidity problems for a bank by having volatile short term source funds support long maturity securities with significant market depreciation.

- Stand-by or optional delivery forward placements or delayed delivery contracts covering GNMAs with the option to deliver being at the dealer's discretion. The dealer pays the bank a stand-by fee for the privilege of delivering the securities at a fixed price and future date; if prices go up the option is not exercised, if prices go down the securities are delivered at the original price. In this manner the dealer can hedge the possibility of loss by paying a modest fee. The most an investor can gain is the amount of the fee, while simultaneously incurring a substantial exposure to loss in a declining market.

- To place the proceeds of a municipal advance refunding issue, which the dealer had underwritten or served as the issuer's financial advisor, on deposit with a bank if the bank agrees to purchase the government securities to be pledged against the escrowed deposit at prices in excess of current market.

- To guarantee a certain level of income if the banker will grant the dealer blanket or discretionary authority to execute trades on behalf of the bank. Transactions executed under such agreements are seldom in the bank's best interest.

Investment officers are advised that good professional practice in connection with all securities transactions demands that they fully educate themselves to the nature of the risk exposures involved both in form of transactions and the underlying securities. It is also fundamental that the financial standing and professional qualifications of the persons or firms soliciting business should be checked out carefully before commitments are made. Transactions should be consistent with the bank's preplanned investment strategy.

The following general investment guidelines are recommended for all transactions:

- Analyze the financial statements of securities firms you do not customarily purchase securities from, prior to transacting business with the firm.
- Never give a blanket or discretionary investment authority to exercise security transactions on your behalf to any securities dealer.
- Do not enter into a transaction the terms of which you do not completely understand.
- Do not purchase an option or security which you cannot comfortably afford to pay for in full.
- Do not advance payment for purchased or resale agreement securities until you are certain the securities have been delivered or until you have obtained proper evidence that the securities exist.
- Test prices of unusually attractive securities offerings by obtaining substantiating quotes from a reputable local or regional dealer.

John G. Heimann
Comptroller of the Currency

Mr. BARNARD. Thank you, Mr. Selby.

Mr. Gray, in the procedure of bank examinations, does the Home Loan Bank Board or the FSLIC, do they get the benefit of examinations of State-chartered institutions that are not insured by the FSLIC, such as the 71 banks in Ohio?

Mr. GRAY. No.

Mr. BARNARD. You have no information from them whatsoever?

Mr. GRAY. No.

Mr. BARNARD. So on the occasion then of this situation, your files, of course, were empty as far as financial statements of these institutions?

Mr. GRAY. That is correct.

Mr. BARNARD. Mr.——

Mr. GRAY. Pardon me. That is not correct with respect to those 11 institutions which are members of the Federal Home Loan Bank of Cincinnati which were also members of the ODGF. There are another three which have no insurance whatsoever which are members of the Federal Home Loan Bank——

Mr. BARNARD. In other words, you had some that were members of both? The FSLIC and the Ohio——

Mr. GRAY. No. In this case——

Mr. BARNARD. No, I realize there were three that had no insurance whatsoever.

Mr. GRAY. Right. That is correct. And still have none.

Mr. BARNARD. And the laws of Ohio permit them to operate without any insurance.

Mr. GRAY. Yes.

Mr. BARNARD. But you indicated there was another exception. What was that exception?

Mr. GRAY. No; in this case, we do receive quarterly financial statements from and State examination reports on members of the Federal Home Loan Bank of Cincinnati.

Mr. BARNARD. But they are not federally insured?

Mr. GRAY. No; they are not federally insured. But they are members of the bank——

Mr. BARNARD. They are Federal savings and loan associations but are not federally insured?

Mr. GRAY. They are not Federal savings and loans. They are members of the Federal Home Loan Bank of Cincinnati for credit purposes only.

Mr. BARNARD. Oh, for credit purposes. OK.

Has the FSLIC been weakened at all because of these new memberships in the fund?

Mr. GRAY. No; I am pleased to say no.

Mr. BARNARD. Mr. Martin and Ms. Horn, were either of you consulted and counseled by the Governor as far as the bank holiday was concerned?

Mr. MARTIN. Yes; I spoke to the Governor on one occasion and I know that President Horn was consulted several times.

Mr. BARNARD. Did you concur in his decision that this was the most expeditious decision to make in view of the circumstances?

Mr. MARTIN. Mr. Chairman, it is not our role to transgress in this area. This is a State-regulated and chartered institution. We provided the counsel from our experience. In my own case as

former Chairman of the Federal Home Loan Bank Board in other States and other situations we had no time attempted to make the decision or to be compelling in the decision——

Mr. BARNARD. Did you advise him of any precedent, as far as a situation like this was concerned?

Ms. HORN. We discussed a number of alternatives over a number of telephone calls, and as the Vice Chairman has indicated, we never recommended a decision since that was not our role in this situation. Among the alternatives that were discussed was a historical situation, and if my memory serves me right it was in the State of Mississippi. That is the one historical situation I remember entering the conversation.

Mr. BARNARD. Yes; I understand that there was a precedent for a bank holiday in the State of Mississippi. I do not know how many institutions were involved or how long it occurred, but that was the purpose of my question: Had the Mississippi situation entered into the decision of Governor Celeste?

Ms. HORN. It had entered into our discussions.

Mr. BARNARD. There was some indication today by some that the Federal Reserve initially—I think we need to clarify this—say, on the first or second day of the crisis, there was not as much interest on the part of the Federal Reserve to get involved as it was after the money market—after the value of the dollar did a somersault. Would you like to address that? Was there any—did that have anything to do to speed up your concern?

Mr. MARTIN. No, sir, the concern arose as soon as there was information with regard to Home State, the implications of other ODGF institutions was patent, and our interest was, let us say, stimulated immediately that there was trading in the dollar, there was trading in the dollar of $50 to $70 billion in foreign exchange trading most days. And that traders may have alluded to Ohio to justify some directional movement in the dollar is neither here nor there.

Mr. BARNARD. My time has expired on this first round, but we shall return.

Mr. Craig.

Mr. CRAIG. Thank you very much, Mr. Chairman. I appreciate the testimony of all of the members of the panel.

Mr. Gray, in your experience with the Home Loan Bank Board and the FSLIC, have you ever had a situation which you had to utilize a procedure because a member institution was having a run on it?

Mr. GRAY. Not out of the ordinary. What we have done in one particular case was to establish a limit of credit available at the Federal Home Loan Bank for regulatory purposes. But that is the only case I am aware of.

Mr. CRAIG. So you could not refer to a procedure or a plan of action that you would utilize in the case of a member institution getting into this kind of trouble?

Mr. GRAY. Well, we certainly would, as a collateral lender, desire to provide credit for liquidity purposes to such an institution, to the extent that collateral was available.

Mr. CRAIG. Have you ever closed one down?

Mr. GRAY. That was experiencing a run? No; I do not believe so. Fortunately.

Mr. CRAIG. In your ability to approve institutions coming into the FSLIC, do you have carte blanche authority there?

Mr. GRAY. In our ability to what?

Mr. CRAIG. Do you do carte blanche approval?

Mr. GRAY. The Federal Home Loan Bank Board approves all applications for insurance of accounts.

Mr. CRAIG. Were you asked during this time to accept all members?

Mr. GRAY. Yes; I was. By a Member of the Congress.

Mr. CRAIG. And because of the Federal law that regulates you and the procedure involved under that law, you did not have carte blanche—you could not offer carte blanche authority or approval?

Mr. GRAY. As I noted in my opening statement, this would contravene both the spirit and the letter of the National Housing Act.

Mr. CRAIG. Mr. Selby, in the narrative you gave us of the episodes in Florida involving principals in ESM and also some of their banking efforts and at a time when two principals, particularly offered to and a Mr. Warner purchased I believe it was American Bancshares, which is a holding company with six nationals?

Mr. SELBY. That is correct.

Mr. CRAIG. And they were then converted to State banks?

Mr. SELBY. Correct.

Mr. CRAIG. In your opinion, why did that conversion take place from Federal to State?

Mr. SELBY. I do not have any definitive answer.

Mr. CRAIG. In your opinion.

Mr. SELBY. My opinion—one reason generally is they did not want to live under our agreements, possibly.

Mr. CRAIG. Your agreements differing——

Mr. SELBY. That limited the national banks from dealing specifically with ESM and the principals and relatives and affiliates of ESM. Now, that is only presumption on my part. I do not know that.

Mr. CRAIG. In your Federal relationship or as the Comptroller of the Currency and a regulator versus State regulation, where would you say the level of scrutiny differs and the thoroughness of investigation?

Mr. SELBY. At the State level versus——

Mr. CRAIG. The State versus Federal in this particular situation?

Mr. SELBY. I just cannot answer that. I know that we scrutinize it and I also know that the other Federal agencies scrutinize it. I cannot speak for the States. My guess is that certainly not in 1977. I think now we have in place better mechanisms where not only the Federal but the State authorities are privy to shared information, mainly through the Federal Financial Institutions Examination Counsel. We routinely now share this information and indeed with the State authorities if they want the information.

Mr. CRAIG. In other words, what you are saying then, a move from national to State could be a result of the ownership of a holding company not wanting to play by one set of rules, therefore moving to play by another set?

Mr. SELBY. Well, the holding company is the Federal Reserve, and obviously——

Mr. CRAIG. I understand that.

Mr. SELBY [continuing]. Has the authority under change of control. The banks converting to a State oftentimes their business plan calls for them to convert. It is cheaper maybe. They have different plans. In this particular instance, I do not know other than we put the agreements on these banks to insulate them against——

Mr. CRAIG. Down to and including any relative?

Mr. SELBY. That is correct. To insulate them and they attempted to get out from under those agreements and we were unrelenting and so I assume their business plan called for them to convert.

Mr. CRAIG. Thank you. My time is up.

Mr. BARNARD. Mr. Spratt?

Mr. SPRATT. Mr. Selby, it seems that the Comptroller's Office by fortune and chance found out about ESM in time to alert your member banks, national banks, and avert substantial losses on the part of these national banks.

Mr. SELBY. Hopefully, by deliberate chance.

Mr. SPRATT. By deliberate chance?

Mr. SELBY. Through the offices of our examiners.

Mr. SPRATT. We will not pursue that. OK. In any event, you found out about it.

Mr. SELBY. Yes.

Mr. SPRATT. Do you think that your office should continue to rely upon chance discoveries of this kind, or fortunate deliberate opportunities of this kind, or should have a regular mechanism by which these other ESM's presumably out there in the securities markets are ferreted out and attention is relayed to your member institutions to be on the alert?

Mr. SELBY. Well, I think there should be a mechanism to perhaps share information such as ESM when one agency finds it, which I think we did, maybe not as well as we would do it now. But, yes, there should be sharing of that information, and I think we do it, quite frankly.

Mr. SPRATT. And with the State——

Mr. SELBY. With the States.

Mr. SPRATT. With the State funds?

Mr. SELBY. Yes.

Mr. SPRATT. In this particular case, however, no similar bulletin or alert went out to the State funds?

Mr. SELBY. No.

Mr. SPRATT. Is it institutionalized now that an alert would go out to State funds?

Mr. SELBY. Not to the State funds. It would go out through the Federal mechanism to not only Federal institutions, that is, savings and loans and banks, through the FFIEC but it would also—we would afford the States the opportunity to have that information and do the same things with the State institutions. So I would assume whatever funds are there we would also be aware of. As a matter of fact, we are working right now through the——

Mr. SPRATT. Do you have a list, are there other memoranda like the suede shoe memorandum about ESM that has gone out. Do you

have a list of suspects, securities dealers with whom national banks and others should not deal?

Mr. SELBY. I imagine that our staff could put together a list of the ones that we are most suspicious of.

Mr. SPRATT. But is there such a list in circulation now?

Mr. SELBY. No, no.

Mr. SPRATT. If you do not advocate regulation or periodic audit, do you not think that information should be compiled and made available?

Mr. SELBY. Not if you go under the premise that our examiners are trained sufficiently and understand the transactions sufficiently and go in and examine the banks and institutions sufficiently to ensure that the banks are not transacting in speculative ventures and are covering their position with collateral.

Mr. SPRATT. But there are other examiners. There are State regulatory examiners. There are Fed examiners. There are FDIC examiners. Why not share your information with them in a systematic way?

Mr. SELBY. Well, I think we do now, was my point.

Mr. SPRATT. I am pursuing that still. If there is no compilation, how are you—you have got a body of information, a data bank of suspect securities dealers, but it is not compiled and it is not being, as I understand it, routinely sent out to other regulatory agencies by way of bulletin or some similar form of contact.

Mr. SELBY. Well, it gets a little iffy, if you ask us to take a suspected bond dealer or securities dealer, and send out a mass mailing that says: "Don't trust this guy." I am not a lawyer, but I do not think I would want to sign that myself.

Mr. SPRATT. Do not sign it. Just send it out under the name of—you have got better immunity than the Ohio State Guarnatee Fund which is——

Mr. SELBY. I do not think my liability insurance covers me that much.

Mr. SPRATT. I think you have got sovereign immunity possibly. I understand, and there may be privileged communications with—but if that is true, if we have legal liable barriers, then maybe we ought to consider some way to remove the barriers, mitigate the barriers, in order to encourage to disseminate this needed information.

Mr. SELBY. I agree with your theory that we should share what we find with other regulators as they examine their institutions and supervise them. I agree with that.

Mr. SPRATT. Am I out of time?

Mr. BARNARD. No.

Mr. SPRATT. If I understand the testimony—I believe it is Mr. Gray who implies that the examination performed by the Ohio Savings and Loan Division was quote "less rigorous than Federal procedures," and in fact, the lessened rigor was held out as an inducement to membership in Ohio Guarantee. Your statement says "that the Ohio Guarantee Fund justified itself to its membership by offering less rigorous procedures than federally required." Is that your empirical observation having dealt with them and looked back at what was happening in Ohio?

Mr. GRAY. In all candor; yes. There are apparently other historic reasons why institutions chose to be members: that is to say, they were not held to the same constraints on interest that could be paid on passbook accounts, and so forth. I reached this conclusion on the basis of conversations with experienced staff that has been around for some time. Certainly long before I came to the Bank Board.

Mr. SPRATT. Out of time? Thank you, Mr. Chairman.

Mr. BARNARD. Thank you. Mr. Saxton.

Mr. SAXTON. Mr. Gray, this morning when Mr. Hunsche was testifying, I think he testified that the Ohio Deposit Guarantee Fund had in its fund a percentage of about 2.9 percent of the gross holdings of its member banks. Does that sound right? I believe that is the figure that he gave us this morning.

Mr. GRAY. I have to take his word for that.

Mr. SAXTON. And he contrasted that in the same light to about one-half of 1 percent figure for the FSLIC.

Mr. GRAY. That would not be correct. I think the closest, the most recent figure would be about 0.76 percent, as a ratio of FSLIC reserves to deposits at our insured institutions.

Mr. SAXTON. In any event, 0.76 percent. Why is it that the FSLIC is able to conduct its business with that kind of reserve while at 2.9 percent or almost 3 percent, the Ohio Deposit Guarantee Fund was not?

Mr. GRAY. Well, obviously we would like to strengthen the reserves of the Federal Savings and Loan Insurance Corporation, as you know, and one of the reasons why that ratio has developed as it has is because of the frankly excessive growth in liabilities and assets at our FSLIC-insured institutions over the last several years under liability deregulation. We have taken actions now through an additional special premium to increase the reserves of the fund. But to answer you specifically, I think it is the full faith and credit of the United States which at least implicitly stands behind both the FSLIC and the FDIC.

Mr. SAXTON. Would you also say that in insurance language we often talk about the spread of risk? And with the FSLIC there are many more member banks, member institutions? Is that an important factor in contrasting the Ohio Deposit Guarantee Fund with the FSLIC?

Mr. GRAY. Well, in all honesty I do not necessarily think that that in itself would represent an advantage as such. Obviously, the reserves of the fund depend on real dollars, real assets. I am not suggesting this would happen but I suppose you could say that with as many members as we have we could, particularly if the law were changed, raise greater amounts of funds through special premiums. But essentially it is full faith and credit of the United States itself which provides public confidence in our institutions.

Mr. SAXTON. The trustees in the Ohio Deposit Guarantee Fund who administered it or who were the backbone organization of it are appointed, were appointed, by member banks; is that correct? Member thrift institutions?

Mr. GRAY. I gather that is correct. At least that is what the gentleman previously testified to.

Mr. SAXTON. Is there any danger in having member institutions actually represent themselves and control themselves? Is that a built-in problem with private insurance funds?

Mr. GRAY. There is always the potential for conflict of interest, although I say that generically, without any great knowledge of the Ohio Deposit Guarantee Fund. And in our efforts to protect the FSLIC, of course, we do have conflict-of-interest regulations which are intended to deal with that problem.

Mr. SAXTON. I am not so concerned perhaps about actual conflict of interest. I am just concerned about who watches the henhouse better, someone who is completely disassociated with an organization or someone who has a rather close association with member institutions.

Mr. GRAY. I think as a general proposition it would be better to have independent governors for that kind of system.

Mr. SAXTON. Thank you, Mr. Chairman.

Mr. BARNARD. Mr. Kindness.

Mr. KINDNESS. Thank you, Mr. Chairman. I will not impose on the time of the subcommittee further with regard to this panel. Thank you.

Mr. BARNARD. Ms. Oakar.

Ms. OAKAR. Thank you, Mr. Chairman.

Ms. Horn, you testified that on March 9 you took action and made some initiations with respect to the impending crisis in Ohio. I want to congratulate you and the Fed on that. You did it under the spirit of the law. But you took that initiation, and I think that it did play a role, at least temporarily, in giving some element of confidence to the situation. I just wanted to congratulate you on that.

Mr. Gray, Mr. Craig asked a very important question which is why I am so interested in potential conflicts of interest. I think what the distinguished minority leader asked was has the Federal Home Loan Bank Board acted or ever had a situation that was extraordinary in which they really took the bull by the horns and acted. I think you answered, not to your knowledge. I am concerned about some of the transactions. For instance I look at the situation with the Financial Corp. of America and its subsidiary in California that had a run on it. I think that was fairly extraordinary. Their subsidiary had some real problems. What the Federal Home Loan Bank Board did, and I realize they were federally insured, but you did extraordinary things. The institution was given unlimited borrowing rights exceeding normal collateralization——

Mr. GRAY. That is not correct.

Ms. OAKAR. Well, how much of the borrowing——

Mr. GRAY. That is absolutely not correct.

Ms. OAKAR. How much has the Home Loan Bank Board lent this institution since October?

Mr. GRAY. From October 31, 1984, to March 31, 1985, the Federal Home Loan Bank of San Francisco advanced $5.6 billion to American Savings & Loan Association in California. During that same period, American repaid $6.5 billion, for a reduction in its net outstanding advances from the San Francisco Bank of about $900 million. I would also note that in every instance, Congresswoman Oakar, the only credit that has been provided to any of our institu-

tions, including American, has been under the collateralization requirements that are imposed by the individual Federal Home Loan Banks.

Ms. OAKAR. Let me just say this. Mr. Chairman, it is my understanding that they have lent at least $4 billion which is no small amount of money. By the way, that approximates the total assets of all 72 institutions that were nonfederally insured, so that was a pretty extraordinary undertaking. I point that out because there have been extraordinary situations. And you may have been right about it, but if I can pursue this. That is why I am concerned about the rumors, and innuendos, concerning your actions or nonactions related to the Ohio situation.

I asked you two questions before the full Banking Committee and I asked you very specifically did you, prior to March 13 or any day thereafter, get any advice on how to handle the situation from the Secretary of Treasury or anybody from the White House. You answered that was not relevant. You would not answer it.

Then we have a situation whether it is accurate or not, in which the Wall Street Journal publishes an article that says, indeed, Secretary Baker discussed this issue with you after having a meeting in terms of how to decide what the Federal response should be. They concluded that if the crisis developed it should remain a problem of the Democratic administration in Ohio.

The role that the Federal regulators should play, whether it is the Federal Home Loan Bank Board or the Federal Reserve Board, should be above politics. I do not understand why you would not answer the questions during the Banking Committee hearing, but I will give you another chance now.

Mr. GRAY. I have been waiting for your question which I am happy to answer.

Ms. OAKAR. Good. I think you could have solved a lot of problems on March 27 if you had answered my two questions.

Mr. GRAY. Well, let me just say, with all due respect to you as a Member of the Congress of the United States, any innuendo, any discussion of partisan politics, was raised by you and certainly not by me. For example, and the record will show this, you referred to the upcoming Governor's race in Ohio.

Ms. OAKAR. That is right.

Mr. GRAY. You referred to my failure to meet with members of both sides of the aisle, Democrats as well as Republicans. Now, you know full well that an invitation was extended to you and Congressman Luken and to others, to come to my office——

Ms. OAKAR. That is right.

Mr. GRAY [continuing]. To meet with me——

Ms. OAKAR. And you know full well why I did not attend.

Mr. GRAY. Well, no, I do not.

Ms. OAKAR. Because you chose to meet with Congressman Wylie privately after we had all agreed on an 11:30 meeting, you chose to meet him for breakfast and my colleague from Ohio can verify that.

Mr. LUKEN. If the gentlelady will yield.

Ms. OAKAR. I will be happy to yield.

Mr. LUKEN. That is exactly what happened. We have the floor. We will ask you the questions.

Mr. GRAY. Well, just a minute. She just made an observation and I am going to answer it.

Mr. LUKEN. Are you running this, Mr. Chairman.

Mr. GRAY. Let me just say, Congresswoman Oakar, that the meeting I had with Congressman Wylie had been set on my calendar 3 weeks before and it was to deal specifically with legislation which was introduced by request by Congressman Wylie and by Chairman St Germain of the House Banking Committee. That was the purpose of that meeting.

Ms. OAKAR. Let me yield to my colleague.

Mr. LUKEN. As the gentlelady has said, at extensive meetings on March 13, with your counsel, we attempted to get a meeting with you that night. Sixteen or more representatives of savings and loans of Ohio were present pleading to meet with you. You were unavailable we were told until 11:30 the following morning. That is what we were told by your counsel seated here today. You were not available until 11:30. Mr. Wylie was there. At 9:30 the following morning Mr. Wylie called me and said he had had breakfast with you, had discussed these issues, and told me what your decisions were. Those are the facts. I repeat, he called me at 9:30, said he had breakfast with you. I was shocked. And he had discussed these issues and he laid out what the decisions were which you later confirmed.

I yield back to the gentlelady.

Mr. GRAY. Well, I cannot speak for Congressman Wylie, but I did tell him at breakfast, which began at 8, that the Bank Board was going to make a very strong effort to expedite applications as soon and as quickly as possible.

Mr. BARNARD. Just a second. Let me advise that we owe Mr. Luken time now. Ms. Oakar's time has expired.

Mr. GRAY. I did not answer, her question which I think——

Mr. BARNARD. I mean I think they are participating together on that.

Mr. LUKEN. I will proceed. Mr. Gray, we did meet with you on March 13, and I will say right now that if you had taken action at that time as we requested, that the closings of Friday, March 15, would not have occurred. Now, I want to say exactly why I say that. First of all, your statements are inconsistent with those of Congressman Gradison and Congressman Wylie, as indicated in the Wall Street Journal.

Mr. Wylie said that you did stall at that time. Mr. Gradison states that you have reversed yourself since. Now, I want to ask you—on March 13 did we ask you to waive the 10-day waiting period? The 10-day notice period? And what was your answer?

Mr. GRAY. Counsel advised me, and you were there, that there was a 10-day notice period which had to be observed.

Mr. LUKEN. And we pleaded with you to waive it and you said, "no way," did you not?

Mr. GRAY. Well, I take the advice of my lawyer, who probably knows more about these things than I do.

Mr. LUKEN. Did you take it a week later when you did waive it?

Mr. GRAY. Yes, I did.

Mr. LUKEN. Oh.

Mr. GRAY. On the advice of counsel.

Mr. LUKEN. It is his fault. And at that we asked you to apply extra help to get other examiners in, and did you not tell us that you were stretched so thin——

Mr. GRAY. That is right.

Mr. LUKEN. That you could not possibly get any more help.

Mr. GRAY. That is essentially correct.

Mr. LUKEN. And a week later you found all that help that you have just been describing.

Mr. GRAY. Well, you know, on Sunday evening, as my testimony indicates, I met with Chairman Volcker in his office and at that time Chairman Volcker pledged to the Federal Home Loan Bank Board as many examiners as we would need to bring about the expeditious processing of these applications.

Mr. LUKEN. You had Chairman Volcker's people with you on March 13, and did you or did you not tell us that it was an Ohio problem, quote "You are in the wrong city. You should be in Columbus"? Did you say that, Mr. Gray?

Mr. GRAY. I said I thought that individuals should be at the State capital talking about this problem.

Mr. LUKEN. And when we pleaded on behalf of the depositors, did you or did you not say that the depositors should have known that they were not federally insured when they deposited in the State institutions?

Mr. GRAY. You know, I do not recall that statement, but I did——

Mr. LUKEN. Well, I will refresh your recollection. You did.

Mr. GRAY. Well——

Mr. LUKEN. And when we talked about the savings and loans and helping the depositors, you said "After all, the savings and loans had the opportunity previously to join FSLIC and they had refused it." You did not say that once. I bet you said that at least six times in our brief meeting.

Mr. GRAY. That is a historical fact.

Mr. LUKEN. And then you would characterize that as cooperative, that you were going to extend yourself? Those reactions that you were extending yourself for the depositors?

Mr. GRAY. You know, I said repeatedly, Congressman, that the Federal Home Loan Bank Board and the FSLIC were committing to do everything possible to expedite applications for insurance of accounts as quickly as possible.

Mr. LUKEN. But you said you had no help. You had no legal authority. How were you going to expedite it if you did not have anybody to apply to processing the applications. And if you had to follow the law, which you said could not allow you to expedite it. And finally, I want to ask one more question.

When the representative of the S&L, his last question to you was, "Give us 30 days. We will close for 30 days and can you examine these in 30 days," and you said you would not even consider it. Is that not true?

Mr. GRAY. I said that with a very severe shortage of 750 examiners around the country that would not be possible, and that was in specific response——

Mr. LUKEN. But you have managed to do it in the last 2 weeks.

Mr. GRAY. But let me finish what I am saying. That was in specific response to a suggestion that all of our examiners be deployed summarily to the State of Ohio.

Mr. LUKEN. No. That was not the——

Mr. GRAY. Well, it certainly was.

Mr. LUKEN. The suggestion was—would you at least——

Mr. GRAY. Congressman Gradison made that suggestion.

Mr. LUKEN. It was not Congressman Gradison. It was the representative of the thrift, and he said that if we close for 30 days—he said he recognized it that you were not going to help, so he said if we close for 30 days will you at least examine them within that 30 days. And you said, "No way." You would not even consider it. And now you are saying that you have already done it in less than 30 days.

Mr. GRAY. Well, now, I have tried to explain to you that on the following Sunday evening, Chairman Volcker pledged the full support of the Federal Reserve and as a matter of fact, has provided 140 examiners—140—to help the Bank Board in this process.

Ms. OAKAR. Chairman Volcker has been great. Will the gentleman yield? I just have to ask you the question.

Did Secretary Baker ever call you and tell you to stall and stonewall the Ohio crisis?

Mr. GRAY. I am glad I get a chance to answer your question.

Ms. OAKAR. Mr. Chairman, I think he should answer. Whatever you want to do. You are investigating it, so maybe you can get it in writing.

Mr. GRAY. I am glad I get a chance to answer that question. I would like to do it briefly.

First of all, the Federal Home Loan Bank Board has traditionally, over many, many years, exchanged information with the Treasury, which is under the Chief Fiscal Officer of the United States, with other regulatory agencies, including the Federal Reserve. And we have continued to do that. Particularly in extraordinary situations.

Now, I want to assure you that I have never taken instructions from anyone, anyone, whether in the White House or Treasury or anywhere else, nor has any other member of the Federal Home Loan Bank Board because, in all honesty, we are an independent agency.

Ms. OAKAR. But did you discuss the politics in Ohio?

Mr. GRAY. I absolutely never discussed any kind of politics in the State of Ohio.

Ms. OAKAR. Well, it is referred to in the Wall Street Journal article.

Mr. GRAY. Well, that is pure unadulterated fiction. Because no one ever called me to talk about politics in Ohio. The first time I ever became aware of the plan alleged in the Wall Street Journal was when I read it in the Wall Street Journal.

Ms. OAKAR. I do not think the question has been answered specifically, but I will leave that to the committee to investigate.

Mr. BARNARD. Thank you very much.

Ms. Horn, how much did the Federal Reserve Bank lend out of its discount window to these Ohio institutions?

Ms. HORN. Altogether——

Mr. BARNARD. I am not asking you individually, but cumulatively?

Ms. HORN. Altogether, throughout this whole period, we have lent in the range of $70 million.

Mr. BARNARD. $70 million.

Ms. HORN. That is a cumulative figure. Of course, it has been paid back.

Mr. BARNARD. For the uninformed, all of that had to be secured.

Ms. HORN. Yes, it was secured.

Mr. BARNARD. And what maturities are you working on for those loans?

Ms. HORN. They are relatively short-term loans.

Mr. BARNARD. Two weeks? Four weeks?

Ms. HORN. We do not have a designated maturity, but we have overall guidelines limiting the frequency that an institution can obtain adjustment credit. I cannot answer your question with a specific number of days, but we are talking about short periods of time.

Mr. BARNARD. Do you think that in some of these more troubled institutions that—even though you are secured—you will be a little bit more liberal in renewing these discount notes?

Ms. HORN. There is no question about it. The guidelines are in place so that we can use judgment in respect to them. As we review the needs of the institutions, we will be adhering to the guidelines——

Mr. BARNARD. And you are not setting precedent here? This precedent is already established?

Ms. HORN. I do not quite understand the question.

Mr. BARNARD. Is this the same practice that you use with other member banks?

Ms. HORN. Absolutely.

Mr. BARNARD. Mr. Gray, did any of the 14 Ohio institutions involved, which were members of the Cincinnati Home Loan Bank, apply formally or informally for credit?

Mr. GRAY. No, they did not.

Mr. BARNARD. Now, we want to get—well, one other question, Mr. Gray. Because of this situation in Ohio, do you recommend a more formal association with State savings and loan agencies or even State private insurance funds, such as the exchange of examinations and so forth? Especially since you are subject to be called on to either—no, you are not necessarily, but Mr. Martin is, the Federal Reserve is subject to be called on as far as the discount window is concerned. Of course, you are not eligible to loan to these State-chartered institutions. Am I correct?

Mr. GRAY. That is correct——

Mr. BARNARD. The Home Loan Bank Board——

Mr. GRAY [continuing]. As to Ohio institutions that were not members of the Federal Home Loan Bank of Cincinnati.

Mr. BARNARD. Mr. Martin?

Mr. MARTIN. Mr. Chairman, I would assure you that the results of the Ohio experience, since it is the most recent of its type, will be communicated in our training sessions with the various officers, discount officers, and others within the whole Federal Reserve System, and will be communicated to those State officials who are

working with our Federal Reserve bank presidents and officials in the so-called training and orientation to improve both their and our operations. This experience will not go on the shelf.

Mr. GRAY. Incidentally, Mr. Chairman, we do exchange information of a supervisory nature with other State savings institutions regulatory agencies.

Mr. BARNARD. Including Ohio?

Mr. GRAY. With the State regulatory agencies.

Mr. BARNARD. Do they exchange information with you though? That is the question. Now, I mean, are they furnishing you a copy of their examinations?

Mr. GRAY. Well, we are really talking here about FSLIC-insured institutions.

Mr. BARNARD. OK, yes. We need to, at this point in time, move our discussion to some of the practices—policies and practice of supervisory agencies, especially as it is associated with ESM. And I will ask all of you this. What procedures—Home Loan Bank Board, Comptroller, and the Federal Reserve—are your examiners supposed to follow, during the examination process, to verify that an institution which has entered into a repo agreement has actual possession of those securities?

Mr. GRAY. Well, in the case of the Federal Home Loan Bank Board, repos and reverse repos are subject to two levels of review. The first is the required annual audit by an accounting firm. Audit procedures require verifications. The second level of review would be during an actual examination of the institution. Examinations procedures would require verification that the association's records of the transaction were complete, adequately maintained, and they would further require a review of such transactions to see if they were in keeping with the Bank Board's regulations and guidelines. Unusual positions or violations such as excess collateralization which we have dealt with in guidelines which were issued on July 13, 1981, would warrant comment and further investigation by our supervisory personnel.

Mr. BARNARD. Mr. Martin?

Mr. MARTIN. Our examiners, according to a series of instructions, written instructions, they have in these matters, check on the documentation, check on the credit worthiness of the institutions with which the banker is dealing, check on the internal auditing procedures within that bank with regard to documentation, location of collateral and so forth, and on and on. We have a rather elaborate system of checking in it.

Mr. SELBY. Well, our examiners' handbook requires that our examiners verify that the banks have taken possession of the securities period.

Mr. BARNARD. In that event then, Mr. Gray, were these procedures followed in the September 1984 examination of the American Savings and Loan?

Mr. GRAY. Yes, I believe they were.

Mr. BARNARD. Did you know that American's securities were mixed in with everybody else's in ESM's account at Bradford Trust?

Mr. GRAY. Yes, yes. Bradford Trust? Let me say, that I am a bit hesitant, in all candor, to talk about it.

Mr. BARNARD. I beg your pardon?

Mr. GRAY. I am a bit reluctant in all candor to talk in this public forum about an ongoing institution where confidence is important and certainly we would be pleased to provide members of the subcommittee with this information privately. I really am reluctant to get into great detail publicly because of the possible harm it could cause to any individual institution.

Mr. BARNARD. I can understand that, Mr. Gray, and we certainly do concur with you in that particular situation.

Mr. Gray, the subcommittee has information that on a number of occasions between 1980 and 1985, the Federal Home Loan Bank Board in its examination supervisory capacities came across unsafe and unsound transactions involving ESM. For example, in 1980 and 1981, the Bank Board participated in a joint examination of Unity Savings Association of Chicago and the issuance of a cease-and-desist order involving Unity's $200 million transaction with ESM.

You have advised the subcommittee that in 1982, the Federal Home Loan Bank of Cincinnati was aware of rumors of Home State's dealings with ESM. And yet these rumors were not investigated. In 1983 and in 1984, immediately after ESM's principal founder, Ronnie Ewton, was made a board member and put on the executive committee of American Savings and Loan of Florida, an FSLIC institution, American entered into a large and unsafe transaction with ESM.

You advised the subcommittee that the FSLIC insurance fund is likely to sustain an $8 million loss because of the dealings of federally insured thrifts with ESM.

Could you provide us with more details as to that loss?

Mr. GRAY. I will be happy to provide information for the record.

[The information referred to follows:]

Federal Home Loan Bank Board

1700 G Street, N.W.
Washington, D.C. 20552
Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

OFFICE OF EXAMINATIONS AND SUPERVISION

April 11, 1985

Mr. Peter S. Barash
Staff Director
Commerce, Consumer, and Monetary Affairs
Subcommittee of the Committee on
Government Operations
Rayburn House Office Building, Room B-377
Washington, DC 20515

Dear Mr. Barash:

During the April 3, 1985 hearing concerning Ohio privately insured savings and loans, several matters were discussed regarding which we agreed to provide you with additional information.

Our estimate of an $8 million dollar potential loss to the FSLIC was based upon the situation of two institutions which are now in the hands of the FSLIC. This estimate is based upon the assumption that liquidation will be necessary in these two cases and represents a worst-case scenario. The actual loss may be considerably less depending on numerous other factors.

I have enclosed for your information a copy of our memorandum R 6-2 which discusses over-collateralization of reverse repurchase agreements and provides guidelines for appropriate collateralization levels. This memorandum was referred to by Chairman Gray during the course of the hearing.

Finally, I am enclosing for your information a copy of a phone log from the Federal Home Loan Bank of Cincinnati for the period from March 11 through April 4, 1985. (This is a log of their on-going monitoring of the situation.)

Please let me know if I can be of any further assistance.

Very truly yours,

William J. Schilling
Director

Enclosures

cc: Chairman Gray

Mr. BARNARD. Evidently, we have lost our records of that, Mr. Chairman, but we will find them. Mr. Chairman, based on your supervisory knowledge of ESM's speculative and dangerous transactions with financial institutions, did you oppose in any way the placing of Ronnie Ewton on the board and the executive committee of American Savings and Loan?

Mr. GRAY. American Savings——

Mr. BARNARD. Or to the Home Loan Bank Board?

Mr. GRAY. I do not believe we had anything to say about that in particular. Counsel advises that this is a State-chartered institution.

Mr. BARNARD. Beg your pardon?

Mr. GRAY. Counsel advises that this is a State-chartered institution and, frankly, apparently we do not have jurisdiction——

Mr. BARNARD. It was FSLIC-insured, though?

Mr. GRAY. Yes. It is FSLIC-insured.

Mr. BARNARD. But would not your authority run to that because of that? Because of FSLIC's insurance, would you not have the jurisdiction to make a determination there?

Mr. GRAY. We can only remove a director if there are grounds based on a violation of rules and regulations of the Federal Savings and Loan Insurance Corporation.

Mr. BARNARD. In other words, there was no objection to Mr. Ewton then being on the board of American Savings and Loan?

Mr. GRAY. Not on the basis of our discretionary authority, I gather from counsel.

Mr. BARNARD. Given the large exposure of American Savings and Loan and its ESM transaction and the involvement of Marvin Warner in initiating those transactions, can you give us an explanation why the Home Loan Bank Board permitted the institution to spend $26 million of its precious capital to buy back Mr. Warner's 50-percent ownership in American? Again, because of FSLIC.

Mr. GRAY. The principal supervisory agent of the Federal Home Loan Bank of Atlanta approved this transaction in which American purchased the Warner stock from Shepard Broad. The purchase price was to be replaced either by the association reselling the stock or by the sales of subordinated debt. The principal supervisory agent in this connection, urged by the State of Florida, as I understand, felt that it would be in the best interests of the association for this transaction to take place.

Mr. BARNARD. Was that capital replaced? Did they sell the stock subsequent to that?

Mr. GRAY. Well, it is in the process of being replaced. I think they have a commitment to do so within 18 to 24 months.

Mr. BARNARD. Let me get back to the six FSLIC-insured institutions that had financial dealings with ESM. We ask whether the latest two examinations of those institutions—if those examinations mentioned or criticized their dealings with ESM?

Mr. GRAY. As I recall—and you are talking about the six—there were comments on several of them. On others apparently there was not.

Mr. BARNARD. I think there was a mention of it on two of the examinations but not the other four.

Mr. GRAY. That is right.

Mr. BARNARD. Is there any reason why it would not have been uniform?

Mr. GRAY. Well, apparently the reason that there was no comment is because their position could have been de minimis or could have been closed out in these instances.

Mr. BARNARD. As you can see—all the members of the panel—we are concerned about security dealers, and what it has done, especially as far as this particular situation in Ohio is concerned. And frankly, I guess that is much of the reason why we are having these unfortunate hearings today.

I guess it is unfortunate, likewise, that the Federal Reserve has not anticipated this sort of event coming for a long time. And I would just like to quote from some testimony given by Mr. Tony Solomon, who was president of the New York Fed back in May 1982. When he testified before the Senate Banking Committee concerning the Drysdale collapse he said, and I quote, ". . . [I]n today's situation, with everybody traumatized by what has happened [in the Drysdale situation] and looking very carefully and reviewing their situation, I would say it was extremely unlikely that there is another Drysdale around."

Now, Mr. Martin, in view of that, and we have had since Drysdale, Lombard-Wall, the Lion Capital, and now ESM. How many—what is the attitude now of the Fed regarding these nonregistered security dealers?

Mr. MARTIN. Mr. Chairman, as my colleague, the new President of the Federal Reserve of New York, has this week testified before another committee of the House of Representatives, we are aware that the volume of trading in these markets is enormous, as I alluded to before. We are aware that there may be need for additional flows of information, additional analysis, even additional supervision. We are going to go ahead, as of May 1, and initiate a reporting—voluntary admittedly—reporting process for the secondary dealers in this market. We are gathering information and reviewing the situation given ESM and just the volume of trading there.

Mr. BARNARD. You would not agree then with the statement that [your supervision of] the Government securities market is really aimed at the maintenance of an orderly market for U.S. debt securities and not at the detection of fraudulent practices or protecting investors?

Mr. MARTIN. Well, the market has of course a whole series of purposes. As a market it is a way of financing our very, very large deficit and the turnover of that deficit. In terms of our responsibility we have not been accorded the specifics in a complete way of protecting depositors or holders of securities, although we make every effort to maintain an orderly market and the sound group of institutions, particularly the primary dealers, because they are the big volume operators.

Mr. BARNARD. In other words, are you saying that if the normal bank examination and supervisory procedures are carried out—so far as banks are concerned and savings and loans—the institutions do not need any more protection, from the standpoint of registering all security dealers?

Mr. MARTIN. I think that every involved agency, State or Federal, can afford to sharpen its procedures in reviewing these kinds of

relationships, to see how adequate they are given today's markets. But I am not here to advocate additional regulations.

Mr. BARNARD. Mr. Martin, in 1980, the Federal Reserve participated with the Treasury and the SEC in a study of fraudulent practices in the Government securities market. What steps has the Federal Reserve taken as a result of that study?

Mr. MARTIN. We have enhanced our examination procedures and instructions to our examiners. We have stepped up our surveillance of the primary dealers in New York through a kind of a suboffice headed by Edward Ging of the Fed of New York, so that we get more information more regularly, do more analyses, have more people, person hours devoted to that process at the Fed in New York.

Mr. BARNARD. Do you feel like that is a satisfactory solution to the present problem?

Mr. MARTIN. I think, sir, that we—I am sorry to be repetitive. I believe that our present review of those procedures will lead us to an answer which we do not have at this moment. I would say it warrants restudy and reappraisal which we are in the process of doing.

Mr. BARNARD. Mr. Martin, I think that, in my own opinion, and I will speak for myself personally, I think the Fed acted very responsibly in this situation. And I think that we probably set some precedent in the involvement of the Fed in these State-chartered institutions, which were also privately insured.

I think the question which everyone has on his mind now is whether the Federal Reserve stands ready to act promptly to supply liquidity to prevent the type of mass closings of even healthy institutions which occurred in Ohio.

Mr. MARTIN. I can only say, Mr. Chairman, that we have learned from this experience. We appreciate the various comments the committee members and the chairman have made with regard to our performance here. We have learned from it. And there is no question of our commitment to you and to the public to act promptly. I think somebody, some official in the Bank of England 100 and some years ago, said in these situations you lend, you lend boldly, and you keep on lending.

Ms. HORN. And I would just add, if I might, Mr. Chairman, that in the Ohio case we did not refuse a single request for liquidity.

Mr. BARNARD. It is interesting, Ms. Horn, though, that in view of all the needs that were developed—in Ohio—was the Fed not surprised by the small amount of requests that they had?

Ms. HORN. Yes, I think that is a fair statement. In fact, we were prepared for more than a week for the requests to come in. We communicated with the institutions about their possible needs. The requests were slow in starting up, as confidence deteriorated, the situation became more severe.

Mr. BARNARD. Do you think this came about because of the wide publicity that was given to the fact that the Fed was involved and that the Home Loan Bank Board was doing all they could to bring other institutions—do you think that that sort of stemmed the need for this additional borrowing?

Ms. HORN. There is no question about it; these institutions run on confidence, even more than they run on cash. And we tried to

make public statements occasionally, when it seemed appropriate, to indicate the Federal Reserve's participation in the situation, and we believe that added to the public confidence.

Mr. BARNARD. One last question I would like to ask of Mr. Selby. In 1977, the Office of the Comptroller of the Currency had substantial supervisory experience involving ESM Government Securities that painted the firm in a highly damaging light. I think you have pretty well testified that your concerns ran so deep that some criminal referrals were made involving the National Bank of South Florida's dealings with ESM. Agreements were entered into with six national banks in Florida prohibiting them from doing any business with ESM. And you wrote the presidents of all national banks warning against the types of securities transactions that ESM regularly offered.

You did alert the SEC as to your concerns and you did provide some information to the FDIC and the Florida comptroller.

You did not, I presume, communicate it at all with your State counterparts. I think we are repeating testimony here but I want to get it for the record. And there was no attempt to sit down and coordinate with the other Federal banking agencies in a concerted enforcement actions against ESM. Knowing what you know now, do you not think that ESM could have been stopped or its tactics exposed years ago, if Federal and State banking and securities agencies had acted together?

Mr. SELBY. Well, I do not know that we could have stopped ESM. I do not think that was our responsibility to say, to make a determination whether ESM was performing illegal transactions. Our responsibilities were to see that the banks were operating in a safe and sound manner. And to avoid having the banks, the national banks particularly, participate in any kind of transactions that might accrue loss to them. And I am not terribly sure I would know how the Federal banking agencies could say to the world at large that an ESM is not—you do not do business with an ESM.

We referred it to the SEC. And I think that was our obligation. I do think in retrospect maybe that we could have, among the Federal agencies, and perhaps even the State agencies, done a better job in talking about an ESM, and all we could do is to share our experiences with ESM. I do not think we could tell the Federal Reserve or the FDIC or the Federal Home Loan Bank Board, "Here is a firm that we suspect of doing illegal things."

Mr. BARNARD. Well, you know, I understand that. And of course, it is very obvious that everybody dealing with ESM did not have losses.

Mr. SELBY. That is right.

Mr. BARNARD. It is very obvious that somewhere along the regulatory process there was some slippage here. Those who did not have segregated accounts, and who did not have trust receipts, they seem to be operating with some regular——

Mr. SELBY. I think we could do a better job, and I think we are doing a better job in disseminating information to the industry. We all along have issued these banking circulars and assurances on the securities transactions. The 1977 was not the only one. We have done it all along, and as a matter of fact, right now I am chairman of the task force on bank supervision under the FFIEC,

and the counsel has approved a drafting of a new circular that will be sent out by all five agencies, talking about these very same things. This was started back in the fall of last year.

Mr. BARNARD. That is the Federal——

Mr. SELBY. The Federal Financial Institutions Examination Council.

Mr. BARNARD. Mr. Gray is Chairman of that.

Mr. SELBY. Mr. Gray is now Chairman of it, that is correct.

Mr. GRAY. I am the Chairman, and we will be looking into this very carefully and closely in the future.

Mr. BARNARD. Mr. Craig.

Mr. CRAIG. Two last questions. First of Mr. Martin and Ms. Horn.

Your activity and the method by which you approached the problem in Ohio and the ability that you could move in was entirely within the law and you were responding to the law as it currently is?

Mr. MARTIN. Yes, sir. We have alluded several times to the Monetary Control Act of 1980 and that is exactly what you all intended us to do——

Mr. CRAIG. That is correct.

Mr. MARTIN. For depository institutions.

Mr. CRAIG. And because of that law you were able to respond in a timely and necessary fashion to the needs of those institutions?

Mr. MARTIN. Yes, sir.

Ms. HORN. That law, and our general approach of wanting to be cooperative with everybody in trying to fashion a solution enabled us to respond in a timely and necessary fashion.

Mr. CRAIG. Thank you.

Mr. Gray, I may make the mistake of quoting from the Wall Street Journal in light of concern about its reporting today, I have here a March 18 Wall Street Journal page with a listing of the activities on a day-by-day basis of the Ohio S&L crisis. I see that on March 9–10, Home State closes. In your testimony, you say on Wednesday evening, March 13, representatives of the Federal Home Loan Bank of Cincinnati examined State reports on Ohio Fund members to make a preliminary estimate of their eligibility for FSLIC insurance.

Why did that Home Loan Bank move at that time?

Mr. GRAY. I think we wanted to move as quickly as we could and we employed the information which we had at that early date to try to get a fix on the situation to the extent we could.

I think much of the information we had at that time was relatively cursory. But we were at least trying to get a feel.

Mr. CRAIG. The Cincinnati board moved on your instruction?

Mr. GRAY. Yes.

Mr. CRAIG. That was how many working days from the time of the public-announced closure of Home State?

Mr. GRAY. Two days.

Mr. CRAIG. Thank you very much. I have no further questions at this time, Mr. Chairman.

Mr. BARNARD. Mr. Kindness.

Mr. KINDNESS. Thank you, Mr. Chairman.

Just one quick question for Chairman Gray. There was some questioning a little while ago which had to do with whom you had

breakfast with on what day, and that sort of thing. And regrettably it is the sort of thing that happens around here once in a while, and you were interrupted constantly. Is there anything else you wanted to say on that subject?

Mr. GRAY. I certainly would.

Mr. KINDNESS. I regret that Representatives Oakar and Luken could not stay, but——

Mr. GRAY. Thank you very much. Well, I appreciate the opportunity.

I read with considerable interest the article in the Wall Street Journal. Frankly, substantial portions of that article were inaccurate, misleading, distorted, and just plain wrong.

It is interesting to note that the author of the article made no attempt at all to solicit my views or my account of our involvement and the efforts which we made. I note that a substantial portion of the article is given to the comments of at least two Members of Congress who have had a disagreement with me over the way we have handled this situation.

I want to point out again that I wanted to send the general counsel to the meeting at the Federal Reserve because I felt that he could provide the kind of information that the Members of Congress and the members of the Ohio thrifts could use. And I felt that at that time it was more appropriate for me to meet with Members of the Congress as soon as possible. And in that evening meeting we extended the invitation through the general counsel to meet in my office the following morning at 11:30. There was no mention of that in the article that Congresswoman Oakar chose not to come to that meeting. And I regret of that. Mr. Luken did.

Another part of the article says that only after some resistance did I let Democratic Representative Luken and one thrift executive join a meeting with Republican Representatives from Ohio. The fact is that Mr. Luken was invited and was obviously a part of the group that came. We did not show any resistance to let him in at all.

Mr. Gradison, one of your colleagues, a Representative from the State of Ohio, told me yesterday that he was not completely quoted in his remarks. In fact, he told me that when he was quoted as saying, "I wonder, too, if political considerations were placed above confidence in and the integrity of the financial system," as is written in the article, the Wall Street Journal left out another part of his statement which clarified it substantially. What he furthermore said was, "There is no indication that that happened."

There is also a suggestion that Mr. Volcker was urging me to expedite the insurance process. Well, you know, as I have already discussed before, I met with Chairman Volcker on the final evening of the bank holiday. I have talked with him for more than 2 years now and he has never called to question, or asked about, a course of action taken by the Federal Home Loan Bank Board—ever!

And I have had some differences, as you may know, with the Treasury from time to time on particular matters. They have been expressed. We do share information with the Department of the Treasury, because after all that is headed by the Chief Fiscal Officer of the United States, just as we share information with the Chairman of the Federal Reserve Board and members of the Feder-

al Reserve Board because it is their responsibility to maintain the integrity and financial stability of this country.

Such communications are a responsible course of action. And we also exchange information with our fellow financial regulators in all of the Federal financial regulatory agencies. That is also a prudent, long established practice.

So I thank you for the opportunity to make my comments, Congressman.

Mr. KINDNESS. Thank you. I am sorry it was necessary.

Mr. BARNARD. Gentlemen, we thank you, and, lady, very much for being with us today. And you certainly have contributed tremendously to this.

I just want to say in closing, we all are concerned about maintaining the confidence in our financial institutions. And certainly I do not have to preach to you about how much we are indebted to you and your organizations in helping us maintain that confidence in the public sector for our financial institutions.

And I sincerely hope that you will continue. We have had some traumatic experiences in the last 4 or 5 years. We have had Penn Square. We have had United American. We had Empire. No regulatory agency has been left out of this, possibly except for the Fed, and you have been lucky.

But we need your continual vigilance in what you are doing in order to help us maintain the confidence in our financial institutions.

Thank you very much.

Mr. GRAY. Thank you.

Mr. BARNARD. Our next panel consists of Charles C. Hogg II, who is president of the Maryland Savings-Share Insurance Corp.; Ms. Pamela A. Hathaway, executive vice president of the Pennsylvania Savings Association Insurance Corp.; Donald R. Beason, president of the Financial Institutions Assurance Corp. of North Carolina; Leonard Lapidus, executive vice president, Mutual Savings Central Fund of Massachusetts; and James L. Burns, Jr., executive vice president of the Cooperative Central Bank of Massachusetts.

We will begin with Mr. Hogg and then go with Ms. Hathaway on across the table and following that, we will have our questions. Mr. Hogg.

STATEMENT OF CHARLES C. HOGG II, PRESIDENT, MARYLAND SAVINGS-SHARE INSURANCE CORP.

Mr. HOGG. Mr. Chairman, members of the subcommittee, it is my pleasure to be here and to address you on this very important issue that is being discussed this morning.

I have submitted complete testimony and a very complete questionnaire. I would request that that be entered into the record.

Mr. BARNARD. Without objection, your entire testimony will be in the record and you may summarize at your convenience.

Mr. HOGG. I will do that, sir.

My name is Charles Hogg. I am president and chief operating officer of the Maryland Savings-Share Insurance Corp., referred to as MSSIC.

MSSIC was created in 1962 by a special act of the Maryland General Assembly for the purpose of providing a viable form of deposit insurance for State-chartered savings and loans.

Our purpose is, in addition to insuring accounts are to facilitate the flexibility of our industry and to provide liquidity.

Currently MSSIC insures 102 State-chartered savings and loans, all of whom have their principal offices in Maryland. These members have assets of about $8.9 billion and savings of $7.2 billion.

The figures I will give you for MSSIC are as of December 31, 1984. They were audited with an unqualified opinion by Touche Ross & Co.

We had total assets at that period of $204 million. Our reserves are $166.8 million. The components of the reserves, as we calculate them, are the capital deposits from our members of about $144.3 million, retained earnings over the 23 years of operation of $17.5 million and a reserve for insurance losses of $5 million, therefore totally $166.8 million.

In addition MSSIC maintains a central reserve fund, which has as its primary purpose liquidity, of $80.8 million. We maintain, with a group of five banks, a line of credit equal to $60 million.

The most important point in my testimony to you today will cover the highly sophisticated regulatory and supervisory system that we have in Maryland in dealing with the State-chartered, MSSIC-insured industry.

This regulatory system includes a very complete monthly report submitted to us by each member whose assets exceed $3 million.

The data on the reports gives us complete knowledge of compliance or noncompliance of members with our regulations. We have a sophisticated data processing system into which the monthly reports are input against the programming of that data. Our highly qualified staff then follows up on exceptions and trends and highlights that the computer output gives us.

An important aspect of our operation in Maryland is close coordination with the State through the division of savings and loan associations which is an agency of the department of licensing and regulation and the true State regulator of the industry.

This coordination includes both exchanging of exams and reports, and cross attendance at board meetings. By that I mean I attend meetings of the board of commissioners. Mr. Brown, from whom you will hear later, attends the MSSIC board meetings. We hold joint supervisory conferences. My staff attends the exit interviews of the division. When they complete an examination of an institution, we get a copy of that examination and we get a copy of the institution's reponse to the comments in the examination.

So, while there is total coordination of our effort, there is independent analysis. The coordination then has to do with dealing with potential problem situations.

We believe that in the insurance company, that we are managing risk through the monitoring of our institutions and through quick, effective response to potential problems.

Both the State and MSSIC are active in our role in dealing with our members, both in examination and in taking corrective action. It has been said today here, many times, that the key to any depos-

it insurance system is confidence. We believe that, obviously. We also think liquidity being strong is also important.

Liquidity in the MSSIC system at yearend was over 16 percent among our members. In addition our members maintain lines of credit with commercial banks. We have proven access, and this topic has been talked about many times this morning, to the Federal Reserve Bank discount window.

MSSIC sources such as its central reserve fund and its own line of credit are also important, so we think both cash and confidence are important in dealing with these problems.

In summary, we know our industry, we respond quickly to problems. We know our jobs and we do them well.

At the appropriate time I would be delighted to answer your questions. Thank you, sir.

[Mr. Hogg's prepared statement follows:]

Testimony of Charles C. Hogg, II
before
Commerce, Consumer and Monetary Affairs Subcommittee
of the
Committee on Government Operations
April 3, 1984

I am pleased to appear before the Subcommittee to present my views on the state/private deposit insurance systems and to discuss in particular the Maryland Savings-Share Insurance Corporation (MSSIC). My testimony will provide brief background on MSSIC and respond to the four topics listed in Chairman Barnard's letter of March 22, 1985.

MSSIC was created in 1962 by a special act of the Maryland General Assembly for the purpose of providing a viable alternative for deposit insurance for state-chartered savings and loan associations. In the early 1970's Maryland law was changed to require deposit insurance for all savings and loans in the state, and MSSIC and the Federal Savings and Loan Insurance Corporation (FSLIC) were the only providers authorized. The Charter of MSSIC appears at Title 10, Financial Institutions Article, Annotated Code of Maryland. The stated purposes of the Corporation are listed there as follows:

"(1) Promote the elasticity and flexibility of the resources of members;

(2) Provide for the liquidity of members through a central reserve fund; and

(3) Insure the savings accounts of members."

The operations of MSSIC are directed by a Board of Directors comprised of three members appointed by the Governor of Maryland and eight members elected from among representatives of member associations. The Board of Directors employs a staff of financial professionals to implement Board policies. I am President and Chief Operating Officer. In addition to the Board of Directors, we have a Membership Committee which meets monthly to review the operations of the member associations and to determine the eligibility of new associations for membership.

Our analysis of the operations and financial condition of member associations is an

active, not a passive, one. Each member whose assets exceed $3 million is required to submit monthly a complete financial report which includes a balance sheet, income statement and supplemental data. This information is entered into an IBM 34 computer which is programmed to point out exceptions to all of our rules, regulations, guidelines and policy statements. In addition the computer provides reports on trend analysis, margin analysis and any change beyond established parameters. These reports are reviewed by our financial analysts, and presented to the Membership Committee and Board. Most importantly, our staff follows up on the reports by on-site visits to and review of the operations of selected institutions high-lighted by the reports. These visits and reviews may include checking on securities portfolios, loan files, operating expenses and other specifics areas of interest, or they may entail a complete review of the operations of the institution.

In addition to our major data processing efforts, our staff uses an IBM Personal Computer to perform selected analysis on member associations as well as for internal uses.

To supplement the analysis and review conducted by my staff, we have complete access to the examinations and files of the Division of Savings and Loan Associations (the Division), the state agency with regulatory responsibilities for the state chartered industry. Members of my staff attend the Exit Interviews conducted by the state upon completion of an examination of an institution, and we receive at the same time as the institution a copy of the Examination Report, and subsequently, a copy of the institutions response to comments in that examination. Coordination between MSSIC and the Division is further enhanced by the Director's attendance at MSSIC Board meetings,and my attendance at meetings of the Board of Commissioners. Our staffs and senior officials meet frequently to coordinate our efforts in dealing with potential problem associations and to insure that total, complete and free lines of communications exist. Copies of correspondence between our offices and member institutions are regularly

Mr. SAXTON. Is there any danger in having member institutions actually represent themselves and control themselves? Is that a built-in problem with private insurance funds?

Mr. GRAY. There is always the potential for conflict of interest, although I say that generically, without any great knowledge of the Ohio Deposit Guarantee Fund. And in our efforts to protect the FSLIC, of course, we do have conflict-of-interest regulations which are intended to deal with that problem.

Mr. SAXTON. I am not so concerned perhaps about actual conflict of interest. I am just concerned about who watches the henhouse better, someone who is completely disassociated with an organization or someone who has a rather close association with member institutions.

Mr. GRAY. I think as a general proposition it would be better to have independent governors for that kind of system.

Mr. SAXTON. Thank you, Mr. Chairman.

Mr. BARNARD. Mr. Kindness.

Mr. KINDNESS. Thank you, Mr. Chairman. I will not impose on the time of the subcommittee further with regard to this panel. Thank you.

Mr. BARNARD. Ms. Oakar.

Ms. OAKAR. Thank you, Mr. Chairman.

Ms. Horn, you testified that on March 9 you took action and made some initiations with respect to the impending crisis in Ohio. I want to congratulate you and the Fed on that. You did it under the spirit of the law. But you took that initiation, and I think that it did play a role, at least temporarily, in giving some element of confidence to the situation. I just wanted to congratulate you on that.

Mr. Gray, Mr. Craig asked a very important question which is why I am so interested in potential conflicts of interest. I think what the distinguished minority leader asked was has the Federal Home Loan Bank Board acted or ever had a situation that was extraordinary in which they really took the bull by the horns and acted. I think you answered, not to your knowledge. I am concerned about some of the transactions. For instance I look at the situation with the Financial Corp. of America and its subsidiary in California that had a run on it. I think that was fairly extraordinary. Their subsidiary had some real problems. What the Federal Home Loan Bank Board did, and I realize they were federally insured, but you did extraordinary things. The institution was given unlimited borrowing rights exceeding normal collateralization——

Mr. GRAY. That is not correct.

Ms. OAKAR. Well, how much of the borrowing——

Mr. GRAY. That is absolutely not correct.

Ms. OAKAR. How much has the Home Loan Bank Board lent this institution since October?

Mr. GRAY. From October 31, 1984, to March 31, 1985, the Federal Home Loan Bank of San Francisco advanced $5.6 billion to American Savings & Loan Association in California. During that same period, American repaid $6.5 billion, for a reduction in its net outstanding advances from the San Francisco Bank of about $900 million. I would also note that in every instance, Congresswoman Oakar, the only credit that has been provided to any of our institu-

tions, including American, has been under the collateralization requirements that are imposed by the individual Federal Home Loan Banks.

Ms. OAKAR. Let me just say this. Mr. Chairman, it is my understanding that they have lent at least $4 billion which is no small amount of money. By the way, that approximates the total assets of all 72 institutions that were nonfederally insured, so that was a pretty extraordinary undertaking. I point that out because there have been extraordinary situations. And you may have been right about it, but if I can pursue this. That is why I am concerned about the rumors, and innuendos, concerning your actions or nonactions related to the Ohio situation.

I asked you two questions before the full Banking Committee and I asked you very specifically did you, prior to March 13 or any day thereafter, get any advice on how to handle the situation from the Secretary of Treasury or anybody from the White House. You answered that was not relevant. You would not answer it.

Then we have a situation whether it is accurate or not, in which the Wall Street Journal publishes an article that says, indeed, Secretary Baker discussed this issue with you after having a meeting in terms of how to decide what the Federal response should be. They concluded that if the crisis developed it should remain a problem of the Democratic administration in Ohio.

The role that the Federal regulators should play, whether it is the Federal Home Loan Bank Board or the Federal Reserve Board, should be above politics. I do not understand why you would not answer the questions during the Banking Committee hearing, but I will give you another chance now.

Mr. GRAY. I have been waiting for your question which I am happy to answer.

Ms. OAKAR. Good. I think you could have solved a lot of problems on March 27 if you had answered my two questions.

Mr. GRAY. Well, let me just say, with all due respect to you as a Member of the Congress of the United States, any innuendo, any discussion of partisan politics, was raised by you and certainly not by me. For example, and the record will show this, you referred to the upcoming Governor's race in Ohio.

Ms. OAKAR. That is right.

Mr. GRAY. You referred to my failure to meet with members of both sides of the aisle, Democrats as well as Republicans. Now, you know full well that an invitation was extended to you and Congressman Luken and to others, to come to my office——

Ms. OAKAR. That is right.

Mr. GRAY [continuing]. To meet with me——

Ms. OAKAR. And you know full well why I did not attend.

Mr. GRAY. Well, no, I do not.

Ms. OAKAR. Because you chose to meet with Congressman Wylie privately after we had all agreed on an 11:30 meeting, you chose to meet him for breakfast and my colleague from Ohio can verify that.

Mr. LUKEN. If the gentlelady will yield.

Ms. OAKAR. I will be happy to yield.

Mr. LUKEN. That is exactly what happened. We have the floor. We will ask you the questions.

Mr. GRAY. Well, just a minute. She just made an observation and I am going to answer it.

Mr. LUKEN. Are you running this, Mr. Chairman.

Mr. GRAY. Let me just say, Congresswoman Oakar, that the meeting I had with Congressman Wylie had been set on my calendar 3 weeks before and it was to deal specifically with legislation which was introduced by request by Congressman Wylie and by Chairman St Germain of the House Banking Committee. That was the purpose of that meeting.

Ms. OAKAR. Let me yield to my colleague.

Mr. LUKEN. As the gentlelady has said, at extensive meetings on March 13, with your counsel, we attempted to get a meeting with you that night. Sixteen or more representatives of savings and loans of Ohio were present pleading to meet with you. You were unavailable we were told until 11:30 the following morning. That is what we were told by your counsel seated here today. You were not available until 11:30. Mr. Wylie was there. At 9:30 the following morning Mr. Wylie called me and said he had had breakfast with you, had discussed these issues, and told me what your decisions were. Those are the facts. I repeat, he called me at 9:30, said he had breakfast with you. I was shocked. And he had discussed these issues and he laid out what the decisions were which you later confirmed.

I yield back to the gentlelady.

Mr. GRAY. Well, I cannot speak for Congressman Wylie, but I did tell him at breakfast, which began at 8, that the Bank Board was going to make a very strong effort to expedite applications as soon and as quickly as possible.

Mr. BARNARD. Just a second. Let me advise that we owe Mr. Luken time now. Ms. Oakar's time has expired.

Mr. GRAY. I did not answer, her question which I think——

Mr. BARNARD. I mean I think they are participating together on that.

Mr. LUKEN. I will proceed. Mr. Gray, we did meet with you on March 13, and I will say right now that if you had taken action at that time as we requested, that the closings of Friday, March 15, would not have occurred. Now, I want to say exactly why I say that. First of all, your statements are inconsistent with those of Congressman Gradison and Congressman Wylie, as indicated in the Wall Street Journal.

Mr. Wylie said that you did stall at that time. Mr. Gradison states that you have reversed yourself since. Now, I want to ask you—on March 13 did we ask you to waive the 10-day waiting period? The 10-day notice period? And what was your answer?

Mr. GRAY. Counsel advised me, and you were there, that there was a 10-day notice period which had to be observed.

Mr. LUKEN. And we pleaded with you to waive it and you said, "no way," did you not?

Mr. GRAY. Well, I take the advice of my lawyer, who probably knows more about these things than I do.

Mr. LUKEN. Did you take it a week later when you did waive it?

Mr. GRAY. Yes, I did.

Mr. LUKEN. Oh.

Mr. GRAY. On the advice of counsel.

Mr. LUKEN. It is his fault. And at that we asked you to apply extra help to get other examiners in, and did you not tell us that you were stretched so thin——

Mr. GRAY. That is right.

Mr. LUKEN. That you could not possibly get any more help.

Mr. GRAY. That is essentially correct.

Mr. LUKEN. And a week later you found all that help that you have just been describing.

Mr. GRAY. Well, you know, on Sunday evening, as my testimony indicates, I met with Chairman Volcker in his office and at that time Chairman Volcker pledged to the Federal Home Loan Bank Board as many examiners as we would need to bring about the expeditious processing of these applications.

Mr. LUKEN. You had Chairman Volcker's people with you on March 13, and did you or did you not tell us that it was an Ohio problem, quote "You are in the wrong city. You should be in Columbus"? Did you say that, Mr. Gray?

Mr. GRAY. I said I thought that individuals should be at the State capital talking about this problem.

Mr. LUKEN. And when we pleaded on behalf of the depositors, did you or did you not say that the depositors should have known that they were not federally insured when they deposited in the State institutions?

Mr. GRAY. You know, I do not recall that statement, but I did——

Mr. LUKEN. Well, I will refresh your recollection. You did.

Mr. GRAY. Well——

Mr. LUKEN. And when we talked about the savings and loans and helping the depositors, you said "After all, the savings and loans had the opportunity previously to join FSLIC and they had refused it." You did not say that once. I bet you said that at least six times in our brief meeting.

Mr. GRAY. That is a historical fact.

Mr. LUKEN. And then you would characterize that as cooperative, that you were going to extend yourself? Those reactions that you were extending yourself for the depositors?

Mr. GRAY. You know, I said repeatedly, Congressman, that the Federal Home Loan Bank Board and the FSLIC were committing to do everything possible to expedite applications for insurance of accounts as quickly as possible.

Mr. LUKEN. But you said you had no help. You had no legal authority. How were you going to expedite it if you did not have anybody to apply to processing the applications. And if you had to follow the law, which you said could not allow you to expedite it. And finally, I want to ask one more question.

When the representative of the S&L, his last question to you was, "Give us 30 days. We will close for 30 days and can you examine these in 30 days," and you said you would not even consider it. Is that not true?

Mr. GRAY. I said that with a very severe shortage of 750 examiners around the country that would not be possible, and that was in specific response——

Mr. LUKEN. But you have managed to do it in the last 2 weeks.

Mr. GRAY. But let me finish what I am saying. That was in specific response to a suggestion that all of our examiners be deployed summarily to the State of Ohio.

Mr. LUKEN. No. That was not the——

Mr. GRAY. Well, it certainly was.

Mr. LUKEN. The suggestion was—would you at least——

Mr. GRAY. Congressman Gradison made that suggestion.

Mr. LUKEN. It was not Congressman Gradison. It was the representative of the thrift, and he said that if we close for 30 days—he said he recognized it that you were not going to help, so he said if we close for 30 days will you at least examine them within that 30 days. And you said, "No way." You would not even consider it. And now you are saying that you have already done it in less than 30 days.

Mr. GRAY. Well, now, I have tried to explain to you that on the following Sunday evening, Chairman Volcker pledged the full support of the Federal Reserve and as a matter of fact, has provided 140 examiners—140—to help the Bank Board in this process.

Ms. OAKAR. Chairman Volcker has been great. Will the gentleman yield? I just have to ask you the question.

Did Secretary Baker ever call you and tell you to stall and stonewall the Ohio crisis?

Mr. GRAY. I am glad I get a chance to answer your question.

Ms. OAKAR. Mr. Chairman, I think he should answer. Whatever you want to do. You are investigating it, so maybe you can get it in writing.

Mr. GRAY. I am glad I get a chance to answer that question. I would like to do it briefly.

First of all, the Federal Home Loan Bank Board has traditionally, over many, many years, exchanged information with the Treasury, which is under the Chief Fiscal Officer of the United States, with other regulatory agencies, including the Federal Reserve. And we have continued to do that. Particularly in extraordinary situations.

Now, I want to assure you that I have never taken instructions from anyone, anyone, whether in the White House or Treasury or anywhere else, nor has any other member of the Federal Home Loan Bank Board because, in all honesty, we are an independent agency.

Ms. OAKAR. But did you discuss the politics in Ohio?

Mr. GRAY. I absolutely never discussed any kind of politics in the State of Ohio.

Ms. OAKAR. Well, it is referred to in the Wall Street Journal article.

Mr. GRAY. Well, that is pure unadulterated fiction. Because no one ever called me to talk about politics in Ohio. The first time I ever became aware of the plan alleged in the Wall Street Journal was when I read it in the Wall Street Journal.

Ms. OAKAR. I do not think the question has been answered specifically, but I will leave that to the committee to investigate.

Mr. BARNARD. Thank you very much.

Ms. Horn, how much did the Federal Reserve Bank lend out of its discount window to these Ohio institutions?

Ms. HORN. Altogether——

Mr. BARNARD. I am not asking you individually, but cumulatively?

Ms. HORN. Altogether, throughout this whole period, we have lent in the range of $70 million.

Mr. BARNARD. $70 million.

Ms. HORN. That is a cumulative figure. Of course, it has been paid back.

Mr. BARNARD. For the uninformed, all of that had to be secured.

Ms. HORN. Yes, it was secured.

Mr. BARNARD. And what maturities are you working on for those loans?

Ms. HORN. They are relatively short-term loans.

Mr. BARNARD. Two weeks? Four weeks?

Ms. HORN. We do not have a designated maturity, but we have overall guidelines limiting the frequency that an institution can obtain adjustment credit. I cannot answer your question with a specific number of days, but we are talking about short periods of time.

Mr. BARNARD. Do you think that in some of these more troubled institutions that—even though you are secured—you will be a little bit more liberal in renewing these discount notes?

Ms. HORN. There is no question about it. The guidelines are in place so that we can use judgment in respect to them. As we review the needs of the institutions, we will be adhering to the guidelines——

Mr. BARNARD. And you are not setting precedent here? This precedent is already established?

Ms. HORN. I do not quite understand the question.

Mr. BARNARD. Is this the same practice that you use with other member banks?

Ms. HORN. Absolutely.

Mr. BARNARD. Mr. Gray, did any of the 14 Ohio institutions involved, which were members of the Cincinnati Home Loan Bank, apply formally or informally for credit?

Mr. GRAY. No, they did not.

Mr. BARNARD. Now, we want to get—well, one other question, Mr. Gray. Because of this situation in Ohio, do you recommend a more formal association with State savings and loan agencies or even State private insurance funds, such as the exchange of examinations and so forth? Especially since you are subject to be called on to either—no, you are not necessarily, but Mr. Martin is, the Federal Reserve is subject to be called on as far as the discount window is concerned. Of course, you are not eligible to loan to these State-chartered institutions. Am I correct?

Mr. GRAY. That is correct——

Mr. BARNARD. The Home Loan Bank Board——

Mr. GRAY [continuing]. As to Ohio institutions that were not members of the Federal Home Loan Bank of Cincinnati.

Mr. BARNARD. Mr. Martin?

Mr. MARTIN. Mr. Chairman, I would assure you that the results of the Ohio experience, since it is the most recent of its type, will be communicated in our training sessions with the various officers, discount officers, and others within the whole Federal Reserve System, and will be communicated to those State officials who are

working with our Federal Reserve bank presidents and officials in the so-called training and orientation to improve both their and our operations. This experience will not go on the shelf.

Mr. GRAY. Incidentally, Mr. Chairman, we do exchange information of a supervisory nature with other State savings institutions regulatory agencies.

Mr. BARNARD. Including Ohio?

Mr. GRAY. With the State regulatory agencies.

Mr. BARNARD. Do they exchange information with you though? That is the question. Now, I mean, are they furnishing you a copy of their examinations?

Mr. GRAY. Well, we are really talking here about FSLIC-insured institutions.

Mr. BARNARD. OK, yes. We need to, at this point in time, move our discussion to some of the practices—policies and practice of supervisory agencies, especially as it is associated with ESM. And I will ask all of you this. What procedures—Home Loan Bank Board, Comptroller, and the Federal Reserve—are your examiners supposed to follow, during the examination process, to verify that an institution which has entered into a repo agreement has actual possession of those securities?

Mr. GRAY. Well, in the case of the Federal Home Loan Bank Board, repos and reverse repos are subject to two levels of review. The first is the required annual audit by an accounting firm. Audit procedures require verifications. The second level of review would be during an actual examination of the institution. Examinations procedures would require verification that the association's records of the transaction were complete, adequately maintained, and they would further require a review of such transactions to see if they were in keeping with the Bank Board's regulations and guidelines. Unusual positions or violations such as excess collateralization which we have dealt with in guidelines which were issued on July 13, 1981, would warrant comment and further investigation by our supervisory personnel.

Mr. BARNARD. Mr. Martin?

Mr. MARTIN. Our examiners, according to a series of instructions, written instructions, they have in these matters, check on the documentation, check on the credit worthiness of the institutions with which the banker is dealing, check on the internal auditing procedures within that bank with regard to documentation, location of collateral and so forth, and on and on. We have a rather elaborate system of checking in it.

Mr. SELBY. Well, our examiners' handbook requires that our examiners verify that the banks have taken possession of the securities period.

Mr. BARNARD. In that event then, Mr. Gray, were these procedures followed in the September 1984 examination of the American Savings and Loan?

Mr. GRAY. Yes, I believe they were.

Mr. BARNARD. Did you know that American's securities were mixed in with everybody else's in ESM's account at Bradford Trust?

Mr. GRAY. Yes, yes. Bradford Trust? Let me say, that I am a bit hesitant, in all candor, to talk about it.

Mr. BARNARD. I beg your pardon?

Mr. GRAY. I am a bit reluctant in all candor to talk in this public forum about an ongoing institution where confidence is important and certainly we would be pleased to provide members of the subcommittee with this information privately. I really am reluctant to get into great detail publicly because of the possible harm it could cause to any individual institution.

Mr. BARNARD. I can understand that, Mr. Gray, and we certainly do concur with you in that particular situation.

Mr. Gray, the subcommittee has information that on a number of occasions between 1980 and 1985, the Federal Home Loan Bank Board in its examination supervisory capacities came across unsafe and unsound transactions involving ESM. For example, in 1980 and 1981, the Bank Board participated in a joint examination of Unity Savings Association of Chicago and the issuance of a cease-and-desist order involving Unity's $200 million transaction with ESM.

You have advised the subcommittee that in 1982, the Federal Home Loan Bank of Cincinnati was aware of rumors of Home State's dealings with ESM. And yet these rumors were not investigated. In 1983 and in 1984, immediately after ESM's principal founder, Ronnie Ewton, was made a board member and put on the executive committee of American Savings and Loan of Florida, an FSLIC institution, American entered into a large and unsafe transaction with ESM.

You advised the subcommittee that the FSLIC insurance fund is likely to sustain an $8 million loss because of the dealings of federally insured thrifts with ESM.

Could you provide us with more details as to that loss?

Mr. GRAY. I will be happy to provide information for the record.

[The information referred to follows:]

Federal Home Loan Bank Board

1700 G Street, N.W.
Washington, D.C. 20552
Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

OFFICE OF EXAMINATIONS AND SUPERVISION

April 11, 1985

Mr. Peter S. Barash
Staff Director
Commerce, Consumer, and Monetary Affairs
Subcommittee of the Committee on
Government Operations
Rayburn House Office Building, Room B-377
Washington, DC 20515

Dear Mr. Barash:

During the April 3, 1985 hearing concerning Ohio privately insured savings and loans, several matters were discussed regarding which we agreed to provide you with additional information.

Our estimate of an $8 million dollar potential loss to the FSLIC was based upon the situation of two institutions which are now in the hands of the FSLIC. This estimate is based upon the assumption that liquidation will be necessary in these two cases and represents a worst-case scenario. The actual loss may be considerably less depending on numerous other factors.

I have enclosed for your information a copy of our memorandum R 6-2 which discusses over-collateralization of reverse repurchase agreements and provides guidelines for appropriate collateralization levels. This memorandum was referred to by Chairman Gray during the course of the hearing.

Finally, I am enclosing for your information a copy of a phone log from the Federal Home Loan Bank of Cincinnati for the period from March 11 through April 4, 1985. (This is a log of their on-going monitoring of the situation.)

Please let me know if I can be of any further assistance.

Very truly yours,

William J. Schilling
Director

Enclosures

cc: Chairman Gray

Mr. BARNARD. Evidently, we have lost our records of that, Mr. Chairman, but we will find them. Mr. Chairman, based on your supervisory knowledge of ESM's speculative and dangerous transactions with financial institutions, did you oppose in any way the placing of Ronnie Ewton on the board and the executive committee of American Savings and Loan?

Mr. GRAY. American Savings——

Mr. BARNARD. Or to the Home Loan Bank Board?

Mr. GRAY. I do not believe we had anything to say about that in particular. Counsel advises that this is a State-chartered institution.

Mr. BARNARD. Beg your pardon?

Mr. GRAY. Counsel advises that this is a State-chartered institution and, frankly, apparently we do not have jurisdiction——

Mr. BARNARD. It was FSLIC-insured, though?

Mr. GRAY. Yes. It is FSLIC-insured.

Mr. BARNARD. But would not your authority run to that because of that? Because of FSLIC's insurance, would you not have the jurisdiction to make a determination there?

Mr. GRAY. We can only remove a director if there are grounds based on a violation of rules and regulations of the Federal Savings and Loan Insurance Corporation.

Mr. BARNARD. In other words, there was no objection to Mr. Ewton then being on the board of American Savings and Loan?

Mr. GRAY. Not on the basis of our discretionary authority, I gather from counsel.

Mr. BARNARD. Given the large exposure of American Savings and Loan and its ESM transaction and the involvement of Marvin Warner in initiating those transactions, can you give us an explanation why the Home Loan Bank Board permitted the institution to spend $26 million of its precious capital to buy back Mr. Warner's 50-percent ownership in American? Again, because of FSLIC.

Mr. GRAY. The principal supervisory agent of the Federal Home Loan Bank of Atlanta approved this transaction in which American purchased the Warner stock from Shepard Broad. The purchase price was to be replaced either by the association reselling the stock or by the sales of subordinated debt. The principal supervisory agent in this connection, urged by the State of Florida, as I understand, felt that it would be in the best interests of the association for this transaction to take place.

Mr. BARNARD. Was that capital replaced? Did they sell the stock subsequent to that?

Mr. GRAY. Well, it is in the process of being replaced. I think they have a commitment to do so within 18 to 24 months.

Mr. BARNARD. Let me get back to the six FSLIC-insured institutions that had financial dealings with ESM. We ask whether the latest two examinations of those institutions—if those examinations mentioned or criticized their dealings with ESM?

Mr. GRAY. As I recall—and you are talking about the six—there were comments on several of them. On others apparently there was not.

Mr. BARNARD. I think there was a mention of it on two of the examinations but not the other four.

Mr. GRAY. That is right.

Mr. BARNARD. Is there any reason why it would not have been uniform?

Mr. GRAY. Well, apparently the reason that there was no comment is because their position could have been de minimis or could have been closed out in these instances.

Mr. BARNARD. As you can see—all the members of the panel—we are concerned about security dealers, and what it has done, especially as far as this particular situation in Ohio is concerned. And frankly, I guess that is much of the reason why we are having these unfortunate hearings today.

I guess it is unfortunate, likewise, that the Federal Reserve has not anticipated this sort of event coming for a long time. And I would just like to quote from some testimony given by Mr. Tony Solomon, who was president of the New York Fed back in May 1982. When he testified before the Senate Banking Committee concerning the Drysdale collapse he said, and I quote, ". . . [I]n today's situation, with everybody traumatized by what has happened [in the Drysdale situation] and looking very carefully and reviewing their situation, I would say it was extremely unlikely that there is another Drysdale around."

Now, Mr. Martin, in view of that, and we have had since Drysdale, Lombard-Wall, the Lion Capital, and now ESM. How many—what is the attitude now of the Fed regarding these nonregistered security dealers?

Mr. MARTIN. Mr. Chairman, as my colleague, the new President of the Federal Reserve of New York, has this week testified before another committee of the House of Representatives, we are aware that the volume of trading in these markets is enormous, as I alluded to before. We are aware that there may be need for additional flows of information, additional analysis, even additional supervision. We are going to go ahead, as of May 1, and initiate a reporting—voluntary admittedly—reporting process for the secondary dealers in this market. We are gathering information and reviewing the situation given ESM and just the volume of trading there.

Mr. BARNARD. You would not agree then with the statement that [your supervision of] the Government securities market is really aimed at the maintenance of an orderly market for U.S. debt securities and not at the detection of fraudulent practices or protecting investors?

Mr. MARTIN. Well, the market has of course a whole series of purposes. As a market it is a way of financing our very, very large deficit and the turnover of that deficit. In terms of our responsibility we have not been accorded the specifics in a complete way of protecting depositors or holders of securities, although we make every effort to maintain an orderly market and the sound group of institutions, particularly the primary dealers, because they are the big volume operators.

Mr. BARNARD. In other words, are you saying that if the normal bank examination and supervisory procedures are carried out—so far as banks are concerned and savings and loans—the institutions do not need any more protection, from the standpoint of registering all security dealers?

Mr. MARTIN. I think that every involved agency, State or Federal, can afford to sharpen its procedures in reviewing these kinds of

relationships, to see how adequate they are given today's markets. But I am not here to advocate additional regulations.

Mr. BARNARD. Mr. Martin, in 1980, the Federal Reserve participated with the Treasury and the SEC in a study of fraudulent practices in the Government securities market. What steps has the Federal Reserve taken as a result of that study?

Mr. MARTIN. We have enhanced our examination procedures and instructions to our examiners. We have stepped up our surveillance of the primary dealers in New York through a kind of a suboffice headed by Edward Ging of the Fed of New York, so that we get more information more regularly, do more analyses, have more people, person hours devoted to that process at the Fed in New York.

Mr. BARNARD. Do you feel like that is a satisfactory solution to the present problem?

Mr. MARTIN. I think, sir, that we—I am sorry to be repetitive. I believe that our present review of those procedures will lead us to an answer which we do not have at this moment. I would say it warrants restudy and reappraisal which we are in the process of doing.

Mr. BARNARD. Mr. Martin, I think that, in my own opinion, and I will speak for myself personally, I think the Fed acted very responsibly in this situation. And I think that we probably set some precedent in the involvement of the Fed in these State-chartered institutions, which were also privately insured.

I think the question which everyone has on his mind now is whether the Federal Reserve stands ready to act promptly to supply liquidity to prevent the type of mass closings of even healthy institutions which occurred in Ohio.

Mr. MARTIN. I can only say, Mr. Chairman, that we have learned from this experience. We appreciate the various comments the committee members and the chairman have made with regard to our performance here. We have learned from it. And there is no question of our commitment to you and to the public to act promptly. I think somebody, some official in the Bank of England 100 and some years ago, said in these situations you lend, you lend boldly, and you keep on lending.

Ms. HORN. And I would just add, if I might, Mr. Chairman, that in the Ohio case we did not refuse a single request for liquidity.

Mr. BARNARD. It is interesting, Ms. Horn, though, that in view of all the needs that were developed—in Ohio—was the Fed not surprised by the small amount of requests that they had?

Ms. HORN. Yes, I think that is a fair statement. In fact, we were prepared for more than a week for the requests to come in. We communicated with the institutions about their possible needs. The requests were slow in starting up, as confidence deteriorated, the situation became more severe.

Mr. BARNARD. Do you think this came about because of the wide publicity that was given to the fact that the Fed was involved and that the Home Loan Bank Board was doing all they could to bring other institutions—do you think that that sort of stemmed the need for this additional borrowing?

Ms. HORN. There is no question about it; these institutions run on confidence, even more than they run on cash. And we tried to

make public statements occasionally, when it seemed appropriate, to indicate the Federal Reserve's participation in the situation, and we believe that added to the public confidence.

Mr. BARNARD. One last question I would like to ask of Mr. Selby. In 1977, the Office of the Comptroller of the Currency had substantial supervisory experience involving ESM Government Securities that painted the firm in a highly damaging light. I think you have pretty well testified that your concerns ran so deep that some criminal referrals were made involving the National Bank of South Florida's dealings with ESM. Agreements were entered into with six national banks in Florida prohibiting them from doing any business with ESM. And you wrote the presidents of all national banks warning against the types of securities transactions that ESM regularly offered.

You did alert the SEC as to your concerns and you did provide some information to the FDIC and the Florida comptroller.

You did not, I presume, communicate it at all with your State counterparts. I think we are repeating testimony here but I want to get it for the record. And there was no attempt to sit down and coordinate with the other Federal banking agencies in a concerted enforcement actions against ESM. Knowing what you know now, do you not think that ESM could have been stopped or its tactics exposed years ago, if Federal and State banking and securities agencies had acted together?

Mr. SELBY. Well, I do not know that we could have stopped ESM. I do not think that was our responsibility to say, to make a determination whether ESM was performing illegal transactions. Our responsibilities were to see that the banks were operating in a safe and sound manner. And to avoid having the banks, the national banks particularly, participate in any kind of transactions that might accrue loss to them. And I am not terribly sure I would know how the Federal banking agencies could say to the world at large that an ESM is not—you do not do business with an ESM.

We referred it to the SEC. And I think that was our obligation. I do think in retrospect maybe that we could have, among the Federal agencies, and perhaps even the State agencies, done a better job in talking about an ESM, and all we could do is to share our experiences with ESM. I do not think we could tell the Federal Reserve or the FDIC or the Federal Home Loan Bank Board, "Here is a firm that we suspect of doing illegal things."

Mr. BARNARD. Well, you know, I understand that. And of course, it is very obvious that everybody dealing with ESM did not have losses.

Mr. SELBY. That is right.

Mr. BARNARD. It is very obvious that somewhere along the regulatory process there was some slippage here. Those who did not have segregated accounts, and who did not have trust receipts, they seem to be operating with some regular——

Mr. SELBY. I think we could do a better job, and I think we are doing a better job in disseminating information to the industry. We all along have issued these banking circulars and assurances on the securities transactions. The 1977 was not the only one. We have done it all along, and as a matter of fact, right now I am chairman of the task force on bank supervision under the FFIEC,

and the counsel has approved a drafting of a new circular that will be sent out by all five agencies, talking about these very same things. This was started back in the fall of last year.

Mr. BARNARD. That is the Federal——

Mr. SELBY. The Federal Financial Institutions Examination Council.

Mr. BARNARD. Mr. Gray is Chairman of that.

Mr. SELBY. Mr. Gray is now Chairman of it, that is correct.

Mr. GRAY. I am the Chairman, and we will be looking into this very carefully and closely in the future.

Mr. BARNARD. Mr. Craig.

Mr. CRAIG. Two last questions. First of Mr. Martin and Ms. Horn.

Your activity and the method by which you approached the problem in Ohio and the ability that you could move in was entirely within the law and you were responding to the law as it currently is?

Mr. MARTIN. Yes, sir. We have alluded several times to the Monetary Control Act of 1980 and that is exactly what you all intended us to do——

Mr. CRAIG. That is correct.

Mr. MARTIN. For depository institutions.

Mr. CRAIG. And because of that law you were able to respond in a timely and necessary fashion to the needs of those institutions?

Mr. MARTIN. Yes, sir.

Ms. HORN. That law, and our general approach of wanting to be cooperative with everybody in trying to fashion a solution enabled us to respond in a timely and necessary fashion.

Mr. CRAIG. Thank you.

Mr. Gray, I may make the mistake of quoting from the Wall Street Journal in light of concern about its reporting today, I have here a March 18 Wall Street Journal page with a listing of the activities on a day-by-day basis of the Ohio S&L crisis. I see that on March 9–10, Home State closes. In your testimony, you say on Wednesday evening, March 13, representatives of the Federal Home Loan Bank of Cincinnati examined State reports on Ohio Fund members to make a preliminary estimate of their eligibility for FSLIC insurance.

Why did that Home Loan Bank move at that time?

Mr. GRAY. I think we wanted to move as quickly as we could and we employed the information which we had at that early date to try to get a fix on the situation to the extent we could.

I think much of the information we had at that time was relatively cursory. But we were at least trying to get a feel.

Mr. CRAIG. The Cincinnati board moved on your instruction?

Mr. GRAY. Yes.

Mr. CRAIG. That was how many working days from the time of the public-announced closure of Home State?

Mr. GRAY. Two days.

Mr. CRAIG. Thank you very much. I have no further questions at this time, Mr. Chairman.

Mr. BARNARD. Mr. Kindness.

Mr. KINDNESS. Thank you, Mr. Chairman.

Just one quick question for Chairman Gray. There was some questioning a little while ago which had to do with whom you had

breakfast with on what day, and that sort of thing. And regrettably it is the sort of thing that happens around here once in a while, and you were interrupted constantly. Is there anything else you wanted to say on that subject?

Mr. GRAY. I certainly would.

Mr. KINDNESS. I regret that Representatives Oakar and Luken could not stay, but——

Mr. GRAY. Thank you very much. Well, I appreciate the opportunity.

I read with considerable interest the article in the Wall Street Journal. Frankly, substantial portions of that article were inaccurate, misleading, distorted, and just plain wrong.

It is interesting to note that the author of the article made no attempt at all to solicit my views or my account of our involvement and the efforts which we made. I note that a substantial portion of the article is given to the comments of at least two Members of Congress who have had a disagreement with me over the way we have handled this situation.

I want to point out again that I wanted to send the general counsel to the meeting at the Federal Reserve because I felt that he could provide the kind of information that the Members of Congress and the members of the Ohio thrifts could use. And I felt that at that time it was more appropriate for me to meet with Members of the Congress as soon as possible. And in that evening meeting we extended the invitation through the general counsel to meet in my office the following morning at 11:30. There was no mention of that in the article that Congresswoman Oakar chose not to come to that meeting. And I regret of that. Mr. Luken did.

Another part of the article says that only after some resistance did I let Democratic Representative Luken and one thrift executive join a meeting with Republican Representatives from Ohio. The fact is that Mr. Luken was invited and was obviously a part of the group that came. We did not show any resistance to let him in at all.

Mr. Gradison, one of your colleagues, a Representative from the State of Ohio, told me yesterday that he was not completely quoted in his remarks. In fact, he told me that when he was quoted as saying, "I wonder, too, if political considerations were placed above confidence in and the integrity of the financial system," as is written in the article, the Wall Street Journal left out another part of his statement which clarified it substantially. What he furthermore said was, "There is no indication that that happened."

There is also a suggestion that Mr. Volcker was urging me to expedite the insurance process. Well, you know, as I have already discussed before, I met with Chairman Volcker on the final evening of the bank holiday. I have talked with him for more than 2 years now and he has never called to question, or asked about, a course of action taken by the Federal Home Loan Bank Board—ever!

And I have had some differences, as you may know, with the Treasury from time to time on particular matters. They have been expressed. We do share information with the Department of the Treasury, because after all that is headed by the Chief Fiscal Officer of the United States, just as we share information with the Chairman of the Federal Reserve Board and members of the Feder-

al Reserve Board because it is their responsibility to maintain the integrity and financial stability of this country.

Such communications are a responsible course of action. And we also exchange information with our fellow financial regulators in all of the Federal financial regulatory agencies. That is also a prudent, long established practice.

So I thank you for the opportunity to make my comments, Congressman.

Mr. KINDNESS. Thank you. I am sorry it was necessary.

Mr. BARNARD. Gentlemen, we thank you, and, lady, very much for being with us today. And you certainly have contributed tremendously to this.

I just want to say in closing, we all are concerned about maintaining the confidence in our financial institutions. And certainly I do not have to preach to you about how much we are indebted to you and your organizations in helping us maintain that confidence in the public sector for our financial institutions.

And I sincerely hope that you will continue. We have had some traumatic experiences in the last 4 or 5 years. We have had Penn Square. We have had United American. We had Empire. No regulatory agency has been left out of this, possibly except for the Fed, and you have been lucky.

But we need your continual vigilance in what you are doing in order to help us maintain the confidence in our financial institutions.

Thank you very much.

Mr. GRAY. Thank you.

Mr. BARNARD. Our next panel consists of Charles C. Hogg II, who is president of the Maryland Savings-Share Insurance Corp.; Ms. Pamela A. Hathaway, executive vice president of the Pennsylvania Savings Association Insurance Corp.; Donald R. Beason, president of the Financial Institutions Assurance Corp. of North Carolina; Leonard Lapidus, executive vice president, Mutual Savings Central Fund of Massachusetts; and James L. Burns, Jr., executive vice president of the Cooperative Central Bank of Massachusetts.

We will begin with Mr. Hogg and then go with Ms. Hathaway on across the table and following that, we will have our questions. Mr. Hogg.

STATEMENT OF CHARLES C. HOGG II, PRESIDENT, MARYLAND SAVINGS-SHARE INSURANCE CORP.

Mr. HOGG. Mr. Chairman, members of the subcommittee, it is my pleasure to be here and to address you on this very important issue that is being discussed this morning.

I have submitted complete testimony and a very complete questionnaire. I would request that that be entered into the record.

Mr. BARNARD. Without objection, your entire testimony will be in the record and you may summarize at your convenience.

Mr. HOGG. I will do that, sir.

My name is Charles Hogg. I am president and chief operating officer of the Maryland Savings-Share Insurance Corp., referred to as MSSIC.

MSSIC was created in 1962 by a special act of the Maryland General Assembly for the purpose of providing a viable form of deposit insurance for State-chartered savings and loans.

Our purpose is, in addition to insuring accounts are to facilitate the flexibility of our industry and to provide liquidity.

Currently MSSIC insures 102 State-chartered savings and loans, all of whom have their principal offices in Maryland. These members have assets of about $8.9 billion and savings of $7.2 billion.

The figures I will give you for MSSIC are as of December 31, 1984. They were audited with an unqualified opinion by Touche Ross & Co.

We had total assets at that period of $204 million. Our reserves are $166.8 million. The components of the reserves, as we calculate them, are the capital deposits from our members of about $144.3 million, retained earnings over the 23 years of operation of $17.5 million and a reserve for insurance losses of $5 million, therefore totally $166.8 million.

In addition MSSIC maintains a central reserve fund, which has as its primary purpose liquidity, of $80.8 million. We maintain, with a group of five banks, a line of credit equal to $60 million.

The most important point in my testimony to you today will cover the highly sophisticated regulatory and supervisory system that we have in Maryland in dealing with the State-chartered, MSSIC-insured industry.

This regulatory system includes a very complete monthly report submitted to us by each member whose assets exceed $3 million.

The data on the reports gives us complete knowledge of compliance or noncompliance of members with our regulations. We have a sophisticated data processing system into which the monthly reports are input against the programming of that data. Our highly qualified staff then follows up on exceptions and trends and highlights that the computer output gives us.

An important aspect of our operation in Maryland is close coordination with the State through the division of savings and loan associations which is an agency of the department of licensing and regulation and the true State regulator of the industry.

This coordination includes both exchanging of exams and reports, and cross attendance at board meetings. By that I mean I attend meetings of the board of commissioners. Mr. Brown, from whom you will hear later, attends the MSSIC board meetings. We hold joint supervisory conferences. My staff attends the exit interviews of the division. When they complete an examination of an institution, we get a copy of that examination and we get a copy of the institution's reponse to the comments in the examination.

So, while there is total coordination of our effort, there is independent analysis. The coordination then has to do with dealing with potential problem situations.

We believe that in the insurance company, that we are managing risk through the monitoring of our institutions and through quick, effective response to potential problems.

Both the State and MSSIC are active in our role in dealing with our members, both in examination and in taking corrective action. It has been said today here, many times, that the key to any depos-

it insurance system is confidence. We believe that, obviously. We also think liquidity being strong is also important.

Liquidity in the MSSIC system at yearend was over 16 percent among our members. In addition our members maintain lines of credit with commercial banks. We have proven access, and this topic has been talked about many times this morning, to the Federal Reserve Bank discount window.

MSSIC sources such as its central reserve fund and its own line of credit are also important, so we think both cash and confidence are important in dealing with these problems.

In summary, we know our industry, we respond quickly to problems. We know our jobs and we do them well.

At the appropriate time I would be delighted to answer your questions. Thank you, sir.

[Mr. Hogg's prepared statement follows:]

Testimony of Charles C. Hogg, II
before
Commerce, Consumer and Monetary Affairs Subcommittee
of the
Committee on Government Operations
April 3, 1984

I am pleased to appear before the Subcommittee to present my views on the state/private deposit insurance systems and to discuss in particular the Maryland Savings-Share Insurance Corporation (MSSIC). My testimony will provide brief background on MSSIC and respond to the four topics listed in Chairman Barnard's letter of March 22, 1985.

MSSIC was created in 1962 by a special act of the Maryland General Assembly for the purpose of providing a viable alternative for deposit insurance for state-chartered savings and loan associations. In the early 1970's Maryland law was changed to require deposit insurance for all savings and loans in the state, and MSSIC and the Federal Savings and Loan Insurance Corporation (FSLIC) were the only providers authorized. The Charter of MSSIC appears at Title 10, Financial Institutions Article, Annotated Code of Maryland. The stated purposes of the Corporation are listed there as follows:

"(1) Promote the elasticity and flexibility of the resources of members;

(2) Provide for the liquidity of members through a central reserve fund; and

(3) Insure the savings accounts of members."

The operations of MSSIC are directed by a Board of Directors comprised of three members appointed by the Governor of Maryland and eight members elected from among representatives of member associations. The Board of Directors employs a staff of financial professionals to implement Board policies. I am President and Chief Operating Officer. In addition to the Board of Directors, we have a Membership Committee which meets monthly to review the operations of the member associations and to determine the eligibility of new associations for membership.

Our analysis of the operations and financial condition of member associations is an

active, not a passive, one. Each member whose assets exceed $3 million is required to submit monthly a complete financial report which includes a balance sheet, income statement and supplemental data. This information is entered into an IBM 34 computer which is programmed to point out exceptions to all of our rules, regulations, guidelines and policy statements. In addition the computer provides reports on trend analysis, margin analysis and any change beyond established parameters. These reports are reviewed by our financial analysts, and presented to the Membership Committee and Board. Most importantly, our staff follows up on the reports by on-site visits to and review of the operations of selected institutions high-lighted by the reports. These visits and reviews may include checking on securities portfolios, loan files, operating expenses and other specifics areas of interest, or they may entail a complete review of the operations of the institution.

In addition to our major data processing efforts, our staff uses an IBM Personal Computer to perform selected analysis on member associations as well as for internal uses.

To supplement the analysis and review conducted by my staff, we have complete access to the examinations and files of the Division of Savings and Loan Associations (the Division), the state agency with regulatory responsibilities for the state chartered industry. Members of my staff attend the Exit Interviews conducted by the state upon completion of an examination of an institution, and we receive at the same time as the institution a copy of the Examination Report, and subsequently, a copy of the institutions response to comments in that examination. Coordination between MSSIC and the Division is further enhanced by the Director's attendance at MSSIC Board meetings,and my attendance at meetings of the Board of Commissioners. Our staffs and senior officials meet frequently to coordinate our efforts in dealing with potential problem associations and to insure that total, complete and free lines of communications exist. Copies of correspondence between our offices and member institutions are regularly

exchanged.

Our coordination and cooperation with the Federal Home Loan Bank Board (FHLBB) is naturally more limited, although we do attend seminars and meetings where representatives of the FHLBB participate. In addition, I have recently held meetings with the Director of the Insurance Section of the FSLIC on methods of planning for and executing institution closings or other supervisory actions. We retain as a consultant the firm of the former Director of Insurance of the FSLIC.

The financial data I will provide today is as of December 31, 1984 to give a good comparative basis, although our data processing capabilities allow us to provide monthly data. We will be pleased to provide any data the committee wants.

At December 31, 1984 the 101 members of MSSIC (now 102) had total assets of $8.9 billion and total savings deposits of $7.2 billion. Included in the assets are mortgage loans of $5.8 billion and Investments and Securities of $1.6 billion. Our largest member had total assets of $1.6 billion and our smallest member had assets of $152,968.

At the same date, MSSIC had total asets of $204.8 million, which included highly liquid investments, primarily U.S. Government or Agency securities of $132.2 million. In addition, the Central Reserve Fund, used for liquidity, had assets of $80.8 million, also invested in liquid securities. Our premium structure consists of a 2% Capital Deposit maintained by member associations with MSSIC. These deposits are adjusted semi-annually as of June 30 and December 31 of each year. We calculate our reserves or net worth to be $166.8 million. The components of this reserve position are Capital Deposits ($144.3 million), Retained Earnings ($17.5 million) and a Reserve for Insurance Losses ($5.0). All of the MSSIC figures are audited as of December 31, 1984 and Touche Ross & Co. has given an unqualified opinion on our financial statements.

At this point in my testimony, I would like to digress to introduce a topic that has significant meaning to MSSIC and which could add over $15 million to our retained earnings and reserve position.

This Subcommittee has asked us to make recommendations to Congress on measures which could be taken to strengthen the private deposit insurance system. Mr. Chairman, MSSIC is proud of its record. We feel depositors in members of MSSIC are thoroughly protected by our continuing to operate as we have since we were established in 1962.

There is one area, however, where a change in the law would allow MSSIC to increase insurance reserves, which would add further protection to our members. As the Committee is aware, the federal deposit insurance agencies, the FDIC and FSLIC and the central liquidity facility of the National Credit Union Administration, are statutorily exempt from federal income taxes. MSSIC is statutorily exempt from Maryland state taxes. MSSIC, however, is not exempt from federal taxes, although several state organizations which perform functions similar to those of MSSIC are exempt from federal taxes.

This disparity in treatment results from the fact that the section of the Internal Revenue Code which provides the federal exemption for deposit insurers, section 501(c)(14)(B), applies only to organizations created before September 1, 1957. MSSIC is excluded by virtue of having been established in 1962.

There is no logical reason for this discrimation. A federal tax exemption for MSSIC would permit us to add approximately fifteen million dollars to our insurance reserve fund, that figure representing taxes owed to the federal government, but not yet paid to the government. If MSSIC were operating under a federal exemption, we would be fifteen million dollars stronger, yet there would be no revenue loss to the federal Treasury. More importantly, we would operate in the same federal tax position as the federal deposit insurance agencies and those private insurers established before September 1, 1957.

A bill H.R. 6199, was introduced last Congress to eliminate entirely the cut-off date in Section 501(c)(14)(B) of the Code. We understand that a similar bill will be

reintroduced this session. We hope it will be enacted into law. In light of Congress' concerns over the ability of federal and state deposit insurers to do their jobs well, all deposit insurers should have the same federal tax treatment, particularly when they perform as well as MSSIC.

As we have pointed out, our exacting procedures for membership in MSSIC, and the careful ongoing scrutiny that we make of our state's savings and loan industry, are a depositor's best protection against loss. No depositor in Maryland has lost even a single penny since MSSIC was organized in 1962, and we intend to continue this fine record. A federal tax exemption would help us perform the job of assuring the maximum protection available under law to depositors with members of MSSIC.

A proper and appropriate early-warning and regulatory/supervisory system such as is in place in Maryland and at MSSIC should preclude the failure of one or more large insured thrifts from occurrring suddenly or as a suprise to regulators and insurers. Careful and constant monitoring must be used to detect potential problems before they become serious, and enforcement and corrective action must be taken quickly and effectively. Should a significant failure occur, however, several options are available to the regulator and insurer. These options, exercised early and decisively, include voluntary merger, assisted merger or acquisition, conservatorship or receivership, assumption of management and control, sale of branches or other assets and controlled liquidiation. Obviously all sources of liquidity, including the Federal Reserve Bank Discount Window, bank lines and other sources must be activated. Communications among all parties concerned must be open and effective.

Several lessons have been learned from the events in Ohio. These deal primarily with communications, liquidity sources, and regulatory response. As a result of the Ohio situation, we have reviewed our methods of communications with our members, and with the executive and legislative branches of our State government. We are capable of disseminating quickly critical information to 102 savings and loans, and of getting from

these institutions, and their branches, fast and accurate information.

We have reviewed and are assured that those institutions who are eligible are properly filed and prepared to utilize their access to the Federal Reserve Bank Discount Window. We have instructed our members to reconfirm the terms and conditions of borrowing under bank lines of credit. MSSIC's own liquidity position has been temporarily increased

We have the systems in place to deal with an unfortunate event. All the parties involved, including the Federal Reserve Bank, are prepared to do our jobs,quickly and effectively.

It has been my pleasure to appear before you. I would be happy to answer any questions. Thank you for your time and interest.

STATEMENT OF PAMELA A. HATHAWAY, EXECUTIVE VICE PRESIDENT, PENNSYLVANIA SAVINGS ASSOCIATION INSURANCE CORP.

Ms. HATHAWAY. Thank you, Mr. Chairman.

Mr. Chairman and distinguished members of the subcommittee, I am pleased to be able to appear before you today on behalf of the Pennsylvania Savings Association Insurance Corp.

I am Pamela Hathaway and I am the executive vice president of the corporation.

The Pennsylvania Savings Association Insurance Corp. was created by act 5 of 1979 of the general assembly of the Commonwealth of Pennsylvania as a nonstock, nonprofit corporation and I quote, "to promote the elasticity and flexibility of the resources of member associations, to provide for the liquidity of such associations through a central reserve fund and to insure the savings accounts in such association."

The general assembly created the corporation at the same time it passed a law mandating insurance of accounts in Pennsylvania. At that time there were 139 State-chartered, uninsured savings and loan associations in that State. The majority of these institutions were small, neighborhood, traditional building and loan associations, many of which had been serving the thrift and mortgage needs in their local communities since before the turn of the century. The general assembly had attempted to pass legislation requiring Federal insurance of accounts but realized that the majority of these associations would not qualify for Federal insurance because of their small size and lack of full-time offices. The creation of the PSAIC allowed the continued existence of these small, but otherwise viable and well-run neighborhood associations.

After commencing business in November 1979, the corporation approved its first group of associations for insurance of accounts on August 13, 1980. Of 102 applications submitted to the corporation, 89 associations were approved for insurance of accounts. As of Jan-

uary 31, 1985, the corporation insured accounts in 69 associations ranging in asset size from $128,700 to $89 million.

That asset range is broken down as follows: We have 14 associations under $500,000. Between $500,000 and $1 million—16 associations; $1 to $3 million—19 associations; $3 to $5 million—10 associations; $5 to $10 million—7 associations; $10 to $15 million—2 associations and over $15 million—1 association.

The median asset size of all of our insured institutions is $2.2 million. Net worth at our insured institutions averages a strong 13 percent as a ratio to total deposits and our institutions maintain average liquidity of approximately 15 percent.

Any building, savings or savings and loan association organized under the laws of Pennsylvania may become a member of the corporation so long as its fiscal affairs, solvency, management and directorship have been certified as approved for insurance of accounts by the secretary of banking.

Act 5 also provides that the central insurance fund shall consist of capital contributions by each member in an amount equal to not less than 2 percent of total savings on deposit. Each member institution is presently assessed a membership or what we call a capital deposit, of 2 percent of total savings liabilities. This deposit is adjusted at least semiannually for each institution but is adjusted on a monthly basis for those institutions which experience net savings activity greater than $100,000 per month.

The corporation also has the authority to assess additional capital deposits against member associations upon 75-percent membership approval of such action. As of January 31, 1985, capital deposits by members stood at $4,040,000. This figure, when added to the fund balance or our retained earnings, gives the corporation insurance reserves of $5.1 million which translates to a reserve-to-member savings ratio of 2.46 percent.

The board of directors of the corporation exercises the corporate powers of PSAIC and the size and composition of the board is set by law at 11 members, 3 of whom are appointed by the Governor and 8 of whom are elected representatives of member institutions.

The corporation's monitoring system is geared to early detection of problems and is carried out in very close cooperation with the department of banking. Each of our insured institutions is required to submit to the corporation, monthly financial data consisting of a balance sheet, income statement and information regarding slow loans, mortgage commitments, lines of credit and savings activity.

Our associations are also required to submit a complete copy of their annual independent audit report to the corporation and the department of banking provides the corporation with a copy of its examination report and supervisory letter and all subsequent correspondence and information.

The corporation has the authority to assess penalties and fines against member institutions for failure to comply with reporting requirements. The corporation's staff reviews all financial reports and information and prepares the data for review by the membership committee which meets on a regular bimonthly schedule to discharge its duties of making recommendations to the board with respect to the admission of new members, the withdrawal of members and the standing of members which continue in the corpora-

tion. Any action deemed necessary by the staff or committee is reviewed with the department of banking and carried out jointly.

The corporation does have the authority to examine the books and records of member institutions at anytime and to terminate the insurance of any member upon good cause shown. The corporation may issue cease-and-desist orders; appoint a "supervisor in charge" at an institution; remove officers, directors and employees for violations of the law or the bylaws and rules and regulations and enter into written agreements with member institutions to avert default and lend money to or purchase assets from institutions.

All member associations are required to abide by the regulations of the Savings Association Code of Pennsylvania as well as our bylaws and rules and regulations.

These regulations include but are not limited to a loans-to-one borrower limit of 10 percent of total savings and maintenance of at least 8 percent reserves and 10-percent total net worth as a ratio to total savings. Borrowings are limited to 50 percent of total savings deposits and although none of our institutions approaches this limit, the corporation monitors any borrowed money at an institution very closely.

Our regulations require an institution to maintain at least 7-percent liquidity. As stated earlier, the majority of our members maintain liquidity well in excess of that requirement and the corporation can, from time to time, require that associations maintain additional liquidity in accordance with guidelines set by the board to assure prudent management.

Although we have never had any payouts from the fund, our bylaws do outline the procedures for such claims.

The corporation maintains a very close working relationship with the savings association bureau of the department of banking. A representative of the bureau attends all of our board and membership committee meetings and as noted previously, we regularly receive all examination reports for our insured members and the bureau keeps us informed of their actions in regard to our members at all times and, in fact, no supervisory action would be taken by the bureau without first discussing the matter with the corporation.

If supervisory action is deemed to be necessary and appropriate, we would act jointly with the bureau in that regard.

The department of banking and the corporation share the same goal of maintenance of a strong, viable and well-run State-chartered, privately-insured system of savings institutions. It is in the best interests of not only the department and the corporation but also our savings institutions and their depositors to fully coordinate our efforts to monitor and supervise our institutions.

In addition to those aspects of the relationship which I previously outlined, the secretary of banking must approve any amendments to the bylaws and rules and regulations of the corporation prior to final adoption. The secretary of banking has the statutory authority to examine the corporation's books and records and the corporation is required by statute to provide the secretary with an annual report of our activities and financial condition as examined and certified to by an independent public accountant after the

close of each fiscal year. The secretary of banking also has statutory authority to require the corporation to discharge its obligation to act for the protection of depositors of member institutions.

Thirteen of our institutions are also members of the Federal Home Loan Bank System and although we do not have the same extensive relationship with the Federal Home Loan Bank that we do with the department of banking, we do receive copies of their mailings to our members and we have always had ready access to the officials at the Federal Home Loan Bank. We do not receive any examination reports from the Federal Home Loan Bank Board because the Board does not examine any of our institutions or exercise supervisory authority over them.

With regard to precautions which have been taken to prevent or minimize dissipation of the assets of the insurance fund, the regulations which are in place to assure adequate liquidity and reserves and limits on borrowing and lending at member institutions ensure prudent management of our insured member associations.

We believe that closely monitoring and supervising our institutions in close cooperation with the department of banking to insure and enforce such prudent management allows the corporation to identify potential problems and act to solve them before they reach the point where the assets of the fund could be jeopardized.

The corporation also can work with the department of banking to arrange mergers, capital infusions and underwriting agreements, and as noted earlier, we do have supervisory powers to appoint a new manager, remove officers, directors and employees, issue cease-and-desist orders and terminate insurance of accounts.

In addition, the corporation can make mandatory the purchase of debentures, notes or other evidence of indebtedness in an amount not to exceed 2 percent of a member's total assets and we can increase the 2-percent membership deposit upon the affirmative vote of 75 percent of all members entitled to vote. We would also point out that the number of insured institutions which are larger than the fund are not in the majority as evidenced by the member asset ranges provided earlier in this statement and our largest member has filed a written agreement with the corporation and with the department of banking to maintain capital and net worth levels in excess of the 10-percent requirement.

Prior to the recent events in Ohio, the corporation was already looking at various ways in which the fund could be strengthened. Specific options being considered were establishing lines of credit, reinsurance, assessing member associations a nonrefundable annual fee in addition to the 2-percent capital deposit and establishment of a central reserve fund to provide for members' liquidity.

When we have more complete information available to us, other than what has been reported in the news media regarding recent events in Ohio, we will carefully review that data with a view toward making any changes we might consider necessary to further improve and strengthen our fund.

As explained in this statement, we do maintain close coordination and cooperation with the department of banking which is the principal thrift supervisory agency for our member associations.

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After working so closely with the savings association bureau since our inception, we would stress that State supervision of our thrift institutions is first rate. We feel that the State examiners are well qualified to supervise our institutions and the management of the bureau has, as its foremost concern, the protection of member associations and their depositors and the Pennsylvania Savings Association Insurance Corp.

The bureau staff's experience and knowledge of the savings industry, in general, and of our members, in particular, contributes to a strong State-chartered, privately insured savings and loan system in Pennsylvania. This system has served the citizens of Pennsylvania well and should continue to do so in the future.

Mr. Chairman and distinguished members of the subcommittee, I thank you for your attention and for the opportunity to make this statement today.

[Ms. Hathaway's prepared statement follows:]

STATEMENT OF PAMELA A. HATHAWAY, EXECUTIVE VICE PRESIDENT
PENNSYLVANIA SAVINGS ASSOCIATION INSURANCE CORPORATION

Mr. Chairman and distinguished members of the Commerce, Consumer, and Monetary Affairs Subcommittee of the House of Representatives Committee on Government Operations, I am pleased to be able to appear before you today on behalf of the Pennsylvania Savings Association Insurance Corporation.

The Pennsylvania Savings Association Insurance Corporation was created by Act 1979-5 of the General Assembly of the Commonwealth of Pennsylvania as a nonstock, nonprofit corporation "to promote the elasticity and flexibility of the resources of member associations, to provide for the liquidity of such associations through a central reserve fund and to insure the savings accounts in such associations".

The General Assembly created the Corporation at the same time it passed a law mandating insurance of accounts in Pennsylvania. At that time there were 139 state-chartered, uninsured savings and loan associations in the state. The majority of these institutions were small, neighborhood, traditional building and loan associations, many of which had been serving the thrift and mortgage needs in their local communities since before the turn of the century. The General Assembly had attempted to pass legislation requiring federal insurance of accounts but realized that the majority of these associations would not qualify for federal insurance because of their small size and lack of fulltime offices; the creation of PSAIC allowed the continued existence of these small, but otherwise viable and well-run neighborhood associations.

After commencing business in November, 1979, the Corporation approved its first group of associations for insurance of accounts on August 13, 1980. Of 102 applications submitted to the Corporation, 89 associations were approved for insurance of accounts. As of January 31, 1985 the Corporation insured accounts in 69 associations ranging in asset size from $128,700 to $89,089,000.

That asset range is broken down as follows: under $500,000 - 14 associations, $500,000 to 1 million - 16 associations, 1 to 3 million - 19 associations, 3 to 5 million - 10 associations, 5 to 10 million - 7 associations, 10 to 15 million - 2 associations and over 15 million - 1 association. The median asset size of PSAIC-insured institutions is $2,280,500. Net worth at our insured institutions averages a strong thirteen (13) percent as a ratio to total deposits and our institutions maintain average liquidity of approximately 15%. Any building, savings or savings and loan association organized under the laws of Pennsylvania may become a member of the Corporation so long as its fiscal affairs, solvency, management and directorship have been certified as approved for insurance of accounts by the Secretary of Banking.

Act 1979-5 provides that the central insurance fund "shall consist of capital contributions by each member in an amount equal to not less than 2% of total savings on deposit". Each member institution is presently assessed a membership (capital) deposit of two (2) percent of total savings liabilities; this capital deposit is adjusted at least semi-annually for each institution but is adjusted on a monthly basis for those institutions which experience net savings activity of $100,000 or more monthly. The Corporation has the authority to assess additional capital deposits against member associations upon 75 percent membership approval of such action. As of January 31, 1985 capital deposits by members stood at $4,040,000; this figure when added to the fund balance gives the Corporation insurance reserves of $5,120,000 which translates to a reserve-to-member savings ratio of 2.46% based on total member savings liabilities of $208,502,800.

The Board of Directors of the Corporation exercises the corporate powers of PSAIC and the size and composition of the Board is set by law at eleven (11) members, three (3) of whom are appointed by the Governor and eight (8) of whom are elected representatives of member institutions. The bylaws require the Board to meet at least once every two months.

The Corporation's monitoring system is geared to early detection of problems and is carried out in close cooperation with the Department of Banking. Each of our insured institutions is required to submit to the Corporation monthly financial data consisting of a balance sheet, income statement and information regarding slow loans, mortgage commitments, lines of credit and savings activity. Associations are also required to submit a complete copy of their annual independent audit report to the Corporation and the Department of Banking provides PSAIC with a copy of its examination report and supervisory letter and all subsequent correspondence and information. The Corporation has authority to assess penalties and fines against member institutions for failure to comply with reporting requirements. The Corporation's staff reviews all financial reports and information and prepares the data for review by the Membership Committee which meets on a regular bimonthly schedule to discharge its duty of making recommendations to the Board with respect to the admission of new members, the withdrawal of members and the standing of members which continue in the Corporation. Any action deemed necessary by the staff or committee is reviewed with the Department of Banking and carried out jointly.

The Corporation has the authority to examine the books and records of member institutions at any time and to terminate the insurance of any member upon good cause shown. The Corporation may issue cease-and-desist orders; appoint a "supervisor in charge" at an institution; remove officers, directors and employees for violations of the law or bylaws, rules and regulations and enter into written agreements with member institutions to avert default and lend money to or purchase assets from institutions.

All member associations are required to abide by the regulations of the Savings Association Code of Pennsylvania as well as our bylaws, rules and

regulations. These regulations include but are not limited to a loans-to-one borrower limit of 10% of total savings and maintenance of at least 8% reserves and 10% total net worth as a ratio to total savings. Borrowings are limited to 50% of total savings deposits and although none of our institutions approaches this limit, the Corporation monitors any borrowed money at an institution very closely. Our regulations require an institution to maintain at least 7% liquidity; the majority of our members maintain liquidity well in excess of that requirement and the Corporation can, from time to time, require that associations maintain additional liquidity in accordance with guidelines set by the Board to assure prudent management.

Although we have never had any payouts from the fund, our bylaws outline the procedures for such claims. These procedures are as follows:

(1) The Secretary of Banking declares an institution in default, takes possession and values the assets pursuant to the Department of Banking Code.

(2) The Corporation calculates the net insurable loss in accordance with its bylaws.

(3) The Corporation then pays such net insurable loss in cash to the Secretary of Banking or to the owner of the account, or makes available a transferred, unrestricted savings account in another PSAIC-insured institution.

The Corporation maintains a very close working relationship with the Savings Association Bureau of the Department of Banking. A representative of the Bureau attends all of our Board and Membership Committee meetings and as noted previously, we regularly receive all examination reports for our insured members and the Bureau keeps us informed of their actions in regard to our members at all times. In fact, no supervisory action would be taken by the Bureau without

first discussing the matter with PSAIC; if supervisory action is deemed to be necessary and appropriate we would act jointly with the Bureau in that regard. The Department of Banking and the Corporation share the same goal of maintenance of a strong, viable and well-run state-chartered, privately-insured system of savings institutions. It is in the best interests of not only the Department and the Corporation but also the member savings institutions and their depositors to fully coordinate our efforts to monitor and supervise our institutions.

In addition to those aspects of the relationship outlined above, the Secretary of Banking must approve any amendments to the bylaws, rules and regulations of the Corporation prior to final adoption. The Secretary of Banking has statutory authority to examine the Corporation's books and records and the Corporation is required by statute to provide the Secretary with an annual report of our activities and financial condition as examined and certified to by an independent public accountant after the close of each fiscal year. The Secretary of Banking also has statutory authority to require the Corporation to discharge its obligation to act for the protection of depositors of member institutions.

Thirteen (13) of our insured institutions are also members of the Federal Home Loan Bank system and although we do not have the same extensive relationship with the FHLBB that we do with the Department of Banking, we do receive copies of the general mailings which are sent out to FHLB member associations and we have always had ready access to the FHLBB officials who work with our FHLB system members. We do not receive examination reports from the Federal Home Loan Bank Board because the Board does not examine any of our institutions or exercise supervisory authority over them.

With regard to precautions which have been taken to prevent or minimize dissipation of the assets of the insurance fund, the regulations which are in place to assure adequate liquidity and reserves and limits on borrowing and lending at member institutions ensure prudent management of our insured member associations. We believe that closely monitoring and supervising our institutions in close cooperation with the Department of Banking to ensure and enforce such prudent management allows the Corporation to identify potential problems and act to solve them before they reach the point where the assets of the fund could be jeopardized. The Corporation also can work with the Department of Banking to arrange mergers, capital infusions and underwriting agreements, and as noted earlier, the Corporation has the supervisory powers to appoint a new manager at an institution, remove officers, directors and employees, issue cease-and-desist orders and terminate insurance of accounts. In addition, the Corporation can make mandatory the purchase of debentures, notes or other evidence of indebtedness in an amount not to exceed two (2) percent of a member's total assets and can increase the 2% membership deposit upon the affirmative vote of 75 percent of all members entitled to vote at a meeting called for that purpose. We would also point out that the number of insured institutions which are larger than the fund are not in the majority as evidenced by the member asset ranges provided earlier in this statement and our largest member has filed a written agreement with the Corporation and the Department of Banking to maintain capital and net worth levels in excess of the ten (10) percent requirement.

Prior to recent events in Ohio, the Corporation was already looking at various ways in which the funds could be strengthened. Specific options being considered were establishing lines of credit, reinsurance, assessing member

institutions a nonrefundable annual fee in addition to the two (2) percent capital deposit and establishment of a central reserve fund to provide for members' liquidity. At a recent directors' meeting, the PSAIC Board passed a resolution to require all member associations which have not already done so to establish a relationship with the Federal Reserve Bank to allow access to the discount window and also voted to amend the PSAIC rule which requires an affirmative vote of 75% of the membership to allow the Corporation to assess a capital deposit in excess of two (2) percent of total savings. When we have more complete information available to us other than what has been reported in the news media regarding recent events in Ohio, we will carefully review that data with a view toward making any changes we might consider necessary to further improve and strengthen our fund.

As explained in this statement, we maintain close coordination and cooperation with the Department of Banking which is the principal thrift supervisory agency for our member associations. After working so closely with the Savings Association Bureau since our inception, we would stress that state supervision of our thrift institutions is first-rate; we feel that the state examiners are well-qualified to supervise our institutions and the management of the Bureau has as its foremost concern the protection of member associations and their depositors and the Pennsylvania Savings Association Insurance Corporation. The Bureau staff's experience and knowledge of the savings industry in general and of our members in particular contributes to a strong state-chartered, privately-insured savings and loan system in Pennsylvania. This system has served the citizens of Pennsylvania well and should continue to do so in the future.
Mr. Chairman and distinguished members of the Commerce, Consumer, and Monetary Affairs Subcommittee of the House of Representatives Committee on Government Operations, I thank you for your attention and for the opportunity to make this statement before you today.

NAME OF DEPOSIT INSURANCE FUND Pennsylvania Savings Association Insurance Corporation

I. General Information:

1. Type(s) of Financial Institution(s) whose deposits you insure: Savings & loan associations

2. In which state(s) do you insure: Pennsylvania

3. A. Cost of initial membership in your fund, if any: Non-refundable filing fee - $1,250.00

   B. Annual premium: None

   C. Continuing equity contribution or membership deposit: Two (2) per cent of savings membership deposit

4. Maximum coverage per account or per depositor: $100,000 per account

5. Do you insure brokered deposits: Yes, however our institutions do not use brokered deposits

6. Number of insured institutions, by type:

   A. Under $100 million: Sixty-eight (68)

   B. $100 million to $500 million: None

   C. $500 million to $1 billion: None

   D. Over $1 billion: None

7. Aggregate amount of deposits insured, by type of institution: $208,502,800 (Jan. 31, 1985)

8. Your fund's total useable assets: $5,120,000 (Jan. 31, 1985)

9. Ratio of usable insurance fund assets to deposits insured: 2.46% (Jan. 31, 1985)

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

We are a private agency created by State law (P.L. 17, No. 5 - April 6, 1979) as a nonstock, nonprofit corporation, the purpose of which is "to promote the elasticity and flexibility of the resources of member associations, to provide for the liquidity of such associations through a central reserve fund and to insure the savings accounts in such associations."

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc. By statute, the Secretary of Banking "may make such examinations and inspections of the corporation and require the corporation to furnish him with such reports and records or copies thereof as the Secretary of Banking may consider necessary or appropriate in the public interest or to effectuate the purposes of this act." In addition the Secretary of Banking must approve any amendment to the bylaws, rules and regulations (attached sheet).

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or

No.

b. authority to assess other insured institutions enough to cover the losses?

The Corporation can make mandatory the purchase of debentures, notes or other evidence of indebtedness, in an amount not to exceed two (2) percent of a member's total assets. We also can increase the 2% membership deposit but only upon the affirmative vote of 75 percent of all members entitled to vote at a meeting called for that purpose. The Board is, however, presently considering (attached sheet)

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured? Act 5-1979 provides that the "fund shall consist of capital contributions by each member in an amount equal to not less than 2% of the total savings on deposit with each member."

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

No.

II. Background:

2. (cont'd.)

of the Corporation prior to final adoption. We are also required to make an annual report of our financial condition and activities to the Secretary of Banking after the close of our fiscal year.

3. (cont'd.)

b. language to remove the need for approval of the membership to increase the assessment.

6. Do you reinsure your risks with any other insurance carriers? Please provide details. No.

7. Regarding your board of directors:

a. How is your board of directors selected? We have an eleven (11) member Board of Directors - eight (8) are elected by the membership from the representatives of insured associations and three (3) are appointed by the Governor of Pennsylvania upon the advice of the Secretary of Banking.

b. What rules govern the size and composition of the board? Section 4 of Act 5-1979 and Article II, Section 2 of the Bylaws require that eight of the directors be selected from among the insured institutions and three be appointed by the Governor to comprise the required board membership of eleven.

c. Who are the present members of your board? (Please provide names and principal affiliations.)

Edward J. Bartosiewicz - Metropolitan Savings & Loan Assn., Secretary-Treasurer

Walter A. Benfield - Bally Building & Loan Assn., President

Herbert J. Blair - Tioga-Franklin Savings Assn., Secretary

Shirley C. Chiesa - Carnegie Savings, Building & Loan Assn., President

J. Richard Eshleman - public director appointed by the Governor

John J. Kelly, Jr. - public director appointed by the Governor

Anthony V. Miscavige, Jr., - Sobieski Building & Loan Assn., Secretary

Edward B. Servov - public director appointed by the Governor

Gregory L. Walker - Huntingdon Savings & Loan Assn., EVP

Fred J. Wiest - Union Savings & Loan Assn., Solicitor

John M. Zdanowicz - Windthorst Warsaw Savings Assn., Secretary

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

All institutions must abide by the provisions of the Savings Association Code of Pennsylvania, as per reserve and capital requirements, as well as lending limits, borrowing limits and investment authority. Our associations must maintain at least 8% reserves and 10% total net worth, loans to one borrower are limited to 10% of total savings, associations are permitted to borrow only up to 50% of total savings and we require associations to maintain at least 7% liquidity at all times.

2. Please respond separately for each state in which you insure deposits:

a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund? Yes - Our rules and regulations provide for termination of insurance and expulsion from membership in the Corporation.

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance? We may expel an association and terminate its insurance if:

(1) The member is violating any provisions of the laws of the Commonwealth.
(2) The member is conducting unsafe or unsound practices in the conduct of business.
(3) The member is in violation of any of the bylaws, rules and regulations of the Corporation.

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

None.

3. Please respond separately for each state in which you insure deposits:

   a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

Yes - The rules and regulations provide that an association must "provide and permit examination of any and all books, papers and records of the member as may be requested by the Board of Directors of the Corporation."

   b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget? We presently employ no examiners or auditors. The Department of Banking provides us with a complete copy of the examination which they conduct once a year at each of our institutions. We also receive monthly financial data from each of our insured members as well as a copy of the annual audit report as conducted by an independent accountant. With regard to any special examinations we might request, we can employ an outside auditor for that purpose or request that the Department of Banking conduct a special examination.

   c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis? Yes we have a right of access to the examination reports and we do receive them on a regular basis. In addition, we are a part of any subsequent correspondence or action in regard to the examination.

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

Yes - at least annually at the close of their fiscal year.

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance? We have the authority to issue cease-and-desist orders and temporary cease-and-desist orders which are effective immediately upon service upon the institution. If such orders are violated we have the authority to appoint a "Supervisor in Charge" of the institution. We also have authority to remove from participation in the conduct of business of the association any officer, director or employee who has violated the law, rules and regulations or cease-and-desist order. We are authorized to enter into written agreements with members for the purpose of averting an event of default - this can include lending money, purchasing assets, endorsing or acting as surety on obligations of the member. In conjunction with the Department of Banking we can also arrange mergers, require infusion of capital or require other underwriting.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?
No. The Secretary of Banking would declare an association "in default" and become receiver. After depositors are paid off, the Secretary would turn over the assets of the failed institution to the Corporation for liquidation.

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process? Depositors would receive their funds immediately upon determination of the net insurable loss.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

No.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution? Yes - we would work with the Department of Banking to arrange such a takeover.

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner? Yes - as long as an institution has not been declared "in default" and closed we can keep it operating while we work with the Department to find a merger partner.

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date:

a. The name, location, and size of the institution;

b. The total dollar cost of the insolvency to your fund;

c. The dollar amount of insured deposits in the institution at time of closing;

d. The dollar amount of uninsured deposits in the institution;

e. The percentage recovery to date to depositors on uninsured deposits;

f. The gross dollar amount of outstanding unpaid depositor claims; and

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

No insolvencies covered, to date.

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

1981 - $2,094,634
1982 - $2,386,713
1983 - $2,792,376
1984 - $4,612,357

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

As of February 28, 1985:

Bank Deposits - $2,596,531
U. S. Treasury Securities - $2,275,852
U. S. Agency Bonds - $125,000
Money Market Fund - $26,573

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

No

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

1981 - 13.71%
1982 - 14.30%
1983 - 13.23%
1984 - 12.20%

5. Please provide a copy of your latest annual report.

Mr. BARNARD. Thank you very much.

STATEMENT OF DONALD R. BEASON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FINANCIAL INSTITUTIONS ASSURANCE CORP. OF NORTH CAROLINA

Mr. BEASON. Thank you, sir.

My name is Donald R. Beason and I am president and chief executive officer of the Financial Institutions Assurance Corp. of North Carolina.

I have previously submitted testimony and information which I would request be included in the record.

Mr. BARNARD. Without objection, it will so be. You may summarize, it's your decision.

Mr. BEASON. To quickly summarize, I want to emphasize a few points and then I will be available for any questions that you may have.

It is important to point out that we are strongly regulated and supervised by State government. We fully cooperate with them and the statutes give them authority over our operations including the ability to remove officers and directors of the insurance company.

The majority of our board of directors is independent of the insured institutions and has no relationship with them at all.

Our company has clear authority to take any actions we deem appropriate for the protection of the depositors. That action does include the removal of officers and directors of insured institutions and other areas that we would feel appropriate at any time.

We don't operate a fund, we run a risk management insurance company. To do that, we have a financial analysis system which assists us in identifying risk and we have a trained professional staff to help manage those risks once they are identified.

All the conversation today is about losses and risk and I think risk in financial institutions and their regulators, by the way, can be defined in five broad areas: Management, capital, liquidity, credit risk, and interest rate risk.

We audit management which many people, including some on the national level say is impossible to do, but it is absolutely necessary because management controls the other four areas of risk. We perform operational audits and diagnostic reviews on our institutions to identify potential risks so that we have the time to work with them before they become losses.

We also impose a risk-related cost factor on individual institutions. If the risk is more than we perceive to be normal, institutions are charged a higher cost for the insurance coverage.

We have, in the past, and will in the future, take whatever action is appropriate under our contracts and our statutory authority to protect the depositors. That includes not closing an institution, but maintaining them as an ongoing entity should that need ever occur.

I would also like to say that we have in the past, do today, and will in the future support strong standards for private deposit insurance.

Thank you, sir, for the time to be here and I will answer questions when it is appropriate.

Mr. BARNARD. Thank you, Mr. Beason.

[The prepared statement of Mr. Beason follows:]

Statement of Donald R. Beason
President, Financial Institutions Assurance Corporation
Before the
Commerce, Consumer, and Monetary Affairs Subcommittee
House Committee on Government Operations
April 3, 1985

Mr. Chairman and members of the Subcommittee, my name is Donald R. Beason. I am President of Financial Institutions Assurance Corporation ("FIAC") of Raleigh, North Carolina. FIAC, established in 1967 as a mutual deposit guaranty insurance association under North Carolina law, operates in four states and insures the deposits of savings and loan associations, credit unions, and industrial loan companies. Under North Carolina law, FIAC is supervised and examined (on an annual basis) by the State Secretary of Commerce.

FIAC appreciates this opportunity to provide the Subcommittee with information about its deposit insurance program and related matters. Pursuant to the Subcommittee's request, this statement includes a discussion of the purposes, operations and financial resources of FIAC, the supervision of its insured institutions, and its recommendations to maintain the soundness of the deposit insurance system.

FIAC Deposit Insurance System

Through effective financial management and growth of FIAC's capital and reserve accounts and close supervision of its member institutions, FIAC has developed a strong deposit insurance system over the past 17 years. As such, it has consistently met the following North Carolina statutory standards governing its existence:

1. Assure the liquidity of insured institutions;
2. Guarantee the withdrawable accounts, shares of deposits of insured institutions; and
3. Serve as receiver, when appointed, of an insured institution.

Since its organization in 1967, FIAC has never suffered a loss and none of its members has failed. FIAC's ratio of reserves to insured deposits (2.24%, including reinsurance contracts, as of Dec. 31, 1984) exceeds those of the federal deposit insurance funds and the aggregate net worth to savings ratio of its member institutions (6.7% as of Dec. 31, 1984) exceeds the regulatory requirements of state and federal authorities. FIAC insures individual accounts up to $100,000 and IRA accounts up to $250,000.

FIAC funds its operations and reserves by requiring each member to place with it a non-interest bearing deposit equal to 1.25% of such member's savings accounts. This is supplemented by statutory authority to impose additional, risk-related capital assessments and/or annual premiums. For

example, FIAC may require an institution to increase its capital deposit to 2% of savings or pay an annual premium of up to 1/12 of 1% of savings. These additional risk-related premiums may be assessed when FIAC determines that an institution poses more than a "normal" risk to the system. FIAC's funding system assures the maintenance of a sufficient capital base and provides flexibility to assess risk-based fees in individual circumstances. Although none of the federal funds have such capital deposit and risk-related assessment authority, Congress enacted legislation last year as part of the Deficit Reduction Act of 1984 to provide the National Credit Union Share Insurance Fund with capital deposit maintenance authority. This year, the Federal Home Loan Bank Board has proposed a FSLIC recapitalization plan which closely resembles the Share Insurance Fund capital deposit program.

The operations and activities of FIAC are devoted to the active and ongoing identitication and management of risk entailed in the operations of its member institutions. To that end, FIAC has developed an extensive financial analysis system to monitor such risk and has retained staff with the requisite skills, background and experience to implement this risk management function. This is in addition to state supervisory examination and independent audit requirements applicable to FIAC insured institutions.

Details of the numbers and asset range of FIAC insured institutions are included in the preliminary material made available to the Subcommittee on March 25, 1985. To

summarize those figures, FIAC insures 34 savings and loan associations with total deposits of $2,071,789,000; 25 credit unions with total deposits of $1,092,946,000; and 8 industrial thrift and loans with total deposits of $382,945,000. The majority of FIAC's 68 insured institutions have assets of less than $100 million and only one institution has assets exceeding $500 million.

Our Corporation employs a number of systems and procedures to assure the safety and soundness of insured thrifts. A sophisticated, computer-based financial analysis system tracks financial information on a monthly basis to provide us with an historical perspective on our members' performance and insight into the future direction of their operations. These financial reports are checked against the institutions' independent audits and state examinations for accuracy. This system also "flags" those items which we believe represent danger signals so that we can identify and act on potential problems before they become so acute as to pose a risk of loss. For example, under our system, a reverse repurchase borrowing, which is a separate line item on our monthly report from members, is "flagged" on a computer print-out and the analyst primarily responsible for that institution must obtain detailed information on such a transaction. Copies of some reports generated by this system were included in the preliminary materials sent to the Subcommittee.

In addition to the information provided us by our monthly reports, FIAC has a procedure under which periodic

visits are made to member institutions for the purpose of obtaining information about developments or trends which do not necessarily appear on the monthly reports. Interviews with management provide us with knowledge of new products or services, changes in operating policies or strategic plans, and give us a basis for assessing the degree of management risk of a given institution. FIAC believes that part of its role as a risk manager includes taking positive steps to improve the profitability of its insureds. Diagnostic reviews and operational audits designed to pinpoint operating deficiencies and make constructive suggestions are among these positive steps. Through these processes, FIAC works to ensure that its members continue to be financially sound.

Even the systems and procedures we have in place could not be effective without qualified and capable staff to perform the analysis and follow-up on identified problems. FIAC has attracted qualified personnel from a number of disciplines to carry out this critical aspect of our operations. In addition, outside professional help is engaged, when needed, to supplement the activities of staff.

Liquidity and Funding

With respect to FIAC's procedures for paying potential claims, we are not constrained under any statutory limitation from using our funds to pay depositors upon demand. Accordingly, in the unlikely event of a liquidation of

a member institution, depositors would not have to wait for the liquidation of an institution's assets before they could receive their funds. In that respect, our response to demands for withdrawals would be similar to that of the FSLIC or FDIC. Of course, while we have effected a number of sales and merger transactions in dealing with supervisory cases, no FIAC-insured institution has been liquidated since FIAC's organization in 1967.

FIAC has assets which provide sufficient funding to handle foreseeable problems. Its assets of $49.8 million are heavily liquid, with approximately $30.3 million invested in U.S. Treasury and Agency securities, $9.5 million in other intermediate investments, and $9.4 million in interest bearing cash accounts. The average maturity of the investment portfolio is less than one year. FIAC's investment philosophy of safety and liquidity has provided it with a steady income stream and asset growth.

The combination of regulatory powers and financial oversight minimize the risk that any of our institutions will fail and cause FIAC to suffer a loss. On the other hand, extra attention is focused on any institution deemed to require special supervisory attention. Moreover, as any insurer would, we pay close attention to the larger FIAC insured institutions. Even with the oversight and funding systems we have in place, we have to consider the possibility that one of our insureds could fail and we have adopted measures to further protect our assets.

Such measures include our reinsurance policies (which aggregate $27 million and for which we commit a substantial portion of our annual budget) and our authority to increase member deposits from 1.25% to 2% of deposits. However, based on our experience, we are confident that FIAC can react to any foreseeable problem in such a manner as to prevent any serious dissipation of its own assets.

The fact that we have never suffered a loss does not mean that we are inexperienced in finding solutions to problem cases. We have in the past exercised our broad powers to solve these situations. This has included the removal, for good cause, of officers and directors from problem institutions and arranging the merger or sale of troubled instituions.

With regard to liquidity needs of FIAC members, the following are several of the available sources:

1. Member institution liquidity, which FIAC constantly monitors for adequacy. (At December 31, 1984, FIAC insured institutions had liquid assets equal to 30% of withdrawable savings.)
2. Member institution lines of credit. FIAC-insured institutions are required to maintain independent lines of credit with reputable lenders. At December 31, 1984, these lines aggregated some $139 million.
3. Federal Reserve discount window. All FIAC members have access to the Federal Reserve's discount window. Such access, mandated by the Monetary Control Act of

1980 for all depository institutions which are required to maintain non-interest bearing reserves at the Federal Reserve Banks, is provided to all such institutions on a fully secured basis. As was stated in the House Banking Committee's Report on the Monetary Control Act legislation, such access to this liquidity source "enhances the safety and soundness of the banking system". House Report No. 263, 96th Cong., 1st Sess., p. 5.

4. FIAC's liquidity. Our investment portfolio's average maturity is presently less than one year and can be converted to cash in a very short time.

5. FIAC's lines of credit. FIAC maintains a $75 million line of credit with two large commercial banks. This facility is tested periodically to ensure that funds can be mobilized within a matter of hours.

These funding procedures underscore FIAC's belief that an institution should not be closed to the public unless all other efforts have been expended. To do otherwise would not only create a possible lack of confidence in the financial system, but more importantly it would destroy any remaining franchise value of the closed institution. It is public confidence that maintains the franchise value which is so important to a financial institution and is a valuable asset for an insurer seeking a merger or sale solution to a supervisory problem.

Supervisory Responsibility

Under North Carolina law, FIAC's primary regulator is the North Carolina Department of Commerce, which has broad regulatory powers over FIAC's operation. Those regulatory powers extend from performing annual safety and soundness examinations to removing any officer or Trustee of FIAC.

The state's annual examination evaluates the ability of FIAC's systems and personnel to identify and act on insured institution risk within FIAC's system. This examination program was developed by a former Federal Reserve System official who is presently a staff advisor to the North Carolina Department of Commerce assigned to the Savings and Loan Division.

Besides the regulatory link between the Department of Commerce and FIAC, there is a close working relationship between the two entities regarding the insured institutions. Because FIAC and the state regulator share responsibility to the depositors of the insured institutions, we have developed a system of communication that each party uses to keep the other fully posted on current developments which affect those institutions. For example, if a state examiner should become aware of a problem, we are immediately notified instead of waiting until the final report is published. Of course, all examination reports covering institutions insured by FIAC are made available to us on a routine basis, just as the results of any

examination or study we conduct are shared with the state regulator of the insured institution.

In addition, representatives from the state regulator's office have a standing invitation to attend all of the meetings of the underwriting committee of FIAC's board of trustees. This board committee, composed entirely of public members, regularly meets to discuss the financial condition of FIAC insured institutions and to make formal recommendations to staff regarding supervisory matters.

Finally, the monthly report we use to monitor the condition of members is the same one that our regulators use. Any modifications to the reporting form are approved by both parties before implementation. We work with state regulators to insure that safety and soundness is maintained through teamwork between our offices rather than through duplication of effort.

This unique combination of regulatory oversight and communication has contributed greatly to FIAC's success in acting quickly and effectively to solve problems before they become crises.

While no formal link exists between our Corporation and the Federal Home Loan Bank Board, we do maintain close contact with that supervisory body to stay abreast of current developments affecting federally chartered institutions. We have participated jointly in special investigations and have shared information which might have an impact on our respective insured institutions.

Overview of the Deposit Insurance System

FIAC believes that its capital deposit and risk-related assessment funding powers provide it with innovative tools necessary to maintain a strong and sound deposit insurance system. The events in Ohio during the past few weeks have focused attention on both federal and state deposit insurance systems, and FIAC believes that Congress should consider the flexible and effective funding methods of FIAC and other state funds in its current review of the federal funds.

The federal deposit insurance funds for banks (FDIC) and thrift institutions (FSLIC) require each institution to pay the same annual assessment percentage. Unlike FIAC, these funds receive no capital deposits from insured institutions nor are the funds authorized to impose risk-related assessments. This has resulted in lower ratios of reserves to insured deposits for the federal funds, premium subsidies for institutions with more portfolio risk, and greater potential exposure on the U. S. Treasury. FIAC's risk management funding and oversight program is one example of an alternative to the present federal system. Besides considering ways in which to strengthen that system, FIAC believes that the federal government should spread its potential liability to a larger financial base than the federal insurance funds. Thus, state and private insurers such as FIAC increase the alternatives, both as to types of insurance systems and additional financial

resources, available to the existing federal deposit insurance programs. We believe that these alternatives should be examined as part of a comprehensive review of all deposit insurance.

Whether the underlying cause of the Ohio situation is ultimately determined to be inadequate supervision of a thrift institution, lack of a monitoring framework over government securities dealers, premature closure of all institutions, inadequate cooperation with the Federal Reserve Bank to assure liquidity, or some other reason, regulators and insurers must redouble their efforts to provide a safe and sound financial system.

On the state level, FIAC has been active in promoting the development of standards for all deposit insurance funds and is continuing its efforts to achieve that goal. Examples of such standards which FIAC supports include, but are not limited to:

1. A requirement that a majority of the insurer's board of trustees be independent of the insured institutions;
2. Enforcement powers for the insurer including cease and desist orders and the power to remove officers and directors;
3. An adequate system to gather data and analyze financial condition of insureds on an ongoing and timely basis;

4. Procedures to ascertain that the insurer has qualified and competent staff to carry out the risk management function;
5. Access to examination reports of insured institutions;
6. A strong working relationship with the primary regulator of its insured institutions and the Federal Reserve;
7. Adequate external funding sources;
8. Risk related premium or assessment powers; and
9. Well developed contingency procedures.

I expect that state and private insurers will continue to pursue such matters and assist one another in developing standards and operations best suited for their insured institutions.

Conclusion

The dual banking system has been an historical bedrock of our financial system. State and private deposit insurance programs have become a more visible part of this dual system. FIAC believes that its operations add to the strengths of the financial system and is an example of why private deposit insurance works.

FIAC appreciates having been invited to participate in this hearing in order to highlight the positive aspects of a private deposit insurer.

STATEMENT OF LEONARD LAPIDUS, EXECUTIVE VICE PRESIDENT, MUTUAL SAVINGS CENTRAL FUND

Mr. LAPIDUS. My name Leonard Lapidus. I am executive vice president of the Mutual Savings Central Fund.

I have prepared written testimony and have answered the questions of the committee which have been submitted before this and ask that it be put in the record.

Mr. BARNARD. Without objection, your entire testimony will be included in the record.

Mr. LAPIDUS. The central fund was created by State law in 1932 as a liquidity facility and undertook deposit insurance services for State-chartered savings banks in 1934 and actually began insuring savings banks in the State of Massachusetts before the FDIC began insuring savings banks elsewhere.

All State-chartered savings banks must be members of the fund and by State law, all deposits must be insured in full. The central fund is supervised and examined by the banking division of the State.

We have 145 member banks. They have about $25 billion of deposits but they may also be insured by the FDIC and 49 of them are. The FDIC has about half the deposit liability and the central fund has the other half, so we insure roughly $12 billion of deposits. We have a fund of $400 million in assets available to meet our insurance responsibility and that gives us a so-called coverage ratio of 3.2 percent which is among the highest of any deposit insurer in the country, including the Federal agencies.

The fund may also draw 1 percent of deposits of members which would give us access to an additional $250 million of funds if that became necessary.

We have a liquidity backup of $40 million of contractural lines and we have a standby liquidity program with $40 million of lines with two investment banks which are noncontractural.

As I have indicated, we have been in business over 50 years. No depositor has ever lost money in those 50 years and no bank has ever been closed to the inconvenience of depositors and borrowers.

I think our success is based upon three factors. We have a very strong conservative industry and, in fact, even though we're called thrifts, the condition of the State-chartered savings banks in Massachusetts bear hardly any resemblence to thrifts elsewhere in the country.

The average capital ratio of our institutions is 7.5 percent. They have a strong earnings base. During the hard times of 1980, 1981, and 1982, we had to provide assistance to only one of our banks and in the 50-year history, we have provided assistance only to about a dozen banks.

The second reason is that we have had the resolute and conscientious supervision by the banking department. There is a long tradition of good banking regulation in Massachusetts.

Third, there is very close cooperation between the banking department and the central fund in monitoring banks and effecting solutions of problems as they arise.

The surveillance techniques that the banking department and the central fund use include examination reports which we receive

from the banking department on the basis of statutory authority. The banks also provide us with quarterly financial reports that we transform into what we call the performance measurement system, a comprehensive detailed ratio analysis, and we get monthly reports on deposits, on delinquencies, and special reports and analysis as needed.

Many of these reports are required by regulations approved by the banking commissioner and have the same force as the regulations of the banking commissioner.

The information is effective, not simply because it's information, but because of the readiness to act when the information indicates that we have a problem.

The committee in its request of us asked what did we learn from the Ohio situation. I think the record that we have shaped in Massachusetts indicates that what we are doing seems to make sense. The only thing I would add is that we probably need more Federal and State cooperation than we have had in the past. I think that might be more formalized, as many speakers this morning, many witnesses this morning indicated. In fact, in Massachusetts, there has been a very good, close informal relationship but, perhaps some of that has to be made more concrete.

Thank you very much.

[The prepared statement of Mr. Lapidus follows:]

Testimony of Leonard Lapidus
Executive Vice President
Mutual Savings Central Fund
before
Commerce, Consumer and Monetary Affairs Subcommittee
of the
House Committee on Government Operations
April 3, 1985

My name is Leonard Lapidus. I am the Executive Vice President of the Mutual Savings Central Fund, Inc., which insures deposits in state-chartered savings banks in Massachusetts. Our deposit insurance fund was established in 1934, and actually began operating before the FDIC. The Central Fund is one of three private deposit insurers in Massachusetts, the others being deposit insurers for the state's cooperative banks and credit unions.

The Central Fund insures the full amount of deposits in Massachusetts savings banks. All of the state's 145 savings banks are required by law to be members of the Fund. These banks range in asset size from $9.4 million to $1.2 billion, although most of them have less than $200 million in assets. Members have the option of joining the FDIC, in which case the Central Fund insures only those amounts over $100,000 that are not covered by FDIC insurance. Forty-nine of our members, including 13 of the state's 15 largest savings banks, are members of the FDIC. The Fund has $401 million in assets available to meet its insurance obligations and insures approximately $12.3 billion of deposits. Its coverage ratio is over 3.2 percent. The Fund is backed only

by its own assets and does not have any statutory backing of the State Treasury.

Members pay an annual insurance premium set by the Central Fund Board with the approval of the Commissioner of Banks. The maximum premium is 1/16 of one percent of insured deposits, and the premium is currently set at 1/24 of one percent. The Board, with the Commissioner's approval, can levy additional assessments up to a total of one percent of each bank's deposits, or about $250 million. The Fund also has $40 million in contractual lines of credit with five different commercial banks, and has another $40 million of non-contractual lines of credit with two investment banks.

Regular surveillance of members is accomplished primarily through a system of monthly, quarterly, and semi-annual reports that are required to be submitted to the Fund by regulations approved by the Commissioner of Banks. The Central Fund compiles the information received and develops a quarterly performance measurement report on each member bank. These reports, which are also sent to each member bank, provide the Central Fund with a great deal of information about its members and are a very effective monitoring tool as well as an important management tool for the member banks. The Fund has also developed a savings bank simulation model that enables it to project future balance sheet and income data under different interest-rate and

operational scenarios, and we are in the process of developing an interest-rate-gap-measurement report. Officials of the Fund also have regular meetings with State Banking Division staff. Our extensive reporting and monitoring system and cooperative efforts with the Banking Division enable the Central Fund to maintain close surveillance of its members and to detect problems before they become unmanageable.

In over 50 years of operation, the Central Fund has never had to liquidate a bank, and pay off depositors. It has been the policy of the Fund to solve problem bank situations by providing direct assistance or by arranging a merger, and that is how we envision solving any problems in the future. In the event of a liquidation, we would expect to pay off all depositors in the bank immediately and to take over the bank's assets and proceed to liquidate them in an orderly fashion.

I have already touched on the nature and extent of the Central Fund's coordination and cooperation with the Massachusetts Banking Division in discussing our monitoring efforts. In general, the Banking Division and the Central Fund work closely and exchange information to assist each other in monitoring savings bank performance. At least quarterly, Central Fund and Banking Division staff meet to discuss and compare notes on general industry conditions and specific banks that may be experiencing problems. By law, the Central Fund receives a copy

of each member's examination report from the Commissioner, and the Commissioner is also authorized by law to provide, in his discretion, any information that may be useful when problems are suspected. Because the Central Fund was created by an act of the legislature, its role is formally recognized in Massachusetts law. This is an advantage because it assures coordination and cooperation between the Fund and the Banking Division.

While no formal arrangements exist between the Central Fund and the Federal Home Loan Bank System, on various occasions Central Fund officials meet or exchange information with Home Loan Bank and Bank Board officials. Although the Bank Board has no supervisory role with regard to our members, many of them are members of the Federal Home Loan Bank of Boston, and in light of the Ohio situation, we plan to explore the possibility of developing closer ties with the Home Loan Bank in the future.

The Subcommittee has posed the question of what special precautions the Central Fund has taken to minimize the likelihood of the occurrence of a problem like that which arose in Ohio. The Central Fund's membership is much more evenly distributed than was the case in Ohio. Taken together, the sum of the two largest non-FDIC banks aggregates only 10 percent of the Central Fund's deposit liability, and if these two banks were to suffer the same relative losses as Home State, the Central Fund could handle the situation without any difficulty.

We are, of course, concerned about problems that may arise at our larger banks, and greater attention is paid to these banks than to smaller ones in our surveillance program. We have a very strong surveillance program based on regular reporting requirements, detailed performance measurement reports generated by the Fund, our simulation model, access to examination and independent audit reports of each member, and a continuing exchange of information with the Banking Division.

The Subcommittee has also sought our views as to the lessons that have been learned from the recent events in Ohio, and any specific recommendations that we may have. In this connection, we offer the following thoughts:

1. Deposit insurers must have the powers and authorities necessary to meet their responsibilities. This is obvious on its face, but is not always the case. The funds must have the authority to get information to monitor on a continuing basis the financial condition of the banks that they insure. First, the insurer must have examination authority or the authority to receive examination reports of the bank regulatory agency. It must also be able to get standard and special financial reports appropriate to its responsibilities. Its authority may rest on law or regulation or contract. Second, when potential problems are detected, the insurers must have the necessary powers to

occurs to make the necessary contacts and arrangements. Development of contingency plans should be encouraged by the Federal Reserve and Home Loan Bank Systems, and the necessary documents, collateral arrangements, etc. put in place for prompt access to the Federal liquidity facilities. Despite enactment of the Monetary Control Act of 1980, there sometimes is a tendency on the part of the federal regulators to view privately insured institutions and their insurers as outside the system and to place legal or policy impediments in the way that make it difficult to effect the necessary coordination. This must be recognized and every effort made to encourage working relationships between federal authorities and private deposit insurers, whether by statute, regulation or policy.

4. Deposit insurance funds must be adequately capitalized. What constitutes adequate capitalization is, of course, relative and depends on other factors such as the degree of risk diversification. Obviously, funds like the failed fund in Nebraska, which was largely a sham, should not be permitted to operate. A fund like the Ohio fund, whose capitalization appeared credible on its face but which had structural problems that ultimately caused its downfall, poses more difficult problems. Nevertheless, realistic standards can and should be developed.

deal effectively with them before they become unmanageable. The authorities should be broad to provide direct assistance in many different ways; to facilitate mergers and purchase and assumption transactions; to conserve and, if necessary, to liquidate. This authority need not be independent of state supervision -- for example, in Massachusetts, all Central Fund actions with respect to troubled banks require the approval of the Commissioner, but our close relationship to the Banking Division and parallel interests have assured the effective superintendence of our members.

2. Coordination and cooperation between state supervisory officials and the insurance funds is a must. Private deposit insurers are generally not agencies of the state governments, and there can be barriers, whether legal or political, to the sharing of information and cooperation in the decision-making process. Every effort should be made to ensure that state agencies and private insurers act as allies in monitoring the banks and developing solutions to problems. Recognition of the deposit insurer's role in state statutes probably contributes to greater cooperation between state supervisory authorities and private insurers.

3. Deposit insurance funds must also have the cooperation of federal banking authorities. This cooperation must be continuing; we cannot afford to wait until an emergency

5. There is no substitute for strong financial institutions and vigilant supervision. Massachusetts savings banks have an average capital-to-assets ratio of nearly 7.5 percent. Their health and the effective supervision by the Massachusetts Banking Division are significant factors that contribute to the strength of the Central Fund. Deposit insurance is a valuable protection and contributes to the public's confidence in the system, but the success of both private and federal deposit insurers depends ultimately on the strength of the institutions they insure.

Thank you for the opportunity to testify before the Subcommittee. I would be pleased to answer any questions.

STATEMENT OF JAMES L. BURNS, JR, EXECUTIVE VICE PRESIDENT, THE CO-OPERATIVE CENTRAL BANK, BOSTON, MA

Mr. BURNS. Initially I would like to express to you our appreciation for the opportunity to address this committee relative to the function and capability of the Co-operative Central Bank.

The Co-operative Central Bank is a source of liquidity and is the deposit insurer for the 100 co-operative banks in the Commonwealth of Massachusetts. The Central Bank's reserve fund was founded in 1932 to be utilized as a source of liquidity by our member banks. As you well know, liquidity is normally the first need to be satisfied in the event difficulty occurs within any banking system.

The reserve fund has been maintained and increased since its inception in 1932 and has continued to be utilized by our member banks to meet their occasional liquidity needs.

The leaders of our industry recognized, at that time, the need for the existence of a deposit insurance fund in addition to the liquidity fund. Our industry implemented the share insurance fund in 1934 at a time when no other deposit insurance funds existed in the country. This fund is a prime example of the banking community, the banking department and our legislature acting in conjunction with one another in our Commonwealth.

As a result of these two funds, a very strong, confident, conservative and well-regulated industry evolved. Our depositors have never lost any money nor ever had any difficulty in obtaining their funds at any of our co-operative banks, even during the depths of the Depression. This service to our customers continues to exist.

At this time our industry consists of 100 co-operative banks with total assets of $5.25 billion. There are 220 co-operative bank offices throughout our Commonwealth. The principal activity within our

system for well over 100 years has been the granting of home mortgages. These mortgages comprise nearly 70 percent of our total asset base. With the changes which have occurred in banking over the past two decades, our member banks have provided additional service to their depositors such as NOW accounts, auto loans, personal, student and home modernization loans, ATM's, Keough retirement accounts and IRA's, and so forth.

The net worth of our industry is about 7.3 percent of deposits. At the Central Bank we have $170 million in fund reserves, should the need arise. We also have over $60 million in lines of credit with commercial banks in Boston, New York and Washington, DC. One additional strength within our system is our size. The average size of our member banks is approximately $50 million in assets. Only 12 are over $100 million and none have deposits in excess of $300 million.

The methods of obtaining moneys for our reserve fund and insurance fund differ somewhat. In our reserve liquidity fund, deposits are adjusted annually as the result of the vote of the board of the Central Bank. A dividend is paid on these moneys. Because of the good earnings of the fund, that dividend has been at the rate of 12 percent for a number of years. It acts as a source of liquidity for member banks, as well as an additional income stream.

The share insurance fund was initially funded by an original assessment in 1934 and special assessment in the mid-1940's. Each year the banks are assessed—for many years that assessment has been at a reduced rate of one-twenty-seventh of 1 percent of deposits and notes payable.

This assessment is determined by a vote of the board of the Central Bank and is subject to the approval of the commissioner of banks.

By statute, the assessment could be increased to one-twelfth of 1 percent of deposits and notes payable. Once the coverage factor of the share insurance fund alone, is 3 percent of deposits, no further assessments would be made unless the coverage factor fell below 3 percent.

Each member bank, including the Central Bank, is subject each year to regular recurring field examinations by the State banking department and an audit by independent public accountants. All examination reports and audits are required to be sent to the Central Bank for review. In addition, monthly reports are required by law, with fines, if late, to be sent to the Central Bank. These reports include balance sheet items, income statement items, along with delinquency reporting, commitments outstanding, liquidity, and other selected important data. Our monitoring system would recognize any significant change occurring in these figures. Immediate telephone inquiry and/or visitation by our staff, and possibly banking department staff would soon occur.

In Massachusetts, the banking department has maintained a very conservative philosophy in its supervision and regulation of State-chartered banks. This supervisory approach has resulted in one of the strongest banking communities in America.

The following capital guidelines have been established for a number of years by the State banking department and we adhere to them:

If any bank's capital ratio falls below 5 percent of assets, the bank is placed on a supervisory concern list. When the ratio falls below 4 percent, the Board is directed to formulate and implement immediately a course of action which should include, but not be limited to, seeking a merger or raising additional capital. When the ratio falls below 3 percent, the certification of the bank as unsafe and unsound would be imminent.

In addition to these capital requirements, we also monitor variations in any of the classifications in our early warning system. There have been instances where we have taken action with banks of relatively high net worth when a deterioration trend has been diagnosed in one of these other categories. This policy of early remedial action has been successful in preventing deterioration of the bank's financials and for the maintenance of a very important item, public confidence.

We have been able to assist some 15 banks over the recent past utilizing our ability to restructure, merge, provide income streams along with administrative assistance and financial assistance purely from the income of the insurance fund. The principal of the fund has not been used and through the 1930's and the difficult period of high interest rates and deregulation in the early 1980's, the fund has continued to successfully grow each year.

It should be noted that since 1980, the Central Bank has furnished financial assistance to insured members to facilitate mergers, or to assist in asset restructure. None of these cases involved insolvency but were cases of early detection and prompt remedial action to maintain the banking system's safety and soundness.

I won't bother you with the amount of funds which have been injected or loaned to our member banks. It's included in my testimony.

Ninety percent of the assisted cases are now in a repayment mode.

In order to attain this enviable record, it is of the utmost necessity that the regulator and insurer work together. Since assuming my responsibilities at the Central Bank some 12 years ago, I have worked with four State banking commissioners in Massachusetts and, am very proud to say, have worked well with each and every one, enabling us to fulfill our duties as the watchdog and the insurer of our industry.

Forty-two of our member banks are also members of the Federal Home Loan Bank System and, as such, have access to that discount window. We in the Massachusetts thrift business have been very reluctant in the past to borrow. However, the opportunity is still there should we need it.

The average borrowing, in the recent past, for our over $5 billion industry has averaged out to approximately $50 million. We work in conjunction with the Federal Home Loan Bank of Boston insofar as supplying monthly information to them relative to our 42 member banks who are also members of that system.

The examination, audit and reporting process, together with visitations by personnel of the Central Bank, enable us to keep a very close scrutiny of our banks' performance, thus ensuring the safety and soundness of our industry.

Our two largest institutions each represent only 6 percent of the total assets of our industry. We monitor all our institutions on a very thorough basis.

Our industry is a very stable one—community banks serving community needs. They are not involved with brokered CD's or out-of-State repurchase agreements.

Your letter of invitation to appear before this committee requested specifically that I make comment as to the lessons learned and specific recommendations to the Congress regarding the events in Ohio in terms of strengthening our system, State supervision and improving the Federal response to the strains on our industry.

Situations such as that which occurred in Ohio would not be permitted to exist in our Commonwealth for a number of reasons.

Such a rapid increase in asset size over a short period of time would immediately trigger an investigation. In addition, the resultant gross deterioration of net worth would violate ours and the banking department's net worth requirements which I discussed previously. Upon audit review, the holding of collateral by a nonregulated Government securities dealer would be detected and would not be permitted to continue.

The situation in Ohio appears to me to have been a regulatory problem which, when ignored and not acted upon, became an insurance problem.

Our banks' own strong liquidity positions, substantial lines of credit, the membership in our own reserve/liquidity fund, the Monetary Control Act of 1980, which would allow their access to the Federal Reserve discount window, the overall strength of our industry and what we consider to be a very strong Co-operative Central Bank—all of these would prevent anything so traumatic as the Ohio situation from occurring in our Commonwealth.

We also have in Massachusetts a very conservative State legislature which has wisely placed limitations on the amount of borrowing and also the total amount of any one particular loan or investment to any one individual.

You can see that these checks and balances would prevent a situation similar to Ohio from occurring in our Commonwealth.

While the situation has been a major item in the media, by and large depositor confidence has been maintained and through our tracking process, it appears to us that we are still experiencing deposit in-flows.

I would like to stress to the committee, once again, that not even during the traumatic experience of the 1930's and the early 1980's, not one co-operative bank has ever failed, not one depositor has ever lost a dollar in our system, liquidity has always been maintained and all deposits have been insured in full.

Thank you very much.

[The prepared statement of Mr. Burns follows:]

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AND TREASURER

MARCH 28, 1985

TO MEMBERS OF THE COMMERCE, CONSUMER,
AND MONETARY AFFAIRS SUBCOMMITTEE

GENTLEMEN:

INITIALLY I WOULD LIKE TO EXPRESS TO YOU OUR APPRECIATION FOR THE OPPORTUNITY TO ADDRESS THIS COMMITTEE RELATIVE TO THE FUNCTION AND CAPABILITY OF THE CO-OPERATIVE CENTRAL BANK. THE CO-OPERATIVE CENTRAL BANK IS A SOURCE OF LIQUIDITY AND IS THE DEPOSIT INSURER FOR THE 100 CO-OPERATIVE BANKS IN THE COMMONWEALTH OF MASSACHUSETTS.

THE CO-OPERATIVE CENTRAL BANK'S RESERVE FUND WAS FOUNDED IN 1932 TO BE UTILIZED AS A SOURCE OF LIQUIDITY BY OUR MEMBER BANKS. AS YOU WELL KNOW, LIQUIDITY IS NORMALLY THE FIRST NEED TO BE SATISFIED IN THE EVENT DIFFICULTY OCCURS WITHIN ANY BANKING SYSTEM. THE RESERVE FUND HAS BEEN MAINTAINED AND INCREASED SINCE INCEPTION IN 1932 AND HAS CONTINUED TO BE UTILIZED BY OUR MEMBER BANKS TO MEET THEIR OCCASIONAL LIQUIDITY NEEDS.

THE LEADERS OF OUR INDUSTRY RECOGNIZED AT THAT TIME THE NEED FOR THE EXISTENCE OF A DEPOSIT INSURANCE FUND IN ADDITION TO THE LIQUIDITY FUND. OUR INDUSTRY IMPLEMENTED THE SHARE INSURANCE FUND IN 1934 AT A TIME WHEN NO OTHER DEPOSIT INSURANCE FUNDS EXISTED IN THE COUNTRY. THIS FUND IS A PRIME EXAMPLE OF THE BANKING COMMUNITY, THE BANKING DEPARTMENT AND THE LEGISLATURE ACTING IN CONJUNCTION WITH ONE ANOTHER IN THE COMMONWEALTH OF MASSACHUSETTS.

AS A RESULT OF THESE TWO FUNDS, A VERY STRONG, CONFIDENT, CONSERVATIVE AND WELL-REGULATED INDUSTRY EVOLVED. OUR DEPOSITORS HAVE NEVER LOST ANY MONEY NOR EVER HAD ANY DIFFICULTY IN OBTAINING THEIR FUNDS AT ANY OF OUR CO-OPERATIVE BANKS, EVEN DURING THE DEPTHS OF THE DEPRESSION. THIS SERVICE TO OUR CUSTOMERS CONTINUES TO EXIST.

AT THIS TIME OUR INDUSTRY CONSISTS OF 100 CO-OPERATIVE BANKS WITH TOTAL ASSETS OF $5 1/4 BILLION. THERE ARE 220 CO-OPERATIVE BANK OFFICES THROUGHOUT THE COMMONWEALTH. THE PRINCIPAL ACTIVITY WITHIN OUR SYSTEM FOR WELL OVER 100 YEARS HAS BEEN THE GRANTING OF HOME MORTGAGES. THESE MORTGAGES COMPRISE NEARLY 70% OF OUR TOTAL ASSET BASE. WITH THE CHANGES WHICH HAVE OCCURRED IN BANKING OVER THE PAST TWO DECADES, OUR MEMBER BANKS HAVE PROVIDED ADDITIONAL SERVICE TO THEIR DEPOSITORS SUCH AS NOW ACCOUNTS, AUTO LOANS, PERSONAL, STUDENT AND HOME MODERNIZATION LOANS, ATM'S, KEOUGH AND IRA RETIREMENT ACCOUNTS, ETC.

THE NET WORTH OF OUR INDUSTRY IS OVER 7.3% OF DEPOSITS. AT THE CO-OPERATIVE CENTRAL BANK WE HAVE $170 MILLION IN THE FUNDS' RESERVES, SHOULD THE NEED ARISE. WE ALSO HAVE OVER $60 MILLION IN LINES OF CREDIT WITH BOSTON, NEW YORK AND WASHINGTON, D.C. COMMERCIAL BANKS. ONE ADDITIONAL STRENGTH WITHIN OUR SYSTEM IS OUR SIZE. THE AVERAGE SIZE OF OUR MEMBER BANKS IS APPROXIMATELY $50 MILLION IN ASSETS. ONLY TWELVE ARE OVER $100 MILLION AND NONE HAVE DEPOSITS IN EXCESS OF $300 MILLION.

THE METHODS OF OBTAINING MONEYS FOR OUR RESERVE FUND AND INSURANCE FUND DIFFER SOMEWHAT. IN OUR RESERVE/LIQUIDITY FUND, DEPOSITS ARE ADJUSTED ANNUALLY AS THE RESULT OF A VOTE OF THE BOARD OF THE CO-OPERATIVE CENTRAL BANK. A DIVIDEND IS PAID ON THESE MONEYS. BECAUSE OF THE GOOD EARNINGS OF THE FUND, THAT DIVIDEND HAS BEEN AT THE RATE OF 12% FOR THE PAST NUMBER OF YEARS. IT ACTS AS A SOURCE OF LIQUIDITY FOR MEMBER BANKS, AS WELL AS AN ADDITIONAL INCOME STREAM.

THE SHARE INSURANCE FUND WAS INITIALLY FUNDED BY AN ORIGINAL ASSESSMENT IN 1934 AND A SPECIAL ASSESSMENT IN THE MID-1940S. EACH YEAR THE BANKS ARE ASSESSED -- FOR MANY YEARS THAT ASSESSMENT HAS BEEN AT A REDUCED RATE OF 1/27TH OF 1% OF DEPOSITS AND NOTES PAYABLE. THIS ASSESSMENT IS DETERMINED BY A VOTE OF THE BOARD OF THE CO-OPERATIVE CENTRAL BANK AND IS SUBJECT TO THE APPROVAL OF THE COMMISSIONER OF BANKS. BY STATUTE THE ASSESSMENT COULD BE INCREASED TO 1/12TH OF 1% OF DEPOSITS AND NOTES PAYABLE. ONCE THE COVERAGE FACTOR OF THE SHARE INSURANCE FUND ALONE IS 3% OF DEPOSITS, NO FURTHER ASSESSMENTS WOULD BE MADE UNLESS THE COVERAGE FACTOR FELL BELOW 3%.

EACH MEMBER BANK, INCLUDING THE CENTRAL BANK, IS SUBJECT EACH YEAR TO REGULAR RECURRING FIELD EXAMINATIONS BY THE STATE BANKING DEPARTMENT AND AN AUDIT BY INDEPENDENT PUBLIC ACCOUNTANTS. ALL EXAMINATION REPORTS AND AUDITS ARE REQUIRED TO BE SENT TO THE CO-OPERATIVE CENTRAL BANK FOR REVIEW. IN ADDITION, MONTHLY REPORTS ARE REQUIRED BY LAW TO BE SENT TO THE CO-OPERATIVE CENTRAL BANK. THESE REPORTS INCLUDE BALANCE SHEET AND INCOME STATEMENT

ITEMS TOGETHER WITH DELINQUENCY REPORTING, COMMITMENTS OUTSTANDING, LIQUIDITY DATA AND OTHER SELECTED IMPORTANT DATA. OUR MONITORING SYSTEM WOULD RECOGNIZE ANY SIGNIFICANT CHANGE OCCURRING IN THESE BANK FIGURES. IMMEDIATE TELEPHONE INQUIRY AND/OR VISITATION BY CENTRAL BANK STAFF, AND POSSIBLY BANKING DEPARTMENT STAFF, WOULD OCCUR.

IN MASSACHUSETTS, THE BANKING DEPARTMENT HAS MAINTAINED A VERY CONSERVATIVE PHILOSOPHY IN ITS SUPERVISION AND REGULATION OF STATE CHARTERED BANKS. THIS SUPERVISORY APPROACH HAS RESULTED IN ONE OF THE STRONGEST BANKING COMMUNITIES IN AMERICA. THE FOLLOWING CAPITAL GUIDELINES, ESTABLISHED FOR A NUMBER OF YEARS BY THE COMMISSIONER OF BANKS, SERVES AS A GOOD EXAMPLE OF A STRONG, CONSERVATIVE APPROACH:

"IF ANY BANK'S CAPITAL RATIO FALLS BELOW 5% OF ASSETS THE BANK IS PLACED ON A SUPERVISORY CONCERN LIST, WHEN THE RATIO FALLS BELOW 4% THE BOARD IS DIRECTED TO FORMULATE AND IMPLEMENT IMMEDIATELY A COURSE OF ACTION WHICH SHOULD INCLUDE, BUT NOT BE LIMITED TO, SEEKING A MERGER OR RAISE ADDITIONAL CAPITAL. WHEN THE RATIO FALLS BELOW 3% THE CERTIFICATION OF THE BANK AS UNSAFE AND UNSOUND WOULD BE IMMINENT."

IN ADDITION TO THESE CAPITAL REQUIREMENTS, WE ALSO MONITOR VARIATIONS IN ANY OF THE CLASSIFICATIONS IN OUR EARLY WARNING SYSTEM. THERE HAVE BEEN INSTANCES WHERE WE HAVE TAKEN ACTION WITH BANKS OF RELATIVELY HIGH NET WORTH WHEN A DETERIORATION TREND HAS BEEN DIAGNOSED IN ONE OF THESE OTHER CATEGORIES. THIS POLICY OF EARLY REMEDIAL ACTION HAS BEEN SUCCESSFUL IN PREVENTING

DETERIORATION OF THE BANK'S FINANCIALS AND FOR THE MAINTENANCE OF A VERY IMPORTANT ITEM -- PUBLIC CONFIDENCE.

WE HAVE BEEN ABLE TO ASSIST SOME FIFTEEN BANKS OVER THE RECENT PAST UTILIZING OUR ABILITY TO RESTRUCTURE, MERGE, PROVIDE INCOME STREAMS ALONG WITH ADMINISTRATIVE ASSISTANCE AND FINANCIAL ASSISTANCE PURELY FROM THE INCOME FROM THE INSURANCE FUND. THE PRINCIPAL OF THE FUND HAS NOT BEEN USED, AND THROUGH THE 1930S AND DIFFICULT PERIOD OF HIGH INTEREST RATES AND DEREGULATION IN THE 1980S, THE FUND HAS CONTINUED TO SUCCESSFULLY GROW EACH YEAR.

IT SHOULD BE NOTED THAT SINCE 1980 THE CO-OPERATIVE CENTRAL BANK HAS FURNISHED FINANCIAL ASSISTANCE TO INSURED MEMBERS TO FACILITATE MERGERS, OR TO ASSIST IN ASSET RESTRUCTURE. NONE OF THESE CASES INVOLVED INSOLVENCY BUT WERE CASES OF EARLY DETECTION AND PROMPT REMEDIAL ACTION TO MAINTAIN BANKING SYSTEM SAFETY AND SOUNDNESS.

(A) PERMANENT CAPITAL OF $1,950,000 WAS DISBURSED TO TWO INSTITUTIONS.

(B) INTEREST BEARING LOANS OF $3,529,670 WERE ADVANCED TO THREE INSTITUTIONS. CURRENT OUTSTANDING BALANCE OF $899,670 EXISTS.

(C) CAPITAL CERTIFICATES OF $16,724,000 WERE ISSUED TO FOUR INSTITUTIONS. $13,819,700 REMAINS OUTSTANDING PRESENTLY.

(D) SECURITIES OF $10,065,000 WERE ACQUIRED FROM ONE INSTITUTION AT BOOK VALUE. $8,731,700 REMAINS OUTSTANDING SUBJECT TO RESALE ON 4/21/87.

IN ORDER TO ATTAIN THIS ENVIABLE RECORD IT IS OF THE UTMOST NECESSITY THAT THE REGULATOR AND THE INSURER WORK TOGETHER. SINCE ASSUMING MY RESPONSIBILITIES AT THE CO-OPERATIVE CENTRAL BANK SOME TWELVE YEARS AGO I HAVE WORKED WITH FOUR STATE BANKING COMMISSIONERS IN MASSACHUSETTS AND, AM VERY PROUD TO SAY, HAVE WORKED WELL WITH EACH AND EVERY ONE, ENABLING US TO FULFILL OUR DUTIES AS THE WATCHDOG AND INSURER OF OUR INDUSTRY.

FORTY-TWO OF OUR MEMBER BANKS ARE ALSO MEMBERS OF THE FEDERAL HOME LOAN BANK SYSTEM AND, AS SUCH, HAVE ACCESS TO THEIR DISCOUNT WINDOW. WE IN THE MASSACHUSETTS THRIFT BUSINESS HAVE BEEN VERY RELUCTANT IN THE PAST TO BORROW. HOWEVER, THE OPPORTUNITY IS STILL THERE SHOULD WE NEED IT. THE AVERAGE BORROWING IN THE RECENT PAST FOR OUR OVER $5 BILLION INDUSTRY HAS BEEN APPROXIMATELY $50 MILLION. WE WORK IN CONJUNCTION WITH THE FEDERAL HOME LOAN BANK OF BOSTON INSOFAR AS SUPPLYING MONTHLY INFORMATION TO THE HOME LOAN BANK RELATIVE TO OUR 42 MEMBER BANKS WHO ARE ALSO MEMBERS OF THAT SYSTEM. THE EXAMINATION, AUDIT AND REPORTING PROCESS, TOGETHER WITH VISITATIONS BY PERSONNEL OF THE CENTRAL BANK, ENABLE US TO KEEP A VERY CLOSE SCRUTINY OF OUR BANKS' PERFORMANCE, THUS ENSURING THE SAFETY AND SOUNDNESS OF OUR INDUSTRY.

OUR TWO LARGEST INSTITUTIONS EACH REPRESENT ONLY 6% OF THE TOTAL ASSETS OF THE INDUSTRY. WE MONITOR ALL OUR INSTITUTIONS ON A VERY THOROUGH BASIS.

OUR INDUSTRY IS A STABLE ONE -- COMMUNITY BANKS SERVING COMMUNITY NEEDS. THEY ARE NOT INVOLVED WITH BROKERED CD'S OR OUT-OF-STATE REPURCHASE AGREEMENTS.

YOUR LETTER OF INVITATION TO APPEAR BEFORE THIS COMMITTEE REQUESTED SPECIFICALLY THAT I MAKE COMMENT AS TO THE LESSONS LEARNED AND SPECIFIC RECOMMENDATIONS TO THE CONGRESS REGARDING THE EVENTS IN OHIO IN TERMS OF STRENGTHENING OUR SYSTEM, STATE SUPERVISION AND IMPROVING THE FEDERAL RESPONSE TO STRAINS ON THE THRIFT INDUSTRY. SITUATIONS SUCH AS THAT WHICH OCCURRED IN OHIO WOULD NOT BE PERMITTED TO EXIST IN THE COMMONWEALTH OF MASSACHUSETTS FOR A NUMBER OF REASONS. SUCH A RAPID INCREASE IN ASSET SIZE OVER A SHORT PERIOD OF TIME WOULD IMMEDIATELY TRIGGER AN INVESTIGATION. IN ADDITION, THE RESULTANT GROSS DETERIORATION OF NET WORTH WOULD VIOLATE OURS AND THE BANKING DEPARTMENT'S NET WORTH REQUIREMENTS WHICH I DISCUSSED PREVIOUSLY. UPON AUDIT REVIEW, THE HOLDING OF COLLATERAL BY A NON-REGULATED GOVERNMENT SECURITIES DEALER WOULD BE DETECTED AND WOULD NOT BE PERMITTED TO CONTINUE.

THE SITUATION IN OHIO APPEARS TO ME TO HAVE BEEN A REGULATORY PROBLEM AND WHEN IGNORED AND NOT ACTED UPON BECAME AN INSURANCE PROBLEM.

OUR BANKS' OWN STRONG LIQUIDITY POSITIONS, SUBSTANTIAL LINES OF CREDIT, THE MEMBERSHIP IN OUR OWN RESERVE/LIQUIDITY FUND, THE MONETARY CONTROL ACT OF 1980 WHICH WOULD ALLOW THEIR ACCESS TO THE FEDERAL RESERVE DISCOUNT WINDOW, THE OVERALL STRENGTH OF OUR INDUSTRY AND WHAT WE CONSIDER TO BE A VERY STRONG CO-OPERATIVE

CENTRAL BANK -- ALL OF THESE WOULD PREVENT ANYTHING SO TRAUMATIC AS THE OHIO SITUATION FROM OCCURRING WITHIN OUR COMMONWEALTH. WE ALSO HAVE IN MASSACHUSETTS A CONSERVATIVE STATE LEGISLATURE WHICH HAS WISELY PLACED LIMITATIONS ON THE AMOUNT OF BORROWING AND ALSO ON THE TOTAL AMOUNT OF ANY ONE PARTICULAR LOAN OR INVESTMENT TO ANY ONE INDIVIDUAL.

YOU CAN SEE THAT THESE CHECKS AMD BALANCES WOULD PREVENT A SITUATION SIMILAR TO OHIO FROM EVER OCCURRING IN MASSACHUSETTS.

WHILE THE SITUATION HAS BEEN A MAJOR ITEM IN THE MEDIA, BY AND LARGE DEPOSITOR CONFIDENCE HAS BEEN MAINTAINED AND THROUGH OUR TRACKING PROCESS IT APPEARS THAT WE ARE STILL EXPERIENCING DEPOSIT IN-FLOWS.

I WOULD LIKE TO STRESS TO THE COMMITTEE ONCE AGAIN THAT EVEN THROUGH THE TRAUMATIC EXPERIENCE OF THE '30S AND EARLY '80S NOT ONE CO-OPERATIVE BANK HAS EVER FAILED, NOT ONE DEPOSITOR HAS EVER LOST A DOLLAR IN OUR SYSTEM, LIQUIDITY HAS ALWAYS BEEN MAINTAINED AND ALL DEPOSITS HAVE BEEN INSURED IN FULL.

RESPECTFULLY SUBMITTED,

JAMES L. BURNS, JR.
EXECUTIVE VICE PRESIDENT

Mr. BARNARD. I thank all of you for very, very splendid testimony.

One of the thrusts of our hearing and investigation has been to look into the adequacy of what we term the "State private insurance funds" and certainly all of you have brought testimony which is, at this point in the hearing, a breath of fresh air as to what you are doing to offset things that we have seen happen in Ohio.

And, I certainly want to commend you and say that it certainly gives this member of the committee a lot more confidence in the experience of funds such as you have.

Mr. Burns, I was intrigued by your statement that upon an audit review, the holding of collateral by a nonregulated Government securities dealer would be detected and would not be permitted to continue. I would just like to ask, briefly, all the members of the panel: How would you have responded if you had been confronted several months ago by a situation like Home State?

You have listened to the testimony this morning and I would be interested to know what would you have done in a situation such as this. We'll begin with Mr. Hogg.

Mr. HOGG. Mr. Chairman, in Maryland, we have had on the books of MSSIC since 1976, a regulation which would prohibit a borrowing position of that level. We limit all borrowing of our member institutions to 15 percent of their savings, not anywhere near the Ohio situation.

In addition, we have loan concentration limits which would limit the involvement with one institution.

Mr. BARNARD. Ms. Hathaway.

Ms. HATHAWAY. Yes, Mr. Chairman.

I think we have basically the same setup in Pennsylvania in that, as I stated in my testimony, we do have a law on the books of Pennsylvania that no institution may borrow more than 50 percent of its total savings. However, right now I know that at all of my institutions, most do not have borrowings and of those that do, the highest percentage is 3 percent.

Although we don't have a formal written guideline or written policy on that issue, I think we would start to very closely look at the borrowed money if it got to be 10 percent.

Mr. BARNARD. Both you and Mr. Hogg would have gotten this information, then, from the monthly reports furnished to you by your membership?

Ms. HATHAWAY. That's correct, I would and I think Mr. Hogg also would.

Mr. BARNARD. Mr. Beason.

Mr. BEASON. Yes, thank you, Mr. Chairman. Our regulations and, I think, State regulation limits a concentration of borrowings or lendings to 10 percent of assets or less than capital of some figure.

The financial analysis system we have has a flag system that kicks out items that are outside the norm and it just so happens that reverse repurchase agreements are a flag within our system and anytime those were to develop, it would be kicked out. Such a concentration would be found within a 45-day period from the time it took place.

Mr. BARNARD. Do your examinations come only through sharing of examination reports from the North Carolina State Department of Banking or Savings and Loan?

Mr. BEASON. No, sir.

Mr. BARNARD. You do your own examinations?

Mr. BEASON. Not examination, no, sir. The State does an annual examination as we would normally think of a bank examination. We perform operational audits or diagnostic reviews, more of the operational audit concept.

Our primary source of information is a monthly financial analysis system that is performed.

Mr. BARNARD. Mr. Lapidus?

Mr. LAPIDUS. The savings banks in Massachusetts are not limited in the amount of borrowing they can do, but the level of borrowing that was engaged in by Home State would have been considered to be an unsafe and unsound practice, we would have picked that up as, in fact, the Ohio Division of Savings and Loan picked it up. The issue was once you get the information, what do you do with it? I think that was where the difference would be. I think in Massachusetts something would have been done, something on the basis of the way the banking department has handled its responsibilities in the past.

Mr. BARNARD. Mr. Burns.

Mr. BURNS. Thank you. Our early warning system would have detected this immediately. We are informed on a monthly basis now as to the source of loans in terms of the loans.

Of our $50 million outstanding at the moment, 45 is on a matched basis from the Federal Home Loan Bank, 3 from our own liquidity fund, and 2 from the commercial banking system.

Anything above 10 percent would kick out a flag.

Mr. BARNARD. Mr. Beason, I believe that your insurance fund is the only one that has directors outside of your membership. Am I correct there?

Mr. BEASON. We have that. I don't know about the others.

Mr. BARNARD. Mr. Lapidus?

Mr. LAPIDUS. We have a board of 25 members, 21 are bankers and 4 are outside directors.

Mr. BARNARD. Mr. Beason, yours is exclusively outside directors; is that it?

Mr. BEASON. No, sir. The statute requires that a majority of the nine-member board be outsiders and independent.

Mr. BARNARD. Outside and independent. How do you feel this strengthens your fund or your organization?

Mr. BEASON. It gives us the quality of people who can look at what we do on a subjective basis without any personal feelings or motivations being involved.

Mr. BARNARD. How are they selected?

Mr. BEASON. They are nominated by a nominating committee made up for public directors.

Mr. BARNARD. Not from any supervisory agency or political entity?

Mr. BEASON. That's correct.

Mr. HOGG. Mr. Chairman, in Maryland, the Governor appoints three members of our board of directors.

Mr. BARNARD. Which are outside of your membership?

Mr. HOGG. Yes, sir.

Mr. BARNARD. Pennsylvania?

Ms. HATHAWAY. Pennsylvania has the same set up, eight are elected from the membership and three are appointed by the Governor as public interest directors.

Mr. BARNARD. Mr. Burns, what about your organization?

Mr. BURNS. Yes, sir. Soon our board will be made up of 15 elected from the officers and directors of the industry and 4 public interest directors nominated by nominating committee and elected by the corporate membership.

Mr. BARNARD. Mr. Lapidus, in your statement today, I believe you said there sometimes is a tendency on the part of the Federal regulators to view privately insured institutions and their insurers as outside of the system and that they put into place legal and policy impediments that make it difficult to effect the necessary coordination. Would you care to elaborate on that?

Mr. LAPIDUS. I don't mean to point fingers unnecessarily. I think it's a matter that the private insurance funds don't have a governmental nexus so there is a tendency to think of them as simply outsiders.

I think it is something that is remediable. I have the good fortune of having worked within the Federal regulatory system for a large part of my career and have very good relationships with Federal supervisors.

I haven't had any problem making those connections on my own, but I think in other States, it might be more difficult.

Mr. BARNARD. Mr. Beason, in your testimony, you said that we have fought within the private deposit insurance industry to establish national standards and a certification body for deposit insurers. What type of certification body would you like to see established?

Mr. BEASON. I'm not sure I have the answer to that yet. We have been working first, to try to set the parameters of what the standards ought to be. Obviously the first reaction would be an independent body, independent of us and independent of Government, if you will, but I don't think that we are opposed to that body having Government representation or being Government controlled though.

Mr. BARNARD. In other words, you see a body made up of representatives from the FSLIC, the FDIC, the Federal Reserve, or who are you talking about?

Mr. BEASON. Certainly not the FDIC or the FSLIC. I would have full faith in that body being under the jurisdiction of the Federal Reserve System.

Mr. BARNARD. From what membership would you obtain this certification group?

Mr. BEASON. Maybe it ought to be under the Federal Reserve System and that body appoint the other members and they could come from government or business and industry for that matter.

Mr. BARNARD. Why do you object to the FSLIC or FDIC?

Mr. BEASON. Well, quite frankly, I think the standards that we have set are clear and stand on their own and I would personally object to that situation.

Mr. BARNARD. In other words, in your valuation, you've got a better system than the Federal system?

Mr. BEASON. I was trying not to say that.

Mr. BARNARD. I think it's obvious you said that.

That's a very interesting approach. Do you foresee that in this situation that there would be a mandatory membership or would it be a voluntary membership, as far as the State insurance funds are concerned?

Mr. BEASON. I think being from North Carolina, you have to recognize that I am a States Righter without any reservation. But, at the same time, I think national public policy does come into play and has to override some things. With the depositors in Ohio suffering as they have, regardless of whose responsibility it is or how it developed.

Nebraska and California are having the same situation. That's where we come down and think that something has to be done for the national policy aspect of this and yes, I think that overrides and is effective.

Mr. LAPIDUS. Mr. Chairman, may I comment on that question as well?

Mr. BARNARD. Sure.

Mr. LAPIDUS. Mr. Beason and I and a number of people at the table have spent sometime over the past year discussing regulatory standards. As far as the State funds go, we're not making a circle with the wagons, but if we are making a circle with the wagons, we only want the good guys inside.

We have been injured by funds such as the Ohio fund and Nebraska fund which went under. What we want to do is distinguish ourselves from the funds that are weak and, in fact, in discussing these standards, all of us admitted, very clearly that if we have real standards, appropriate standards, some people are going to be left out and that's exactly what should happen.

Mr. BARNARD. You know, I was interested in—and I am going to finish so I can let my colleagues finish this questioning—the percentage of reserves to total assets insured.

Mr. Hogg, did I understand you to say that your ratio is 16 percent?

Mr. HOGG. No, sir. That 16 percent was the liquidity level of our member institutions.

Our reserves to savings insured at yearend was 2.31 percent.

Mr. BARNARD. Your's was 2.31.

Mr. HOGG. Yes, sir.

Mr. BARNARD. What about Pennsylvania, Ms. Hathaway?

Ms. HATHAWAY. Pennsylvania's, at the end of January, were 2.46 percent.

Mr. BARNARD. Well, since we're on that subject——

Mr. BEASON. Our reserves to savings, I think are 2.4 and the liquidity position of our institutions is over 30 percent. The net worth position of the institutions is over 6 percent.

Mr. BARNARD. Mr. Lapidus?

Mr. LAPIDUS. Ours is 3.2 percent.

Mr. BURNS. Our coverage factor, including the reserve liquidity fund, are about 3.6 percent. Liquidity is about 28 percent and the

net worth of the industry is about 7.2 percent of deposits and 6.8 percent of assets.

Mr. BARNARD. In Ohio, we have a situation which I might describe as a catastrophic loss. I mean, here's a $1.5 billion institution, the largest institution insured.

Is there some danger in any of these funds that an institution, the largest that you have, could cripple your fund?

Mr. BEASON. Mr. Chairman, that's always a possibility, but a $50 million total asset savings and loan association could suffer a $150 million loss if they engaged in the kind of concentration that you have been talking about in Ohio.

Mr. BARNARD. Would anyone else like to respond to that?

Mr. LAPIDUS. Yes. Our largest institution—our largest fully insured institution is about $800 million in assets. If it suffered the same relative loss as Home State had suffered, the loss would be $120 million and we could easily cover that.

Our two largest institutions don't constitute more than 10 percent of our liabilities so we could cover that as well.

Mr. BARNARD. Mr. Burns?

Mr. BURNS. Our four largest institutions were among the 15 we assisted in the early 1980's, primarily because they are located in metropolitan areas and were losing money to the money market funds. They are all about 5 percent in assets now and most are paying us back.

Mr. BARNARD. Mr. Burns, are the institutions in your fund, do they have access to the discount window?

Mr. BURNS. Under the Monetary Control Act of 1980, they would, sir, and out of that 100, 42 would be members of the Federal Home Loan Bank System and would have access to that window as well.

Mr. BARNARD. Were you encouraged this morning—I presume you were here—by what you heard from the Federal Reserve as to the so-called precedent it established here with Ohio? Are you encouraged by that? What is your general feeling about that?

Mr. HOGG. Well, we've known, sir, since 1980 the Monetary Control Act, that the Fed had the requirement to lend to our institutions. There has not been opportunity for the thrift industry to really exercise that until the Ohio situation, but it did not surprise us because the Fed is very good at what it does and it has been authorized and required to do that since 1980.

Mr. BARNARD. You didn't learn anything new from that?

Mr. HOGG. No, but we were pleased with their response.

Ms. HATHAWAY. I would just add too that we in Pennsylvania were pleased with the Fed's response. The Federal Reserve Bank of Philadelphia was in immediate contact with me regarding whether or not our members were experiencing any troubles and giving me the information to disseminate to our members immediately that if they did start to have liquidity problems, we had a certain set of guidelines in place that they should follow and our institutions do have the same access to the Federal Reserve. The one thing I would stress, that I think I skipped over inadvertently in my testimony was that one of the lessons we did learn from the Ohio situation is that we are requiring our member institutions, at this point, to establish a borrowing relationship with a Federal Reserve bank. Some of them do not now have that.

Mr. BEASON. After the act of 1980, we immediately required all of our institutions to file and maintain borrowing agreements with the Fed. They have been in place since that time. We have had no reason to believe that the Fed would act in any other way than to honor this.

I might point out that we have read that the institutions in Ohio did not have those borrowing agreements in place.

Mr. LAPIDUS. As Ms. Hathaway indicated, we are not only encouraged by the testimony this morning, but by the actions of the Federal Reserve after the Ohio situation broke. The commissioner of banks, Paul Bulman, who will be on the next panel, and I chatted about that. I got in touch with the Federal Reserve and they indicated they were prepared to meet their responsibilities under the Monetary Control Act. They subsequently sent in a group of examiners to take a look at our reports. We filled them full of information and Girl Scout cookies, which had just come in, and I think they left happy on both counts.

Mr. BURNS. The Fed did its job and it did it very well. We appreciate that very much. We have been in daily contact with the Boston Fed and as Len has said, we have had their examiners contact our office and they have been very cooperative. We appreciate it.

Mr. BARNARD. Mr. Craig.

Mr. CRAIG. Thank you very much, Mr. Chairman. I appreciate the extent and depth of your testimony this morning and the obvious confidence you do display and the ability of your individual funds to handle crisis and the method by which you operate. That is, as the chairman reflected, very gratifying to all of us.

A couple of questions and I would ask them somewhat generically so if you would all like to respond as you have to the chairman, I would appreciate that.

Are your respective States allowed to, or have they, by law, placed their full faith and credit behind your deposit insurance funds?

Mr. HOGG. In Maryland specifically, no, sir. Our charter, which is title 10 of the Financial Institutions Article of the Maryland Code does not place the full faith and credit of Maryland.

Mr. CRAIG. Do you feel that is necessary?

Mr. HOGG. No, sir.

Ms. HATHAWAY. In Pennsylvania, our statute, the statute that created the corporation, does state that the faith and credit of the Commonwealth is not pledged in any way.

Mr. CRAIG. Is not?

Ms. HATHAWAY. Is not pledged and we do not feel that that is necessary.

Mr. BEASON. The answer to the question is no, and it's one reason we have a name that does not have the name of the State within in.

Mr. LAPIDUS. The same is true of Massachusetts. I'll answer for both Mr. Burns and me. Full faith and credit is not dedicated to the fund.

Mr. CRAIG. You have, in large part, responded. Would either or any of you like to respond in any additional way as to how you might handle in your own States, based on your own experience, a

situation somewhat like the Home State situation in Ohio and how you might deal with that if that were to occur? Mr. Burns.

Mr. BURNS. On a for-instance basis, if that reverse had gone to $60 million, we would have staff at that particular institution finding out the terms, conditions, collateral, requirements, and so forth and then would work with the banking department and get that reversed.

Mr. LAPIDUS. I'll respond to that with the luxury of not having faced the situation, and not having all the facts, so I can work out a nice solution. First, I would draw a distinction between solvency problems and liquidity problems.

And, Ohio is interesting because there were both of them, the solvency problem was with the Home State Savings Bank and solvency problems are handled by insurers.

Liquidity problems are handled, partly out of one's own resources, partly out of lines that you might have with commercial banks or investment banks or what have you.

From the Home Loan Bank, if you're a member, and ultimately from the Federal Reserve which has the authority to lend to any depository institution under the Monetary Control Act.

In order to keep Home State open, and perhaps also in order to stop the runs that occurred, the insurance entity would have had to have made up the loss. If the insurance company didn't have the resources to make up the loss, then it has to come from someone else and in the typical circumstance, there would have been some additional assessment from members to make up the loss.

The difference between the resources of the Ohio Fund and, at least, the indicated loss at the time, did not seem to be very great. It would seem to me that there should have been a possibility of assessing the membership and effectively making up the difference.

With respect to the liquidity problem, to the extent that there weren't lines available or resources available within the institution, one would have hoped that the Federal Reserve could have done the job as they appeared to be ready to do.

Now, there are gaps in this scenario of mine because I am not familiar with all of the facts of the situation except what was testified to this morning.

Mr. CRAIG. Mr. Beason.

Mr. BEASON. Not to repeat what they have said, but maybe go back to an earlier date, I understand from what I have heard and read that the State and the fund had agreements from the institution to back out of these investments.

The first time they found a failure to follow those agreements, I think we would have replaced officers and directors of that institution and caused a change of control which would have then effected those changes.

Mr. CRAIG. Do you have cease-and-desist authority?

Mr. BEASON. We do not use the words, "cease-and-desist." We have the authority to take any action we deem appropriate for the protection of the depositors and then we have a list in our standards and procedures of what those include but not a limit, that would include removing officers and directors if they do not take the actions we request them to take.

Mr. CRAIG. Ms. Hathaway.

Ms. HATHAWAY. Yes. I think that in that regard, and I don't want to echo what everyone else has said, but I think we, in Pennsylvania, do have requirements and regulations in place that would prevent that same kind of scenario, in the first place, and we do have the supervisory powers to issue cease-and-desist orders, replace management, remove officers and directors and certainly we would be enforcing those kinds of things.

Mr. HOGG. I would just add, sir, that to be in this business, you need regulations. You need an early warning system, but neither of those works unless you enforce violations of your regulations and bring about compliance through the cease-and-desist order, removal power or whatever authority you need to correct the problem.

Mr. CRAIG. I appreciate those comments. One last question and then I am going to have to run and vote.

Mr. Lapidus, the State and private funds like yours have been a part of a dual banking system for quite some time. There are some that are now arguing that all regulations should be done at the Federal level, that there is no longer a need or an advantage to a dual system of chartering regulation and insurance. What are your views on this and the reasons for your position and, of course, if any of you would like to comment on that question, we would be more than happy to hear it.

Mr. LAPIDUS. Yes, I would like to comment on that.

I have served both as regulator in State systems and in the Federal system. I worked for the Federal Reserve for 13 years in New York. I was in the New York State Banking Department for 2 years as first deputy superintendent and later as acting superintendent and was assistant to the chairman of the FDIC for a few years and I headed the Central Liquidity Facility of the National Credit Union Administration and was director of the National Credit Union Share Insurance Fund. So, I have spent most of my career in banking and bank regulations on both the State side and the Federal side.

I think there is a significant underappreciation of the importance of the dual banking system despite the fact that we very often salute it.

If you take a look at the kinds of initiatives that have developed at the State level and the richness that it provided to the banking industry, I think you have to recognize how important it is that it not be destroyed in times of crisis through the overreaching at the Federal level.

Just to tick off some of the important things, the NOW account was developed in Massachusetts at a time when we did not have Federal insurance, at the time that Federal insurance was not imposed upon Massachusetts banks, and it would not have otherwise developed. The NOW account was the seed that led to the development of the financial reform on the national level.

Variable rate mortgages developed in the States long before it was made possible for federally chartered institutions to offer VRM's. Now, as you know, probably 70 percent of the mortgages are issued in VRM form and everybody is pushing institutions to match their asset and liability maturities by use of VRM's.

Financial reform of the Garn-St Germain type was first passed in the State of Maine.

Competitive standards, of the kind that were developed in the 1960's, probably were developed in New York State before they were developed here.

Those are only examples.

Mr. SPRATT. There will be a short recess while the members go to the floor to vote.

[Recess taken.]

Mr. BARNARD. We apologize for the process, but we will be underway like this now for the rest of the afternoon.

Were any of you notified by any Federal agency or otherwise as to the situation at ESM in Florida?

Mr. HOGG. No, sir, we were not.

Ms. HATHAWAY. No, in Pennsylvania we weren't.

Mr. BEASON. Not to my knowledge by a Federal agency, but by some means our people determined that what was happening there was not an appropriate investment for our institutions to make and we were able to put that word out ourselves sometime back.

Mr. BARNARD. You don't insure credit unions, do you?

Mr. BEASON. Yes, sir, I do.

Mr. BARNARD. You do?

Mr. BEASON. Yes, sir.

Mr. BARNARD. Did you get information from the National Credit Union Administration?

Mr. BEASON. Not to my knowledge. We may have, but I don't know that for a fact. Some of my supervisory people may have.

Mr. BARNARD. Mr. Lapidus?

Mr. LAPIDUS. No, we were not.

Mr. BARNARD. Mr. Burns?

Mr. BURNS. No, sir, we were not, but we conduct regular seminars for our people, instructions on how to safeguard the purchase and sale of securities.

Mr. BARNARD. We want to thank all of you for your very valuable testimony today and it is encouraging that these organizations which you represent are as strong as they are. I am sure it is of confidence, as well, for the public and we appreciate your testimony. Thank you very much.

The next panel will represent the supervisors of the State savings and loan organizations.

I would like to ask at this time if Mr. Charles H. Brown would take the witness stand, Mr. George C. King, Mr. Ben McEnteer, and Mr. Paul E. Bulman.

Gentlemen, we appreciate very much your being here today and helping us with this testimony as to the operation of your supervisory agencies and we would certainly entertain your testimony at this time.

I would like to say that we would be more than pleased to include your entire statement in the record without objection and if you care to summarize, it would certainly be up to your own decision.

And, we will begin with Mr. Brown.

STATEMENT OF CHARLES H. BROWN, JR., DIRECTOR, DIVISION OF SAVINGS AND LOAN ASSOCIATIONS, STATE OF MARYLAND

Mr. BROWN. Mr. Chairman, members of the committee, I am Charlie Brown, director of the division of savings and loan associations for the State of Maryland.

I think, Mr. Hogg, from the Maryland Savings-Share Insurance Corp., when he addressed you, stole some of my thunder. A lot of my testimony he has already given you, but I will say that the division regulates 115 associations, 13 of which are insured by the Federal Savings and Loan Insurance Corporation and has assets of $1.6 billion.

We have 102 State-chartered associations insured by the Maryland Savings-Share Insurance Corp. with assets of $8.9 billion, so we have a $10.5 billion industry on the State-chartered side.

Additionally in the State of Maryland, just for informational purposes, there are 44 federally-chartered associations with $9.5 billion in assets so we have a $20 billion industry in the State of Maryland.

The assets of the 102 MSSIC-insured institutions range from $1.6 billion downward to our smallest association of $152,000. We have 18 associations with assets in excess of $100 million and 58 associations with assets under $10 million.

We have many small neighborhood ethnic associations, many of which are open to the public only 1 or 2 evenings a week.

Under Maryland law, the division is required to examine our associations at least once every 2 years. At the present time, examinations are made approximately every 14 to 15 months.

If need be, an association could be examined more frequently if the division director considers it necessary. Additionally both the division and the insurer, MSSIC, require that our institutions submit a monthly operating report so that we can keep abreast of the operations between examination periods.

Associations with assets of $5 million or more are required to have an annual audit done by an independent C.P.A. That annual audit goes to MSSIC, the insurer, and to the division.

The division works very closely with the insurer, MSSIC, in the supervision of the State-chartered industry. MSSIC receives copies of the examinations made by the division. MSSIC attends the exit conference that we have with management after the examination is completed.

Both agencies receive copies of the independent audit. Information is exchanged by the agencies so that we are kept fully aware of the operations of each and every institution. If a supervisory conference, with any institution, is necessary, both agencies are involved. Additionally the division director, myself, attends the monthly meeting of the board of directors of the insurer and Mr. Hogg, president of MSSIC, attends the meetings of the board of savings and loan association commissioners.

There is full cooperation between the two agencies in the supervision of our industry.

One of the questions that I was asked in that letter that was sent me was, "Comment on the Ohio Deposit Insurance situation and the adequacy of responses by State and Federal officials."

I would like to state that the regulator and the insurer in Maryland took steps to insure that our institutions were fully informed of the situation, that our associations were prepared to meet unusual withdrawals resulting from publicity from the failure of Home State and the Ohio fund.

Our insurer, MSSIC, was very liquid and was prepared to render whatever assistance that might be needed by the membership.

On learning of this situation, Mr. Hogg and myself met with the Governor's staff within a day or two. We met with the president of the senate in Maryland, the speaker of the house to apprise them what was going on and that it could have some effect on Maryland associations. We met with the larger commercial banks in Maryland and the head of the Baltimore office of the Federal Reserve Bank of Richmond.

We had full cooperation from the banks. The Federal Reserve bank was outstanding. They moved fast to render whatever assistance they could give to us. A lot of our associations had already given the necessary documentation to the Federal Reserve bank years ago when the opportunity presented itself.

The Federal Reserve bank was there when they were needed. The Federal Home Loan bank in Atlanta kept in touch with me twice a day to see what was going on in Maryland, anticipating that there might be a lot of applications for conversion.

As late as yesterday, I talked with them, yesterday afternoon.

I would just like to say that the Government agencies, both on the Federal level and the State level reacted promptly for the protection of the industry and the public in the State of Maryland.

That's all I have to say, Mr. Chairman.

[Mr. Brown's prepared statement follows:]

HARRY HUGHES
GOVERNOR

FREDERICK L. DEWBERRY
SECRETARY

STATE OF MARYLAND

DEPARTMENT OF LICENSING AND REGULATION
DIVISION OF SAVINGS AND LOAN ASSOCIATIONS
THE BROKERAGE - SUITE 800
34 MARKET PLACE
BALTIMORE, MARYLAND 21202-4078
301 659-6330

CHARLES H. BROWN, JR.
DIRECTOR

WILLIAM S. LECOMPTE, JR.
DEPUTY DIRECTOR

March 29, 1985

Representative Doug Barnard, Jr., Chairman
Commerce, Consumer and Monetary Affairs Subcommittee
Rayburn House Office Building, Room B-377
Washington, D. C. 20515

Dear Representative Barnard:

In response to your letter of March 22, 1985, I would be pleased to appear at the subcommittee's hearings on the Ohio deposit insurance situation which will be held on Wednesday, April 3, 1985.

I am enclosing herewith the data requested in your letter and which will be included in any testimony that I might give during the hearings.

Very truly yours,

Charles H. Brown, Jr.
Director

CHB:kg
Enclosure

HARRY HUGHES
GOVERNOR

STATE OF MARYLAND

CHARLES H. BROWN, JR.
DIRECTOR

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FREDERICK L. DEWBERRY
SECRETARY

WILLIAM S. LECOMPTE, JR.
DEPUTY DIRECTOR

The Division of Savings and Loan Associations was created by the State Legislature in 1961 for the purpose of regulating the State-chartered savings and loan industry in Maryland. The insurer, more popularly referred to as MSSIC, was created by the Maryland State Legislature in 1962 for the purpose of insuring savings accounts of State-chartered savings and loan associations which were not federally insured by the Federal Savings and Loan Insurance Corporation (F.S.L.I.C.). The corporation, although created by the State Legislature, is not a State agency nor is the insurance of savings accounts backed or guaranteed by the State of Maryland. However, under Maryland Law the Governor of the State of Maryland does appoint three public interest or consumer members to the Board of Directors of the corporation. The remaining eight directors are elected by the membership consisting of the 101 institutions insured by it.

The Savings and Loan Division for the State of Maryland has a staff of 30 individuals of which 18 are field examiners, 2 examiner-supervisors and a chief examiner. Additionally, there is the Director of the agency, Charles H. Brown, and the Deputy Director, William S. LeCompte, plus clerical employees. Since 1982 the Division has operated on the budgets as set forth below:

1982	Actual	$ 674,125
1983	Actual	708,387
1984	Actual	734,015
1985	Appropriated	960,785
1986	Proposed	1,020,604

The Division of Savings and Loan Associations, for the State of Maryland, regulates 114 State-chartered associations as follows:

	Assets December 31, 1984 in Billions
13 State-chartered with insurance of savings accounts by the Federal Savings and Loan Insurance Corporation (FSLIC)	$ 1.6
101 State-chartered with insurance of savings accounts by the Maryland Savings-Share Insurance Corporation (MSSIC)	8.9
Total State-chartered industry	$10.5

The 13 associations insured by the FSLIC have assets ranging from $495 million downward to $21 million. The assets of the 101 MSSIC insured institutions range from $1.6 billion downward to our smallest association of $152,968. We have 18 associations with assets in excess of $100 million and 58 associations with assets under $10 million. We have many small, neighborhood associations, some of which are open to the public only one or two evenings per week.

Under Maryland law the Division is required to examine our associations at least once every two years. At the present time examinations are made approximately every 14 to 15 months. If need be an association could be examined more frequently if the Division Director considers it necessary. Additionally, both the Division and the insurer, MSSIC, require that our institutions submit a monthly operating report so that we can keep abreast of the operations between examination periods. Associations with assets of $5 million or more are required to have an annual independent audit by a Certified Public Accountant.

Presently, the Division has limited enforcement authority. However, as a result of a 1984 Maryland legislative summer task force study of the savings and loan industry, several bills were introduced in the State legislature this year which will give the Division greater authority to regulate the industry. These bills cover the following:

1. The authority to issue a Cease and Desist Order for any violations of Maryland law or regulations of the Division.

2. Would allow the removal of any officer or director found to be operating in an unsafe and unsound manner.

3. Clarification of the regulatory authority of the Board of Savings and Loan Commissioners over State-chartered associations.

4. Requirement that an association must have available for the public an annual financial statement.

The Division Director and the Board of Savings and Loan Association Commissioners are satisfied that these new powers will give the Division the authority to regulate the State-chartered industry. These bills are awaiting passage in the Senate and the House and when passed and signed by the Governor will become law effective July 1, 1985.

By regulations of the Board of Commissioners, our institutions are required to maintain a net worth of at least 3% of the savings deposits. Additionally, the insurer, MSSIC, also has its own net worth requirements which I am sure will be included in the presentation by Charles Hogg, President of MSSIC.

Presently we do not have any associations that we feel have severe operating problems. There are always some associations which we feel we need to monitor more closely than others and at this time we have three associations in this category.

The Division works very closely with the insurer, MSSIC, in the supervision of the State-chartered industry. MSSIC receives copies of the examinations made by the Division. Both the Division and the insurer receive the monthly operating report of each association. Both agencies receive copies of the annual independent audit. Information is exchanged by the agencies so that we are both kept fully aware of the operations of each and every institution. If a supervisory conference with any institution is necessary, both agencies are involved. Additionally, the Division Director attends the Board of Directors meetings of the insurer and Mr. Hogg, President of MSSIC, attends the meetings of the Board of Savings and Loan Commissioners. There is full cooperation between the two agencies in the supervision of our industry.

Maryland Law requires that any institution operating within the State must have insurance of savings accounts by either the Maryland Savings-Share Insurance Corporation or the Federal Savings and Loan Insurance Corporation. Although the Division does not have the authority to terminate the insurance, the insurer, MSSIC, does have such authority. The termination of the insurance, however, would probably result in a supervisory merger of an institution with a stronger association or the appointment of a conservator or a receiver for liquidation purposes. In that respect, under Maryland law the Federal Savings and Loan Insurance Corporation or the Maryland Savings-Share Insurance Corporation has an absolute right to be appointed conservator or receiver of a savings and loan insured by it.

With regards to the Ohio situation it is felt the regulator and insurer here in Maryland took steps to assure that our institutions were fully informed of the situation and that our associations were prepared to meet unusual withdrawals resulting from publicity from the failure of the Home State Savings and Loan Association and the Ohio Deposit Guaranty Fund. Our insurer, MSSIC, was very liquid and was prepared to render whatever assistance that might be needed by the membership. It is felt other government agencies, in particular the Federal Reserve Bank, moved promptly to render any needed assistance for institutions which qualified. The Federal Home Loan Bank of Atlanta kept in constant touch with the Division to determine whether Maryland was having any savings losses which could result in a large number of applications for federal insurance of savings accounts.

In conclusion I would say that all government agencies on both the state and federal level reacted promptly for the protection of the industry and, more in particular, the public.

Submitted by Charles H. Brown, Director
Division of Savings and Loan Associations,
State of Maryland

March 29, 1985

Mr. BARNARD. Thank you very much, Mr. Brown.

STATEMENT OF GEORGE C. KING, ADMINISTRATOR, SAVINGS AND LOAN DIVISION, NORTH CAROLINA DEPARTMENT OF COMMERCE

Mr. KING. I am happy to respond to your recent inquiry concerning the manner in which State/private insurance funds interact with their supervisory agencies. The savings and loan division presently has a very competent 13-member professional staff that is responsible for supervising 81 State-chartered savings and loans representing a total of approximately $6.5 billion in assets.

Thirty-four of the 81 institutions have their deposits insured by the Financial Institution Assurance Corp. [FIAC] and they have about $2 billion in deposits. We have very broad supervisory and enforcement powers provided in our State statutes. We examine all institutions at least annually.

We monitor the associations based on monthly information submitted to us and, if adverse trends are detected, take appropriate action to make necessary corrections. It is my opinion that present powers vested in me by State statutes are adequate to address any foreseeable adverse situations.

Our statutes and regulations do require that our State-chartered associations maintain reserves and liquidity and minimum limits are established for these purposes.

Minimum reserves are based on perceived risk of the association's assets. Liquidity investments are limited to cash and unpledged short-term securities with maturities of 5 years or less. Although the minimum liquidity requirement is 5 percent of net deposits, the average liquidity of all State-chartered shops is approximately 12 percent and the average liquidity of FIAC-insured associations is almost 20 percent.

I feel that the cooperation between the division and FIAC is most satisfactory. All of our examination information is provided to the fund on a timely basis. Because of the very close working relationship that exists between the division and the fund, any supervisory actions taken are carefully coordinated.

We examine FIAC on an annual basis as well as maintain a continuing dialog throughout the course of the year. Accordingly, we feel adequately qualified to address this area. Basically, we are very pleased with the operation and approach utilized by FIAC in keeping abreast of its insured institutions on an ongoing basis.

Moreover, we are of the opinion that necessary coordination and full cooperation between FIAC and ourselves is fully in place at the present time. We are entirely satisfied that FIAC is adequately carrying out its responsibilities in a competent manner and, cooperation with our division is more than satisfactory.

In regards to the recent situation in Ohio, the following remarks/observations are predicated entirely on media articles that have been released to date. Accordingly, the following comments are offered in that context. The most disturbing aspect of the Ohio deposit insurance situation is that the State and the fund apparently did not have adequate plans in place for dealing with a major crisis or default.

It also appears that the State had very little supervisor oversight over the Ohio Deposit Guarantee Fund [ODGF] and little direction as to how the fund could or would respond to a major crisis. Significant questions surround this situation but apparently both the State regulator of savings and loans and the ODGF were either not aware or not capable of acting to correct serious deficiencies in the financial condition of a large supervised institution. As a State regulator working in a State with State/private insurance fund, I cannot understand how the situation in Ohio got to the position it did without the State and the ODGF taking action to defuse the problem.

I feel that our system in North Carolina is sound. We closely monitor all State-chartered associations and endeavor to work closely with our Federal and private insurance counterparts to see that the deposit of funds in our institutions are safe.

Moreover, we supervise and annually examine the private insurance fund and monitor its operation. We communicate with FIAC on a continuous ongoing basis as to the condition of our privately-insured institutions and I am fully confident that we have adequate contingency plans in place to deal with potential problems.

The lesson we have learned from the recent debacle in Ohio is that situations and actions in other geographic locations over which we have no input or control can have an effect on us in North Carolina.

We would like to see strong, minimum standards be put into place that would have to be met by any entity that wishes to provide deposit insurance for financial institutions. These standards should include: (1) capable fund management; (2) minimum reserve requirements; (3) strong monitoring capabilities; (4) adequate enforcement powers; (5) independent directorate; (6) qualified State regulators; (7) liquidity capabilities, and (8) underwriting standards.

Mr. Chairman, at the appropriate time, I will be glad to respond to any questions the committee may have.

Mr. SAXON. Mr. Chairman, the gentleman, when his microphone was turned off, I heard him say, I believe the primary problem in Ohio or the most important problem in Ohio is, and I couldn't understand where you went from there.

Mr. BARNARD. We heard a lot of words today. I didn't know if our ears were playing out or not.

Mr. KING. I'm sorry, Mr. Chairman. I just thought that it was on. What I had said, sir, was, "The most disturbing aspect of the Ohio deposit situation is that the State and the fund, apparently did not have adequate plans in place for dealing with a major crisis or default."

This is something that, from our standpoint, we do on an ongoing basis to try to determine what a worse-case-type situation would be and how we would deal with it, both from a safety and soundness standpoint and from a liquidity situation.

[Mr. King's prepared statement follows:]

North Carolina Department of Commerce
430 North Salisbury Street • Raleigh, North Carolina 27611

James G. Martin, Governor — Howard H. Haworth, Secretary

March 29, 1985

The Honorable Doug Barnard, Jr.
United States House of Representatives
Washington, D.C. 20515

Dear Mr. Barnard:

This is in response to your letter of March 22, 1985 in which you request specific information in anticipation of my appearance before your Subcommittee on April 3, 1985.

The response follows the same chronological order as outlined in your letter. Also enclosed are exhibits which we concluded would provide additional pertinent information to assist the Subcommittee in their deliberations.

1a.

	Budget	Professional Staff	
Fiscal Year End 6-30		Supervisory	Examination
1982	$580,000	3	8
1983	$523,000	3	10
1984	$616,000	5	9
1985 (Projected)	$780,000	5	8

1b.

Asset Size	FIAC Insured		FSLIC Insured	
(Millions of Dollars)	Number	Avg. Size	Number	Avg. Size
0-25	8	$16,540,811	13	$17,904,453
25-50	12	$33,873,275	11	$38,294,918
50-100	7	$65,576,672	11	$71,405,151
100+	7	$221,537,769	12	$202,848,806

1c. Under the North Carolina General Statutes the Administrator may examine savings and loan associations any time he "deems it prudent". In actual practice, every association is examined within twelve calendar months from the date of the previous examination. Moreover, if any adverse trend is discernible from our review of the required associations' monthly monitoring reports, the examination process is accelerated to determine what, if any, problems may be developing. This could include a full scope examination or a modified examination specifically geared to address the perceived problem area. Also, in instances of known problem institutions, the examining cycle is shortened.

The Administrator is vested with considerable power to maintain safety and soundness in the institutions for which he is responsible. These powers cover the whole range of supervisory prerogatives from the issuance of cease and desist orders, civil and criminal sanctions and removal of officers and directors. Enclosed under Exhibit 1 are the applicable statutes that address the remedies that are available to the Administrator to affect correction of unsafe and unsound practices or procedures by an association and its officers and/or directors.

Since my employment with the Division in 1976, in two instances it was considered necessary to resort to a written supervisory agreement to affect correction, while in five other situations it proved necessary to arrange a supervisory acquisition action. The other remedial options available to the Administrator have not proved necessary to utilize up to the present time. We have found that moral suasion has been an effective tool to correct most association problems. However, in direct response to your question, we opine that the present powers vested in the Administrator are adequate to address any foreseeable adverse situations. Further, because of our close supervisory working relationship with the Financial Institutions Assurance Corporation and FSLIC respectively, which obviously share our common goals of assuring the safety and soundness of our supervised institutions, their additional powers such as termination of deposit insurance further assists in assuring the ongoing viability of our savings associations.

1d. We impose both a General Reserve Requirement (adequacy of net worth/capital) and a Liquidity Requirement as provided under North Carolina Administrative Code, Title 4, Chapter 16D.0701, .0601, and .0602, respectively. See Exhibit 2.

Under the General Reserve Requirements, varying percentages of net worth are applied against an association's assets based on the perceived risk inherent in a particular type/class of asset. Accordingly, investments in the insurer's fund are considered riskless, while assets classified loss are considered a 100% risk, with various other graduations between these two extremes as indicated under Exhibit 3. This form was recently upgraded to more adequately reflect the present composition of an association's assets (under deregulation) as well as the perceived risk associated with such assets.

Basically the Liquidity Analysis (See Exhibit 4) format is designed to identify those assets that are considered reasonably liquid and that can be sold (with minimal loss potential) to augment possible liquidity demends such as unexpected deposit withdrawals, etc. Assets that are considered liquid include cash, deposits with other institutions and unpledged securities with maturities of five years or less. The minimum requirement is equal to 5% of the association's net deposits.

1e. We do not maintain a "problem" list, per se. However, we have adopted an adaptation of the interagency rating system used by the Federal agencies known as the CAMEL rating system. We are reluctant to disclose any additional information because of the obvious sensitivities of the situation.

2a. All of our examination reports on FIAC insured institutions are provided to the insurance fund in a timely manner; usually within 30 days after the close of the examination. In addition, copies of all correspondence between the Savings and Loan Division and FIAC insured associations are provided to the insuring corporation. Because we work closely with the insurance fund, any supervisory actions taken by the Savings and Loan Division involving FIAC insured associations are carefully coordinated between the fund and the Division. All related information and documents are also provided by us to the insurance fund.

2b. North Carolina statute requires that all savings and loans have insurance of accounts. The termination of this insurance, if the need for such action should arise, would be initiated by FIAC. Specific authority for taking this action is not vested in the Administrator of the Savings and Loan Division nor in the Savings and Loan Commission. There has never been an insurance of accounts termination in North Carolina. Because of the close ongoing working relationship that exists between the Division and FIAC, we cannot envision that an insurance of accounts termination could occur without the full knowledge and concurrence of the Savings and Loan Division.

3. We examine FIAC on an annual basis as well as maintain a continuing dialogue throughout the course of the year. Accordingly, we feel adequately qualified to address this area. Basically, we are very pleased with the operation and approach utilized by FIAC in keeping abreast of its insured institutions on an ongoing basis. Moreover, we are of the opinion that necessary coordination and full cooperation between FIAC and ourselves is fully in place at the present time. In summation, we are entirely satisfied that FIAC is adequately carrying out its responsibilities in a competent manner and, cooperation with our Division is more than satisfactory.

4. The following remarks/observations are predicated entirely on media articles that have been released to date. Accordingly, the following comments are offered in that context. The most disturbing aspect of the Ohio deposit insurance situation is that the state apparently did not have adequate plans in place for dealing with a major crisis or default. It also appears that the state had very little supervisory oversight over the Ohio Deposit Guaranty Fund (ODGF) and little direction as to how the fund could or would respond to a major crisis. Significant questions surround this situation but apparently both the state regulator of savings and loans and the ODGF were either not aware or not capable of acting to correct serious deficiencies in the financial condition of a large supervised institution. As a state regulator working in a state with a state/private insurance fund, I cannot understand how the situation in Ohio got to the position it did without the state and the ODGF taking action to either prevent or defuse the problem.

I feel that our system in North Carolina is sound. We closely monitor all state chartered associations and endeavor to work closely with our federal and private insurance counterparts to see that the deposit funds in our institutions are safe. Moreover, we supervise and annually examine the private insurance fund and monitor its operation. We communicate with FIAC on a continuous ongoing basis as to the condition of our privately insured institutions and I am fully confident that we have adequate contingency plans in place to deal with potential problems. The lesson we have learned from the recent debacle in Ohio is that situations and actions in other geographic locations over which we have no input or control can have an effect on us in North Carolina. We would recommend that strong, minimum standards be put into place that would have to be met by any entity that wishes to provide deposit insurance for financial institutions. These standards should include 1) capable fund management, 2) minimum reserve requirements, 3) strong monitoring capabilities, 4) adequate enforcement powers, 5) independent directorate, 6) qualified state regulators, 7) liquidity capabilities and 8) underwriting standards.

6. We are forwarding to Mr. McSpadden a blank copy of our examination report used in conjunction with examining a privately insured savings and loan association as well as a blank copy of the examination report used in connection with our annual examination of FIAC. The purpose in forwarding these two examination reports is to provide the Subcommittee with some indication of the overall scope and depth of the respective examinations that we undertake in North Carolina. Each examiner is also furnished a comprehensive manual of instructions to assist in the examination of both federal and nonfederal savings and loan associations.

I trust the foregoing is fully responsive to your request.

Sincerely,

George C. King, Administrator
Savings and Loan Division

GCK/pr

(3) Notice to file claims;
(4) Claims of members;
(5) Payments of claims and distribution; and
(6) Final distribution and liquidation.

(b) Upon completion of liquidation, the liquidators shall file with the Administrator a final report and accounting of the liquidation. The approval of the report by the Administrator shall operate as a complete and final discharge of the liquidators, the board of directors, and each member or stockholder in connection with the liquidation of such association. Upon approval of the report, the Administrator shall issue a certificate of dissolution of the association and shall record same in the manner required by this Chapter for the recording of certificates of incorporation; and upon such recording, the dissolution shall be effective. (1981, c. 282, s. 3.)

§ 54B-43. Stock dividends.

No dividend on stock shall be paid unless the association has the approval of the Administrator. (1981, c. 282, s. 3; 1983, c. 144, s. 7.)

Effect of Amendments. — The 1983 amendment, effective April 6, 1983, rewrote this section, which formerly referred to stock ownership and dividends.

§ 54B-44. Supervisory mergers, consolidations, conversions, and combination mergers and conversions.

(a) Notwithstanding any other provision of this Chapter, in order to protect the public, including members, depositors and stockholders of a State association, the Administrator, upon making a finding that a State association is unable to operate in a safe and sound manner, may authorize or require a short form merger, consolidation, conversion, or combination merger and conversion of the State association as to which the finding is made. The resulting association may be a mutual association or a stock association.

(b) The Administrator shall promulgate rules and regulations to govern supervisory mergers, consolidations, conversions, and combination mergers and conversions authorized by this section. (1981, c. 670, s. 2; 1981 (Reg. Sess., 1982), c. 1238, s. 11.)

Editor's Note. — Session Laws 1981, c. 670, s. 3, provides: "This act is effective upon ratification but shall not apply to any savings and loan association chartered, but not yet operating, prior to said effective date." The act was ratified June 24, 1981.

Effect of Amendments. — The 1981 (Reg. Sess., 1982) amendment, in subsection (a), substituted "stockholders" for "shareholders" near the beginning of the first sentence, substituted "authorize or require a short form merger, consolidation, conversion, or combination merger and conversion of the State association as to which the finding is made" for "authorize a short form conversion, if the finding is made with regard to a mutual association, or a merger or consolidation of the State association as to which the finding was made, with any other State association" at the end of the first sentence and added the second sentence. In subsection (b), the amendment substituted "consolidations, conversions, and combination mergers and conversions" for "consolidations and conversions."

§§ 54B-45 to 54B-51: Reserved for future codification purposes.

ARTICLE 4.

Supervision and Regulation.

§ 54B-52. Administrator of Savings and Loan Division.

The Administrator of the Savings and Loan Division of the State is hereby empowered and directed to perform all the duties and exercise all the powers as to savings and loan associations organized or operated under this Chapter, unless herein otherwise provided. (1981, c. 282, s. 3.)

§ 54B-53. Savings and Loan Commission.

(a) The Savings and Loan Commission, which has heretofore been created, shall continue to exist and the seven members of the Savings and Loan Commission who have heretofore been appointed by the Governor shall continue to serve their full terms and their successors shall be appointed by the Governor as required by this section. The Governor shall on July 1, 1981, appoint three persons to the Commission for four-year terms. On July 1, 1983, he shall appoint two persons to the Commission for three-year terms, and two persons for four-year terms. All appointments to the Commission thereafter shall be for four-year terms. Any vacancy on the Commission shall be filled by the Governor for the unexpired term. A newly appointed commissioner shall assume office at the first regular or special meeting subsequent to his appointment.

(b) The members of the Commission shall elect one of their number to serve as chairman of the Commission for such term as set forth in rules adopted by the Commission. A vice-chairman and other officers may be elected as specified by the Commission.

(c) The term of a commissioner shall be four years, or until his successor is appointed and qualified.

(d) At least two members of the Commission shall be persons who are currently serving as managing officers of State associations. Four members of the Commission shall be appointed as representatives of the borrowing public and shall not be employees of or directors of any

financial institution or have an interest in any financial institution other than as a result of being a depositor or borrower.

(e) Meetings of the Commission shall be held regularly as provided in rules adopted by the Commission but no less than once each calendar quarter. Special meetings shall be held at any time upon the call of the chairman, or upon the call of any three commissioners. The Administrator shall call meetings when consideration by the Commission is required by law for contemplated action of the Administrator. Members of the Commission shall be reimbursed as prescribed by law for expenses incurred in the performance of their duties under this section.

(f) The relationship between the Secretary of Commerce and the Savings and Loan Commission shall be as defined for a Type II transfer under Article [Chapter] 143A of the General Statutes.

(g) The Savings and Loan Commission is hereby vested with full power and authority to review, approve, disapprove, or modify any action taken by the Administrator in the exercise of all powers, duties and functions vested in or exercised by the Administrator under the savings and loan laws of this State. (1981, c. 282, s. 3.)

§ 54B-54. Deputy administrator of Savings and Loan Division.

(a) There shall be a deputy administrator of the Savings and Loan Division who, in the event of the absence, death, resignation, disability or disqualification of the Administrator, or in case the office of Administrator shall for any reason become vacant, shall have and exercise all the powers and duties vested by law in the Administrator.

(b) The deputy administrator is authorized and empowered at any and all times to perform such duties and exercise such powers of the Administrator as the Administrator may direct. (1981, c. 282, s. 3.)

§ 54B-55. Power of Administrator to promulgate rules and regulations; reproduction of records.

(a) The Administrator shall have the right, and is empowered, to promulgate rules, instructions and regulations as may be necessary to the discharge of his duties and powers as to savings and loan associations for the supervision and regulation of said associations, and for the protection of the public investing in said savings and loan associations.

(b) Without limiting the generality of the foregoing paragraph, rules, instructions, and regulations may be promulgated with respect to:

(1) Reserve requirements;
(2) Stock ownership and dividends;
(3) Stock transfers;
(4) Incorporators, stockholders, directors, officers and employees of an association;
(5) Bylaws;
(6) The Savings and Loan Commission;
(7) The structure of the office of the Administrator;
(8) The operation of associations;
(9) Withdrawable accounts, bonus plans, and contracts for savings programs;
(10) Loans and loan expenses;
(11) Investments;
(12) Forms and definitions;
(13) Types of financial records to be maintained by associations;
(14) Retention periods of various financial records;
(15) Internal control procedures of associations;
(16) Conduct and management of associations;
(17) Chartering and branching;
(18) Liquidations;
(19) Mergers;
(20) Conversions;
(21) Reports which may be required by the Administrator;
(22) Conflicts of interest;
(23) Collection of State savings and loan taxes;
(24) Service corporations; and
(25) Savings and loan holding companies.

(c) Repealed by Session Laws 1983, c. 144, s. 14, effective April 6, 1983.

(d) Any association may cause any or all records by it to be recorded, copied or reproduced by any photographic, photostatic or miniature photographic process which correctly, accurately, permanently copies, reproduces or forms a medium for copying or reproducing the original record on a film or other durable material.

(e) Any such photographic, photostatic or miniature photographic copy or reproduction shall be deemed to be an original record in all courts and administrative agencies for the purpose of its admissibility in evidence. A facsimile, exemplification or certified copy of any such photographic copy or reproduction shall, for all purposes, be deemed a facsimile, exemplification or certified copy of the original record.

(f) The provisions of this section with reference to the retention and disposition of records shall apply to any federal savings and loan association operating in North Carolina unless in conflict with regulations prescribed by its supervisory authority. (1981, c. 282, s. 3; 1983, c. 144, s. 14.)

Effect of Amendments. — The 1983 amendment, effective April 6, 1983, deleted subsection (c), which read, "In order to supervise the continuing operation of stock associations, the Administrator shall promulgate rules to ensure the compliance by such associations."

§ 54B-56. Examinations by Administrator; report.

(a) If at any time the Administrator deems it prudent, it shall be his duty to examine and investigate everything relating to the business of a State association or a savings and loan holding company, and to appoint a suitable and competent person to make such investigation, who shall file with the Administrator a full report of his finding in such case, including in his report any violation of law or any unauthorized or unsafe practices of the association disclosed by his examination.

(b) The Administrator shall furnish a copy of the report to the association examined and may, upon request, furnish a copy of or excerpts from the report to the Federal Home Loan Bank Board, a Federal Home Loan Bank, any mutual deposit guaranty association organized and operated under the provisions of Article 12 of this Chapter, or the Federal Savings and Loan Insurance Corporation or its successor.

(c) No association may willfully delay or willfully obstruct an examination in any fashion. Any person failing to comply with this subsection shall be guilty of a misdemeanor.

(d) No person having in his possession or control any books, accounts or papers of any State association shall refuse to exhibit same to the Administrator or his agents on demand, or shall knowingly or willingly make any false statement in regard to the same. Any person failing to comply with this subsection shall be guilty of a misdemeanor. (1981, c. 282, s. 3.)

§ 54B-57. Supervision and examination fees.

(a) Every State association, including associations in process of voluntary liquidation or savings and loan holding company, shall pay into the office of the Administrator each July a supervisory fee. Examination fees shall be paid promptly upon an association's receipt of the examination billing. The Administrator, subject to the advice and consent of the Commission, shall, on or before June 1 of each year:

(1) Determine and fix the scale of supervisory and examination fees to be assessed and collected during the next fiscal year;

(2) Determine and fix the amount of the fee and set the fee collection schedule for the fees to be assessed to and collected from applicants to defray the cost of processing their charter, branch, merger, conversion, location change, savings and loan holding company acquisition, and name change applications and all fees associated with foreign associations.

(b) All funds and revenue collected by the Division under the provisions of this section and the provisions of all other sections of this Chapter which authorize the collection of fees and other funds shall be deposited with the State Treasurer of North Carolina and expended under the terms of the Executive Budget Act, solely to defray expenses incurred by the office of the Administrator in carrying out its supervisory and auditing functions.

(c) Notwithstanding any of the provisions of subsections (a) and (b) of this section, whenever the Administrator under the provisions of G.S. 54B-56 appoints a suitable and competent person, other than a person employed by the Administrator's office, to make an examination and investigation of the business of a State association, all costs and expenses relative to such examination and investigation shall be paid by such association. (1981, c. 282, s. 3; 1983, c. 144, s. 15.)

Effect of Amendments. — The 1983 amendment, effective April 6, 1983, inserted "savings and loan holding company acquisition" in subdivision (a)(2).

§ 54B-58. Prolonged audit, examination or revaluation; payment of costs.

(a) If, in the opinion of the Administrator, an examination conducted under the provisions of G.S. 54B-57 fails to disclose the complete financial condition of an association, he may in order to ascertain its complete financial condition:

(1) Make an extended audit or examination of the association or cause such an audit or examination to be made by an independent auditor;

(2) Make an extended revaluation of any of the assets or liabilities of the association or cause an independent appraiser to make such revaluation.

(b) The Administrator shall collect from the association a reasonable sum for actual or necessary expenses of such an audit, examination or revaluation. (1981, c. 282, s. 3.)

§ 54B-59. Cease and desist orders.

(a) If any person or association is engaging in, or has engaged in, any unsafe or unsound practice or unfair and discriminatory practice in conducting the association's business, or of any other law, rule, regulation, order or condition imposed in writing by the Administrator, the Administrator may issue a notice of charges to such person or association. A notice of charges shall specify the acts alleged to sustain a cease and desist order, and state the time and place at which a hearing shall be held. A hearing before the Commission on the charges shall be held no earlier than seven days, and no later than 14 days after issuance of the notice. The charged institution is entitled to a further extension of seven days upon filing a request with the Administrator. The Administrator may also issue a notice of charges if he has reasonable grounds to believe that any person or association is about to engage in any unsafe or unsound business practice, or any violation of this Chapter, or any other law, rule, regulation or order. If, by a preponderance of the evidence, it is

shown that any person or association is engaged in, or has been engaged in, or is about to engage in, any unsafe or unsound business practice, or unfair and discriminatory practice or any violation of this Chapter, or any other law, rule, regulation, or order, a cease and desist order shall be issued. The Commission may issue a temporary cease and desist order to be effective for 14 days and may be extended once for a period of 14 days.

(b) If any person or State association is engaging in, has engaged in, or is about to engage in any unsafe or unsound practice in conducting the association's business, or any violation of this Chapter or of any other law, rules, regulation, order, or condition imposed in writing by the Administrator, and the Administrator has determined that immediate corrective action is required, the Administrator may issue a temporary cease and desist order. A temporary cease and desist order shall be effective immediately upon issuance for a period of 14 days, and may be extended once for a period of 14 days. Such an order shall state its duration on its face and the words, "Temporary Cease and Desist Order." A hearing before the Commission shall be held within such time as such an order remains effective, at which time a temporary order may be dissolved or made permanent. (1981, c. 282, s. 3.)

§ 54B-60. Administrator to have right of access to books and records of association; right to issue subpoenas, administer oaths, examine witnesses.

(a) The Administrator and his agents:

(1) Shall have free access to all books and records of an association, or a service corporation thereof, that relate to its business, and the books and records kept by an officer, agent or employee relating to or upon which any record is kept;

(2) May subpoena witnesses and administer oaths or affirmations in the examination of any director, officer, agent, or employee of an association, or a service corporation thereof or of any other person in relation to its affairs, transactions and conditions;

(3) May require the production of records, books, papers, contracts and other documents; and

(4) May order that improper entries be corrected on the books and records of an association.

(b) The Administrator may issue subpoenas duces tecum.

(c) If a person fails to comply with a subpoena so issued or a party or witness refuses to testify on any matters, a court of competent jurisdiction, on the application of the Administrator, shall compel compliance by proceedings for contempt as in the case of disobedience of the requirements of a subpoena issued from such court or a refusal to testify in such court. (1981, c. 282, s. 3.)

§ 54B-61. Test appraisals of collateral for loans; expense paid.

(a) The Administrator may direct the making of test appraisals of real estate and other collateral securing loans made by associations doing business in this State, employ competent appraisers, or prescribe a list from which competent appraisers may be selected, for the making of such appraisals by the Administrator, and do any and all other acts incident to the making of such test appraisals.

(b) In lieu of causing such appraisals to be made, the Administrator may accept an appraisal caused to be made by a Federal Home Loan Bank, the Federal Home Loan Bank Board or by the Federal Savings and Loan Insurance Corporation or any mutual deposit guaranty association organized and operating under the provisions of Article 12 of this Chapter.

(c) The expense and cost of test appraisals made pursuant to this section shall be defrayed by the association subjected to such test appraisals, and each association doing business in this State shall pay all reasonable costs and expenses of such test appraisals when it shall be directed. (1981, c. 282, s. 3.)

§ 54B-62. Relationship of savings and loan associations with the Savings and Loan Division.

(a) Except as provided by subsection (b) of this section, a savings and loan association or any director, officer, employee, or representative thereof shall not grant or give to the Administrator or to any employee of the Administrator's office, or to their spouses, any loan or gratuity, directly or indirectly.

(b) Neither the Administrator nor any person on the staff of the Savings and Loan Division shall:

(1) Hold an office or position in any State association or exercise any right to vote on any State association matter by reason of being a member of the association;

(2) Be interested, directly or indirectly in any savings and loan association organized under the laws of this State; or

(3) Undertake any indebtedness, as a borrower directly or indirectly or endorser, surety or guarantor, or sell or otherwise dispose of any loan or investment to any savings and loan association organized under the laws of this State.

(c) Notwithstanding subsection (b) of this section, the Administrator or any other person employed in or by his office may be a withdrawable account holder and receive earnings on such account.

(d) If the Administrator or other person has any prohibited right or interest in a savings and loan association, either directly or indirectly, at the time of his appointment or employment, he shall dispose of it within 60 days after the date of his appointment, or employment. If the Administrator or other such person is indebted as borrower directly or indirectly, or is an endorser, surety or guarantor on a note, at the time of his appointment or employment, he may continue in such capacity until such loan is paid off. (1981, c. 282, s. 3.)

§ 54B-63. Confidential information.

(a) The following records or information of the Commission, the Administrator or the agent(s) of either shall be confidential and shall not be disclosed:

(1) Information obtained or compiled in preparation of or anticipation of, or during an examination, audit or investigation of any association;

(2) Information reflecting the specific collateral given by a named borrower, the specific amount of stock owned by a named stockholder, or specific withdrawable accounts held by a named member or customer;

(3) Information obtained, prepared or compiled during or as a result of an examination, audit or investigation of any association by an agency of the United States, if the records would be confidential under federal law or regulation;

(4) Information and reports submitted by associations to federal regulatory agencies, if the records or information would be confidential under federal law or regulation;

(5) Information and records regarding complaints from the public received by the Division which concern associations when the complaint would or could result in an investigation, except to the management of those associations;

(6) Any other letters, reports, memoranda, recordings, charts or other documents or records which would disclose any information of which disclosure is prohibited in this subsection.

(b) A court of competent jurisdiction may order the disclosure of specific information.

(c) The information contained in an application shall be deemed to be public information. Disclosure shall not extend to the financial statement of the incorporators nor to any further information deemed by the Administrator to be confidential.

(d) Nothing in this section shall prevent the exchange of information relating to associations and the business thereof with the representatives of the agencies of this State, other states, or of the United States, or with reserve or insuring agencies for associations. The private business and affairs of an individual or company shall not be disclosed by any person employed by the Savings and Loan Division, any member of the Commission, or by any person with whom information is exchanged under the authority of this subsection.

(e) Any official or employee violating this section shall be liable to any person injured by disclosure of such confidential information for all damages sustained thereby. Penalties provided shall not be exclusive of other penalties. (1981, c. 282, s. 3.)

§ 54B-64. Civil penalties; State associations.

(a) Except as otherwise provided in this Article, any association which is found to have violated any provision of this Article may be ordered to forfeit and pay a civil penalty of up to twenty thousand dollars ($20,000). Any association which is found to have violated or failed to comply with any cease and desist order issued under the authority of this Article may be ordered to forfeit or pay a civil penalty of up to twenty thousand dollars ($20,000) for each day that the violation or failure to comply continues.

(b) To enforce the provisions of this section, the Administrator is authorized to assess such a penalty and to appear in a court of competent jurisdiction and to move the court to order payment of the penalty. Prior to the assessment of the penalty, a hearing shall be held by the Administrator which shall comply with the provisions of Article 3 of Chapter 150A of the General Statutes.

(c) If the Administrator determines that, as a result of a violation of any provision of this Article, or of a failure to comply with any cease and desist order issued under the authority of this Article, a situation exists requiring immediate corrective action, the Administrator may impose the civil penalty in this section on the association without a prior hearing, and said penalty shall be effective as of the date of notice to the association. Imposition of such penalty may be directly appealed to the Wake County Superior Court.

(d) Nothing in this section shall prevent anyone damaged by a State association from bringing a separate cause of action in a court of competent jurisdiction. (1981, c. 282, s. 3.)

§ 54B-65. Civil penalties; directors, officers and employees.

(a) Any person, whether a director, officer or employee, who is found to have violated any provision of this Article, whether willfully or as a result of gross negligence, gross incompetency, or recklessness, may be ordered to forfeit and pay a civil penalty of up to five thousand dollars ($5,000) per violation. Any person who is found to have violated or failed to comply with any cease and desist order issued under the authority of this Article, may be ordered to forfeit and pay a civil penalty of up to five thousand dollars ($5,000) per violation for each day that the violation or failure to comply continues.

(b) To enforce the provisions of this section, the Administrator is authorized to assess such a penalty and to appear in a court of competent jurisdiction and to move the court to order payment of the penalty. Prior to the assessment of the penalty, a hearing shall be held by the Administrator which shall comply with the provisions of Article 3 of Chapter 150A of the General Statutes.

(c) Whenever the Administrator shall determine that an emergency exists which requires immediate corrective action, the Administrator, either before or after instituting any other action or proceeding authorized by this Article, may request the Attorney General to institute a civil action in a court of competent jurisdiction, in the name of the State upon the relation of the Administrator seeking injunctive relief to restrain or enjoin the violation or threatened violation of this Article and for such other and further relief as the court may deem proper. Instituting an action for injunctive relief shall not relieve any party to such proceedings from any civil or criminal penalty prescribed for violation of this Article.

(d) Nothing in this section shall prevent anyone damaged by a director, officer or employee of a State association from bringing a separate cause of action in a court of competent jurisdiction. (1981, c. 282, s. 3.)

§ 54B-66. Criminal penalties.

(a) The provisions of this section shall in no event extend to persons who are found to have acted only with gross negligence, simple negligence, recklessness or incompetence.

(b) In addition to any of the other penalties or remedies provided by this Article, the following shall be deemed to be misdemeanors and shall be punishable as provided in Chapter 14 of the North Carolina General Statutes:

(1) The willful or knowing violation of the provisions of this Article by any employee of the Savings and Loan Division.

(2) The willful or knowing violation of a cease and desist order which has become final in that no further administrative or judicial appeal is available.

(c) In addition to any of the other penalties or remedies provided by this Article, the willful omission, making, or concurrence in making or publishing a written report, exhibit, or entry in a financial statement on the books of the association, which contains a material statement known to be false shall be deemed to be a misdemeanor and shall be punishable as provided in Chapter 14 of the North Carolina General Statutes. For purposes of this section, "material" shall mean "so substantial and important as to influence a reasonable and prudent businessman or investor."

(d) The Administrator is authorized to enforce this section in a court of competent jurisdiction. (1981, c. 282, s. 3.)

§ 54B-67. Primary jurisdiction.

Whenever an agency of the United States government shall defer to the Administrator, or notify the Administrator of pending action against an association chartered by this State or fail to exercise its authority over any State- or federally-chartered association doing business in this State, the Administrator shall have the authority to exercise jurisdiction over such association. (1981, c. 282, s. 3.)

§ 54B-68. Supervisory control.

(a) Whenever the Administrator determines that an association is conducting its business in an unsafe or unsound manner or in any fashion which threatens the financial integrity or sound operation of the association, the Administrator may serve a notice of charges on the association, requiring it to show cause why it should not be placed under supervisory control. Such notice of charges shall specify the grounds for supervisory control, and set the time and place for a hearing. A hearing before the Commission pursuant to such notice shall be held within 15 days after issuance of the notice of charges, and shall comply with the provisions of Article 3 of Chapter 150A of the General Statutes.

(b) If, after the hearing provided above, Commission determines that supervisory control of the association is necessary to protect the association's members, customers, stockholders or creditors, or the general public, the Administrator shall issue an order taking supervisory control of the association. An appeal may be filed in the Wake County Superior Court.

(c) If the order taking supervisory control becomes final, the Administrator may appoint an agent to supervise and monitor the operations of the association during the period of supervisory control. During the period of supervisory control, the association shall act in accordance with such instructions and directions as may be given by the Administrator directly or through his supervisory agent and shall not act or fail to act except when to do so would violate an outstanding cease and desist order.

(d) Within 180 days of the date the order taking supervisory control becomes final, the Administrator shall issue an order approving a plan for the termination of supervisory control. The plan may provide for:

(1) The issuance by the association of capital stock;

(2) The appointment of one or more officers and/or directors;

(3) The reorganization, merger, or consolidation of the association;

(4) The dissolution and liquidation of the association.

The order approving the plan shall not take effect for 30 days during which time period an appeal may be filed in the Wake County Superior Court.

(e) The costs incident to this proceeding shall be paid by the association, provided such costs are found to be reasonable.

(f) For the purposes of this section, an order shall be deemed final if:

(1) No appeal is filed within the specific time allowed for the appeal, or

(2) After all judicial appeals are exhausted. (1981, c. 282, s. 3.)

§ 54B-69. Removal of directors, officers and employees.

(a) If, in the Administrator's opinion, one or more directors, officers or employees of any association has participated in or consented to any violation of this Chapter, or any other law, rule, regulation or order, or any unsafe or unsound business practice in the operation of any association; or any insider loan not specifically authorized by or pursuant to this Chapter; or any repeated violation of or failure to comply with any association's bylaws, the Administrator may serve a written notice of charges upon the director, officer or employee in question, and the association, stating his intent to remove said director, officer or employee. Such notice shall specify the conduct and place for the hearing before the Commission to be held. A hearing shall be held no earlier than 15 days and no later than 30 days after the notice of charges is served, and it shall comply with the provisions of Article 3 of Chapter 150A of the General Statutes. If, after the hearing, the Commission determines that the charges asserted have been proven by a preponderance of the evidence, the Administrator may issue an order removing the director, officer or employee in question. Such an order shall be effective upon issuance and may include the entire board of directors or all of the officers of the association.

(b) If it is determined that any director, officer or employee of any association has knowingly participated in or consented to any violation of this Chapter, or any other law, rule, regulation or order, or engaged in any unsafe or unsound business practice in the operation of any association, or any repeated violation of or failure to comply with any association's bylaws, and that as a result, a situation exists requiring immediate corrective action, the Administrator may issue an order temporarily removing such person or persons pending a hearing. Such an order shall state its duration on its face and the words, "Temporary Order of Removal," and shall be effective upon issuance, for a period of 15 days, and may be extended once for a period of 15 days. A hearing must be held within 10 days of the expiration of a temporary order, or any extension thereof, at which time a temporary order may be dissolved or converted to a permanent order.

(c) Any removal pursuant to subsections (a) or (b) of this section shall be effective in all respects as if such removal had been made by the board of directors, the members or the stockholders of the association in question.

(d) Without the prior written approval of the Administrator, no director, officer or employee permanently removed pursuant to this section shall be eligible to be elected, reelected or appointed to any position as a director, officer or employee of that association, nor shall such a director, officer or employee be eligible to be elected to or retain a position as a director, officer or employee of any other State association. (1981, c. 282, s. 3.)

§ 54B-70. Involuntary liquidation.

(a) The Administrator with prior approval of the Commission may take custody of the books, records and assets of every kind and character of any association organized and operated under the provisions of this Chapter for any of the purposes hereinafter enumerated, if it reasonably appears from examinations or from reports made to the Administrator that:

(1) The directors, officers, or liquidators have neglected, failed or refused to take such action which the Administrator may deem necessary for the protection of the association, or have impeded or obstructed an examination; or

(2) The withdrawable capital of the association is impaired to the extent that the realizable value of its assets is insufficient to pay in full its creditors and holders of withdrawable accounts; or its liquidity fund or general reserve account is impaired; or

(3) The business of the association is being conducted in a fraudulent, illegal or unsafe manner, or that the association is in an unsafe or unsound condition to transact business; (any association which, except as authorized in writing by the Administrator, fails to make full payment of any withdrawal when due is in an unsafe or unsound condition to transact business, notwithstanding such provisions of the certificate of incorporation or such statutes or regulations with respect to payment of withdrawals in event an association does not pay all withdrawals in full); or

(4) The officers, directors, or employees have assumed duties or performed acts in excess of those authorized by statute or regulation or charter, or without supplying the required bond; or,

(5) The association has experienced a substantial dissipation of assets or earnings due to any violation or violations of statute or regulation, or due to any unsafe or unsound practice or practices; or

(6) The association is insolvent, or is in imminent danger of insolvency or has suspended its ordinary business transactions due to insufficient funds; or

(7) The association is unable to continue operations.

(b) Unless the Administrator finds that such an emergency exists which may result in loss to members, withdrawable account holders, stockholders, or creditors, and which requires that he take custody immediately, he shall first give written notice to the directors and officers specifying the conditions criticized and allowing a reasonable time in which corrections may be

made before a receiver shall be appointed as outlined in subsection (d) below.

(c) The purposes for which the Administrator may take custody of an association include examination or further examination; conservation of its assets; restoration of impaired capital; the making of any reasonable or equitable adjustment deemed necessary by the Administrator under any plan of reorganization.

(d) If the Administrator after taking custody of an association, finds that one or more of the reasons for having taken custody continue to exist through the period of his custody, with little or no likelihood of amelioration of the situation, then he shall appoint as receiver or co-receiver any qualified person, firm or corporation for the purpose of liquidation of the association, which receiver shall furnish bond in form, amount and with surety as the Administrator may require. The Administrator may appoint the association's withdrawable account insurance corporation or its nominee as the receiver, and such insuring corporation shall be permitted to serve without posting bond.

(e) In the event the Administrator appoints a receiver for an association, he shall mail a certified copy of the appointment order by certified mail to the address of the association as it shall appear on the records of the Division, and to any previous receiver or other legal custodian of the association, and to any court or other authority to which such previous receiver or other legal custodian is subject. Notice of such appointment shall be published in a newspaper of general circulation in the county where such association has its principal office.

(f) Whenever a receiver for an association is appointed pursuant to subsection (d) above the association may within 30 days thereafter bring an action in the Superior Court of Wake County, for an order requiring the Administrator to remove such receiver.

(g) The duly appointed and qualified receiver shall take possession promptly of the association for which he or it has been so appointed, in accordance with the terms of such appointment, by service of a certified copy of the Administrator's appointment order upon the association at its principal office through the officer or employee who is present and appears to be in charge. Immediately upon taking possession of the association, the receiver shall take possession and title to books, records and assets of every description of such association. The receiver, by operation of law and without any conveyance or other instrument, act or deed, shall succeed to all the rights, titles, powers and privileges of the association, its members or stockholders, holders of withdrawable accounts, its officers and directors or any of them: and to the titles to the books, records and assets of every description of any previous receiver or other legal custodian of such association. Such members, stockholders, holders of withdrawable accounts, officers or directors, or any of them, shall not thereafter, except as hereinafter expressly provided, have or exercise any such rights, powers or privileges or act in connection with any assets or property of any nature of the association in receivership: Provided however, that any officer, director, member, stockholder, withdrawable account holder, or borrower of such association shall have the right to communicate with the Administrator with respect to such receivership. The Administrator, with the approval of the Commission, may at any time, direct the receiver to return the association to its previous or a newly constituted management. The Administrator may provide for a meeting or meetings of the members or stockholders for any purpose, including, without any limitation on the generality of the foregoing, the election of directors or an increase in the number of directors, or both, or the election of an entire new board of directors; and may provide for a meeting or meetings of the directors for any purpose including, without any limitation on the generality of the foregoing, the filling of vacancies on the board, the removal of officers and the election of new officers, or for any of such purposes. Any such meeting of members or stockholders, or of directors, shall be supervised or conducted by a representative of the Administrator.

(h) A duly appointed and qualified receiver shall have power and authority to:

(1) Demand, sue for, collect, receive and take into his possession all the goods and chattels, rights and credits, moneys and effects, lands and tenements, books, papers, choses in action, bills, notes, and property of every description of the association;

(2) Foreclose mortgages, deeds of trust, and other liens executed to the association to the extent the association would have had such right;

(3) Institute suits for the recovery of any estate, property, damages, or demands existing in favor of the association, and he shall, upon his own application, be substituted as party plaintiff in the place of the association in any suit or proceeding pending at the time of his appointment;

(4) Sell, convey, and assign all the property rights and interest owned by the association;

(5) Appoint agents to serve at his pleasure;

(6) Examine and investigate papers and persons, and pass on claims as provided in the regulations as prescribed by the Administrator;

(7) Make and carry out agreements with the insuring corporation or with any other financial institution for the payment or assumption of the association liabilities, in whole or in part, and to sell, convey, transfer, pledge, or assign assets as security or otherwise and to make guarantees in connection therewith; and

(8) Perform all other acts which might be done by the employees, officers and directors.

Such powers shall be continued in effect until liquidation and dissolution or until return of the association to its prior or newly constituted management.

(i) A receiver may at any time during the receivership and prior to final liquidation be removed and a replacement appointed by the Administrator.

(j) The Administrator may determine that such liquidation proceedings should be discontinued. He shall then remove the receiver and restore all the rights, powers, and privileges of its members and stockholders, customers, employees, officers and directors, or restore such rights, powers, and privileges to its members, stockholders and customers, and grant such rights, powers and privileges to a newly constituted management, all as of the time of such restoration of the association to its management unless another time for such restoration shall be specified by the Administrator. The return of an association to its management or to a newly constituted management from the possession of a receiver shall, by operation of law and without any conveyance or other instrument, act or deed, vest in such association the title to all property held by the receiver in his capacity as receiver for such association.

(k) A receiver may also be appointed under the authority of G.S. 1-502. No judge or court, however, shall appoint a receiver for any State association unless five days' advance notice of the motion, petition or application for appointment of a receiver shall have been given to such association and to the Administrator.

(l) Following the appointment of a receiver, the Administrator shall request the Attorney General to institute an action in the name of the Administrator in the superior court against the association for the orderly liquidation and dissolution of the association, and for an injunction to restrain the officers, directors and employees from continuing the operation of the association.

(m) Claims against a State association in receivership shall have the following order of priority for payment:

(1) Costs, expenses and debts of the association incurred on or after the date of the appointment of the receiver, including compensation for the receiver;
(2) Claims of general creditors;
(3) Claims of holders of special purpose or thrift accounts;
(4) Claims of holders of withdrawable accounts;
(5) Claims of stockholders of a stock association;
(6) All remaining assets to members and stockholders in an amount proportionate to their holdings as of the date of the appointment of the receiver.

(n) All claims of each class described within subsection (m) above shall be paid in full so long as sufficient assets remain. Members of the class for which the receiver cannot make payment in full because assets will be depleted during payment to such class shall be paid an amount proportionate to their total claims.

(o) The Administrator shall have the authority to direct the payment of claims for which no provision is herein made, and may direct the payment of claims within a class. The Administrator shall have the authority to promulgate rules and regulations governing the payment of claims by an association in receivership.

(p) When all assets of the association have been fully liquidated, and all claims and expenses have been paid or settled, and the receiver shall recommend a final distribution, the dissolution of the association in receivership shall be accomplished in the following manner:

(1) The receiver shall file with the Administrator a detailed report, in a form to be prescribed by the Administrator, of his acts and proposed final distribution, and dissolution.
(2) Upon the Administrator's approval of the final report of the receiver, the receiver shall provide such notice and thereafter shall make such final distribution, in such manner as the Administrator may direct.
(3) When a final distribution has been made except as to any unclaimed funds, the receiver shall deposit such unclaimed funds with the Administrator and shall deliver to the Administrator all books and records of the dissolved association.
(4) Upon completion of the foregoing procedure, and upon the joint petition of the Administrator and receiver to the superior court, the court may find that the association should be dissolved, and following such publication of notice of dissolution as the court may direct, the court may enter a decree of final resolution and the association shall thereby be dissolved.
(5) Upon final dissolution of the association in receivership or at such time as the receiver shall be otherwise relieved of his duties, the Administrator shall cause an audit to be conducted, during which the receiver shall be available to assist in such. The accounts of the receiver shall then be ruled upon by the Administrator and Commission and if approved, the receiver shall thereupon be given a final and complete discharge and release. (1981, c. 282, s. 3.)

§ 54B-71. Judicial review.

Any person or State association against whom a cease and desist order is issued or a fine is imposed may have such order or fine reviewed by a court of competent jurisdiction. Except as otherwise provided, an appeal may be made only within 30 days of the issuance of the order or the imposition of the fine, whichever is later. (1981, c. 282, s. 3.)

§ 54B-72. Indemnity.

No person who is fined or penalized for a violation of any criminal provision of this Article shall be reimbursed or indemnified in any fashion by the association for such fine or penalty. (1981, c. 282, s. 3.)

Exhibit 2

SECTION .0600 - LIQUIDITY FUND

.0601 LIQUIDITY FUND REQUIREMENT

(a) Each association shall maintain a liquidity fund as defined in G.S. 54B-210 for the sole purpose of assuring the liquidity of the association.

(b) The liquidity fund required by this Section shall be deemed identical with and not supplementary to the liquidity fund required to be maintained by associations insured by the Federal Savings and Loan Insurance Corporation.

(c) Reserves required to be maintained pursuant to Title I of the Depository Institutions Deregulation and Monetary Control Act of 1980 and established pursuant to 12 C.F.R. 204 may be used to satisfy the liquidity fund requirements of this Section.

(d) In addition to those investments set forth in G.S. 54B-210(a), a state association's liquidity fund may also include debt securities which are hedged, subject to options, or redeemable, in the manner allowed to members of the Federal Home Loan Bank Board, by the board's regulations, as amended from time to time; the limitations regarding amounts of investments, investments in, or hedged by, a single source, and other similar limitations set forth in the bank board's regulations, which apply to members of the Federal Home Loan Bank Board, shall also apply to state associations.

History Note: Statutory Authority G.S. 54B-55; 54B-210; 54B-211; Eff. August 31, 1981; Amended Eff. July 1, 1983.

.0602 AMOUNT OF LIQUIDITY FUND

The liquidity fund shall be maintained in an amount equal to at least the greater of:

(1) five percent of the net withdrawal value of the association's withdrawable accounts; or

(2) two hundred fifty thousand dollars ($250,000).

History Note: Statutory Authority G.S. 54B-55; 54B-210; 54B-211; Eff. August 31, 1981.

SECTION .0700 - GENERAL RESERVE ACCOUNT 26.6

.0701 GENERAL RESERVE REQUIREMENTS 26.8

(a) Each association shall establish and maintain a general reserve account for the sole purpose of covering losses. The general reserve account shall be established and maintained separately from any specific loss reserve accounts established and maintained at the election of the association. 26.10 26.11 26.12 26.13

(b) Any state association which has insurance of withdrawable accounts with the Federal Savings and Loan Insurance Corporation and meets the statutory reserve requirement of the Federal Savings and Loan Insurance Corporation need not comply with the general reserve requirement of this Rule. 26.14 26.15 26.16 26.17 26.18

(c) The level of the general reserve account shall be calculated at the end of each fiscal year using the percentages set forth in Paragraph (d) of this Rule, and shall be based on the amount of assets at the end of each fiscal year. Each association shall make such transfers as may be necessary to reach the calculated level no later than 90 days after the end of the fiscal year. 26.19 26.20 26.21 26.22 26.23

(d) The level of the general reserve account which shall be established and maintained against assets is fixed at the following percentages: 26.24 26.25

(1) zero percent for the following "Group One" assets: 26.27
  (A) Stock in the Federal Home Loan Bank of Atlanta; 26.28
  (B) FSLIC secondary reserve; 26.29
  (C) Deposits in the North Carolina Savings Guaranty Corporation; and 26.30 26.31
  (D) Unencumbered land and fixed assets used in course of the association's business. 26.33 26.34
(2) two percent for the following "Group Two" assets: 26.36
  (A) investments eligible for liquidity under G.S. 54B-210, except stock in the Federal Home Loan Bank of Atlanta and deposits in the North Carolina Savings Guaranty Corporation; and 26.38 26.39 26.40
  (B) encumbered land and fixed assets used in course of the association's business. 26.41 26.42
(3) three percent for the following "Group Three" assets: 26.44
  (A) residential mortgage loans and mortgaged-backed securities; 26.46 26.47
  (B) loans on withdrawable accounts; 26.49
  (C) premiums or discounts on mortgage loans to be amortized; and 26.51 26.52
  (D) other assets not listed under this Paragraph (d). 26.54
(4) five percent for the following "Group Four" assets: 26.55
  (A) commercial loans; 26.56

(B) secured consumer loans;
(C) loans to facilitate; and
(D) investment in service corporation.
(5) eight percent for the following "Group Five" assets:
(A) unsecured loans;
(B) real estate owned;
(C) standby, fixed-rate, long term commitments in excess of six months at time of issuance; and
(D) loans in bankruptcy.

(e) Upon a review of an association's assets and for just cause, the administrator may require an amount to be reserved in addition to the amounts prescribed in Paragraph (d) of this Rule.

(f) For the purposes of meeting the required level of the general reserve account, any account which is a part of the association's net worth as defined in G.S. 54B-4(b)(38) shall be considered a part of the association's general reserve account.

History Note: Statutory Authority G.S. 54B-216;
Eff. December 1, 1981;
Amended Eff. November 1, 1982; October 1, 1982.

.0702 REQUIREMENTS FOR NEWLY-CHARTERED STOCK ASSOCIATIONS

History Note: Statutory Authority G.S. 54B-216;
Eff. December 1, 1981;
Repealed Eff. November 1, 1982.

Exhibit 3

GENERAL RESERVE REQUIREMENT (ADEQUACY OF NET WORTH/CAPITAL)

Description of Assets	Amount			Requirement
GROUP I				
Stock in FHLB-Atlanta	_____			
FSLIC Secondary Reserve	_____			
Deposits with FIAC	_____			
Unencumbered Land and Fixed Assets Used in the Course of Assn. Business	_____			
Total Group I		_____		
GROUP II				
Investments Eligible for Liquidity (Exclude FHLB-Atlanta Stock and Deposits with FIAC)	_____			
Encumbered Land and Fixed Assets Used in the Course of Assn. Business	_____			
Total Group II		_____	x 2% =	_____
GROUP III				
Residential Mortgage Loans and Mortgage Backed Securities	_____			
Loans in Withdrawable Accounts	_____			
Premiums/Discounts on Mortgage Loans to be Amortized	_____			
Assets not Otherwise Listed	_____			
Total Group III		_____	x 5% =	_____
GROUP IV				
Commercial Loans	_____			
Unsecured Loans	_____			
Consumer Loans	_____			
Loans to Facilitate	_____			
Investment in Service Corporation	_____			
Special Mention Assets	_____			
Total Group IV		_____	x 10% =	_____
GROUP V				
Real Estate Owned	_____			
Assets Classified Substandard	_____			
Total Group V		_____	x 20% =	_____
GROUP VI				
Assets Classified Doubtful		_____	x 50% =	_____
GROUP VII				
Assets Classified Loss		_____	x 100% =	_____
Total Assets		_____		
Total General Reserve Requirement				_____
General Reserve on Exam Date				_____
Excess (Deficiency)				_____

Reference 4 NCAC 16D.0701

Exhibit 4

LIQUIDITY ANALYSIS

Cash on Hand	$
Bank Deposits (Checking Accounts)	
Federal Funds and Overnight Deposits	
Stock in Federal Home Loan Bank	
Deposit with Financial Institutions Assurance Corporation	
U. S. Governments and Agency Obligations	
Certificates of Deposit (Banks and S&Ls)	
Bankers Acceptances	
Corporate Debt/Commercial Paper	
Repurchase Agreements	
Debt Securities Hedged	
Other Investments	
Accrued Interest on Above	
Less Total Amount Pledged	( )
Actual Liquidity (A)	$
Total Savings	$
Less:	
Share Loans	( )
Pledged Collateral on Other Loans	( )
Net Savings	
Required Liquidity Ratio	x 5%
Required Liquidity (B)	$
Excess (Deficiency)	$
(A) Should Exceed (B)	

Comments:

References:

N C General Statute 54B-210 - Components of Liquidity Fund
4 NCAC 16D.0601 - Liquidity Fund Requirement
4 NCAC 16D.0602 - Amount of Liquidity Fund
Section 523.10 - Liquidity Definitions - Bank System Regs

Mr. BARNARD. Mr. McEnteer, before you begin, I would like to ask, as Pennsylvania's secretary of banking, do you have the joint supervisory control of banks and savings and loans?

Mr. MCENTEER. Yes, sir.

Mr. BARNARD. You have both under your jurisdiction?

Mr. MCENTEER. Yes, sir.

Mr. BARNARD. Not divided in other words?

Mr. MCENTEER. Yes, sir.

Mr. BARNARD. What about credit unions?

Mr. MCENTEER. We have them also. State-chartered credit unions also.

Mr. BARNARD. You have all three under your jurisdiction?

Mr. MCENTEER. And consumer credit companies also, and pawn brokers too.

Mr. BARNARD. Well, now we're getting to the important aspects now. [Laughter.]

Mr. MCENTEER. All State-chartered financial institutions that comes under the purview of the department of banking.

Mr. BARNARD. The other 2 witnesses, you just have savings and loans, correct?

Mr. BROWN. The State of Maryland's Savings and Loan Division is a separate agency. Credit unions come under the bank commissioner's office which is a separate agency.

Mr. KING. Yes, sir, that's correct.

Mr. BARNARD. Mr. McEnteer, we will hear from you at this time.

STATEMENT OF BEN McENTEER, SECRETARY, DEPARTMENT OF BANKING, COMMONWEALTH OF PENNSYLVANIA

Mr. MCENTEER. Thank you, Mr. Chairman, distinguished members of the subcommittee.

I am Ben McEnteer, secretary of banking of the Pennsylvania Department of Banking.

We have submitted detailed testimony, as requested by the committee and I appreciate the opportunity to highlight this testimony.

Mr. BARNARD. Without objection, your entire testimony will be entered in the record.

Mr. MCENTEER. The Pennsylvania Savings Association Bureau is the division within the department of banking charged with the examination and supervision of savings associations and directly responsible to the secretary of banking of Pennsylvania.

Under the Savings Association Code, the department of banking is vested with the authority to annually or more frequently examine or investigate any State-chartered association. Along with the power to investigate and examine is the power to issue orders to discontinue any violation of law or any unsafe or unsound business practice.

The department is authorized to take possession of an association, and either liquidate the association or appoint a deputy receiver for that purpose in the event the institution is in an unsafe or unsound condition.

The savings association bureau presently supervises 104 State-chartered, federally insured savings associations with assets ranging from $4 million to $2.019 million and 68 State-chartered asso-

ciations insured by the Pennsylvania Savings Association Insurance Corp. with assets ranging from $125,000 to $82.9 million.

The largest association insured by PSAIC is $82.9 million. The remaining 67 associations have assets of between $125,000 and $13.5 million. These associations have been in business for a period of up to a 117 years. The average net worth of these associations equals 13 percent of total savings on a GAAP accounting basis. I think that is very important, that the average net worth of these associations amounts to 13 percent.

This has been an historical pattern for a considerable portion of the Commonwealth's associations. Pennsylvania is the home of this country's first building and loan association.

Associations insured by the Pennsylvania Savings Association Insurance Corp. are normally examined by the examing staff of the bureau on an annual basis. The department has the authority to examine and conduct investigations whenever it deems appropriate.

The department of banking may, by written order, direct an association to discontinue any violation of law or any unsafe or unsound business practice. Any director, officer, attorney, or employee of an association who, after the department orders it to cease and desist from any violation of law or any unsafe and unsound business practice, continues such violation or practice, may be removed from office. Based upon our experience, we are confident the enforcement powers provided the department by law are sufficient to monitor the safety and soundness of Pennsylvania's associations.

The Savings Association Code provides that whenever the general reserves of an association are not equal to at least 8 percent of the savings accounts or whenever the net worth of the association is not equal to at least 10 percent of the savings accounts, it shall credit annually to its general reserves an amount equal to not less than 5 percent of its net income before payment of interest on savings accounts.

The State's capital requirements then are significantly higher than those required by the Federal Savings and Loan Insurance Corporation. Even with the recently adopted FSLIC capital requirements imposing higher capital, the Pennsylvania State requirements are still higher.

After the Commonwealth amended its law in 1979 to require that all State-chartered associations obtain account insurance, the department had the task of reviewing the financial status of every association applying for insurance from the Pennsylvania Savings Association Insurance Corp. If the financial status of an association did not support a department certification for PSAIC insurance, the department would first condition its certification upon the pledging of accounts by officers or directors.

The second method of certification would be the traditional method of arranging for a supervisory merger and the third method is a relatively new procedure of recapitalizing an association by a supervisory conversion to stock form.

Based upon our continuous monitoring of both federally insured and nonfederally-insured thrifts, we report that at the present time we have no problem associations within the Pennsylvania State system.

The statute establishing the Pennsylvania Savings Association Insurance Corp. provides that the department of banking shall monitor the operations of the PSAIC and require the corporation to furnish reports or records as deemed necessary or appropriate in the public interest.

Since the PSAIC has been in operation, the department has provided the PSAIC with copies of reports of examinations, supervisory letters and related correspondence between the bureau and the insured members. Accordingly, our supervisory letters require that the member associations provide copies of all their responses to the savings association bureau for the PSAIC.

Since the inception of the PSAIC, a representative from the savings association bureau has attended all board of director's meetings, and membership committee meetings as well as annual meetings of the insurance corporation. This provides for continuous dialog and a most effective joint supervisory program for all the State-chartered associations insured by PSAIC.

It is appropriate, in our opinion, to emphasize that the safety of a savings association primarily comes from (1) sound management; (2) blue-chip home mortgage and investment portfolios; (3) strong supervisory-enforced reserve position; (4) adequate liquidity for meeting withdrawals; (5) the ability of the savings association to secure funds in time of need from the Federal Home Loan Bank's system, or the Federal Reserve Bank's discount window, or other reliable sources; and (6) in addition, the insurance of savings accounts.

As the department's line of communication between itself and the Pennsylvania Savings Association Insurance Corp. is operating effectively, the department is not aware of any method that would materially improve that relationship.

One important lesson to be learned from the Ohio situation is that the well-being of any financial institution depends ultimately on public confidence.

The privately-insured institutions in Pennsylvania have been in business for a long time. They are strong, well managed, and well regulated. These are the key features to insure that any type of financial institution remains fiscally sound.

Again, Mr. Chairman, I appreciate the opportunity to appear before the subcommittee today and I will be pleased to take any questions you may have. Thank you.

[The prepared statement of Mr. McEnteer follows:]

TESTIMONY

BY

BEN McENTEER
SECRETARY, DEPARTMENT OF BANKING
COMMONWEALTH OF PENNSYLVANIA

Mr. Chairman and Distinguished Members of the Subcommittee: I am Ben McEnteer, Secretary of Banking of the Pennsylvania Department of Banking.

I appreciate the opportunity to come before you today to review the operation of the Pennsylvania Savings Association Insurance Corporation, (a deposit insurance fund created by the Pennsylvania Legislature) and to discuss the manner in which the Corporation interacts with the Department of Banking of the Commonwealth of Pennsylvania.

The Pennsylvania Savings Association Bureau is the division within the Department of Banking charged with the examination and supervision of savings associations (hereinafter associations) and directly responsible to the Secretary of Banking of Pennsylvania. The department enforces and administers all laws of the Commonwealth relating to any state-chartered financial institutions. The department exercises general supervision over institutions in order to afford the greatest possible safety to depositors, other creditors, and shareholders thereof. It also acts to insure the safe conduct of the business of such institutions, conserve their assets, maintain the public confidence in such institutions, and protect the public interest.

Under the Savings Association Code of 1967 and the Department of Banking Code, the department is vested with the authority to annually or more frequently examine or investigate any state-chartered association. Along with the power to investigate and examine is the power to issue orders to discontinue any violation of law or any unsafe or unsound business practice. Under the Department of Banking Code, the Department is authorized to take possession of an association, and either liquidate the association or appoint a deputy receiver for that purpose in the event the

institution is in an unsafe or unsound condition.

In response to the request of this committee, as contained in the communication of March 22, 1985, I submit the following:

The budget of the Pennsylvania Savings Association Bureau for the fiscal year ended June 30, 1983 was $1,008,000; for the year ended June 30, 1984, $1,004,400; and for the current fiscal year, $1,033,000. The professional staff of the Bureau consists of 12 field examiners, 3 supervisory examiners, an assistant director and a director.

The Savings Association Bureau presently supervises 104 state-chartered, federally-insured savings associations with assets ranging from $4,000,000 to $2,219,000,000; and 68 state-chartered associations insured by the Pennsylvania Savings Association Insurance Corporation with assets ranging from $125,000 to $82,900,000. A further breakdown of the state-chartered associations insured by the Pennsylvania Savings Association Insurance Corporation shows that although the largest association is $82.9 million, the remaining 67 associations have assets of between $125,000 and $13.5 million. These associations have been in business for a period of 28 to 117 years. The average net worth of these associations equals 13% of total savings on a GAAP accounting basis. This has been an historical pattern for a considerable portion of the Commonwealth's associations. Pennsylvania is the home of this country's first building and loan association. We further note that all savings and loan associations domiciled in Pennsylvania are managed in a conservative manner.

Associations insured by the Pennsylvania Savings Association Insurance Corporation are normally examined by the examining staff of the bureau on an annual basis. Under the Savings Association Code of 1967 and the Department of Banking Code, the Department has the authority to examine or

conduct investigations whenever it deems appropriate. Both Codes provide that the Department of Banking may, by written order, direct an association to discontinue any violation of law, or any unsafe or unsound business practice. Ancillary to these powers is the power to issue subpoenas, which includes contempt penalties for failure to appear or to testify before a Department proceeding. Any director, officer, attorney or employee of an association who after the Department orders to cease and desist from any violation of law, or any unsafe and unsound business practice, continues such violation or practice, may be removed from office. There are criminal penalties for directors, officers, employees and attorneys who engage in insider transactions, fail to keep proper records, repledge collateral, or submit required documents with false statements to the Department. Based upon our experience, we are confident the enforcement powers provided the Department by law are sufficient to monitor the safety and soundness of Pennsylvania's associations.

The Savings Association Code of 1967 provides that whenever the general reserves of an association are not equal to at least 8% of the savings accounts, or whenever the net worth of the association is not equal to at least 10% of the savings accounts, it shall credit annually to its general reserves an amount equal to not less than 5% of its net income before payment of interest on savings accounts. The Savings Association Code requires adherence to various standards such as loan to value ratios, maximum loans to one borrower, maximum percentage of various types investments to assets and a maximum limitation on borrowing. These provisions are designed to ensure the safety and soundness of our savings associations and prevent the possibility of the insolvency of any association.

The state capital requirements are significantly higher than those required by the Federal Savings and Loan Insurance Corporation (hereinafter FSLIC). Even with the recently adopted FSLIC capital requirements imposing higher capital requirements on the marginal deposits increase for rapidly growing FSLIC insured associations, the state requirements are still higher.

Even though capital requirements play an important role in preventing insolvencies, the Department does not solely rely on them. Ultimately, conservative, profitable good management is the best insurance against insolvency. From a regulatory standpoint, the Department attempts through its examination procedures and the close relationship the Department has with its chartered institutions, to identify problem associations at the earliest possible moment. When such an association is identified, the Department generally requires one of the following approaches: the pledging of deposits by certain savings members; supervisory mergers; or a supervisory conversion from a mutual to stock form.

After the Commonwealth amended its law in 1979 to require that all state-chartered associations obtain account insurance, the Department had the task of reviewing the financial status of every association applying for insurance from the Pennsylvania Savings Association Insurance Corporation (PSAIC). If the financial status of an association did not support a Department certification for PSAIC insurance, the Department would condition its certification upon the "pledging" of accounts by officers or directors These pledged accounts not only increased the association's net worth, but increased the pledgor officer's or director's motivation to insure good management. The Department continues to use this method to increase net worth and has found it to be successful, especially in the case of small or part-time associations.

The second method is the traditional method of arranging for a supervisory merger. With the advent of statewide branching in 1982, the Department may arrange the merger of any two associations located in the Commonwealth. Two reasons for the success of supervisory mergers are the Department's knowledge of the savings and loan industry in the state and its ability to foster mergers that are in the best interests of both associations.

The third method is the relatively new procedure of recapitalizing an association by a supervisory conversion to the stock form. Using this method, the Department determines, after a public hearing, that no public purpose would be served by offering the stock to the current savings members and authorizes a sale of the entire stock issue to a single person or entity, or a control group. Stock conversions were first authorized in Pennsylvania in 1982. The statutory authorization for stock conversions in Pennsylvania gives the Department more flexibility than the Federal Home Loan Bank Board (hereinafter FHLBB) or the Federal Savings and Loan Insurance Corporation (FSLIC). Since 1982, the Department has completed two such transactions. The first resulted in a stock association that grew from $4,000,000 in deposits to over $80,000,000 in deposits. This association is now well capitalized, is well managed, and has increased the net worth of PSAIC through its required deposit balances.

Based upon our continuous monitoring of both federally-insured and nonfederally-insured thrifts, we report that at the present time we have no problem associations within the Pennsylvania state system.

The statute establishing the Pennsylvania Savings Association Insurance Corporation (PSAIC) provides that the Department of Banking, through the Savings Association Bureau, shall monitor the operations of the

PSAIC and require the corporation to furnish reports or records as deemed necessary or appropriate in the public interest. The PSAIC must annually submit a written report certified by an independent public accountant relative to the conduct of its business, including financial statements. The statute further provides that all applications for membership in the PSAIC shall be referred to the Department of Banking, that the Department examine the affairs of all such applicants, and that the Department provide certification of such applicants as to the quality and soundness of the applicant association's financial affairs, solvency, management and directorship.

Since the PSAIC has been in operation, the Department, through the Savings Association Bureau, has provided the PSAIC with copies of reports of examinations, supervisory letters and related correspondence between the Bureau and the insured members. Accordingly, our supervisory letters require that the member associations provide copies of all their responses to the Savings Association Bureau for the PSAIC. In addition, as part of our monitoring program, the PSAIC provides the Savings Association Bureau with copies of its insured member associations' monthly reports to the Insurance Corporation for review by the Savings Association Bureau.

Since the inception of the PSAIC a representative from the Savings Association Bureau has attended all Board of Directors' meetings and membership committee meetings, as well as annual meetings of the Insurance Corporation. This provides for continuous dialogue and a most effective joint supervisory program for all the state-chartered associations insured by PSAIC. The sole power to terminate insurance of accounts for those associations insured by PSAIC rests with the Insurance Corporation.

It is appropriate, in our opinion, to emphasize that the safety of a

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savings association primarily comes from (1) sound management, (2) blue-chip home mortgage and investment portfolios, (3) strong supervisory-enforced reserve position, (4) adequate liquidity for meeting withdrawals, (5) the ability of the savings association to secure funds in time of need from the Federal Home Loan Bank's system, or the Federal Reserve Bank's discount window, or other reliable sources, and (6) in addition, the insurance of savings accounts.

Effective dual regulation depends on the mutual respect and cooperation between the department and the Pennsylvania Savings Association Insurance Corporation. This, coupled with the appropriate remedial action, including the pledging of accounts, supervisory mergers and supervisory stock conversions, has contributed to the public confidence Pennsylvanians have in the Pennsylvania Savings Association Insurance Corporation's insurance.

As the Department's line of communication between itself and the Pennsylvania Savings Association Insurance Corporation is operating effectively, the Department is not aware of any method that would materially improve that relationship.

One important lesson to be learned from the Ohio situation is that the well-being of any financial institution depends ultimately on public confidence.

All financial institutions perform the same economic function as a financial intermediary in the gathering of funds from the ultimate lenders and distributing them to the ultimate borrowers. The ultimate lenders exchange their cash for deposit accounts or debt instruments of the financial institution and the ultimate borrowers obtain cash from the institutions and give the financial institution a note or a security

evidencing their obligation to repay their debts. All financial institutions' asset-liability management plans assume that all the ultimate lenders will not ask the financial institution to honor withdrawal of deposits at one time. In fact, if this were not so, financial institutions could not perform their economic function of efficiently allocating credit in our ecomony. Therefore, public confidence is paramount. Furthermore, sound management and profitable operations with effective government monitoring is the key to maintaining public confidence.

It seems premature to condemn a segment of the savings and loan industry for the actions of one large state-insured institution. None of the PSAIC-insured institutions have invested in the type of repos or reverse repos marketed by the ESM government securities firm.

The privately insured institutions in Pennsylvania have been in business for a long time. They are strong, well-managed, and well-regulated. These are the key features to ensure that any type of financial institution remains fiscally sound.

Again, Mr. Chairman, I appreciate the opportunity to appear before the subcommittee today, and I will be pleased to take any questions you may have.

Official Advance Copy of Statute Enacted at 1979 Session

No. 1979-5

AN ACT

HB 153

Establishing the Pennsylvania Savings Association Insurance Corporation and providing for its powers and duties.

TABLE OF CONTENTS

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

Section 1. Definitions.

The following words and phrases when used in this act shall have, unless the context clearly indicates otherwise, the meanings given to them in this section:

"Association." Any building, savings or savings and loan association organized under the laws of this Commonwealth and any Federal savings and loan association incorporated pursuant to the Federal act of June 13, 1933 (48 Stat.128), known as the "Home Owners' Loan Act of 1933," which has its principal office in this Commonwealth and 75% of its total assets invested in this Commonwealth.

"Corporation." The Pennsylvania Savings Association Insurance Corporation.

"Directors" or "board of directors." The Board of Directors of the Pennsylvania Savings Association Insurance Corporation.

"Savings account." Any sum of money deposited with an association in exchange for a promise to pay interest or earnings to or for the account of the depositors.

Section 2. Pennsylvania Savings Association Insurance Corporation.

A nonstock, nonprofit corporation is hereby created, which shall be known as the Pennsylvania Savings Association Insurance Corporation and the members of which shall be certain eligible associations of this Commonwealth as defined in section 1. Except as otherwise provided in this act, the corporation possesses all the powers, privileges and immunities which now are or hereafter may be conferred on corporations by the General Corporation Law applicable to corporations organized thereunder.

Section 3. Purposes and powers.

(a) Purposes.—The purposes of the corporation are to promote the elasticity and flexibility of the resources of member associations, to provide for the liquidity of such associations through a central reserve fund and to insure the savings accounts in such associations.

(b) Powers.—In furtherance of these purposes the corporation has the following powers:

(1) To provide for the liquidity of member associations through the creation of a central reserve fund for the purpose of making loans to member associations. The central reserve fund shall not be subject to payment of insurance claims against the corporation by member associations or their account holders or otherwise.

(2) To insure the savings accounts in member associations through the creation of a central insurance fund, which fund shall consist of capital contributions by each member in an amount equal to not less than 2% of the total savings on deposit with each member.

(3) To borrow money and otherwise incur indebtedness for any of its purposes; to issue its bond, debentures, notes or other evidences of indebtedness, whether secured or unsecured, therefor; and to secure the same by mortgage, pledge, deed of trust or other lien on its property, rights and privileges of every kind and nature or any part thereof.

(4) To lend money to, and to guarantee, endorse or act as surety on the bonds, notes, contracts or other obligations of or otherwise assist financially, any member association; and to establish and regulate the terms and conditions with respect to any such loans or financial assistance and the charges for interest and service connected therewith.

(5) To purchase, receive, hold, lease or otherwise acquire and to sell, convey, mortgage, lease, pledge or otherwise dispose of, upon such terms and conditions as its board of directors may deem advisable, real and personal property, together with such rights and privileges as may be incidental and appurtenant thereto and the use thereof, including, but not restricted to, any real or personal property acquired by the corporation from time to time in the satisfaction of debts or enforcement of obligations.

(6) To invest any of its funds, upon proper authorization thereof by the board of directors, in any of the following:

(i) Cash or deposits in checking or savings accounts, or under certificates of deposit in National or State banking institutions, to the

extent that such accounts are insured by the Federal Deposit Insurance Corporation. This condition regarding Federal insurance shall not apply to investments in certificates of deposit when such condition would result in a lower interest rate than would otherwise be available.

(ii) Savings accounts in associations to the extent that such accounts are insured by the Federal Savings and Loan Insurance Corporation.

(iii) Interest bearing bonds, notes, certificates of indebtedness, bills or other obligations of the United States, any state or the District of Columbia, or of any commission, instrumentality, agency, authority or political subdivision of the United States, any state or the District of Columbia, having legal authority to issue the same.

(iv) Interest bearing bonds, notes or other interest bearing obligations of any corporation created or existing under the laws of the United States, any state or the District of Columbia.

(v) Dividend paying stocks or shares having readily marketable values of any corporation created or existing under the laws of the United States or of any state. The board of directors may not invest more than 10% of its total assets in such stocks, nor more than 3% of its total assets in the stock of any one corporation.

(vi) Loans secured by first mortgages or deeds of trust on otherwise unencumbered fee simple real estate or improved leasehold property in this Commonwealth.

(vii) Ground rents in this Commonwealth.

(viii) Collateral loans secured by pledge of any security hereinabove named.

(ix) Direct loans to member associations under the terms and conditions established therefor by the board of directors.

(7) To exercise all other corporate powers granted by general law to corporations in this Commonwealth which are not inconsistent herewith and which are necessary or appropriate to the purposes hereof.

(c) Accumulated earnings.—The earnings shall be accumulated by the corporation and no part thereof shall be returned to member associations. The provisions of this subsection shall not prohibit the payment of interest by the corporation to member associations which have made deposits, loans or advances to the central reserve fund.

Section 4. Board of directors.

(a) Directors elected by member associations.—All of the corporate powers of the corporation shall be exercised by a board of directors, composed of 11 members who initially shall be appointed by the Governor within 60 days of the effective date of this act with the advice of the Secretary of Banking, and who shall serve until the first annual meeting. After a minimum of 25 associations have become members of the corporation, the first annual meeting of the corporation shall be held, and the member associations of the corporation shall elect eight directors, each of whom shall be a registered voter of and shall reside in this

Commonwealth. Of the directors elected at the first annual meeting, three shall be elected for terms of two years each, three shall be elected for terms of three years each and two shall be elected for terms of four years each, and thereafter all terms shall be for four years each.

(b) Directors appointed by Governor.—In addition to the eight directors elected by the member associations as provided in subsection (a), the Governor shall, with the advice of the Secretary of Banking, appoint three directors of the corporation, one for a term of two years, one for a term of three years and one for a term of four years. The terms shall commence on the date of the first annual meeting of the corporation, and thereafter all terms shall be for four years. Any director so appointed shall be a registered voter of and shall reside in this Commonwealth.

(c) Vacancies.—If any vacancy occurs in the membership of any director elected by the members of the corporation, through death, resignation or otherwise, the remaining directors shall within 60 days elect a person to fill the vacancy of the unexpired term. Any vacancy occurring in the term of director appointed by the Governor shall be filled by the Governor within 60 days, with the advice of the Secretary of Banking, for the unexpired term. Upon the expiration of the term of any director, the directorship shall remain vacant until his successor has been elected or appointed and has qualified. In no case shall a director whose term has expired continue to serve unless he is reelected or reappointed to a new term and has qualified.

(d) Quorum.—Six members of the board of directors are a quorum at any meeting thereof.

(e) Voting.—In the election of directors and in voting on any other matter legally to come before a meeting of the corporation, each member association of the corporation has one vote, to be cast by a delegate authorized to act by that association. A delegate may not vote on behalf of more than one member association. A majority of the votes so cast shall elect directors or determine any question put to a vote.

(f) Compensation.—The directors of the corporation may receive such reasonable compensation from the funds of the corporation as may be determined by the board of directors.

(g) Surety bonds of officers and employees.—The directors of the corporation shall fix the amount of the surety bonds of the officers and employees of the corporation conditioned upon the faithful performance of their duties, as provided in the bylaws of the corporation.

Section 5. Qualifications for membership in corporation.

(a) General rule.—

(1) The membership of the corporation consists of those associations:

(i) the quality and soundness of whose financial affairs, solvency, management and directorship have been certified to the corporation in an expeditious manner, as approved for insurance of savings accounts, by the Secretary of Banking; and

(ii) which have thereupon filed a formal application for membership accepted by the board of directors, which acceptance shall not be denied except for good cause shown regarding the quality and soundness of their financial affairs, solvency, management or directorship.

(2) The corporation may accept an applicant for membership subject to the imposition of certain conditions concerning the quality and soundness of the applicant's financial affairs, solvency, management and directorship.

(3) Subject to the conditions set forth in paragraphs (1) and (2), every association of this Commonwealth may become a member of the corporation and may invest in and pay such assessments, premiums and other charges as may be required for participation in the corporation. Membership in the corporation is for the life of the corporation, subject to the bylaws, rules and regulations of the corporation.

(b) Withdrawal.—Any member may withdraw from the corporation upon written notice given one year in advance of the intended date of withdrawal and upon complying with the bylaws, rules and regulations of the corporation.

Section 6. Exchange of information.

The laws of this Commonwealth, including but not limited to the act of May 15, 1933 (P.L.565, No.111), known as the "Department of Banking Code," shall be construed and applied so as not to prevent an exchange of information relating to associations and their business, between the Secretary of Banking and representatives of the corporation. Any document or information supplied to the corporation by the Secretary of Banking shall be kept confidential unless the Secretary of Banking specifically specifies otherwise, and violation of such confidentiality shall subject the personnel of the corporation to the same sanctions to which the Secretary of Banking would be subject under the "Department of Banking Code."

Section 7. Faith or credit of Commonwealth not pledged.

Under no circumstances is the faith or credit of the Commonwealth of Pennsylvania pledged herein.

Section 8. Bylaws, rules and regulations.

(a) General rules and regulations.—Within 60 days of its appointment and before the acceptance of the membership of any associations, the board of directors shall promulgate, subject to the approval of the Secretary of Banking, such bylaws, rules and regulations as may be necessary and proper to carry out the provisions of this act and as are not inconsistent with this act. Thereafter, the bylaws, rules and regulations so adopted may be amended or revoked by the board of directors and will, upon approval of the Secretary of Banking become effective upon their adoption. The rules and regulations shall establish a limit on the amount of insurance which may be provided for each separate savings account of an association; and this limit shall be the amount of prevailing insurance

available from the Federal Savings and Loan Insurance Corporation or its successor instrumentality from time to time.

(b) Internal rules and regulations.—The board of directors shall have the power to adopt such bylaws, rules and regulations which may be necessary for the internal operations of the corporation.

Section 9. Corporation or member associations not subject to insurance laws.

Neither the corporation, the member associations, nor those persons owning savings accounts therein are subject to the provisions of any laws of this Commonwealth concerning insurance by reason of participation herein except that the provisions of section 641, act of May 17, 1921 (P.L.789, No.285), known as "The Insurance Department Act of one thousand nine hundred and twenty-one," shall continue to apply.

Section 10. Liability of officer or director upon contracts.

No officer or director of the corporation, whether appointed or elected, is personally liable upon any of its contracts legally entered into on behalf of the corporation unless the same by its terms shall expressly obligate him or them.

Section 11. Perpetual life of corporation.

The life of the corporation is perpetual.

Section 12. Exemption from taxation.

The corporation is exempt from all special and ordinary taxes and from documentary stamp and transfer taxes imposed by this Commonwealth or any political subdivision thereof.

Section 13. Application for membership.

(a) Applications before organization of board.—All applications from associations for membership received by the corporation prior to appointment and organization of the board of directors shall be referred to the Secretary of Banking. The Secretary of Banking shall examine the affairs of all such applicants and as a result thereof if he finds the applicants to meet the qualifications for membership in the corporation set forth herein under section 5, he shall so certify them. The corporation shall not extend the benefits to be accorded to member associations to any applicant until:

(1) it has received the report and recommendation as provided herein from the Secretary of Banking as to such applications so filed prior to appointment and organization of the board of directors and has acted thereon in accordance with section 5; and

(2) it has accepted for membership a minimum of 25 associations having savings accounts in the aggregate total of at least $25,000,000.

(b) Applications after organization of board.—All applications from associations for membership received by the corporation subsequent to appointment and organization of the board of directors shall be made to the corporation. The corporation shall then refer this preliminary application to the Secretary of Banking within 30 days of receipt thereof for action in accordance with the requirements set forth herein under section 5.

Section 14. Functions of Secretary of Banking.

(a) Requiring corporation to discharge its obligation.—In the event of the refusal of the corporation to commit its funds or otherwise to act for the protection of depositors of any member association of the corporation, the Secretary of Banking may apply to the Commonwealth Court for an order requiring the corporation to discharge its obligation under this act and for such other relief as the court may deem appropriate to carry out the purposes of this act.

(b) Examinations and inspections; reports.—The Secretary of Banking may make such examinations and inspections of the corporation and require the corporation to furnish him with such reports and records or copies thereof as the Secretary of Banking may consider necessary or appropriate in the public interest or to effectuate the purposes of this act. As soon as practicable after the close of each fiscal year, the corporation shall submit to the Secretary of Banking a written report relative to the conduct of its business and the exercise of the other rights and powers granted by this act, during such fiscal year. Such report shall include financial statements setting forth the financial position of the corporation at the end of such fiscal year and the results of its operations, including the source and application of its funds, for such fiscal year. The financial statements so included shall be examined by an independent public accountant, or firm of independent public accountants, selected by the corporation and satisfactory to the Secretary of Banking, and shall be accompanied by the report thereon of such accountant or firm.

Section 15. Filing certificate of commencement of business.

After the first meeting of the board of directors, a certificate shall be filed by the board of directors with the Department of State certifying that the corporation has commenced business as provided in this act. Such certificate shall be conclusive evidence that business was begun.

Section 16. Termination of existence of corporation.

If the corporation fails to insure savings accounts by January 1, 1981, its existence terminates at that time without further action by the General Assembly and the Governor, the provisions of this act then are null and void and shall expire on January 1, 1981.

Section 17. Effective date.

This act shall take effect in 60 days.

APPROVED—The 6th day of April, A. D. 1979.

DICK THORNBURGH

Official Advance Copy

No. 1983-13

AN ACT

HB 575

Amending the act of April 6, 1979 (P.L.17, No.5), entitled "An act establishing the Pennsylvania Savings Association Insurance Corporation and providing for its powers and duties," further providing for the regulation of the amount of earnings paid on savings deposits by certain associations.

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

Section 1. Section 3(b) of the act of April 6, 1979 (P.L.17, No.5), referred to as the Pennsylvania Savings Association Insurance Corporation Act, is amended by adding a paragraph to read:

Section 3. Purposes and powers.

* * *

(b) Powers.—In furtherance of these purposes the corporation has the following powers:

* * *

(6.1) To approve any association insured by the corporation to pay any earnings on savings accounts except when the Pennsylvania Department of Banking finds that such payment of earnings would be excessive in light of the financial condition of the association or would constitute an unsafe or unsound business practice.

* * *

Section 2. Section 804 of the act of December 14, 1967 (P.L.746, No.345), known as the Savings Association Code of 1967, is repealed insofar as it is inconsistent with this act.

Section 3. This act shall take effect immediately.

APPROVED—The 15th day of June, A. D. 1983.

DICK THORNBURGH

Mr. BARNARD. Mr. Bulman, I would like to ask you, as I did Mr. McEnteer. Under your jurisdiction, you have banks, savings and loans and credit unions?

Mr. BULMAN. That's correct, Mr. Chairman.

In the division of banking in the Commonwealth of Massachusetts, we have loan companies, we have credit unions, we have cooperative banks, we have savings banks and we have commercial banks.

Mr. BARNARD. Thank you very much.

STATEMENT OF PAUL E. BULMAN, COMMISSIONER OF BANKS, COMMONWEALTH OF MASSACHUSETTS

Mr. BULMAN. Mr. Chairman and members of the Commerce, Consumer, and Monetary Affairs Subcommittee.

My name is Paul Bulman and I presently serve as commissioner of banks of the Commonwealth of Massachusetts.

Like most Americans, the citizens of Massachusetts have indicated concern about the recent events that have involved the privately-insured State S&L's in Ohio. This concern in Massachusetts did not escalate into anything resembling the Ohio situation however. The reaction can be more fully understood when one reviews a number of interesting records held by the Commonwealth of Massachusetts.

First of all, our two private funds are the oldest continuously operated funds in the country. Founded in 1931, they predate the start of the Federal Deposit Insurance Corporation which came into existence 2 years later. Today these two State funds hold $575 million in resources to insure nonfederally insured deposits of $15.3 billion in 245 savings and cooperative banks throughout the Commonwealth.

This means that our insurance funds presently provide 3½ cents coverage for every dollar on deposit. To the best of my knowledge, no other deposit insurance fund, whether it be Federal or State, can match that ratio. Our two funds have certainly provided a significant part of the public confidence in our thrift industry for the past 54 years.

Whether they shall continue this role is not predictable at this time. Within the past week, because of the press coverage of Ohio, we have been advised that 41 privately insured savings banks have asked the Boston office of the FDIC for Federal insurance applications. Reportedly six of our privately insured cooperative banks have made similar requests for FSLIC insurance applications. Also, within the past week, the banking committee of the State legislature held a public hearing on a bill that, if enacted into law, would require our thrifts to obtain Federal insurance.

Although my comments thus far have focused upon the status of the private insurance companies in Massachusetts, it should be noted that I, as a State regulator, do not look upon them as the primary source of public confidence in our thrift industries. Rather the thrift banks themselves have historically demonstrated what has been described as "good old Yankee conservatism."

Many of these institutions were founded over 150 years ago; and the fact that they were able to survive through dozens of reces-

sions, depressions and other manifestations of economic upheaval says a lot for their inherent soundness.

Today our 145 savings banks hold $27 billion of total resources and $2 billion of surplus funds, which means that the surplus-to-asset ratio stands at 7.4 percent. Our 100 cooperative banks currently hold $5 billion dollars of total resources and $354 million in surplus, which works out to a surplus to asset ratio of 6.8 percent.

In contrast, the March 1985 Federal Reserve Bulletin indicates that nationally the FSLIC-insured institutions hold a 3.9 percent ratio and savings banks hold a 5.2 ratio.

When one looks at the current operating performance, the same disparity continues with the Massachusetts savings banks and cooperative banks showing returns on average assets of 0.44 percent and 0.72 percent, respectively, while nationwide savings banks and FSLIC-insured institutions were reflecting 0.07 percent and 0.24 percent respectively.

While we obviously take some comfort from the traditionally higher financial performance of our thrift industry, we recognize the potential problem that could adversely impact the industry as it attempts to restructure its balance sheets to survive in a more competitive deregulated environment. Through annual examinations by a staff of experienced, well-trained field examiners, together with the close monitoring of quarterly call report data that has been computerized to yield individual bank performance ratios in comparison with peer group norms, we feel able to detect problems at a very early stage.

To summarize, Massachusetts, during the past five decades has relied upon a three-stage plan to maintain public confidence in its banking system. First and foremost, the institutions themselves, through years of conservative practices have held higher capital positions and generally profitable operations.

Our second line of defense has rested upon the State's continuous commitment to maintain a strong regulatory authority to monitor and supervise the industry. And, finally, we have the best funded insurance companies in the country, albeit private funds.

In compliance with your specific requirements for detailed information, I am submitting a list of detailed responses. I would also like to thank the committee for your attention and affording Massachusetts the opportunity to testify here today.

[The prepared statement of Mr. Bulman follows:]

MR. CHAIRMAN AND MEMBERS OF THE COMMERCE, CONSUMER AND MONETARY AFFAIRS SUBCOMMITTEE:

MY NAME IS PAUL E. BULMAN, AND I PRESENTLY SERVE AS COMMISSIONER OF BANKS OF THE COMMONWEALTH OF MASSACHUSETTS.

LIKE MOST AMERICANS, THE CITIZENS OF MASSACHUSETTS HAVE INDICATED SOME CONCERN ABOUT THE RECENT EVENTS THAT HAVE INVOLVED THE PRIVATELY-INSURED STATE S & Ls IN OHIO. THIS CONCERN IN MASSACHUSETTS DID NOT ESCALATE INTO ANYTHING RESEMBLING THE OHIO SITUATION. THE REACTION CAN BE MORE FULLY UNDERSTOOD WHEN ONE REVIEWS A NUMBER OF INTERESTING RECORDS HELD BY MASSACHUSETTS. FIRST OF ALL, OUR TWO PRIVATE FUNDS ARE THE OLDEST CONTINUOUSLY OPERATED ONES IN THE COUNTRY. FOUNDED IN 1931, THEY PREDATE THE START OF THE FEDERAL DEPOSIT INSURANCE CORPORATION, WHICH CAME INTO EXISTENCE TWO YEARS LATER. TODAY, THESE TWO FUNDS HOLD $575 MILLION TO INSURE NON-FEDERALLY INSURED DEPOSITS OF $15.3 BILLION IN 245 SAVINGS AND CO-OPERATIVE BANKS. THIS MEANS THAT OUR INSURANCE FUNDS PRESENTLY PROVIDE 3 1/2 CENTS COVERAGE FOR EVERY DOLLAR ON DEPOSIT. TO THE BEST OF MY KNOWLEDGE NO OTHER DEPOSIT INSURANCE FUND, WHETHER IT BE FEDERAL, OR STATE, CAN MATCH THIS RATIO. OUR TWO FUNDS HAVE CERTAINLY PROVIDED A SIGNIFICANT PART OF THE PUBLIC CONFIDENCE IN OUR THRIFT INDUSTRY FOR FIFTY-FOUR YEARS. WHETHER THEY SHALL CONTINUE THIS ROLE IS NOT PREDICTABLE AT THIS TIME. WITHIN THE PAST WEEK WE HAVE BEEN ADVISED THAT FORTY-ONE PRIVATELY INSURED SAVINGS BANKS HAVE ASKED THE BOSTON OFFICE OF THE FDIC FOR FEDERAL INSURANCE APPLICATIONS. REPORTEDLY, SIX OF OUR PRIVATELY INSURED CO-OPERATIVE BANKS HAVE MADE SIMILAR REQUESTS FOR FSLIC INSURANCE APPLICATIONS. ALSO, WITHIN THE PAST WEEK, THE BANKING COMMITTEE OF THE STATE LEGISLATURE HELD A PUBLIC HEARING ON A BILL THAT, IF ENACTED INTO LAW, WOULD REQUIRE OUR THRIFTS TO OBTAIN FEDERAL INSURANCE.

ALTHOUGH MY COMMENTS THUS FAR HAVE FOCUSED UPON THE STATUS OF THE PRIVATE INSURANCE COMPANIES IN MASSACHUSETTS, IT SHOULD BE NOTED THAT I, AS THE STATE REGULATOR, DO NOT LOOK UPON THEM AS THE PRIMARY SOURCE OF PUBLIC CONFIDENCE IN OUR THRIFT INDUSTRY. RATHER THE THRIFT BANKS THEMSELVES HAVE HISTORICALLY DEMONSTRATED WHAT HAS BEEN DESCRIBED AS "GOOD OLD YANKEE CONSERVATISM." MANY OF THESE INSTITUTIONS WERE FOUNDED OVER ONE-HUNDRED AND FIFTY YEARS AGO, AND THE FACT THAT THEY WERE ABLE TO SURVIVE THROUGH DOZENS OF RECESSIONS, DEPRESSIONS AND OTHER MANIFESTATIONS OF ECONOMIC UPHEAVAL SAYS A LOT FOR THEIR INHERENT SOUNDNESS. TODAY, OUR ONE-HUNDRED AND FORTY FIVE SAVINGS BANKS HOLD $27 BILLION OF TOTAL RESOURCES AND $2 BILLION OF SURPLUS FUNDS, WHICH MEANS THAT THE SURPLUS TO ASSET RATIO STANDS AT 7.4%. OUR 100 CO-OPERATIVE BANKS CURRENTLY HOLD $5 BILLION OF TOTAL RESOURCES AND $354 MILLION IN SURPLUS, WHICH WORKS OUT TO A SURPLUS TO ASSET RATIO 6.8%. IN CONTRAST, THE MARCH 1985 FEDERAL RESERVE BULLETIN INDICATES THAT, NATIONALLY, THE FSLIC-INSURED INSTITUTIONS HOLD A 3.9% RATIO AND SAVINGS BANKS HOLD A 5.2% RATIO.

WHEN ONE LOOKS AT CURRENT OPERATING PERFORMANCE, THE SAME DISPARITY CONTINUES WITH THE MASSACHUSETTS SAVINGS AND CO-OPERATIVE BANKS SHOWING RETURNS ON AVERAGE ASSETS OF .44% AND .72%, RESPECTIVELY, WHILE NATIONWIDE, SAVINGS BANKS AND FSLIC-INSURED INSTITUTIONS WERE REFLECTING .07% AND .24%, RESPECTIVELY.

NOW WHILE WE OBVIOUSLY TAKE SOME COMFORT FROM THE TRADITIONALLY HIGHER FINANCIAL PERFORMANCE OF OUR THRIFT INDUSTRY, WE RECOGNIZE THE PROBLEM POTENTIAL THAT COULD ADVERSELY IMPACT THE INDUSTRY AS IT RESTRUCTURES ITS BALANCE SHEET TO SURVIVE IN A MORE COMPETITIVE DEREGULATED ENVIRONMENT. THROUGH ANNUAL EXAMINATION BY A STAFF OF EXPERIENCED, WELL-TRAINED FIELD EXAMINERS, TOGETHER WITH THE CLOSE MONITORING OF QUARTERLY CALL REPORT DATA THAT HAS BEEN COMPUTERIZED TO YIELD INDIVIDUAL BANK PERFORMANCE RATIOS IN COMPARISON WITH PEER GROUP NORMS, WE FEEL ABLE TO DETECT PROBLEMS AT AN EARLY STAGE.

TO SUMMARIZE, MASSACHUSETTS, DURING THE PAST FIVE DECADES, HAS RELIED UPON A THREE-STAGE PLAN TO MAINTAIN PUBLIC CONFIDENCE IN OUR THRIFT BANKS. FIRST AND FOREMOST, THE INSTITUTIONS, THEMSELVES, THROUGH YEARS OF CONSERVATIVE PRACTICES, HAVE HELD HIGHER CAPITAL POSITIONS AND GENERALLY PROFITTABLE OPERATIONS. OUR SECOND LINE OF DEFENSE HAS RESTED UPON THE STATE'S CONTINUOUS COMMITMENT TO MAINTAIN A STRONG REGULATORY AUTHORITY TO MONITOR AND SUPERVISE THE INDUSTRY. AND FINALLY, WE HAVE THE BEST FUNDED INSURANCE COMPANIES IN THE NATION.

IN COMPLIANCE WITH YOUR SPECIFIC REQUIREMENTS FOR DETAILED INFORMATION, I AM SUBMITTING A LIST OF DETAILED RESPONSES. THANK YOU FOR YOUR ATTENTION AND AFFORDING ME THE OPPORTUNITY TO TESTIFY THIS MORNING.

1. Please describe your agency's operations and enforcement powers, and the general condition of the thrifts in your state. In so doing, please answer or furnish the following:

1a. For each year, 1982 to date, the budget of the Massachusetts Office of Commissioner of Banks and the number of individuals employed in professional level examination/supervisory capacities.

	Annual Budget	Examination/Supervisory Personnel
1982	$4,333,708	125
1983	4,334,745	121
1984	4,640,534	127
1985	4,670,813	125

1b. The number and asset range of (i) state-chartered and insured and (ii) state-chartered but federally insured, thrift institutions currently supervised by your office.

	Number	Asset Range
(i) State-chartered and insured	196	$2.3 to $743.1 million
(ii)State-chartered, but federally insured	49	$38.5 million to 1.2 billion

1c. Describe briefly the frequency with which Massachusetts institutions are examined and the civil and criminal powers available to your agency to supervise these institutions (i.e., cease and desist powers, suspensions or removal powers, civil fines, etc.) Are you satisfied with the sufficiency of these powers?

Massachusetts General Law presently requires a minimum of one examination every two years for each financial institution. However, we have historically examined almost all banks on an annual basis. My office is fully empowered to issue cease and desist orders, remove officers, and impose civil fines. I am satisfied with the sufficiency of these powers.

1d. Do you impose on the institutions you supervise reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

In recent years we have generally required a 5% surplus/asset ratio for our thrifts. If an institution falls below the 5% level, it is placed on a "watch list" and monitored monthly. If the level falls below 4% we begin to work actively with management to obtain corrective action. If the capital level falls to 3%, we either replace management, merge the institution into a stronger institution, or liquidate the assets.

In this connection, we are cognizant of the federal agencies recent call for a 6% capital adequacy level. Because most of our thrifts hold a mutual-ownership charter which limits their ability to increase

capital to earnings retention, only, we are unconvinced that this higher level requirement could be realistically attained in a short time frame for the vast majority of the industry. As long as our thrifts maintain their traditional commitment to providing home financing and other consumer services, we will be satisfied with our 5% requirement.

For those institutions that may be inclined to enter into activities formerly reserved for commercial banks, we would expect them to immediately raise their capital to the 6% level. This, of course, could only be obtained by converting to a stock corporation.

1e. How many of Massachusetts's (i) federally insured and (ii) nonfederally insured thrifts are presently on you "problem" list?

As indicated in the response to question 1.d., above, we have a "watch list" of those banks that have recently displayed one or more financial deficiencies or violations of law. Presently there are ten institutions that have minor deficiencies such as technical violations of community reinvestment or consumer protection laws, higher that average overhead expenses, deficient lending policies, or slightly less than 5% capital. We do not presently have any institutions that pose any high level of concern.

2a. Do you routinely and systematically make available to the insurance fund administrators (i) examination reports and related documents involving, and (ii) information about any supervisory actions taken against, the state/private insured thrifts?

(i) Both private insurers are furnished with examination reports, audit reports and pertinent documents.
(ii) Bank Supervision's management staff meets three to four times annually with representatives of the insurance funds to discuss both industry wide and on a bank-by-bank basis, any negative trends, deterioration of financial components, alleged improprieties, anticipated management changes and other factors that may be material.

2b. Do you have authority to order the termination of an association's state/private deposit insurance? If so, under what set of conditions are you authorized to do so; and set forth the number of such insurance terminations from 1980 to date. If you do not have insurance termination authority, does that authority reside elsewhere?

The Commissioner, personnally, does not have any authority to order the termination of an association's state/private deposit insurance.

With regard to the Massachusetts Savings Banks insured by the Mutual Savings Central Fund, Inc., and Cooperative Banks insured by the Cooperative Central Bank, termination of insurance coverage takes place only upon the happening of certain events as set forth in Chapters 168 and 170 of the Massachusetts General Laws and as set forth in the statutes governing their respective insurance funds.

Termination of coverage by the applicable insurance fund occurs when there is a merger or consolidation between thrift institutions as to the institution whose corporate existence is dissolved.

Termination of coverage by the state/private insurer occurs when a state-chartered savings bank or cooperative bank is consolidated or merged into a federally chartered institution.

Termination also occurs when a state-chartered savings bank or cooperative bank converts to a federal charter.

Finally, when a state-chartered savings bank or cooperative bank acquires federal insurance under the FDIC or FSLIC, then state insurance terminates to the extent of the federal insurance coverage, but deposits in both savings banks and cooperative banks in excess of those covered by the federal insurance continue to be covered by their respective state/private insurance funds.

Since 1980, four savings banks have converted to federal charter, two cooperative banks converted to federal charter, resulting in termination of insurance by the Mutual Savings Central Fund, Inc. and the Cooperative Central Fund.

Since 1980, three cooperative banks have merged into Massachusetts savings banks with termination of insurance by the Cooperative Central Fund. These banks are now insured by the Mutual Savings Central Fund.

3. Please set forth your views on how Cooperative Central Bank might operate more effectively to prevent or minimize losses to the fund; and how your agency's coordination and cooperation with the operators of the insurance fund could be improved.

As the regulator of the two private deposit insurance companies I have no problem with their current operations. We have always maintained open lines of communication with the operators of both funds and have always received the full cooperation of the funds' operators when dealing with institutions of supervisory concern.

4. Please comment on the Ohio deposit insurance fund situation and the adequacy of responses by state and Federal officials (including the Federal Reserve, Home Loan Bank Board, and SEC officials). What specific lessons have been learned and what recommendations are you prepared to make to Congress regarding recent events in Ohio and their possible repetition elsewhere?

I really can not comment on the problems in Ohio, because my only information has come from recent articles in the media.

6. Please feel free to provide any additional information or views which you believe are relevant to the issues being studied by the subcommittee.

I have no additional comments to make at this time.

Mr. BARNARD. I thank all of you very much.

Is there any supervisory relationship at all between your office and the insurance funds? I mean, you don't examine—do you examine their funds or audit them in any way or examine them in anyway?

Mr. BROWN. In Maryland, Mr. Chairman, we do not supervise the day-to-day operations of the insurance fund. However, under Maryland law, any changes that they make in their regulations or bylaws must be approved by the director of the division. Other than that we have nothing to do with the day-to-day operations.

Mr. BARNARD. Mr. King?

Mr. KING. Mr. Chairman, in North Carolina, the secretary of commerce who I serve at the pleasure of, has the statutory authority for that responsibility under State statute.

Mr. BARNARD. Does he automatically serve on the board?

Mr. KING. No, sir.

Mr. BARNARD. He doesn't serve on the private insurance board?

Mr. KING. No, sir. Now, about 2 years—2½ years ago, pretty soon after that statute was changed delegating that authority to the secretary of commerce or giving him that statutory responsibility, that responsibility was delegated to me as administrator of the savings and loan division. So, in my particular case, I do directly supervise the Financial Institution Assurance Corp. We examine them every year. We have designed a special examination program.

Mr. BARNARD. Are they also independently audited?

Mr. KING. Yes, sir, they have an independent audit by one of the big eight accounting firms.

Mr. BARNARD. Mr. McEnteer?

Mr. MCENTEER. We have the same thing in Pennsylvania, that PSAIC is required to have a certified public accountant audit it annually and we review those reports. We also have a representative of our savings association bureau at each meeting of the corporation and we look at their investments and what they are doing with their money and follow it very closely and consult with the manager of the association quite frequently. We keep close tabs on it.

Mr. BARNARD. Mr. Bulman.

Mr. BULMAN. Mr. Chairman, we examine all three funds in Massachusetts, produce examination reports much like those produced for all member banks and distribute those reports to the board of directors of those funds.

Mr. BARNARD. Gentleman, the situation that happened at ESM—did any of you receive any notification from Federal agencies with reference to that company?

Mr. BROWN. We did not in Maryland, Mr. Chairman.

Mr. KING. No, sir, not at all in North Carolina.

Mr. MCENTEER. No, sir, not to my knowledge. In Pennsylvania, we didn't receive anything.

Mr. BULMAN. We did not in Massachusetts. But, in fairness, one of the comptroller officers testified earlier that there was a memorandum produced, I believe, in 1977 and from memory, I can recall seeing such a memorandum. I believe we obtained it from the Federal Deposit Insurance Corporation, which highlighted what they referred to as Memphis bond dealers.

Mr. BARNARD. In your regular examination procedure, would the situation that appeared in Home State—where they did not have a segregated account—where evidently there was no trust receipt or other evidence of ownership of these Government securities. Would that have been discovered by your examiners?

Mr. BROWN. I think the examiners would pick that up and include it in their report.

Mr. BARNARD. Would they have criticized it?

Mr. BROWN. To the point of making a comment in the exam and then it would be up to me to take some action.

Mr. BARNARD. Would the criticism have gone to the fact that they didn't have trust receipts? Would it have gone to the fact that they had, say, bought 35 to 40 percent more securities pledged than borrowed?

Mr. BROWN. I think it would, Mr. Chairman, yes. I think the examiners would pick it up and would report it in detail to us.

Mr. BARNARD. Mr. King?

Mr. KING. Mr. Chairman, that would have been detected in our examination process. It is a normal part of the written examination program. In addition to that, we had, and I can't remember exactly the timeframe, 2 or 3 years ago now, three or four FSLIC-insured institutions in the State, both State and federally chartered, that were burned in one of the earlier failures and as a result of that, we learned some lessons and put in a little more stringent procedures in our examination process and one of those, in fact, was to definitely ascertain, during the examination process, that collateral was delivered in these types of transactions.

Mr. BARNARD. Mr. McEnteer, in addition to that question, do you have any knowledge of any Pennsylvania financial institutions that were involved with ESM?

Mr. MCENTEER. We don't have any knowledge of any State-chartered financial institutions that were involved with ESM, especially the savings associations. I am not sure about any national banks that might have been involved. There are no State-chartered associations, to our knowledge, that were involved in any ESM transactions.

As far as the savings and loans, we would have discovered it, I believe, because they are limited in their borrowing to 50 percent of their deposits and if something like Ohio happened, it would stick out like a sore thumb and also we confirm the securities, the presence of the securities or their deposit with a correspondent bank or something. When we go in on an examination, if they have a repo situation, we want to know that they have the securities.

Mr. BARNARD. Mr. Bulman?

Mr. BULMAN. Yes, sir. I don't think there is any question that the total borrowings would have been recognized but more importantly I would hope that the examiners would have criticized the margin requirements required for Government securities.

I believe the 25-percent margin requirement the committee heard this morning in testimony, is far and beyond what the normal margin requirement for Government securities is. My memory would suggest that it's somewhere between 5 and 10 percent in Massachusetts.

Mr. BARNARD. Mr. Craig.

Mr. CRAIG. Thank you very much, Mr. Chairman and to all of the panel, I appreciate your testimony and your observations of this situation and your response and frank way to the chairman of the committee. Mr. Chairman, I have no specific questions of these gentlemen.

Mr. BARNARD. Mr. Spratt.

Mr. SPRATT. There was a suggestion made by Mr. Gray to the effect that once institutions insured by funds such as those with which you work in your own States, reached a certain level of size, then at that threshhold, these institutions should be required to obtain FSLIC coverage. Would you respond to that recommendation?

Mr. BROWN. I feel that there is room for both systems in this country. We're not having any problems with our associations. We know what's going on, the insurer knows that's going on and I don't agree with Mr. Gray.

Mr. SPRATT. Well his point was, taking his cue from the Ohio situation where one institution failed because of its size, wiped out the whole fund, that there came a point in risk when the FSLIC, with its much broader base and ultimately the Federal Government behind it, ought to be the insurer, but you don't think that's necessary in light of the situation in Ohio?

Mr. BROWN. No, I do not, sir, no, sir.

Mr. KING. Based on what I basically read in the newspaper and the little bit of additional knowledge that I picked up about the Ohio situation, I don't think who was insuring the accounts had anything to do with the problem. I think it was a combination of some bad and probably fraudulent management decisions made by the association in addition to the failure of the securities firm that led to the downfall and lack of proper oversight and supervision by the State regulator and the insurance fund and, you know, anytime you have a break down in the system, you're going to have those kinds of failures and the Federal system can have those same types of problems also.

Mr. SPRATT. But the Federal system has the resources ultimately, to cover the loss.

Mr. KING. No question about that. When you have received full faith and credit of the U.S. Treasury behind the insurance funds that prevents losing the public confidence, which was the basis for the failure in Ohio. It makes a big difference.

Mr. SPRATT. Mr. McEnteer.

Mr. MCENTEER. I don't believe the size of the association has anything to do with the failure or nonfailure. I think it is the management and the integrity of the management and the type of assets and we have no thought in Pennsylvania of making an association apply for Federal insurance when it reaches a certain size, although I will admit that most of ours are small. Our largest one, because of this Ohio situation, has made arrangements for lines of credit if anything should happen there and the others, we have worked with the Federal Reserve, they came in and looked over our examination reports to determine that these associations are sound and have good assets on which to borrow, so I think we're in pretty good shape in Pennsylvania now for any emergency that might arise.

Mr. BULMAN. I would just say that I think it is somewhat ironic that we are here today talking about solvent State funds, advising all their members to get FSLIC insurance. It seems to me in the last couple of weeks, we were reading about the failures of FSLIC. I don't know why we're all jumping into that system. There is an awful lot being made of the full faith and credit of the U.S. Government. I know of lines of credit established at the Treasury. I know of no law issued by this Congress that says the full faith and credit of the U.S. Government is involved.

Mr. SPRATT. I agree. I understand that. But, implicitly, that back up is available and the resources are larger than any of your individual pools.

Mr. BULMAN. I think the other issue that is important here, whether we talk about State funds Federal funds, is that they are all made up of industry premiums. The source of funds that we're using today are premiums paid for insurance by the industry itself.

I don't know that we should get into the Treasury backing an industry. If an industry chooses to insure its own deposits, then that industry should be willing to pay for it. I don't know that the citizens of the United States that don't avail themselves of these services should be taxed for that process.

The fundamentalist issue on States, as many of the State bankers in Massachusetts would tell you, is that they are going to maintain capital adequacy status in Massachusetts in their own banks and they are able to do that through reaching their State legislature, through reaching their State regulator and through their own central fund. They can maintain the safe and sound controls that they are interested in. Massachusetts bankers cannot maintain them in California and they are not willing to take their premium dollars and underwrite a Federal system that has much different standards.

The opposite of that, of course, is the federal system pools those resources and protects all.

Mr. SPRATT. Do the examiners who work for you or work in your State-regulated systems confer and consult with private auditors outside auditors for the S&L's whom they regulate?

Mr. BULMAN. In Massachusetts, sir, on occasion, we will contact an auditor. We have authority, through statute, to appoint our own auditor. We can contract our own C.P.A. firm to examine an institution and the institution is billed for that examination.

Mr. MCENTEER. In Pennsylvania, our examiners don't actually work with the auditors, but they confer with them on certain situations that arise. We have the availability to do that. They don't examine at the same time is what I am saying, but if something comes up, they confer with them.

Mr. SPRATT. Well, we encountered the curiosity and the failure of the UAB in Knoxville where both the private audit firm, the outside auditors and the FDIC were in the bank at the same time and they apparently, from the facts we developed, weren't talking to each other. Each was doing his own thing and it just struck me as not a very wise allocation or use of resources in a period like that.

Mr. MCENTEER. We don't have any of that in Pennsylvania. I hope we don't run into that. We get along very well with the private auditors.

Mr. KING. I might respond in our situation. We don't look at our process, that we go through in supervising our S&L's, as an audit function. We are examining the associations for compliance with State statutes, but mainly for safety and soundness reasons.

We depend on the private auditors and all of our associations are required to have independent audits. That information is very important to us as a part of that process. It's not something that we ignore. We have a step in our examination process in which the audit report is reviewed as a part of the examination. If we have any questions then the contact is made directly with the independent auditor.

Mr. BROWN. In Maryland, part of the preexam analysis by the examiner is going over the audit report that has been received, probably between examinations and that report is taken with him into the association for verification.

There are times when they do talk to the auditor and might question something that is in the audit report, but we do look at it and study it very seriously.

Mr. SPRATT. One more question, Mr. Chairman.

Mr. Beason indicated that the State of North Carolina, your FIAC, in particular, has a fairly sophisticated monitoring system where monthly data comes to the attention of the FIAC which is watched carefully.

Do your various agencies monitor broker deposit levels, outside investments and self-generated income among other items as indicia that trouble might be coming.

Mr. KING. Well, as you indicated, the monthly reports that we get from the institutions is a very detailed report, in fact, almost to the point of being cumbersome. We have expanded it over the last 2 or 3 years and it is a joint report, one that was developed by us and FIAC together and all of those things would show up as separate items on that report.

Mr. SPRATT. Broker deposits, self-generated income, outside investments?

Mr. KING. Yes, sir, absolutely.

Mr. SPRATT. Have you found a correlation between these accounts, growth in these areas and shakiness of these institutions?

Mr. KING. I think the best way to respond to that is that we haven't had that type of tremendous growth in any of our institutions. Most of our operations are fairly conservative. Those that are more aggressive handle their growth in an orderly manner. We do watch associations very closely that are growing more than normal for that average size institution, but to date, we have experienced no problems.

Mr. BROWN. We have some very tight regulations on loans to one person that cannot exceed more than 10 percent of the assets of an association. Any loans to an officer or a director must be approved by the division director and then there must be appraisal reports. It must be approved by two-thirds vote of the board of directors of the association.

Mr. SPRATT. Who is the division director, is that a director?

Mr. BROWN. No, the director of the association, two-thirds of the directors must approve a loan to another officer or director. At the same time, that loan must be approved by the division director and

I must have all the data, appraisal, et cetera, to go along with it. We do watch self-dealings and things of that nature very closely.

Mr. SPRATT. I was talking about self-generated income. I'm talking about construction loans where points and fees are taken which are immediately booked as income before the project itself is completed and, in my opinion, the income is earned and realized.

Mr. BROWN. Right, I agree with that.

Mr. SPRATT. Rather than self-dealing.

Mr. BROWN. We do watch that.

Mr. KING. I would add for our associations in North Carolina, they are required to follow generally accepted accounting principles [GAAP]. We do have the RAAP accounting and the loan lost deferrals and the appraised equity capital, but none of our private-insured associations use it, so therefore they comply with generally accepted accounting principles and the GAAP accounting principles are pretty stiff on that type of situation, as far as taking in income before it is earned.

Mr. BULMAN. In Massachusetts, we have specific point regulations that allow an institution to take one point to recover underwriting expenses. If there are other points in the contract, then they have to be tied into direct costs on the secondary market. If there are points on commercial loans, then they are deferred and they are accreted to income over the term of loan.

We do that so that when we're using our performance measurement system in looking at the income statement, and measuring it to its previous month and industry norms, we're not looking at high and low periods based on point income.

Mr. SPRATT. Mr. McEnteer. I'm sorry you didn't have a chance to answer. Thank you Mr. Chairman.

Mr. BARNARD. Mr. Erdreich.

Mr. ERDREICH. Thank you, Mr. Chairman.

Just one question. I'm curious to what extent, if any, that your State agencies receive any communications from the various Federal financial regulatory agencies. I was shocked to see this letter of 1977 when the Comptroller of the Currency identified ESM as the "Memphis Bond Bandits," and said they apparently were notorious among some folks' knowledge, but did you, or do your agencies have any regular communication with these Federal regulatory agencies?

It seems to me but for a 22-cent stamp and the mailout of the banking circular that the Comptroller sent out in 1977, we may have avoided some of the chaos in Ohio.

Mr. MCENTEER. In Pennsylvania, we work very closely with the FDIC and the Federal Reserve and the FSLIC. In 1977, I was an officer in a bank myself. It was a State-chartered bank and I didn't remember getting any of that information on ESM. I do know that there were some suede shoe guys from Memphis that used to come up to the Pennsylvania Bankers' Association convention, annual convention and try to collar bankers at the doors of meetings and finally the officials of the Pennsylvania Bankers' Association barred them from coming to our convention and I guess they disappeared and took residence in Fort Lauderdale or some place.

But, I never saw any communication from any Federal or regulatory authority. Of course I wasn't in a position at that time and I have only been in this department since 1979.

Mr. ERDREICH. Apparently, and this is just an example, but the Comptroller of the Currency's circular that it sent out, went out July 26, 1977, it went to presidents of all national banks and talked about various and proper security practices. It was triggered by the ESM investigation they did and the credit union folks came in very effectively and apparently dealt with their own credit union entitites and others. I'm just trying to get some sense. I take it then that your agencies are not on the mailing list for the Comptroller of the Currency. I understand that you're not under them in any way, but just to share information. If you got such a circular, would it be helpful?

Mr. MCENTEER. I think we're on the mailing list more now since the Federal Financial Institution Examination Council has been in being and we have Conference of State Bank Supervisors as a representative on that and we get frequent bulletins from the Comptroller's Office. There's no question about it, the information that is exchanged today is much better than it has been over the years and it gets better all the time. I think we're all in business for the same purpose. I don't believe we're trying to keep secrets from anyone. We're trying to do a job for the banking industry and the people and it takes cooperation and that's what we're coming to right now.

Mr. ERDREICH. Yes, Mr. Bulman.

Mr. BULMAN. Sir, I think there are different levels of cooperation amongst Federal agencies and State agencies. For example, I think most of us share an awful lot of information with the FDIC because they represent the Federal presence in State banks. Now, we have very little dealings with the Comptroller of the Currency. We may have some dealings with him as well as the Fed through holding companies where you have a mixed group of State banks and national banks in a holding company environment. But, I think most of us work more closely with the FDIC because they represent the Federal presence in State banks.

Mr. BROWN. In Maryland the savings and loan division is an independent agency. We get nothing from the Comptroller of the Currency. I can see where it might be advisable for me to be in contact with the State bank commissioner and, if she does get anything along those lines, she would let me have it. The only thing we get is data from the Federal Home Loan Banks and some of our State-chartered associations are federally insured, but as far as banks go, we get nothing.

Mr. ERDREICH. Mr. King.

Mr. KING. We are on the regular mailing list for the Federal Home Loan Bank Board and the Federal Home Loan Bank of Atlanta and in addition to that, the Federal Reserve Board. We get all their standard mailout information.

To the best of my knowledge, we receive nothing at all from the Comptroller.

Mr. ERDREICH. Thank you, Mr. Chairman.

Mr. BARNARD. Mr. Kindness.

Mr. KINDNESS. Thank you, Mr. Chairman. Secretary McEnteer, your testimony indicated that your department has the authority, under law to, in effect, to take over control of an association and appoint a deputy receiver for that purpose in the event that the institution is an unsafe or unsound condition.

Would you have similar authority with respect to the private insurance corporation for deposits? That is, under the Pennsylvania insurance setup, deposit insurance setup which is private, would you have the authority without going into a court to take over control?

Mr. MCENTEER. Yes. Under the banking code and the savings association code, the secretary of banking has that authority.

Mr. KINDNESS. And if that insurance corporation had the assets or could readily obtain them by additional assessment of members or whatever mechanism might be employed from State to State, and others might want to respond to this, but if they had the assets or could readily obtain them by assessment, would you consider it prudent to take over direct control under your department?

Mr. MCENTEER. You're talking about direct control of an association?

Mr. KINDNESS. No. Of the insurance corporation.

Mr. MCENTEER. Well, I don't know of any reason we would take direct control of the insurance association.

Mr. KINDNESS. That is unless there is something highly unusual in the circumstances, you would allow the deposit insurance corporation to function and allow it to employ its assets to protect depositors, is that correct?

Mr. MCENTEER. Yes, I believe that's part of the establishment of the insurance association. They can lend to a member association and they haven't, as yet, set up a general fund for lending purposes, but if we stepped in and found an association that wasn't operating properly, it would probably be the last resort to go to the insurance association.

We would look around for a merger to start with and maybe a supervisory conversion to a stock company which we have done twice and have somebody come in with capital and take it over and that sort of thing.

Mr. KINDNESS. Mr. King, in your case, you have direct supervisory authority with regard to the associations and the insurance function as well. Do you have sufficient sanctions available to you that in the event of need, for example, a growing run on savings and loans around the State, as occurred in Ohio, and lacking a proper response from the deposit insurance corporation, could you take over or appoint a receiver or conservator under existing law and operate the deposit insurance corporation?

Mr. KING. Yes, sir, and I think probably the way we would approach that, in our situation, would be to replace management and directors, if necessary, in order to facilitate that situation rather than trying to place it in some type of receivership or conservator appointment, this type of thing.

We do have the authority to remove management and directors for cause.

Mr. KINDNESS. But if you had some default in your supervison of the whole situation, would that be about the only reason that you would attempt to take over the deposit insurance function?

Mr. KING. I think, like Mr. McEnteer, I can't imagine that situation happening. I suppose it could. It would have to—really the only situation I could really even envision would be, you know, some type of problem with the individual or individuals involved with the insurance corporation itself.

Mr. KINDNESS. I just ask this because it appears that we're dealing with questions of principle and function here affecting a lot of States, when the trouble seems to be something that is highly irregular, highly unusual and shouldn't reflect on your States one iota, but it does reflect badly on my State of Ohio, but it seems to boil down to problems with the supervisory and regulatory function more than the insurance function, but we have a deposit insurance fund that's not functioning. It's controlled now by a conservator in the same hands, an employee of the division by the way, that conservator is. It's in the control of the same hands where the regulatory control has broken down. We got a tight little nest here that, as I say, just is not typical of any other State's functioning, it seems to me.

In the State of Maryland, Mr Brown, is there any control directly under your function that could be asserted over the deposit insurance fund?

Mr. BROWN. No. As I mentioned before, I have no jurisdiction over the insurance fund in their day-to-day operation, however, I don't know whether you were here when I made the comment before. Any rule, regulation, changes, changes in the by laws must be approved by the division director. Now, you're speaking of a default, probably, of the insurance corporation. There is nothing in the code that would give me the authority to take over the insurance corporation. I would say there would have to be a court-appointed conservator or receiver to do what you are referring to.

Mr. KINDNESS. Or the Governor might go to the legislative branch and get a special law passed and then take over——

Mr. BROWN. Could be.

Mr. KINDNESS [continuing]. The $81 million of assets or whatever it might be that was left at the time.

Mr. BROWN. God forbid, let's hope that doesn't happen.

Mr. KINDNESS. Yes, let's hope it doesn't happen.

Mr. BROWN. But it is an interesting question.

Mr. KINDNESS. I suggest that it is not the kind of contingency against which you would ordinarily expect to protect the functioning of your department or agency.

Mr. Chairman, I yield back.

Mr. BARNARD. Thank you very much. Gentlemen, we appreciate very much your being here today, the testimony that you have offered and thank you very much.

Our next witnesses today are the Chairman of the Securities and Exchange Commission, the Honorable John S.R. Shad and also Mr. Thomas Tew, who is the trustee in bankruptcy for the ESM Government Securities.

We apologize that we have gone over somewhat, but you can understand the seriousness of the subject that we have before us today and how it is understandable.

Because of that, I am going to ask Mr. Tew if he would permit us to hear your testimony, Chairman Shad, and ask questions of you so that you may depart and then we will work with Mr. Tew. I'm sure he doesn't have any problems with that.

So, Mr. Chairman, at this time, we would like to have your testimony. I might say that your entire testimony, without objection, will be included in the record and you have the opportunity to summarize if you so see fit.

STATEMENT OF JOHN S.R. SHAD, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION, ACCOMPANIED BY CHARLES HARPER, ASSOCIATE REGIONAL ADMINISTRATOR, MIAMI BRANCH OFFICE, AND DAN GOELZER, GENERAL COUNSEL

Mr. SHAD. Thank you very much, Chairman Barnard and members of the committee, I appreciate this opportunity to testify concerning the Government securities market. It is requested that the written statement, as you have indicated, be included in the record.

With me today is also Charles Harper, the associate regional administrator in charge of the SEC's Miami Office.

The market in U.S. Government securities is by far the largest in the world. In 1984, just the 36 primary Government bond dealers, which report directly to the Federal Reserve Board, traded over $1.5 trillion per month, as compared with the total stock trading volume on all U.S. securities exchanges and over-the-counter markets of less than a $100 billion per month. In other words, the trading in the other stocks and bonds, over-the-counter and on the exchanges, amounts to less than 7 percent of the transactions handled by the 36 primary Government bond dealers, and there are many others away from them that trade, but I would say that those primary bond dealers do handle the bulk of the trading in Government securities, the original offering.

The highly liquid, keenly competitive and efficient Government securities market is critical to the effective execution of the Nation's monetary and fiscal policies.

The Securities Act of 1933 and the Securities Exchange Act of 1934 specifically exempt Government securities and broker-dealers from regulation by the SEC, but the general antifraud provisions apply to the offer, purchase and sale of all securities, including Government. The Commission also has jurisdiction over those broker-dealers registered with the SEC that deal in Government securities.

The Federal Reserve Board obtains daily reports on market activity and positions, monthly financial statements and annual reports from the 36 primary Government securities dealers and encourages secondary dealers to report the same information on a monthly basis.

Also, many entities—and I know you're well aware of this from the testimony you have just had from several—but let me repeat briefly that there are many other entities that are engaged in the Government securities market that are subject to the oversight of a

variety of Federal agencies. For example: The banks by the Federal Reserve Board, the Comptroller of the Currency, and the FDIC; the savings and loan associations and other thrift organizations by the Federal Home Loan Bank Board; registered securities firms and publicly owned corporations, other than banks and S&L's, by the SEC; credit unions by the National Credit Union Administration and pension funds by the Department of Labor, under ERISA. Various State agencies also regulate the activities of these entities as well as insurance companies.

Now, I would like to briefly describe the Commission's response to the very serious problems of the Government securities market since 1977.

The 1977 failure of Winters Government Securities Corp. resulted in $4 million of losses to three dealer firms before insurance and civil suit recoveries, if any. The Commission's injunctive and administrative actions alleged boiler-room sales tactics, excessive markups and misrepresentations concerning the safety of transactions in Government National Mortgage Association securities known as Ginnie Maes, as well as misrepresentations concerning the financial condition of Winters Government Securities.

The defendants were enjoined from future securities law violations, barred from association with any broker-dealer, investment company or advisor as supervisors, and Winters and Co.'s broker-dealer registration was revoked.

In 1982, Drysdale Government Securities, Inc., failed 3 months after it commenced operations causing approximately $300 million in losses to other dealers before insurance and civil suit recoveries, if any. Most of the losses were born by the Chase Manhattan Bank.

The Commission alleged, among other things, that Drysdale borrrowed securities in increasing amounts and sold them in the cash market to obtain the accrued interest. The Drysdale officers were enjoined from future securities law violations and from aiding and abetting broker-dealer recordkeeping violations and were barred from association with any broker-dealer, investment company or advisor, or any municipal securities dealer.

The Commission also assisted in criminal prosecutions. The Drysdale chairman was sentenced to 6-years imprisonment and ordered to pay $10 million to certain institutions he had defrauded before, actually before Drysdale Government Securities was set up before 1982.

The Drysdale head trader was sentenced to 3-years imprisonment and the controller to 3 years probation.

Last week the Commission's injunctive action against an Arthur Andersen & Co. partner, who had audited the Drysdale firm, was dismissed on the grounds that his alleged misconduct had not occurred in connection with—those are the key words—the purchase or sale of securities. The Commission will determine in the very near future whether to appeal this dismissal.

Since the 1982 failure of Lombard-Wall, Inc., was apparently due to normal economic forces rather than fraud, and neither the SEC nor the Justice Department have brought actions against the firm or its principals.

Reported losses of $20 million was sustained by the New York State Dormitory Authority before insurance and civil suit recoveries, if any.

Since the Commission's investigation of the Lion Capital Group is pending, I must limit my comments to publicly available information.

Lion went into bankruptcy in 1984. About 60 institutions, including 24 State of New York school districts have alleged that they were induced to invest approximately $40 million in repurchase agreements with Lion by promises of yields higher than those available elsewhere, based on rate quotations provided by National Money Market Securities, Inc., a California money broker.

Lion's confirmations represented that the underlying securities were held with Bradford Trust Co. In response to creditors' demands for such securities, Bradford has claimed that these securities were collateral for loans by Bradford to Lion. A settlement proposal has been taken under advisement by the courts.

Last week a New York State Grand Jury indicted certain Lion officers for alleged fraud and grand larceny.

With reference to ESM Government Securities, in order not to prejudice suits filed and investigations in progress by the SEC, my comments must be limited to publicly available information.

Charles Harper of the Commission's Miami Office first learned of apparent securities law violations by ESM at 8:30 a.m. on Monday, March 4, from Thomas Tew, who I would add has done an outstanding job in all aspects of this situation.

At that time, Mr. Tew was retained by ESM; he had just been retained, in fact, the previous Friday, on March 1. The information that he provided indicated that ESM had incurred $250 to $300 million of unreported losses. That was Monday morning. By Monday afternoon, Mr. Harper had obtained Commission authority and a temporary restraining order from the U.S. District Court in Miami against future securities law violations, a freeze of the defendant's assets and the appointment of Mr. Tew as receiver.

The Commission alleged that ESM's audited financial statements failed to properly reflect the firms' true financial condition.

On Thursday, March 7, I called Paul Volcker, Chairman of the Federal Reserve Board; Gerald Corrigan, president of the New York Federal Reserve Bank; Edwin Gray, Chairman of the Federal Home Loan Bank Board; as well as senior SEC staff members to coordinate the effort of these organizations.

The next day, on Friday, March 8, the Commission issued a formal order of investigation. Subpoenas were issued that afternoon, and the interrogation of witnesses began the next day, Saturday, March 9. Representatives of the SEC, the New York Federal Reserve Bank, and the Federal Home Loan Bank Board met in Miami on the next day, Sunday, March 10. That evening I was advised by Michael Wolensky, the senior member of the SEC's staff on the scene, of the conclusions of the investigation to date which I reported that evening, Sunday evening, to Paul Volcker.

Since I was leaving to catch a plane—I was in New York at the time, and I was catching a plane back to Washington that night—I asked Mr. Wolensky to brief Governor Celeste of Ohio. Mr. Wolensky reached an aide of Governor Celeste and did brief him.

The staff's intensive investigation continued, and on Friday, March 15, the Commission authorized the staff to obtain a court order granting access to the bank records of Jose Gomez of Alexander Grant & Co., the partner in charge of ESM's annual audit since at least 1980. The court immediately granted the application.

On Monday, March 18, the Commission granted the staff authority to file an injunctive action against Jose Gomez, alleging that he lacked independence as the auditor of ESM because he had received at least $125,000 from ESM principals.

On March 20, the court entered an order freezing Mr. Gomez' assets, restraining him from destroying or secreting relevant records and requiring him to provide an accounting, by March 26. He has asserted his fifth amendment privilege against self-incrimination.

As mentioned, this investigation is proceeding. Preliminarily, it appears that approximately $200 million of the losses sustained by the Home State Savings Bank of Cincinnati and the American Savings & Loan Association of Miami were due to the extension of substantially more than normal margin to ESM and the concentration of their transactions with ESM.

Home State and American were apparently controlled by, or under the control of Marvin L. Warner, at the time they engaged in those transactions.

An additional $100 million of losses by municipalities and others appear to have resulted from the lack of adequate collateralization of their transactions with ESM.

On March 21, the Commission indicated, at House hearings, that it would review the regulatory structure of the Government securities market in consultation with the Federal Reserve Board and the Treasury and report its conclusions to Congress within 90 days. This effort is underway.

Senior members of the Commission staff and I have met with Chairman Volcker of the Federal Reserve Board and Assistant Secretary Thomas Healy of the Treasury Department. The Commission also intends to publish a release shortly seeking comments on the nature and extent of unregulated Government securities dealer activities, alternative forms of regulation and oversight of Government securities dealers and markets and the extent to which those who deal with Government securities dealers are modifying their practices in response to the extensive publicity that has already occurred on ESM.

Possible regulatory initiatives range from encouraging or requiring those who deal with Government securities dealers to properly collateralize such transactions. They range from that level to enacting rules and regulations under the supervision of a self-regulatory organization, or the direct aegis of one or more existing or new Federal agencies.

Also because of the nature and frequency of transactions in Government securities, the vast majority are handled without incident through low-cost high-speed electronic book entry systems.

Those who deal with Government bond dealers might be encouraged or required to use such facilities. It may also be necessary to adapt such facilities to the unique needs of the repurchase agreement market.

It would be premature to speculate on these and other possibilities before the Commission, in consultation with the Federal Reserve Board and the Treasury, has obtained and analyzed the best available facts. The Commission will attempt to weigh the costs and benefits of the various alternatives and promptly submit its conclusions to Congress. Thank you, Mr. Barnard.

[The prepared statement of Mr. Shad follows:]

STATEMENT OF JOHN S.R. SHAD,
CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION,
TO THE SUBCOMMITTEE ON COMMERCE, CONSUMER AND
MONETARY AFFAIRS OF THE HOUSE
COMMITTEE ON GOVERNMENT OPERATIONS

Chairman Barnard and members of the Subcommittee:

I welcome this opportunity to testify concerning the government securities market. It is requested that this statement be included in the record.

This testimony briefly describes the size and nature of the government securities market; the extent of the authority of the Commission and the Federal Reserve Board ("FRB") over the government securities market; problems involving government securities dealers; the Commission's recent enforcement actions arising out of the failure of ESM Government Securities, Inc. ("E.S.M. Government"); and the Commission's review of the government securities market that is in progress.

This testimony responds to many of the specific questions raised in Chairman Barnard's letter of March 20, 1985. To the extent not addressed herein, specific answers are set forth in the Appendix to this testimony.

I. The Government Securities Markets

The market in United States government securities is by far the largest in the world. In 1984, just the 36 primary dealers, which report daily to the Federal Reserve Board, traded over $1.5 trillion per month, as compared with total

stock trading volume on all U.S exchanges and over-the-counter markets of less that $100 billion per month (i.e., 7% of the government market). The highly liquid, keenly competitive and efficient government securities market is critical to the effective execution of the nation's monetary and fiscal policies.

II. The Commission's and the FRB's Regulatory Authority

The Commission's statutory authority over the government securities markets is based primarily on the anti-fraud provisions of the securities laws. Section 3(a)(2) of the Securities Act of 1933 (the "Securities Act") and 3(a)(12) of the Securities Exchange Act of 1934 ("Exchange Act") exempt government securities from registration. Section 15(a)(1) of Exchange Act exempts from registration broker-dealers who effect transactions exclusively in government securities. As a result, while the Commission has regulatory authority over registered broker-dealers that engage in government securities business, it does not have statutory authority to regularly examine broker-dealers that restrict their business to government securities transactions.

However, the general anti-fraud provisions of the federal securities laws (Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder) apply to the offer, purchase, or sale of securities by any person. Accordingly, the Commission may conduct investigations to

determine whether firms that deal exclusively in government securities have violated the anti-fraud provisions in connection with the offer, purchase, or sale of government securities.

The FRB monitors the activity and financial soundness of the 36 primary dealers in government securities by obtaining daily reports of market activity and positions, monthly financial statements, and annual reports. The FRB supplements these reports with telephone calls and on-site visits. These oversight activities depend largely on voluntary compliance and moral suasion, as well as the ultimate threat of the FRB ending a firm's primary dealer status. The FRB has no statutory investigation or enforcement authority over any government securities dealers. The FRB has encouraged secondary dealers to report voluntarily the same information as is required of primarily dealers, on a monthly rather than a daily basis. As described below, the FRB also recently proposed voluntary capital adequacy guidelines for government securities dealers not subject to Federal regulation.

Also, those entities that engage in government securities activities are subject to the direct regulatory oversight of several federal agencies: for the banks, the FRB, the Comptroller of the Currency and the Federal Deposit Insurance Corporation; for the saving and loan associations and other thrift institutions, the Federal Home Loan Bank Board; for the registered securities

firms, the SEC; for the credit unions, the National Credit Union Association; and for the pension funds, the Department of Labor, under ERISA. Various state agencies also regulate the activities of the foregoing groups, as well as insurance companies.

III. Government Securities Dealer Problems

The following government securities dealer failures have occurred since 1977: Winters Government Securities Corporation (1977), Drysdale Government Securities (1982), Lombard-Wall, Inc. (1982), Lion Capital (1984), and ESM Government (1985). There follows a review of each of these situations and the Commission's responses.

Winters Government Securities

Winters Government Securities Corporation ("WGSC"), an unregistered government securities dealer, began business in 1973 and failed in 1977. It was involved in the sale of Government National Mortage Association ("GNMA") mortgage-backed securities to banks, thrifts, and credit unions for delayed delivery. WGSC's activities were brought to the Commission's attention by the State of Alabama, which had received complaints from two savings and loan associations that WGSC had executed unauthorized trades for their accounts. In August 1977, the Commission filed an injunctive action against WGSC, Winters & Co., a registered broker-dealer affiliate of WGSC, and seven individuals who were affiliated with WGSC as officers, directors, or salesmen.

In its action, the Commission alleged that the defendants had engaged in fraudulent sales practices in connection with the offer, purchase, and sale of GNMA securities for delayed or forward delivery and payment. The alleged fraudulent practices at WGSG included the use of "boiler-room" sales tactics, excessive mark-ups, and misrepresentations concerning the safety of the investments and the financial condition of WGSC. The failure of the firm occurred when the market price for these securities decreased and institutional customers of the firm who had been subject to the practices discussed above, disavowed trades that, if accepted, would have resulted in losses to them. As a result of WGSC's failure, three originating dealers sustained $4 million in losses, before insurance and civil suit recoveries, if any.

As a result of the Commission's injunctive action, all of the defendants were enjoined from engaging in future violations of the antifraud provisions of the federal securities laws. The Commission also instituted administrative proceedings against the individual defendants, in which they were barred from associating with a registered broker-dealer, investment adviser, or investment company as supervisors. The Commission also revoked the broker-dealer registration of Winters & Co.

rysdale Government Securities, Inc.

Drysdale Government Securities, Inc. ("DGSI") was a government securities dealer, incorporated in 1981, but dormant until it took over activities formerly conducted by its predecessor, Drysdale Securities Corp. ("DSC"), _/ in February 1982. DGSI operated for approximately three months before its collapse in May 1982, causing approximately $300 million in losses to other dealers, before insurance and civil suit recoveries, if any. Most of the losses were borne by the Chase Manhattan Bank.

The transactions involved in the Drysdale failure were repurchase and reverse repurchase agreements concerning government securities. The DGSI failure was largely attributable to an alleged ongoing fraud. When DGSI began to function in February 1982, it assumed short positions in government securities of over $2 billion, which included an unrealized loss exceeding $190 million. By commencing business, DGSI represented that it stood ready and able to fulfill its obligations under agreements to repurchase and to resell securities and pay the interest which had accrued on the underlying securities. The Commission alleged that DGSI's principals knew that the firm could meet those obligations

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_/ Drysdale Securities Corporation ("DSC") was a registered broker-dealer.

only so long as it could continue to borrow securities in increasing amounts and sell them in the cash market to obtain the accrued interest.

It was alleged that DGSI concealed this loss from other dealers and potential creditors. It was alleged that throughout its three and one-half months of business life, DGSI essentially engaged in a frantic and ultimately futile effort to meet the undisclosed deficit, mainly by expanding its positions and through speculative trading.

Drysdale collapsed in May 1982. On July 27, 1983, the Commission filed a complaint for injunctive relief against DSC, _/ officers of DSC and DGSI, and a partner of Arthur Andersen & Co., DGSI's accounting firm. Without admitting or denying the allegations, the officers of DSC and DGSI consented to permanent injunctions from future violations of the antifraud provisions of the federal securities laws, from aiding and abetting violations of the Commission's broker-dealer recordkeeping requirements, and two of the officers were ordered, for a period of two years after the entry of their respective orders, to deliver a copy of the order to any broker-dealer with whom they sought to open a brokerage account.

_/ The action against DSC was subsequently dismissed, after DSC was dissolved. DGSI was not named in the Commission's action because it effectively had ceased to exist by July 27, 1983.

On March 29, 1984, the DGSI treasurer and head trader pleaded guilty to an information filed in federal court. The information charged him with securities fraud, willful failure to file tax returns and conspiracy to commit securities fraud, mail fraud, wire fraud and broker-dealer recordkeeping violations. A guilty plea was also entered in the matter by DGSI's former head cashier.

On July 6, 1984, the DSC chairman and chief executive officer was sentenced by the United States District Court to eight years imprisonment (subsequently reduced to six years), based upon his plea of guilty to securities fraud. The court also ordered him to pay $10 million in restitution for the benefit of certain institutional clients whom he had defrauded during a six-year period ending in 1982, unrelated to the DGSI fraud. On the same day, he was sentenced by a New York State Court to a term of 2-1/3 to 7 years (to run concurrent with the federal sentence) upon a guilty plea to grand larceny and securities fraud. That sentence was subsequently reduced to a maximum of six years. The state charges were based upon his DGSI activities. Without admitting or denying the charges, on December 28, 1984, he consented to a Commission Order which barred him from association with any broker-dealer, investment adviser, municipal securities dealer, or investment company. Without admitting or denying the charges, the former head cashier of DGSI also consented to a bar Order entered by the Commission.

On March 15, 1985, the DGSI head trader was sentenced by the United States District Court to three years imprisonment, to be followed by four years probation and, in each of those four years, 200 hours of community service. Based upon his consent, the Commission also barred the former controller of DGSI, who had been convicted in state proceedings of fraud and larceny and sentenced to three years probation.

The Commission's injunctive action against the Arthur Andersen partner was dismissed on March 25, 1985, based upon a ruling by the United States District Court that the partner's alleged misconduct had not occurred "in connection with" the purchase or sale of securities. The District Court based its holding on the fact that alleged misrepresentations by the partner and Andersen related to the capitalization of DGSI, not to the value of the government securities underlying the repurchase agreement or the financial strength of the issuer of the securities. The Commission will, in the near future, determine whether to appeal this ruling.

Lombard-Wall, Inc.

Lombard-Wall was an unregistered government securities dealer that failed on August 12, 1982, apparently due to normal economic forces rather than financial fraud. Therefore, the Commission's inquiry was limited. Lombard-Wall was not affiliated with a broker-dealer registered with the Commission.

Losses were sustained primarily by one state governmental body, the New York State Dormitory Authority. State agencies actively investigated the firm. It immediately went into bankruptcy.

These early assessments were not disproved, and the firm emerged from reorganization in November 1983. Total losses reported in the matter were $20 million to the New York State Dormitory Authority, before insurance and civil suit recoveries, if any. Under these circumstances, the SEC staff did not recommend a formal investigation nor the institution of enforcement proceedings to the Commission.

Lion Capital Group, Inc.

The Commission's investigation of this matter is pending. Accordingly, in order to avoid prejudice to the Commission's investigation and any litigation that may result therefrom, the discussion set forth below is based solely upon publicly available information.

Lion Capital Group, Inc. ("Lion"), a broker-dealer not registered with the Commission, filed for protection under Chapter 11 of the bankruptcy code on May 2, 1984, together with four associated entities. That filing raised issues concerning approximately $40 million invested by about 60 institutions, 24 of which were State of New York School Districts. Those districts had allegedly invested their

funds in repurchase agreements with Lion after receiving rate quotations through National Money Market Securities, Inc., a California-based money broker.

The school districts were allegedly induced to invest by a promise of yields higher than those otherwise available. Lion generally had no direct contact with the school districts other than to issue confirmations of transactions and to receive funds from the school districts and return the funds with the interest earned. The confirmations represented that securities underlying the repurchase agreements were held in trust at Bradford Trust Co. ("Bradford"), Lion's clearing agent. However, shortly after the initiation of the bankruptcy proceedings, Bradford claimed that the government securities that it held as a result of transactions with Lion were not held in trust for the school districts but were collateral for a loan from Bradford to Lion.

It appears that those customers that did not have possession of collateral are involved in litigation with Bradford, in which they alleged that Bradford's lien is invalid. A settlement offer is pending, and a hearing on the offer was held on March 11 and 12, 1985. The Court has taken the settlement offer under advisement.

On Monday, February 25, 1985, a New York State grand jury indicted the chief operating officer of Lion Capital, its operations officer, and its chief financial officer,

alleging, among other things, state law securities fraud and grand larceny.

Initial reports of the amounts at risk as a result of the Lion bankruptcy were approximately $28 million. That amount later turned out to be $40 million, before insurance and civil suit recoveries, if any.

IV. The E.S.M. Government Case.

The Commission's investigation of ESM is pending and all discussion set forth below is based solely on publicly available information. E.S.M. Government is a broker-dealer, not registered with the Commission, that was engaged in the government securities business. It was able to do so, in part, based upon its allegedly fraudulent financial statements.

The Commission first learned of apparent violations of the federal securities laws by E.S.M. Government at approximately 8:30 A.M. on Monday, March 4, 1985, when the Commission's staff received a telephone call from the Special Counsel to E.S.M. Government. The Special Counsel, who had been retained by E.S.M. Government on Friday, March 1, advised the staff that a review of E.S.M. Government's records conducted over the weekend indicated that the firm had allegedly incurred approximately $250-$300 million of unreported losses. The Special Counsel reported that a substantial portion of those

alleged losses appeared to have been caused by large denomination government securities transactions and related interest expenses. Later on the morning of March 4th, the Special Counsel met with the staff to provide further elaboration.

On the afternoon of March 4, the SEC staff sought and obtained authority from the Commission to file a civil action in the U.S. District Court for the Southern District of Florida against E.S.M. Government and three affiliates, E.S.M. Securities, Inc. (a broker-dealer registered with the Commission), E.S.M. Group, Inc. (the holding company for E.S.M. Government and E.S.M. Securities), and E.S.M. Financial Group, Inc. The complaint, filed later in the afternoon of March 4, requested a temporary restraining order against future violations of the antifraud provisions of the federal securities laws, a freeze of the defendants' assets, and the appointment of a receiver. Without admitting or denying the charges, the defendants consented to the entry of a final judgment at the time the complaint was filed. As part of the judgment, the defendants' assets were frozen and the Special Counsel was appointed receiver.

In its complaint, the Commission alleged that ESM Government had purchased and sold securities for over five years when its audited financial statements failed to reflect

properly, as required by generally accepted accounting principles, the true financial condition of the firm. The losses which the firm had incurred had apparently been concealed by recording them on the financial statements of E.S.M. Government's parent company, E.S.M. Group, which in turn reflected a corresponding account receivable from E.S.M. Financial Group, a "shell" corporation which did not engage in any discernible business. Although it allegedly concealed the losses for several years, E.S.M. Government ultimately became unable to meet its obligations as they matured. E.S.M. Government's institutional customers have incurred losses which may exceed $300 million, before insurance and civil suit recoveries, if any.

After filing the action against E.S.M. Government, Commission staff commenced an independent investigation of the matter.

On Friday, March 15, the Commission authorized the staff to file in the District Court an application for an order permitting access, without the delay that would otherwise be required by compliance with the Right to Financial Privacy Act of 1978, to bank records of Jose Gomez, the managing partner of the South Florida offices of Alexander Grant & Company. Alexander Grant had examined and issued a report on E.S.M. Government's financial statements annually since at

least 1980, and Gomez had been the partner in charge of those audits. The Court granted the Commission's application on the day it was filed.

On Friday, March 15, Chairman Shad contacted Chairman Paul Volcker of the FRB, Gerald Corrigan, President of the New York Federal Reserve Bank, Edward Gray, Chairman of the Federal Home Loan Bank Board, and senior staff members, to coordinate the efforts of these organizations. The investigation continued over the week-end. Representatives of these organizations met in Miami on Sunday, March 17th.

On Monday, March 18, after reviewing the bank records obtained pursuant to court order, the staff sought and obtained Commission authority to file an injunctive action against Gomez. In that action, which was filed on Wednesday, March 20, the Commission alleged that Gomez had violated antifraud provisions of the Exchange Act, and sought a temporary and permanent injunction against future violations, as well as other equitable relief. The Commission alleged that Gomez lacked independence as the auditor for E.S.M. Government because he received at least $125,000 from principals of E.S.M. Government in the form of wire transfers into his personal bank account.

On March 20, the Court entered a temporary restraining order against future alleged violations by Gomez, freezing Gomez' assets, restraining Gomez from destroying or secreting relevant records, and requiring Gomez to provide an accounting

by March 26, 1985, of all payments received from E.S.M. Government or related entities or principals. Gomez has subsequently asserted his Fifth Amendment privilege with respect to the accounting. The Court also scheduled a hearing on the Commission's application for a preliminary injunction for March 28, 1985, which has been put over to April 9, 1985.

The Commission's staff is continuing its investigation to ascertain whether other persons and entities have engaged in violations of the federal securities laws. In addition, the staff is continuing to assist the receiver in his efforts to locate and preserve E.S.M. Government's assets. The Commission's staff has also cooperated with other agencies in this matter, including banking agencies having jurisdiction over the financial institutions affected by the insolvency of E.S.M. Government.

Preliminarily, it appears that three of the principal factors that contributed to the losses sustained by those who dealt with ESM have been the lack of adequate collateralization of their transactions; the extension of more than normal margin to ESM by two savings and loan associations; and the concentration by these two savings and loan associations of their transactions with ESM. These two savings and loans apparently were under common control at the time the transactions were made. It also should be noted that a number of the parties involved in ESM had relationships with other government securities firms who

had failed. Nicholas Wallace, an ESM principal, was previously associated with both WGSC and Hibbard O'Connor & Weeks. Ronnie Ewton and George Mead, also principals of ESM, were previously associated with Hibbard O'Connor & Weeks. In addition, Bradford Trust was the clearing agent for both Lion Capital and ESM.

V. Government Securities Regulation

Beginning in March of 1984, representatives of the Federal Reserve Bank of New York consulted with the SEC staff on certain actions designed to improve the functioning of the government securities markets. In particular, the New York Federal Reserve Bank has taken steps to strengthen its market surveillance unit and curtailed certain repurchase agreements practices that had contributed to previously incurred losses. The Bank also proposed for comment standards for a voluntary capital adequacy program that would apply to government securities dealers not subject to Federal supervisory oversight. __/

The proposed capital guidelines include a liquid capital-to-risk ratio applicable to otherwise unregulated government securities dealers that is broadly similar to the Commission net capital rule for registered broker-dealers, but is designed to address the specific risks of government bond dealers. These guidelines would measure both the credit and market risk associated with a government securities dealer's position and set a level designed

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__/ Federal Reserve Bank of New York, Capital Adequacy Guidelines for U.S. Government Securities Dealers, Request for Comments (February 7, 1985).

to ensure that the dealer has sufficient liquid capital to absorb losses incurred on those risk positions. Primary government securities dealers are already required to submit reports used to test their capital adequacy in a manner broadly consisted with this proposal. The guidelines would also encourage certification by an independent auditing firm of compliance by unregulated dealers. Primary dealers in government securities and banks subject to Federal Reserve Board supervision would not be permitted to deal with a non-complying government securities dealer. Moreover, the Federal Reserve Bank would look for certification letters as an element of sound banking practices in examining member banks' clearing and lending activities for government securities accounts, and would encourage other bank supervisiors to do so.

On March 21, 1985, the Commission indicated at hearings held by the Telecommunications, Consumer Protection and Finance Subcommittee of the House Committee on Energy and Commerce that it would review the regulatory structure of the government securities markets, and would consult with the Federal Reserve Board and the Treasury. It also said that it would report to Congress its views regarding cost-effective modifications of the current regulatory scheme, taking into account the critical importance of this market to U.S. monetary and fiscal policies.

This work has begun. Chairman Shad and senior members of the Commission staff have met with Paul Volcker of the Federal Reserve Board and Thomas Healy, Assistant Secretary of the Treasury, and members of their staff.

The Commission also intends to publish a release shortly, seeking comments, among other things, on the extent of unregulated government securities dealer activities, alternative forms of oversight of the government securities markets; and the marketplace's reaction to the extensive ESM publicity and the extent to which those who deal with government bond dealers have modified their practices in response to such publicity. By this means, the Commission will obtain the benefit of the views of the securities industry, federal regulators, and others concerning the relative merits of the present and future form of regulation of the government securities markets. The Commission will incorporate the insights provided by these commentators in its report to Congress.

There are many alternatives and possibilities that range from encouraging or requiring customers of government securities dealers to properly collateralize the transactions, limit their margin payments and concentration with any one dealer to compulsory rules and regulations under the supervision of self regulatory organizations or the direct aegis of an existing or new federal agency.

Also, because of the speed and frequency of transactions in government securities, the vast majority are handled without incident by low cost, high speed electronic book-entry systems. Those who deal with government bond dealers might be encouraged or required to avail themselves of such facilities. It may also be necessary to adapt such facilities to the unique needs of the repurchase agreement market.

It would be premature to speculate on these and other complex possibilities before the Commission, in consultation with the Federal Reserve Board and the Treasury, has obtained and analyzed the best available facts. After the Commission receives the responses to its prospective release, the Commission will attempt to quantify the costs and benefits of the various alternatives, and will submit its conclusions to Congress.

APPENDIX

Responses to Chairman Barnard's letter of March 20, 1985, in the order and as numbered in that letter

1. Discuss generally the SEC's statutory and regulatory role in regulating the government securities market and supervising broker-dealers who trade government securities.

Answer: Government securities are specifically defined as exempted securities under the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act"). Accordingly, these securities are not registered with the Commission and securities professionals who restrict their activities to trading in government securities only, are not required to register as broker-dealers with the Commission or to join a self-regulatory organization ("SRO"). Nevertheless, the Commission may investigate government securities dealers for violations of the antifraud provisions of the federal securities laws. Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit misstatements or misleading information or omissions of material facts, and fraudulent or manipulative acts and practices, in connection with the purchase or sale of securities, apply with equal force to transactions in exempted government securities.

Government securities dealers who also engage in brokerage or dealing in non-exempt stocks or bonds are subject to regulation with respect to their government

securities activities. In particular, those broker-dealers are required to register with the SEC and become a member of an SRO. The recordkeeping, financial responsibility requirements and certain other requirements imposed by the Exchange Act and SRO rules apply to their government securities activities.

2(a) and (b) are answered on pages 12 through 16 of the accompanying testimony.

2(c) The Commission's Office of the General Counsel has prepared a report on the Commission's 1977 investigation of ESM, a copy of which is attached.

3 is answered on pages 4 through 12 of the accompanying testimony.

4(a) There continues to be a significant legal dispute over whether repurchase agreements ("repos") and reverse repurchase agreements ("reverse repos") are securities under the 1933 Act. Provide a brief analysis of this issue, including a discussion of the recent case law, and the SEC's official position on the issue.

Answer: The Commission's staff is preparing a report on the status of repurchase agreements under the federal securities laws. That report will be forwarded to the Congress in the very near future.

4(b) Assuming that the SEC did take the position that such instruments are securities, would this mean that government securities dealers, such as ESM, Inc., would be required to register as broker-dealers under the federal securities laws?

Answer: Generally, any person engaged in the business of buying and selling securities for his own account, as part of a regular business, __/ must register with the Commission as a broker-dealer. __/ Accordingly, if repurchase agreements were considered to be separate securities, government securities dealers trading these instruments would have to register as broker-dealers.

4(c) If ESM, Inc., had been required to register as a broker-dealer with the SEC, would the SEC have been in significantly better position to detect and deal with the sort of fraud and misrepresentations that allegedly took place in this case?

Answer: The federal securities laws subject broker-dealers to a comprehensive system of regulation. The broker-dealer regulatory system cannot be expected to prevent all frauds. That system, through the Commission's and self-regulatory organization's examination and enforcement authority can have a deterrent effect

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__/ Section 3(a)(5) of the Exchange Act defines a "dealer" as: "any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any other person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as part of a regular business."

__/ Section 15(a) of the Securities Exchange Act of 1934.

on fraudulent activity. While we cannot say whether the broker-dealer regulatory scheme would have prevented the failure of ESM, we believe that it could have detected the problems earlier.

5. Has the collapse of ESM, Inc., seriously threatened any registered broker-dealer or other publicly-held corporations? If so, please identify and discuss each one briefly.

Answer: The Commission is not aware of any registered broker-dealers or publicly-held corporations which file with the Commission, other than Home State Savings Bank, which files reports with the Commission, and American Savings and Loan, which is publicly-owned but does not file reports with the Commission, which have suffered substantial losses due to the failure of ESM. Insufficient records exist at ESM to establish conclusively at this point that no other registered broker-dealers or publicly-held corporations have suffered substantial losses as a result of their dealings with ESM.

6. Since the failure of Drysdale Government Securities, Inc., in 1982, what steps have any self-regulatory organizations, the securities market, or other private sector groups taken to prevent the recurrence of such failures and to improve the operations of the government securities market? How successful to you think these steps have been?

Answer: Since the failure of Drysdale Government Securities, Inc., in 1982 participants in the government securities markets have taken steps to improve the operations of those markets. Many participants

in these markets are requesting information on the financial condition of those institutions and brokers with whom they engage in repurchase transactions. In October, 1982, the Public Securities Association prepared a pamphlet entitled "Business Practice Guidelines for Participants in the Repo Market." This pamphlet discusses the valuation of accrued interest, margin requirements, and due diligence procedures, among other things. Currently, there is no self-regulatory organization for government securities dealers.

7(a) and (b) are answered on pages 17 through 19 of the accompanying testimony.

7(c) At this time, what legislative steps would the SEC propose or support to deal with such abuses and failures?

Answer: On March 21, 1985, the Commission indicated at hearings held by the Telecommunications, Consumer Protection and Finance Subcommittee of the House Committee on Energy and Commerce that it would review the regulatory structure of the government securities markets and, after consultation with the Federal Reserve Board and the Treasury, provide any recommendations it may have with respect to regulation of the government securities market, including any prospective legislation.

ATTACHMENT

March 20, 1985

OFFICE OF THE GENERAL COUNSEL
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
REPORT ON 1977 ESM GOVERNMENT SECURITIES, INC. INVESTIGATION

In the early part of 1977, the Commission received information from the Office of the Comptroller of the Currency that indicated that ESM Government Securities, Inc. ("ESM") may have committed violations of the federal securities laws in connection with sale of GNMA securities to the National Bank of South Florida, which resulted in the bank reneging on a purchase from ESM of a $1 million GNMA security. On June 7, 1977, the Commission issued an order commencing a non-public investigation of ESM, and directing the staff to investigate whether ESM had violated antifraud provisions by, inter alia, purchasing securities for the account of customers without authorization and by misrepresenting the potential risk, safety and profitability of certain purchases.

On November 10, 14, and 15, 1977, the staff examined ESM's books and records at ESM's offices. That investigation revealed that in several transactions, ESM had engaged in excessive mark-ups. */ On November 16, 1977, after ESM refused to cooperate further with the Commission's investigation, the staff issued a subpoena directing production of certain of ESM's books and records. After some initial compliance, ESM refused to provide further access to its records on the ground that the staff inquiries into ESM's mark-up policies exceeded the scope of the formal order.

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*/ The preliminary inquiry indicated that in at least 16 transactions with six customers, ESM made a profit which greatly exceeded the profits made by its customers in those transactions. For example, a $2 million GNMA transaction on December 7, 1976, with Central Dupage Federal Savings and Loan Association of Wheaton, Illinois, resulted in a profit to ESM of $66,000, while the customer received $2,500. And in a $4 million GNMA transaction with the same customer, ESM made a profit of $45,000, while the customer made $10,000. Instances of similar mark-up practices were discovered with other institutional customers.

To avoid further doubt concerning the scope of its investigation, the Commission, on January 10, 1978, issued an amended formal order to encompass ESM's mark-up policies as an area of inquiry. Pursuant to the amended order, ESM was served with a second subpoena. When ESM refused to comply with that subpoena, the staff sought authority to file a subpoena enforcement action, which the Commission granted.

On January 27, 1978, the Commission filed an application with the United States District Court for the Southern District of Florida to enforce its subpoena. ESM sought to quash the subpoena on the ground that it was the product of prior illegal conduct by the staff. Essentially, it alleged that during the previous visits to ESM's offices, staff members (i) had exceeded their authority by investigating matters outside the scope of the original order of investigation, and (ii) had obtained ESM's consent to be searched through fraud, trickery or deceit by not advising ESM that it was the target of an investigation and by misrepresenting their purpose in being in its offices. ESM therefore urged that the January 1979 subpoena was the "fruit of a poisonous tree," having been drafted on the basis of illegally obtained information. ESM also sued the Commission investigator engaged in the alleged misconduct to recover damages for violation of ESM's constitutional rights.

Although the Commission denied the allegation of wrongdoing and was prepared to show that the staff did not misrepresent their reason for examining ESM's records, the district court enforced the subpoena without holding an evidentiary hearing on ESM's claims of misconduct. The court held that ESM's allegations did not provide a legal basis for denying enforcement of the Commission's subpoena. On ESM's appeal, the Court of Appeals for the Fifth Circuit reversed and remanded the case to permit ESM to prove its allegations.

The court held that it would be an abuse of the district court's processes to enforce a subpoena that was the result of improper access to the firm's records.

On June 9, 1981, the Commission determined to challenge the decision of the court of appeals by petitioning for rehearing en banc. The Commission determined, however, that if the petition was denied, it would not pursue the matter further in the district court. The Commission was informed by the staff that the underlying violations — the improper mark-up practices — had occurred almost five years earlier and that in light of the staleness of the charges, it would be very unlikely that the Commission could obtain an injunction in a district court against future violations. Before the Commission could even institute such an action, it would have to enforce its subpoena, a process that would have required going through a lengthy hearing in the district court on the charges of alleged staff misconduct which occurred almost four years earlier. The Commission attorneys representing the Commission investigator in ESM's damage action also informed the Commission of their concern that the district court might order discovery of of the investigator's personnel file, which could cause their client unnecessary personal embarrassment. Since the Commission determined not to pursue the subpoena should the petition for rehearing be denied, the Commission also authorized Commission attorneys representing the Commission investigator to seek to have the damage action dropped in return for the Commission's agreement not to pursue its investigation of ESM.

The Commission's petition for rehearing was denied by the Fifth Circuit on June 25, 1981. The subpoena enforcement action was dismissed on November 20, 1981. ESM dropped its suit against the Commission investigator without prejudice to reinstitution of the suit if the Commission brought an action based on any conduct by ESM occurring before May, 1978.

Mr. BARNARD. Thank you, Mr. Chairman.

I am sure that we at this particular time in the country are in, maybe, an unusual state of concern about securities dealers and there may be an overreaction as to whether or not they all of them should be supervised.

I interpret from your remarks today there is some question in your mind that we need to have a brand new system of regulations across the board, as far as the nonregistered dealers. I presume that is what you are saying today.

Mr. SHAD. Well, I think we have to do a lot more more work to give you a well-informed response. It's notable that the 36 primary dealers are under a semi-voluntary type of regulation.

Mr. BARNARD. Was Drysdale one of those 36?

Mr. SHAD. No. Drysdale was unregistered, and while it was one of the 100, it was not one of the 36.

Mr. BARNARD. I am delighted that the Energy and Commerce Committee and other committees of Congress are looking into that. I think it very definitely needs to be looked into because we have some fallout in this particular situation with ESM, that not only affected savings and loans and banks, but likewise many innocent communities. I think it really requires that the Congress take a very deep look at that.

So, inasmuch as that is under study and you have indicated that it is, I would like, at least for now, to turn my questions to the SEC's knowledge and investigation of ESM.

As I understand it, the SEC launched an investigation of ESM soon after it opened for business in 1976, but that the case was tied up in knots for 4 years due to the efforts of ESM's attorney, Mr. Steve Arky and his law firm.

Is that true?

Mr. SHAD. Yes, sir.

Mr. BARNARD. This suit managed to completely halt the SEC's investigation of ESM for 4 years. The question is: Is it your normal practice to stop an investigation as soon as the target challenges one of your subpoenas?

Mr. SHAD. By no means.

Mr. BARNARD. Well, what was so special about this case, Mr. Chairman, that caused the Commission to stop its investigation?

Mr. SHAD. I could give you a brief answer, but I think the best source of information about that would be the general counsel of the Commission. If I might ask Dan Goelzer to respond. He's here with us.

Mr. GOELZER. Mr. Chairman, I wouldn't say that we stopped our investigation because their counsel challenged it.

We issued subpoenas. They refused to comply with those, and we went into court to have those subpoenas enforced. The litigation that resulted, unfortunately, consumed 4 years until the Court of Appeals for the Fifth Circuit remanded the case back to the district court for yet further proceedings on those subpoenas. It took from early 1978 until the middle of 1981 to get even to that stage.

At that point, the Commission was looking into sales practice violations. That is all that the Commission was aware of at ESM at the time, that they might have received excessive markups from certain of their customers. Those were about 4 years old. We had

no evidence to indicate that they had continued over that 4-year period. The Commission concluded, in light of that, that it would drop the investigation at that point.

Mr. BARNARD. So, in other words, the case was only dropped after it was remanded. It was remanded in 1981, right?

Mr. GOELZER. That's correct. To make it very brief, the district court enforced our subpoena in 1978. ESM appealed to the court of appeals. The court of appeals determined that further fact finding was necessary in the district court, and in June 1981 remanded it to the district court.

Mr. BARNARD. You didn't have any feeling at that time, then, that they were involved in any other questionable practices?

Mr. GOELZER. No, sir. My understanding is that the matter was initiated because the Comptroller reported to us that they might have engaged in unauthorized trading on behalf of a certain national bank in Florida. When our people went in and began to look at their records, what they found was not unauthorized trading, but rather was excessive markups. When they began to inquire into these markups, that is the point at which the cooperation ceased. While that is certainly a problem in itself, it is not the problem that later brought them down.

Mr. BARNARD. Did you make any inquiry of any of the Federal banking agencies as to their experience with ESM at that time?

Mr. GOELZER. Not to my knowledge. It went the other way. The Comptroller brought the sales practice problems to our attention. I am not aware of any other communications with the bank regulators.

Mr. BARNARD. What about the Home Loan Bank Board?

Mr. GOELZER. Not to my knowledge, sir.

Mr. BARNARD. I was thinking about the Unity situation in Chicago.

Mr. GOELZER. I am not familiar with that. It's a matter that I am not familiar with, sir.

Mr. BARNARD. Would it have been a matter of normal suspicion that with ESM's vigorous defense against your subpoena, that it would have made you, maybe, pursue the case even harder?

Mr. GOELZER. Well, that's a difficult question to answer. Again, my understanding is that the only knowledge we had at that time was of the sales practice violations. That is, that they were earning more on their transactions with their customers than we might have considered proper. I agree it's unusual for someone to contest one of our investigations with that much fervor, but it is not unheard of either; it happens to us.

Mr. BARNARD. What was the basis for your suit to begin with?

Mr. GOELZER. Our suit was simply to enforce our subpoena. We subpoenaed certain records of theirs which we felt would illuminate these sales practice violations.

Mr. BARNARD. You didn't have any real evidence of wrongdoing but you were subpoenaing records for that purpose?

Mr. GOELZER. That's correct. We had some evidence, but not enough to bring an enforcement action.

Mr. BARNARD. Well, in addition to this investigation, didn't the SEC initiate an entirely separate investigation during the time

period into Mr. Ewton and Mr. Seneca's purchase of America Bancshares, Inc.?

Mr. GOELZER. Yes. I understand that there was an investigation at about the same period of time, I believe it was in 1978, of their disclosures with respect to their acquisition of shares of that company.

Mr. BARNARD. You questioned their disclosures, is that it?

Mr. GOELZER. Yes. To be precise, I would like to check and supply the information for the record, but my recollection is that the investigation involved whether they had accurately described their holdings and their relationships in a 13D filing with the Commission, which is required when someone owns more than 5 percent of a company's shares.

Mr. BARNARD. What was the conclusion of that investigation?

Mr. GOELZER. It's my understanding that it was closed without any action being taken. There was no enforcement action which resulted.

Mr. BARNARD. Mr. Chairman, at the time that the SEC was investigating ESM and other similar Government securities firms, did the SEC have any reason to suspect that many unwitting financial institutions or municipalities were being sucked up into these scams?

Mr. SHAD. In the course of the prior investigation or which investigation, Mr. Chairman?

Mr. BARNARD. Well, of course, I guess the reasons for the subpoenas——

Mr. SHAD. Back in 1977?

Mr. BARNARD. Yes.

Mr. SHAD. Not to my knowledge, but this is long before my association with the Commission and I would rather have somebody respond who is more current on it than I am. But I am not aware that it was thought to be a broad scale thing. It was an inquiry concerning one bank and their dealing with it and the question as to whether or not they were charging unreasonable markups.

Mr. BARNARD. Let me just ask you——

Mr. GOELZER. The information that was presented to the Commission when it started the investigation, in part, revolved around information that ESM, which was then dealing in GNMA forwards, wasn't adequately apprising its customers of the risks involved in dealing with GNMA forwards.

Mr. BARNARD. And this was one of the reasons for your subpoena?

Mr. GOELZER. Well, that's one of the things that triggered the investigation. I think, when our people went in and began to look at the records, the tangible thing that they found were these markup violations.

If the investigation had ultimately gone ahead, I think we would have looked more broadly at these sales practice violations, but the tangible problem that caused the subpoena to be issued, as I understand it, was these excessive markups.

Mr. BARNARD. Let me ask Mr. Harper a question, if I might. Mr. Harper, in your initial investigation of ESM, was the comptroller of the State of Florida notified of ESM's suspicious trading practices.

Mr. HARPER. I can't recall the answer to that. They certainly were aware of the law suit that we had against them.

Let me just clarify something with the subpoena that we issued, and I think you'll understand.

ESM was investigated shortly after Winters Government Securities went out of business. They were both located in the same building, and there was a big hullabaloo, just like now, when Winters went out of business.

One of Winters' problems was markups. What we did in our investigation is that we subpoenaed the records from the customers that we knew of that were dealing with ESM, so we could find the confirmations on their side, about what they paid for the securities or what they sold securities to ESM for, but we were issuing subpoenas to ESM to get their side of the records so we could determine what the markups were.

In other words, we knew what the customers paid for it, but we had to find out what ESM paid. By subtracting those two figures you could determine whether the markups were out of line or not.

Mr. BARNARD. If you could have been successful with that subpoena, do you feel like it would have divulged the practices that have been brought cut now with Home State?

Mr. HARPER. I looked at the subpoena, and Warner National was a customer, and I believe Home State was a customer then.

We subpoenaed records from them, but you see the problems that you're talking about now are different problems. The investigation of ESM started in 1977, not 1976. If you look at our complaint that we filed, in 1976, that was a profitable year for ESM. They made, I think, about $700,000 or $800,000 per the schedule that Mr. Holtz prepared. In 1977 they lost money, about three hundred and some thousand dollars, but they were probably still solvent.

The problems that you are looking at now comes from, one, you know, over collateralization and from ESM's financial insolvency.

When we were there in 1977 taking a look, there may not have been a problem that was apparent. I don't think it would have helped.

Mr. BARNARD. You didn't see any trend or pattern from your knowledge of the operations to continue a real severe investigation?

Mr. HARPER. We were focused on the markups. Keep in mind, we subpoenaed all the customers. We had no customer complaint whatsoever, except for the complaint that was brought to our attention by the Office of the Comptroller of Currency.

Mr. BARNARD. You wouldn't ordinarly just investigate them because of a loss of money?

Mr. HARPER. We had that one customer complaint that was alleging that they were charged too much money. So, there was no loss of money. There was no complaint by any customer about loss of money. There was a queston whether they were charged a price for securities, that included an unreasonable markup.

Mr. BARNARD. Your investigation had to come about because of a complaint and not just normal reporting. I guess they didn't report to you all, did they?

Mr. HARPER. No, sir. They weren't registered with us. We had no inspection rights. Incidentally, I told the committee yesterday, one of the arguments their lawyers used to the court was that we were trying to get evidence for Congress so Congress could start regulating Government securities dealers and that we weren't there on a bona fide purpose doing our job, that we were just there to show Congress.

Mr. BARNARD. What is your general feeling, Mr. Chairman, and your colleagues', about the situation? Is it primarily the responsibility of the institutions? Let me say this is primarily the responsibility of the institutions, but where does the control lie to correct or to define a situation like this in ESM? Is it with the bank examiners, primarily?

I mean, we have got a bad situation here. I'm having a little difficulty trying to determine where the responsibility exists.

Mr. SHAD. It exists at several layers. I think Mr. Tew is going to amplify that as he did in other testimony in terms of all the different levels. It's sort of a situation that could have been, as you identified, been picked up earlier, but one of the fundamental problems here was the fraud involving the accountants, the financial statement fraud.

Concerning the extraordinary credit that was being provided to ESM by these two institutions, the Federal Home Loan Bank Board has jurisdiction over one of them and the Comptroller over the other, as I recall.

You could see the concentration in Home State. Our own Corporation Finance Division, entirely independent of ESM but because we brought an action or we required restatement by the Financial Corp. of America which is the largest S&L in the country—the holding company, we required them to restate because they were engaged in what is referred to as dollar rolls. We then started, as a routine, to review disclosure by other S&L's to see how broadly that type of activity was involved and, in the course of that review, identified Home State, not that they were doing dollar rolls, but that they had such a big concentration of their transactions with this one little dealer, ESM.

And, the more we asked, we started pulling on that string, getting more information and they were dragging their feet and delaying—I think, in that course, in the pursuit of that inquiry, Corporation Finance would have probably come up with enough to start further inquiry, but by then ESM had failed.

Mr. BARNARD. I compliment the Commission. I mean, this condition could have continued on and on and gotten worse and worse if you hadn't moved in like you did and so I certainly can find no fault with that. Mr. Craig.

Mr. CRAIG. In attempting to understand the process, at least better for me, in this case, Mr. Chairman, as your effort to move against ESM for the purpose of finding or determining if there had been improper markup practices, and, of course, attempting to gain a subpoena and having that blocked. I have a letter here that came to Chairman Timothy Wirth, the House Subcommittee on Telecommunications, Consumer Protection, and Finance and let me see, that letter is from Alan Rosenblat, assistant general counsel to the Securities and Exchange Commission.

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It appears in this case that when you attempted to gain subpoena, ESM played hard ball, heavy hard ball and, in fact, this memorandum mentions this statement and I would appreciate your response to it. "The Commission's attorneys representing the Commission's Investigator in ESM's damage action also informed the Commission of their concern that the district court might order discovery of the Investigator's personal file which could cause their client unnecessary personal embarrassment."

The question, I guess, would be: In declining to drop your initial investigation of ESM, was any consideration given to an ESM threatened law suit against a securities employee—Securities and Exchange Commission employee personally?

Mr. SHAD. Mr. Rosenblat works for Mr. Goelzer.

Mr. CRAIG. Fine. I would appreciate a response to that.

Mr. GOELZER. Well, as you correctly read from the report, I don't think that I can say that no consideration was given to that because, as you have indicated, the attorneys representing the investigator did make that point to the Commission. However the attorneys representing the Division of Enforcement indicated separately that they felt that the charges were stale at this point; that there would be a tremendous amount of resources still to be expended in district court simply to enforce the subpoenas; and therefore they recommended that, if the fifth circuit denied the petition for rehearing which was the subject of that Commission meeting, the subpoena enforcement action not be pursued in district court.

Mr. CRAIG. In my words, it wasn't a matter of a single consideration based on the potential of stale information, there was more involved in the determination to drop action than just the question of finding stale information? Can that be assumed?

Mr. GOELZER. My assumption would be that the determinative factor to the Commission was the fact that the enforcement staff, the people responsible for the enforcement program, were telling them they didn't think it was worth the resources to pursue these now 4- or 5-year-old violations, but the other point was also made to the Commission.

Mr. CRAIG. In other words there was a problem with one of the Commission's investigators.

Mr. GOELZER. The attorneys representing that investigator made the point to the Commission, as you read it from the report, that the proceedings in the district court would likely entail discovery of the investigator's personnel file. I do not understand that to be the motivating factor for the Commission in not pursuing the district court action.

Mr. CRAIG. Then you don't believe it was a factor in pursuing additional or further findings of the activities of ESM in anyway?

Mr. GOELZER. I don't understand it to be the motivating factor. I don't know that I can tell you it wasn't any factor at all.

Mr. CRAIG. In other words, am I making the wrong assumption here, that backed against the wall and threatened with personal exposure, SEC backs off?

Mr. GOELZER. Yes, I think you are making the wrong assumption.

Mr. CRAIG. What assumption can I make by this statement then?

Mr. GOELZER. I think that the assumption you can make from this report is that the Commission was advised that, after we had

spent 4 years, this investigation had consumed 4 years now, considerable amounts of further resources would have to be expended simply to enforce our subpoenas. Given that we had no evidence that there had been further violations of the sales practice requirements—and that's what we were investigating—this matter shouldn't be pursued.

Mr. Craig. How were you able to determine that there were no further violations of this kind of an action?

Mr. GOELZER. No further violations had come to the staff's attention.

Mr. CRAIG. In other words, no one out there had reported the possibility that they had been overcharged?

Mr. GOELZER. That's correct. This is a wrong perpetrated against a customer. It initially came to our attention because a complaint came to the Comptroller of the Currency. I don't think it is an unwarranted assumption that if this kind of conduct were continuing there would have been some inkling of it in the ensuing 4 years.

Mr. CRAIG. Did you, and I am not sure that you made the statement yesterday or at another hearing, that SEC dropped its investigation of ESM in 1981 in exchange for Arky dropping ESM's suit against an SEC investigator?

Mr. GOELZER. I don't believe that I made that statement at the hearing yesterday. As the report which I believe you have in front of you says at the end, in the concluding paragraphs, in essence, once the Commission decided it wasn't going to pursue the matter, it wanted to get the charges against the investigator dropped also. But again, I would only repeat that my understanding is the motivation for dropping the investigation was the fact that the Commission felt it simply wasn't worth the resources to pursue now 4- or 5-year-old sales practice violations. Obviously, it wanted the suit against its employee dropped also if it wasn't going to pursue its litigation against ESM.

Mr. CRAIG. Mr. Chairman, I have no further questions. I guess I have a great curiosity in this area. The fact that if the SEC had been able to penetrate EMS' shield, we might not be sitting here today having this investigation as to the failure of a major institution and it is interesting and I understand the tactics that are played. I find it difficult to understand the totality of these tactics when, in fact, there were allegations of wrongdoing and a pursuit of an investigation and then a backing away of that investigation.

Mr. SHAD. Mr. Craig, at the time, as Mr. Harper has indicated, even if we had been successful in penetrating their defense, as you have said, it's doubtful that it would have led anywhere near the problem because they weren't engaged in, at least the financial statements wouldn't have disclosed to us, any serious problems in terms of what they subsequently engaged in.

As far as I am aware the real problems in this organization came when they were trading in high volume, losing enormous amounts of money, hundreds of millions of dollars. That wasn't going on as far as we're aware and certainly we have no reason to believe it was going on back when we were looking at a question of markups, which is a very routine type of sales practice inquiry that we do pursue, but it is not of the order of magnitude of anything like what subsequently transpired.

Mr. CRAIG. Mr. Chairman, when did Commission, what was the date that the Commission decided to drop the suit?

Mr. GOELZER. June 9, 1981.

Mr. CRAIG. After 4 year's effort, is that correct.

Mr. GOELZER. That's correct. The subpoena enforcement action started in January 1978 and the investigation itself started June 7, 1977.

Mr. SHAD. Of course we were examining the 1977 activity and 1976 activities, as I recall.

Mr. CRAIG. In the examination, if you had been able to penetrate the shield and go forth with your subpoenas and therefore examining, you would have only been looking at a specific timeslot, you would not have been able to look at all activities up to 1981?

Mr. SHAD. If it led us on, but again, what did the subpoenas cover?

Mr. HARPER. Well, the subpoenas were issued, it's my recollection, in 1977, so the subpoenas we were trying to enforce just got information up to the return date of the subpoena which was probably some time in 1977.

Mr. CRAIG. That's what I was curious about because I understand that it appears that a Mr. Gomez, who had been involved in auditing ESM since 1980, is now apparently a participant in the problem.

Mr. HARPER. Well, he's a defendant in an SEC lawsuit. We allege that, and this is probably an understatement, that he lacked independence, as an independent certified public accountant as a result of getting $125,000.

Mr. CRAIG. It appears that he became very wealthy as an independent.

Mr. HARPER. We have also discovered another payment to him of $15,000 in 1983.

Mr. CRAIG. But the subpoenas that you were after in the 1970's, because they were specific to a concern, would not have begun to expose or would not have gained access to information that you could have compared against the audits being made in 1979 and 1980?

Mr. HARPER. That information wasn't subpoenaed. It was information to calculate the markups, which we thought was the problem in 1977. What that would have shown was where they purchased the securities.

Mr. CRAIG. Would you not have had total access to their books?

Mr. HARPER. No, sir. Keep in mind, I mean that wasn't a friendly relationship with them at that time.

Mr. CRAIG. Obviously it wasn't. Thank you, Mr. Chairman.

Mr. BARNARD. Mr. Chairman, can the jurisdiction of the SEC be triggered by a referral of information from a banking agency? Does it have to be a complaint of a customer?

Mr. SHAD. It can come from any source.

Mr. BARNARD. In other words, a Federal agency or—what about a State agency?

Mr. SHAD. It could come from any source. Some inquiries are triggered by anonymous phone calls.

Mr. BARNARD. In other words, you could have renewed an investigation of ESM based upon these present so-called activities if you

had been notified, say by the Ohio banking commissioner or even the Ohio Deposit Fund?

Mr. SHAD. Yes, sir. If we had reason to believe that they were committing a fraud in the marketplace, that would be enough for the staff to come and present the facts, and the Commission could grant a formal order of investigation and the staff could go in and find out.

Mr. BARNARD. Once more for the record. The fact that you all moved in when you did this year against ESM—how did that come about?

Mr. SHAD. It was the direct result of the gentleman on my left, who was the special counsel to ESM coming in and providing the gentleman on my right with the facts that clearly evidenced the fact that the company's financial statements were very inaccurate.

Mr. HARPER. Hypothetically if we had other information and we issued another subpoena, based on new information, more likely than not, and this is all hypothetical, we don't know what would have happened. We might have found ourselves with another lawsuit going on for 3 more years, unless it was enough to warrant an immediate SEC enforcement action.

Mr. BARNARD. And, at this point, you have no recommendations for legislation that would assist you in this discovery?

Mr. SHAD. As I mentioned in my brief opening remarks, we are now engaged in a major effort, in consultation with the Federal Reserve Board and the Treasury, to come up within 90 days from March 21—first we have to assess the breadth of the market and the seriousness of the problem.

We have a fix on what the problem is at ESM. We think we know where the problem is there. We think it was principally due to the failure or the inadequacy of collateralization, and that raises a question as to whether people that deal in the market should be encouraged or required to properly collateralize their transactions with Government bond dealers.

We also know that the bulk of the problem—of the $300 million, about $200 million—appears to have been the direct result of excessive margin and concentration of transactions with ESM by just two financial institutions. And as I also mentioned, those two were, at the time, under the control, or appeared to be under the control of one individual. So you can set up a very extensive regulatory structure that wouldn't necessarily identify—we believe this is fraud, and a very collusive type of fraud. It would not necessarily have been identified by normal oversight activities. So there are a lot of different ways to do this.

Do you tighten up on the other side first? What's happening in the marketplace today? The news on ESM is on the front page of every publication in the world. I would think that a lot of people that have been dealing routinely in the Government bond market would be reacting to this right now saying: It's my transaction, I put money up, what have I got to show for it, is it any good? I would think that the marketplace, it tends to respond so instantly and fast to these type of things——

Mr. BARNARD. Have you all had many inquiries about that?

Mr. SHAD. Have we had inquiries about ESM?

Mr. BARNARD. Yes.

Mr. SHAD. I can't answer that and I am not sure that—we do get a large volume of mail at the Commission and phone calls and what not, and I will be glad to see if we can get a run on it and advise you as to the public reaction.

Mr. BARNARD. Mr. Kindness.

Mr. KINDNESS. Thank you, Mr. Chairman.

Returning for just a moment to the matter of the lawsuit filed against or I understand there was a lawsuit filed against the SEC investigator by ESM. For the last three Congresses there have been some fairly sizeable efforts to get the Federal Tort Claims Act amended so that particularly those engaged in various kinds of law enforcement for the United States will be protected against that very kind of lawsuit which is being used increasingly as a tool to try to bring pressure on law enforcement agencies of the Federal Government for so-called constitutional tort actions. Is that not an increasingly frequent experience encountered by the SEC?

Mr. HARPER. How much it is encountered by other offices, I don't know, but I can tell you that the threat of lawsuits against a Federal employee that doesn't have any insurance coverage for this sort of thing, can have a chilling effect and if you can do anything to get through that type of legislation, for myself and the people in my office, we would be very grateful.

Mr. KINDNESS. We have sure been trying and I would sure like to get more support from around the Congress for that very type of legislation and here is an example of the kind of circumstance in which it is used as an undue pressure on Federal employees who are involved in law enforcement functions, that we all want performed.

Mr. GOELZER. I certainly agree with your comments. The Commission has supported that legislation in the last couple of Congresses. I would also like to say, for the record, and I think it's clear from the documents, that we denied emphatically that our investigator had engaged in any misconduct. There was never any trial on the merits of whether he had, and I believe that ultimately it would have been demonstrated that he didn't have any liability.

Mr. KINDNESS. Yes, but it's the pressure on that individual employee that really hurts the cause.

Mr. GOELZER. It's certainly a tool that the people use, yes, sir.

Mr. KINDNESS. Chairman Shad, I would like to express some satisfaction with what I have heard here as to the role that the SEC has performed in this matter and it doesn't quite seem to me that the whole question is answered until the Congress looks, perhaps more closely at possibly expanding the authority and responsibilities of the SEC with respect to what are currently unregistered Government securities dealers, but it looks as though with the existing authority, at least, there has been appropriate action taken and I commend you and the Commission in that respect.

Mr. Tew, I would like to understand the function——

Mr. BARNARD. Mr. Kindness, do you have any more questions for Mr. Shad?

Mr. KINDNESS. Oh, I beg your pardon, I haven't.

I just wanted to express that compliment.

Mr. BARNARD. Before you begin with Mr. Tew—Mr. Chairman, I want to thank you for being here today and I certainly apologize for the extreme delay, but I am sure you have had to wait before.

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

Mr. CRAIG. Mr. Chairman, let me also thank the Chairman for his thoughts and very thorough testimony on this issue and also I think we truly appreciate your recommendations and the potential of dealing with Government security dealers. That obviously has got to be a concern of ours and we appreciate those thoughts and recommendations.

Mr. SHAD. Thank you very much.

Mr. BARNARD. Mr. Kindness, we'll go ahead and proceed with Mr. Tew at this time and then come back for questions.

That's all right, we're keeping an eye on you.

Mr. Tew, I noticed that you were an early attender to our hearings today and you have been as persevering and indulging as anyone. I'm sorry that it has taken so long but we do appreciate your being here today and participating in this hearing. Your testimony is going to be very valuable in the final determination of this study and we would like to hear from you at this time.

Again, without objection, we will admit your entire statement in the record and perhaps you would like to summarize.

Mr. TEW. Let me, at this time, introduce Mr. Laurie S. Holtz, the head of Holtz & Co., the accounting firm I engaged in connection with unraveling this fraud.

Mr. BARNARD. It's Holtz.

Mr. TEW. Holtz, H-o-l-t-z.

Mr. BARNARD. Holtz, H-o-l-t-z for the record.

Thank you and we welcome you to the podium.

STATEMENT OF THOMAS TEW, ATTORNEY, FINLEY, KUMBLE, WAGNER, HEINE, UNDERBERG, MANLEY & CASEY, EQUITY RECEIVER OVER ESM COMPANIES, ACCOMPANIED BY LAURIE S. HOLTZ, C.P.A., HOLTZ & CO., MIAMI, FL

Mr. TEW. Mr. Chairman, I will try to briefly summarize my report that was filed yesterday morning with the U.S. District Court for the Southern District of Florida.

Having been appointed receiver, I was charged by that court to file within 30 days my report of my investigation. The report is factual, however, I think it contains a lot of food for thought that might focus on some of the questions raised here today and that is one reason I enjoyed being here.

Mr. BARNARD. Is that report available for our records?

Mr. TEW. Yes, sir. I have delivered to your staff copies of this report.

My immediate boss was the Federal judge who appointed me and I have filed that report with him and I brought copies to your staff this morning.

Mr. BARNARD. Thank you.

Mr. TEW. It was fascinating to me to hear the events of Ohio because we had one perspective from south Florida and basically we were charged with marshaling assets as rapidly as we could plus conducting a thorough investigation into what had happened.

It became evident early on that there were some very unusual transactions involving some very major savings and loan associations. We directed our attention, in this report to really five areas. I will just touch on them very lightly for you, Mr. Chairman and the panel, and then perhaps I can respond to some questions or areas where you have particular interest.

The report, essentially attempts to analyze, over the 29-day period that I was the receiver up until the point I was appointed the interim trustee by the Bankruptcy Court last week.

Essentially what had happened at ESM from the standpoint, not only of how this fraud was perpetrated, but how was it covered up, and I think that in the covering up there was the most shocking aspect of this and that from the detailed financial analysis we have provided the committee, this firm only made a profit in 1976. Thereafter it continued to be an elaborate and very raw Ponzi scheme whereby they continued to literally drain money off the conversion of customer securities until at the end they had misappropriated approximately $300 million of customer securities.

Now, the tragedy of that is that they have apparently compromised the partner at Alexander Grant by payments of money so that the financial statements prepared from, at least, 1980 were false and as you will hear, I am sure from other witnesses, those false financial statements were then circulated in the financial community and laid the background for the perpetration of the fraud into essentially the municipalities who bought the securities.

We also have put in here a section, for your information, as to how the accounting fraud was conducted, essentially the mirror transactions that were put on the books, the false journal entries. We have examples in the books, to show the blatantness of the fraud.

We also were charged with tracing the fruits of the fraud into the hands of the officers and directors. In the first few days that I was appointed trustee, we obtained constructive trust over all their personal assets and they are listed and detailed in this report.

We have worked closely with the U.S. Securities and Exchange Commission, to whom we have given our acknowledgement in this report and the Federal Reserve.

There are a couple of transactions that we think we should point out to this committee because I have heard the questions asked of others, particularly concerning the American Savings buildup and their T-bill account and the buildup in equity at the Home State account, and I would like, myself, to address the American Savings situation, which was most tragic and have Mr. Holtz address the overcollateralization by Home so that when you put both presentations together you will see that about 95 percent of the cash that ran this fraud came from these two companies.

On page 40 of my report, I have detailed the buildup once Mr. Warner took control of American, their position with ESM.

The tragedy, Mr. Chairman, is that none of these institutions readily comprehended the fact that they were, in essence, making unsecured loans to this small Fort Lauderdale dealer, and you have to think about that for a minute. When you take a firm like American, a very fine institution in my hometown of Miami that has been around as long as I have been around and built brick by brick

by the Broad family, a very fine revered family in our community, took $115 million of Treasury notes and literally handed them to these crooks and use that to leverage a $1.2 billion T-bill arbitrage, literally within months after Mr. Warner took joint control of the company from the Broad family.

It was a situation that I am sure we have seen across the country where this savings and loan had a negative interest spread on an old portfolio of mortgages, needed capital, Mr. Warner provided that capital in exchange for an eroding trust arrangement where he took over half, he had the right to nominate half of the board and Mr. Broad kept half of the board nominations.

Unfortunately, Mr. Warner placed on the board, as one of his nominees, Mr. Ewton, who was the chairman of ESM and by pressures, that we really haven't identified yet, because we haven't had access to subpoenas and testimony, immediately obtained the consent of that board to enter into kind of a teaser transaction where they went into and purchased $40 million in face amounts of T-bills and did a small transaction resulting in a borrowing of about $62 million.

That was just to get their feet wet. And, this S&L, facing that negative interest spread, immediately saw a way to get it locked in profit of interest.

And, the tragedy that you see when you analyze all of these transactions at ESM, they were risk free to the reverse repo side of the deal and they were brought, they weren't subject to the normal market risk of these types of transactions.

So, to affirm those drowning and negative interest spreads who needed money, this was a very seductive deal.

They then went out and rapidly bought $500 million of T-bills, using T-notes as collateral, and then topped it off with a final purchase of $600 million.

Mr. BARNARD. This is American Savings.

Mr. TEW. American Savings. That, in essence, left American with $115 million of its T-notes up as collateral to buy this $1.2 billion, $115 million and either the lack of sophistication or the deceit on the part of ESM allowed American just to hand those T-bills over and to lose possession and control of those T-bills so that once they had lost that possession and control, they essentially had an unsecured loan to this little fraudulent dealer.

Mr. BARNARD. Mr. Tew, that wouldn't have been of concern by the regulatory agencies?

Mr. TEW. Sir, that should have been a concern by anybody because this firm, I don't know the exact percent of American's liquid securities on their balance sheet, but the primary investigative technique is when you walk into a bank and audit a bank, the easiest and the first thing you do is count the securities in the box. You want to know that they are there and you confirm that they are there and that is a primary asset.

This firm, having financial difficulties, Mr. Warner coming in to invest money to get it back on its feet, takes $115 million of Treasury notes and releases possession of them to this small firm.

Now, I would think that that——

Mr. BARNARD. If there had been a verification though, wouldn't there have been a positive verification from ESM?

Mr. TEW. No, sir. In another section, I have a section called Why the Confirmation Process Failed. One of the things that is also tragic here is that no one, not ESM's auditors, American's auditors, Home State's auditors, or the auditors for any of these municipalities, properly verified the position and custody and control of these securities and I am talking about almost $2 billion worth of securities that were involved in the ESM business.

Had any of those affirmed or properly confirmed the location of those securities and thereby triggered and uncovered the fraud, this thing would not have gone where it did.

Mr. BARNARD. This was really triggered, I believe—I don't know whether Mr. Holtz is going to testify to this or not—but wasn't this actually triggered by Home State going down to verify their collateral?

Mr. TEW. Yes, sir. In my narrative, I was brought on the scene as special counsel because Home State was demanding a financial statement from ESM. ESM got what I call the famous 1-day statement from Alexander Grant. It was delivered February 28 and sent copies to the company. Home State was there, on that particular day, by coincidence.

They picked up a copy the next day and Alexander Grant demanded the return of the statement and put out a notice in his transmittal letter that they could no longer be relied upon.

So it was Home State's pushing to get current financial information that, I think, had put the company in a box because they needed that financial information because the only way that these firms do business is to send out into the community a little balance sheet and I have one of them in my briefcase, that is kind of like a statement of conditions. It's not a true 100 percent audited statement. I don't have it, Mr. Chairman, but basically the way this firm and other Government securities firms deal is that they take an audited balance sheet, not P&L and a balance sheet, and they put it in a fancy little brochure and they mail it out to their customers.

Well, the delay in that going out to ESM customers started causing concern. It was almost March 1 and that balance sheet hadn't gone out. Since it is an unregulated dealer, the only comfort that the customer has about the dealer's financial condition is the receipt of that little flyer or statement of conditions. And since it was late in arriving, apparently Home State was down demanding a copy of their current financial information.

So essentially the pressure that was put on the company, I think, led the officers and directors, essentially the two remaining officers, to blow the whistle, essentially on themselves by authorizing me to go to the Securities and Exchange Commission.

Mr. BARNARD. In other words, is it true that they were just at the end of the line, as far as what they were dealing with, and they couldn't go any further?

Mr. TEW. Yes. I think the fraud had played out. They kept it afloat as long as they could. One of the things that we analyzed here is how they kept it afloat, by converting customer's securities. The man who was considered the brains and financial genius had died of a heart attack November 23, Mr. Alan R. Novick. The other

members of the group were essentially salesmen, as characterized in prior testimony.

Mr. Ewton, who was the chairman, spent maybe 2 days a month in the office picking up his phone messages, at best, for which he received $500,000 in salary and $1 million in bonuses. His job, as the employees told me on interview, was to keep Mr. Warner happy and for that he was paid that nice salary.

But the man who had his fingers on all the securities and moved them around to avoid detection, was Mr. Novick and he died of a heart attack November 23, in the office, probably occasioned by the pressures that he was under.

The other salesmen, who were maybe glib salesmen, able to market the products, I don't think were sophisticated enough to hold the numbers together.

Mr. BARNARD. They didn't have him adequately insured, did they? [Laughter.]

Mr. TEW. They did. They had $5 million on him and I think that kept them running almost until January.

Mr. BARNARD. I was being facetious, but I will be serious from this point on——

Mr. HOLTZ. I think that is called key man insurance.

Mr. TEW. That's right, he certainly was a key man.

Getting back to the American transaction, the tragedy of it was that not only did American have $115 million of unsecured, if you look to the Home State transaction, they had $150 million that they had lost jurisdiction over and control over that had essentially turned into an unsecured loan to ESM.

So here is ESM in Fort Lauderdale, with a balance sheet, even in its fraudulent state of only $26 million, sitting with $265 million in unsecured loans from these two sophisticated financial firms.

The board of directors, I don't think knew what they were doing. I don't think the auditors knew what they were confirming and I just can't believe that they turned over, I mean that would be a tough amount of money to turn over to Salomon Brothers or Merrill Lynch, much less this small firm who, in 1983, the last published report, had about $20 million net worth, phony net worth that even if you accepted it on its face, how can you release that type of cash almost on an unsecured basis to that firm and that is what happened here.

Mr. BARNARD. Mr. Tew, it seems that you were able to detect this so quickly and that's a compliment to you and I am sure its because of your background and experience in this type of work. You may not want to make a statement to this, but couldn't the SEC, Mr. Harper, have done just as well if they could have gotten in there?

Mr. TEW. Sir, I think, yes. I think the point needs to be made and I made it in the narrative and people don't believe it, but it's true.

Mr. Holtz and I walked in there on a Saturday, with the assistance of some clerical help that had been provided for us and his seven partners of his accounting firm, before noon, and in less than 2 hours had uncovered the $250 million deficit. And, that is the same deficit that had gone undetected for almost 7 years from the Alexander Grant's audit.

Mr. BARNARD. Mr. Harper, would you like to respond to that?

Mr. HARPER. I think if we had an inspection program inspecting U.S. Government securities dealers, we would have gone in and found it too.

Mr. TEW. Sir, I think that, when we walked in Saturday morning, I was just retained as special counsel to do a financial investigation of the company, I now realize I was being set up to blow the whistle. I called Mr. Holtz, whom I have known from prior cases where I have been appointed by the Federal court as class action counsel in large frauds. He has a nose for fraud. I didn't want any rookies and I asked him only to bring his partners and he brought seven partners.

We walked in and set up three teams, a balance sheet team, a P&L team and an inventory team and then asked the pregnant question, where are the books and we expected that we would get stonewalled and these nice young ladies who worked there started bringing them out and laying them out on the table like this.

I have a chart. I don't know how much time you have or how much interest you have, about how the fraud was buried in the books, but essentially they kept a subsidiary.

You want to open that up. Just briefly I can make it very simple so you'll understand.

Mr. HARPER. I would like to point out that when the SEC comes in, generally they don't bring out a bunch of nice young ladies who bring out the books.

[Chart referred to appears on p. 519.]

Mr. TEW. This was a Government securities firm. The interesting part of the audit engagement was they only audited this subsidiary and they only audited, essentially——

I think the questions are relevant as to the audit and just briefly to show you how simple the detection of the fraud was.

The audit engagement, interestingly, only went over this subsidiary and they only audited the balance sheet of that subsidiary.

Now when we came in and set up to look at the books, we started an analysis on a balance sheet of the parent company group and its two subsidiaries. This is the Government securities dealer. This little subsidiary was a dormant broker dealer firm. I think they had it so they could put the specific little plaque in the hall, as a member of NASD in the hall. This was a registered broker dealer that was dormant.

This Government securities firm here was where all the money was generated. This firm started in 1977, to date, lost about $200 million in trading and interest on that trading and operating losses.

To keep that clean so that the annual audits would show a healthy company, they did two things. They created essentially what we call repos and reverse repo mirrors to in essence move the loss off the subsidiary books to the parent and that is described in my report as doing it with mirrors—a little phrase that I used.

So if you had a losing term repo, you put it a reverse repo on it and you, in essence, created an inner-company accounts receivable at the parent to keep this company healthy.

So, when we found this and started looking at this balance sheet, we didn't understand what the affiliated transaction was in footnote D, as you later can study.

We also found that they were making journal entries, moving losses off the books here, first up to the group parent and then to keep the group healthy, they moved the loss over here and to compound things, they took an account receivable back from that company.

The irony of it is, not only did they bury this company's $200 million losses and kept it healthy, they created an asset in an accounts receivable and started accruing interest on this company's books.

So when Mr. Holtz' auditors came in, we looked at this and it was clean and healthy but we did a combining balance sheet and we saw this was healthy, but interestingly enough, it was held up by a $200 million account receivable from what was called an affiliate.

So I said, we're not going to find those affiliate books, they're going to be in the Gulf Stream, but we asked the young lady, do you have the books on the affiliate and she brought out the books of this company that is 100 percent owned by Mr. Ewton and on the books of that company, in the office, we found $200 million in losses that had been journaled and mirrored all the way here and then that company's sole assets for $50 million consisting of $30 million in officer's loans and to add insult to injury, $10 million in interest accrued on those loans and then $10 million in a coal venture.

So you had $50 million of let's say questionable assets supporting a negative net worth of $200 million.

Now, in the accounting parlance, you did a condensing, combining balance sheet. You did this balance sheet of parent and sub and you combined it with the affiliate, or with the intercompany transaction and you showed that you had a negative net worth of $200 million. If you wrote off the $50 million bad debts, you had $250 million and to the credit of Mr. Holtz and his staff, he did that before lunch from the books on the premises.

After we did that analysis, around noon on Saturday, frankly, I got concerned because we didn't know if we were dealing with organized crime or what.

Mr. BARNARD. What you're telling me, it was very easy, then, for this company to have this many customers because the margins they could offer their customers were out of this world?

Mr. TEW. That's right. They didn't care about operating profits. They didn't have any operating profits, so they could offer outlandish deals to induce the city manager in Toledo, for instance, who was trying to keep, you know the policeman on the street, the garbage picked up and he sees a chance to get an above-average deal, he moves his money to this company and, frankly, this company can make that deal because it isn't in business to make a profit.

Mr. BARNARD. Now, as far as Toledo and Beaumont and others, they were so-called innocent victims of this?

Mr. TEW. Absolutely.

Mr. BARNARD. But now as far as Home State was concerned, Home State was not an innocent victim?

Mr. TEW. Home State, if I could take my seat again.

Mr. BARNARD. What about American? Was American innocent?

Mr. TEW. I think American woke up after they were into the deal. They thought that they had a 16-percent no-lose deal. So I have to question their greed going into it and I think they found out that it wasn't.

It was a no-lose deal mathematically as long as ESM stayed in business.

Mr. BARNARD. Wouldn't it be a normal business understanding that this was highly unusual, that it couldn't be done legitimately?

I mean, if you were the president of the bank, chairman of the board—unless you conspired in it—wouldn't it be normal if you said, "This can't be"?

Mr. TEW. The first thing we did when we looked at these trades was talk to some bond dealers to say, Have you ever seen this? This 1-year arbitrage, going out 1 year on a reverse repo in and of itself, is an unusual transaction.

I think business judgment flew the coop for both institutions. The board members who, I think, made this judgment to go forward must have been desparate to keep their S&L afloat. That's the best I can say for them.

Mr. BARNARD. Can you tell us about how Mr. Warner pumped up the American S&L's assets?

Mr. TEW. Let me sit down over here.

I think that is one of the yet untold stories. Under our Florida law, we have what we call an invitation to do an "asset pump" which is the S&L language.

If you add $1.2 billion in reverse repos to your business by a T-bill arbitrage, like was done here, you would, in essence move from a $3 billion institution to a $4 billion institution and change.

Under Florida's unusual law, you can then invest 20 percent of your gross assets, not your net worth, in other transactions and the theory that has been examined here is, Why do you go into this type of deal? What is your ulterior motive? It may have been, not only to add some interest to income, about $6 million of interest to income out of the T-bill arbitrage, but to give you a large war chest to acquire other savings and loan institutions.

Because, with a billion dollars in new value on your books, I mean new assets, not net worth, you now have $200 million available to buy interest in other S&L's and I think that is one of the things that was probably on the mind of the American board of directors.

They did start a flirtation with a Freedom Savings & Loan, a west coast of Florida savings and loan and were moving to acquire them when this thing blew up.

Mr. BARNARD. Mr. Holtz, would you like to now tell us about ESM? I think you were going to tell us about Home State.

Mr. HOLTZ. Home State was very similar except that instead of having a small number of T-bill arbitrages, they also had an extensive amount of GNMA borrowings as well.

Also, American first got into this transaction in March 1984. The Home State was in for many years.

In the report, we have reflected month-by-month the reverse repos for ever single customer going back to the middle of 1980.

American was a relatively new customer. Did only a small number of T-note collaterals to be able to purchase T-bills at a discount whereas the Home had been in a combination of GNMA's and for a long time T-bills. They were a major customer and they had an extraordinary amount of collateral.

Included in the report, I have reflected that in 1982 and 1983, just how much collateral Home had in 1982 and in 1983 when they were not—they almost had as much collateral back then as later on when they had gotten a much more leverage situation.

In effect, when the loss occurred in Government in 1980 and they were about $100 million behind, the excess collateral on reverse repos was also $100 million, most of which came from Home.

As the losses grew, more collateral was needed. Now, there are three ways to hold up this loss. One is to have excess collateral. Another way is to take term loans on the other side with no collateral at all and the third is generally what we call a mismatch.

When you have excess collateral, you can have a mismatch because, let's assume you give a $100 million collateral and you only loan $85 million, but on the borrowing side, it's $95 million. There is a schedule in the report that reflects the difference between the term repos and the reverse repos. That is the difference that should have shown up on the balance sheet of the audited statement.

The audited statements, 3 years are included in the report. In all 3 years you will see approximately the same amount of securities purchased under agreements to resell, which is the reverse repo, on the asset side, and securities sold under agreements to repurchase, which is the term repo, on the liability side.

In 1984, for example, they reflected $2.945 billion both the asset and the liability. In reality, the asset, securities purchased on the reverse repos, as reflected in footnote (d) to the Alexander Grant audited report, that asset was only $1.324 billion and they had borrowed $1.621 billion so the balance sheet, were it properly presented, would have had, on its face, a $300 million overborrowing.

That was moved over by journal entry to group, the parent and the footnote, I think, kind of describes it in some kind of a minimum way because it does not truly describe a full relationship with the parent and the subsidiary.

The footnote, on its face, is impossible to understand. We were presented with this financial statement on Friday, March 1. The first question that Mr. Tew asked me was to read this statement and what does it look like because tomorrow we're going to go in and look at this company.

I read it and I read it and I read it and I thought that maybe there was something the matter with me because I could not understand it. Once we saw the records and found out that we had ready access to reverse repo computer runs and term repo computer runs, then the footnote made sense.

Consequently these footnotes, in this report, represent unintelligible footnotes for 3 years that have been given out to anybody and everybody who had requested information about this company.

Mr. BARNARD. Mr. Tew, what are the whereabouts of the principals now?

Mr. TEW. Mr. Chairman, they are in south Florida, to the best of my knowledge. We have been able to serve all of them with constructive trust, stripping them of all their assets and placing them in constructive trust.

Mr. BARNARD. What are you going to do with all those automobiles that they've got leased?

Mr. TEW. We got all the toys of the rich.

Mr. BARNARD. Polo ponies included?

Mr. TEW. It was really a corporate rape of unmeasured parallel. We have in the front cover, the front of this report, their compensation, their bonuses, their salaries. In the back, all the assets that we grabbed, a 70-foot Hatteras yacht, brand new, four or five ranches, farms.

At one of the hearings, Mr. Harper said that I had the best motor pool of any Government agency that he was aware of and while it is distressing, we have been able to grab, already, about $27.3 million in ready cash and securities and we have got constructive trust over assets with an estimated value of another $20 million. It leaves us very short, naturally against $300 million, but all the assets that have been recovered are in the schedule.

Mr. BARNARD. Mr. Craig.

Mr. CRAIG. I guess I don't know what to ask. I have been so involved in your statements of the last half hour and this report that you have submitted to us. I have never, in my own life, been exposed to an intricate coverup such as is going on here and the volume of dollars involved.

Did you respond to the chairman as to where Mr. Ewton is at this moment?

Mr. TEW. Yes, sir, he is staying in his home in Boca Raton. It's a $1.600 billion home in a place called the Sanctuary where he is now. I guess, the outcome of—prosecution is certainly going to flow from this.

Mr. Craig, I was asked by several of your staff members to comment on how I think the fraud was sold.

Mr. CRAIG. That's obviously a curiosity of mine because I have no idea how they could perpetrate this for so long other than, of course, the game plan you ultimately outlined on the chart.

Mr. TEW. I have a theory, and we see this, unfortunately, a great deal in southern Florida, where you take a very recognized and a very solid concept, like a Government security, which has been handled by the finest firms in the country, primarily in the Northeast over the years and some sharpies take it and sell it retail on Main Street America where people hear the buzz words of Government securities, they hear the buzz words of repos, they think all of a sudden they have found an answer to a few more points on their budgets and they really don't understand how the game is played by the professionals.

If you look carefully at the list of losers, there are no banks. They would be too sophisticated to be taken. There are no major brokerage firms, they wouldn't play with this type of firm.

What you see, unfortunately, tragically is 16 to 17 municipalities from around the rest of the country whose officers believed, and they have gotten documentation from ESM that their securities were going to be specially segregated for them somewhere and

either through ignorance or deceit, wound up, when the music stopped, not having their securities and I think this is the type of transaction that is well respected. It's a part of our national deficit. And yet when you put it out retail, on the street, in Port Angeles, Washington or Toledo, the city managers in those towns and the small S&L offices have no idea what they are doing and they are easy prey.

The term, "repo" is essentially some guy looking to make a few extra bucks or some casual money for maybe 10 or 20 days. If you're a city manager and you're trying to get more yield and some fast talking guy calls you and gives you 2 points more than you can get at the local bank or maybe 3 points, it's a very enticing thing.

You send out an Alexander Grant auditing statement and you say we deal with American Savings in Miami, a $3 billion institution and a $1.5 billion institution in Ohio and it's a narcotic, it's 2 or 3 more points. It's manna from heaven. They don't understand that they need to take physical possession of those securities in their custodial bank.

A lot of these people just assume that because they're in Government securities, there was an aura of safety and they had no idea that unless they had physical possession, they were dead ducks.

Mr. CRAIG. Thank you very much, Mr. Tew.

Mr. Harper, I guess I have to react by saying maybe you should have spent the time and the money and pursued the subpoena just a little longer.

Mr. HARPER. Well, a decision was made not to do that and that was made by the Securities and Exchange Commission.

Mr. CRAIG. And there was no other indication from that time up until this time?

Mr. Harper. No, sir. From 1977 until the investigation was closed in 1981, not one complaint. Keep in mind that we subpoenaed all of the customers that we knew of that ESM had.

Now, if something were going to surface in the way of a customer complaint, a subpoena would have done that and the subpoenas for their records generated no complaints or anything like that.

The complaint that we received wasn't made by the bank itself, it came to us from the Office of the Comptroller of Currency.

Mr. CRAIG. Do you think the proper regulatory process in supervising Government security dealers, as outlined by your Chairman could have possibly resulted in the avoidance of this kind of scheme?

Mr. HARPER. My own opinion and not that of the SEC?

Mr. CRAIG. Yes.

Mr. HARPER. Yes. I think an inspection program by the SEC or the NASD would have caught it. The NASD, as you know, is a self-regulatory organization that all brokers that are registered with the SEC have to belong to, but some kind of inspection program like that would have surfaced this problem long before it ever got to be of this magnitude.

Mr. CRAIG. What we have heard from Mr. Tew is that this kind of an operation just doesn't tolerate the light of day.

Mr. HARPER. I think that is absolutely right, and I don't think it would tolerate an inspection program, again my personal opinion, by a Government agency.

You have to remember that it's my experience as an SEC enforcement attorney that the undesirable elements in the securities business move to the areas where it's least regulated. We saw that, I think, in municipal securities before Congress caused municipal securities dealers to register with the SEC in 1975.

Mr. TEW. The commodities, CFTC.

Mr. HARPER. Mr. Tew just pointed out that in the commodities business, with the CFTC, they moved to an unregulated part.

So, I think with an inspection program——

Mr. TEW. Mr. Craig, let me pick up on that point.

I'm a trial lawyer, securities lawyer, I deal with the undesirable elements. I have represented them and been the SEC's special counsel in chasing them, but if you look at the parallel. Take the gold, international gold bullion, for which I was bankruptcy counsel.

For many years the man on the street couldn't buy gold and then a couple of brothers named the Alderdices, when that changed and the law permitted the guy on the street to buy gold, they started selling gold by credit card.

They went from $10,000 a year in sales to $88 million in 2 years. They blew out as much as they received. They blew out and left $50 million owed to customers.

I see a parallel here that's disturbing, something that is common parlance for the Salomon Bros. and the Merrill Lynchs and Underwoods and all this moral persuasion stuff that seems to work with the Fed with their 36 primary dealers. It doesn't work with the likes of the ESM.

When you put those people out on the street selling that stuff retail and I'm not talking about—let me show you the size of some of the victims here. It's not $100 for $14 million. Garden City, MI for $300,000. Chelane County, WA for $630,000. That's retail, gentlemen. That's selling the little guy on the street a part of the Government securities dream.

Mr. BARNARD. You're about to eliminate the city of our distinguished chairman there. Don't leave out Beaumont, TX.

Mr. CRAIG. I just told the chairman that the money from Beaumont went to buy that Miami Dolphin sky box, or at least a piece of the yacht.

Mr. HARPER. I have spent more time in my life, probably, interviewing victims of securities frauds than anybody else and it's a horrible thing.

Mr. CRAIG. But you are telling me, based on what you now know and what Mr. Tew has explained to us, that any reasonably capable investigator, if given any kind of exposure, through a regulatory process, could have seen most of this, or at least began to question enough to bring on the kind of investigation that would have either controlled them and/or stopped this kind of activity.

Mr. HARPER. I am confident that the securities compliance examiners that are employed in our office, given unfettered access to the records in an inspection program like we have for the other broker-dealers, would have picked this up a long time ago.

Mr. CRAIG. In 1981, if you had pursued your subpoena, this might have happened?

Mr. HARPER. Beg your pardon, sir.

Mr. CRAIG. And in 1981, if you had pursued your subpoena, this might have happened?

Mr. HARPER. Well, what we were looking at then was again, was the markup problem which was brought to our attention, and when we were in there in 1977, keep in mind that they were likely solvent, not insolvent as they grew to be.

But, the inspection program that the SEC has and more particularly the NASD has, for core firms where there is customer exposure, they examine them every year for financial responsibility and sales practices, so they would have done a very close financial responsibility exam in 1978, 1979, and so forth.

For the SEC to get in there after 1977, first we had no basis to suspect they had financial problems, that they were having any types of problems relating to solvency——

But, moreover, we would have to have had some basis to force the court to let us have access to their records because they're not a regulated Government dealer, I mean, they're not a regulated broker-dealer.

Mr. BARNARD. Mr. Harper, I hope that this will be a case study, though, for that group that is now studying the law. I mean the Fed and the SEC and other agencies that the Chairman has indicated are studying the situation. I hope that this will be a case study so that, at least, this type of transaction would be regulated.

I realize the problems with the multiplicity of securities dealers, but in order to offset what Mr. Tew has described as such an easy transaction to dupe innocent purchasers, something has got to be done.

Mr. HARPER. Let me comment on that.

I don't think it's just that type of transaction and this is again my personal opinion because in Winters Government Securities, it was GNMA forwards, so if you were to regulate that, these people moved into repos.

I think the problem here is that you have got an unregulated dealer. Keep in mind that if you regulate one type of transaction, the unscrupulous will go to another type and the vehicle is the unregulated dealer.

Mr. TEW. Mr. Chairman, may I make one point?

Mr. BARNARD. Sure.

Mr. TEW. I think there is one thing that could have helped a great deal here. Because this was not an SEC filing and listening to the auditors testify yesterday, because this was not an audit that was to be filed with the Securities and Exchange Commission, it wasn't the sobering type of auditor review and interpartner review that goes on when you file any document with the SEC.

The mere fact that a document, a financial statement is filed with the SEC because of the statutory penalties for false filing, in my profession, the legal profession, and the accounting profession, that's a very sobering event in and of itself and in the auditing world when you're making a filing of a broker dealer's financial statements with the Government or a financial statement of a public company, it triggers all sorts of duplicate reviews and interpartner reviews at that filing.

That alone would have uncovered the fraud here, I believe, because Mr. Gomez would not have been able to act so on the audit.

Under the standards of Alexander Grant, some other partner probably in another office, because it was an SEC filing, would have reviewed his work papers.

And that fact, just the mere filing with the Commission has a sobering effect in the professional community.

Mr. BARNARD. Mr. Tew, you and Mr. Holtz have certainly brought very interesting testimony—oh, excuse me, Mr. Chairman.

Mr. BROOKS. I wanted to say that I have one question for you, Mr. Harper. Did the SEC not start an investigation of these same scalawags in 1977?

Mr. HARPER. Yes, sir, we did.

Mr. BROOKS. And did you hassle around with that for 4 years and give up?

Mr. HARPER. We hassled around with it for 4 years.

Mr. BROOKS. And did what?

Mr. HARPER. The Commission made the decision not to pursue the matter further.

Mr. BROOKS. So you did nothing else?

Mr. HARPER. No, sir. What we were investigating, at that time, was a different problem than the one that gave rise to the financial difficulty. We were investigating the profit they made on securities transactions.

Mr. BROOKS. Mr. Tew.

Mr. TEW. Yes, sir.

Mr. BROOKS. Mr. Tew, I wondered sir, with your expertise, if it had not occurred to you that perhaps with the close relationship of Mr. Warner and his son-in-law and that group, if there was not some extreme coincidence that just before the guillotine fell, he went through $39 million and got out scot-free.

Mr. TEW. That raises some very interesting questions, sir.

In the report that I have filed with your committee, I have detailed what I called "certain insider transactions."

Mr. BROOKS. I glanced at those where he apparently borrowed money at less than market and made a good deal of profit.

Mr. TEW. It's more grevious than that. What we did for purposes of determining whether this company should be put into bankruptcy, where we would have greater statutory preference powers, we went back and analyzed every trade in 1984 and 1985 and it only took that little window to see if we were losing any preferences.

In that window we picked up an $80 million T-bill arbitrage of Mr. Warner where he received a 2½-percent interest on his deal.

Essentially and we did it on a little PC computer and it's in your report. At the same time we picked up that all the other insiders and, by the way there were only three individuals who had accounts at this fund; Mr. Baumgard, who was a previous CEO of Home State was one of the favored few; Mr. Warner and Mr. Arky. We found that suspicious from the beginning. Why were only three people allowed to have personal accounts.

Mr. BROOKS. Arky was the son-in-law of Mr. Warner?

Mr. TEW. Yes, sir.

Mr. BROOKS. Chief counsel of the firm that handled their legal matters?

Mr. TEW. Yes, sir.

Mr. BROOKS. That's kind of nice. It makes you feel cozy and comfortable.

Mr. TEW. A family affair. When we looked at what had happened in the 90-day period prior to the fraud being uncovered, we found that all of them closed their trades out and it wasn't even that they closed their trades out, Mr. Brooks, they closed them out at their historic cost, not at market.

Mr. Baumgard and Mr. Arky, their trail ran back to 1980. In June 1980, they were allowed to purchase, for $20,000 a $1 million T-bill and sit with it for 4 years, without a margin call, paying only the interest that was on the coupon, which was 9¾ percent in a period of escalating interest rates and at the end of 4½ years, when the whistle blew and the fraud was about to be uncovered, rather than marking those T-bills to the market, they gave them back their original cost to cash in.

Now I have done an analysis, with Mr. Holtz' assistance, to show that just on those two individuals, had they treated the firm on an arms-length basis, that they would have owed the firm, Mr. Arky's case, approximately $250,000, assuming that he was at a normal interest rate for a 4-year play, and Mr. Baumgard $800,000.

Now, I have been threatened by a law suit by Mr. Arky, as he threatened these gentlemen, for libeling him and making these statements.

Mr. BROOKS. He would probably threaten me if he knew what I would like to do with him.

Mr. TEW. And I was advised, Mr. Arky came to my office and said that he wanted to give me information because he heard that I was going to bring suit as the receiver and indicated to me that he had a series of the transactions which show that he had been a loser, if you total all his trading and we're still waiting for those documents.

I will tell you that we're going to trace every trade that those individuals had from the day the doors opened up until March 4 when I was put in as receiver.

Mr. BROOKS. And when you finish that, I am sure that you will furnish it to us.

Mr. TEW. Yes, sir.

Mr. BROOKS. We will send that to the bar association and maybe they can disbar him and he won't be suing you in person, he'll have to hire a lawyer.

Mr. TEW. We think that's critical because there are a lot of stories that haven't been told here.

You understand our analysis was in 29 days to look at about 1 year and 3 months and so we were able to do only a few limited number of things, but in the next month, we're going to take every trade of Home State, Baumgard, Arky, and Warner and put it on a little PC and play it out so we can see and then we're going to mark the market what a normal arms-length trade would have been had you been a customer of Merrill Lynch, what interest would you have been charged, what would have been the normal customary rate and see what unjust enrichment these fellows received and that amount of money I will report to the Congress.

Mr. BROOKS. One more question. Have you considered the authority by which these cities and municipalities and savings and loans disbursed these moneys to Florida?

When they send a million dollars at a whack, over a period of time, did they check the authority by which a bank released that money? Do you have signed statements, do you have one or two signatures or does some individual just say, hey, Nell, you can send a million bucks to Florida on the phone.

Mr. TEW. It's about that crude. I think that, unfortunately——

Mr. BROOKS. You got a legal disbursement.

Mr. TEW. No. Probably many of these municipalities violated their own charters because essentially a term repo is a financing device.

Mr. BROOKS. But when they violated them, does that mean that the banks sent that money without proper authority to Florida?

Mr. TEW. No. What they did wrong, sir, is they should have had their bank instructed to pay against receipt of securities where their bank would have put the money on the wire when they had confirmed physical possession of the securities. That's the normal conservative way to practice.

Mr. BROOKS. But how would you disburse money without the proper signatures?

Mr. TEW. Well again, I don't know all municipalities involved.

Mr. BROOKS. But they would all differ, you know, various regulations and rules. Some of them have to have two signatures, some of them three or some of them, I guess, she just calls down there and says, hey, Nell, unload another million.

Mr. TEW. I am sure that in certain instances, it worked just that way.

Mr. BROOKS. But that might violate the agreement and might not be a justification for a bank to disburse that money.

Mr. TEW. I think, again, I don't find many banks did anything wrong here. I think that many times city managers, not knowing the rules of the game, just wired money down to good ole ESM, didn't wait until their custodial bank had possession before they paid, and I think there is a lot of unwitting—and remember, we have an analysis since 1980 of every 6 months who was in and out and I think the lucky ones, when the music stopped, had shares and the unlucky ones were left standing.

Mr. BROOKS. Thank you, Mr. Chairman.

Mr. BARNARD. Thank you, Mr. Chairman.

Mr. Tew, we appreciate very much this very fine testimony and we have got to go vote, so we'll adjourn this particular panel at this particular time.

Mr. KINDNESS. Mr. Chairman, I have been sitting here since 8:30 this morning waiting to ask Mr. Tew a question.

Mr. BARNARD. Mr. Kindness, we've got another panel following, if you would like to stay for the last panel.

Mr. KINDNESS. OK, fine. Most of us want to know the name of that $78,000 dog that Mrs. Ewton bought.

Mr. TEW. I don't know the name or the type.

Mr. BARNARD. The committee will recess until the vote is over and we'll be back in about 10 minutes.

Thank you, Mr. Tew and Mr. Holtz.

[The prepared statement of Mr. Tew follows:]

in the
United States District Court
Southern District of Florida
Fort Lauderdale Division

CASE NO. 85-6190-Civ-GONZALEZ

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

ESM GROUP, INC.,
ESM GOVERNMENT SECURITIES, INC.,
ESM SECURITIES, INC., and
ESM FINANCIAL GROUP, INC.,

Defendants.

REPORT ON THE CONDITION OF THE ESM COMPANIES BY THOMAS TEW, RECEIVER

April 2, 1985

REPORT ON THE CONDITION OF
THE ESM COMPANIES
BY
THOMAS TEW, RECEIVER

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INTRODUCTION

On March 4, 1985, the United States District Court for the Southern District of Florida entered a Final Judgment of Permanent Injunction against, and appointed Thomas Tew as equity receiver over, ESM GROUP, INC., ESM GOVERNMENT SECURITIES, INC., ESM SECURITIES, INC., and ESM FINANCIAL GROUP, INC. (collectively referred to as the "ESM Companies" or "ESM" and individually referred to as "Group," "Government," "Securities," and "Financial," respectively). This report of the Receiver's findings is submitted in compliance with the provisions of the Final Judgment of Permanent Injunction requiring the Receiver to file his report with the Court not later than April 3, 1985.

The primary objective which this Receiver sought to attain during the 29-day period beginning March 4, 1985 and ending April 1, 1985 was (i) to identify, locate and secure by physical possession and judicial process the assets and records of the ESM Companies, and the officers, directors and insiders of the ESM Companies; and (ii) to identify and locate ESM's creditors and customers and assist them in understanding the nature of the fraud which had been perpetrated upon them and the extent of their losses. Since a major asset of the ESM Companies includes claims against parties whose actions have

caused harm to the ESM Companies, substantial time was devoted to identifying those claims and developing legal theories of recovery. Finally, due to the enormous impact of the demise of ESM upon numerous segments of many communities, a substantial portion of the Receiver's time, and the time of his accountants and attorneys, was spent assisting federal and state authorities in the fulfillment of their investigative duties.

This report is divided into five sections. The first is a chronology of the receivership to date. The second describes the history of the ESM Companies, their operations, and certain "insider" transactions. The third analyzes the fraud and its accounting cover-up, the failure of the confirmation process and actions of clearing brokers. The fourth describes the events leading to Government's involuntary bankruptcy and the Receiver's appointment as interim trustee. The fifth describes (with accompanying schedules) how the assets of the ESM Companies were marshalled and are now being administered.

CHRONOLOGY OF THE RECEIVERSHIP

Thursday, February 28, 1985

In the late afternoon of February 28, 1985, the Receiver was contacted by William P. Cagney, a Miami attorney, who requested that the Receiver meet that evening with him and George Mead, the executive vice president of Government. As a result of the meeting, the Receiver was asked to meet with

David J. Schiebel, chief executive officer of Home State Savings Bank ("Home State") and Donald M. Collins, Jr., counsel for Home State, on Friday morning, March 1, 1985. Schiebel and Collins had met with Mead on February 28 and had asked for a follow-up meeting on March 1 with the officers of Government and/or Alexander Grant & Company ("Grant"), Government's auditors.

Friday, March 1, 1985

On Friday, March 1, 1985, the Receiver's law firm, Finley, Kumble, Wagner, Heine, Underberg, Manley & Casey ("Finley, Kumble") was retained by Government's president, Nicholas Wallace, and Government's executive vice president, George Mead, the two remaining directors of Government, to conduct an investigation into the financial condition of Government and was paid a $500,000 retainer.

At approximately 11:00 A.M., the Receiver and Cagney met with Schiebel and Collins, who presented them with certain schedules of securities and an audited statement of financial condition of Government at December 31, 1984, which had been prepared by Grant. The statement had been delivered to ESM by Grant on February 28, 1985, with a copy being given on that date by ESM to Home State. Collins indicated that Grant was now demanding the return of all copies of the statement and had advised him that the statement "may not be relied upon." A

decision was made by all present to retain an accounting firm to conduct an immediate analysis of ESM's books.

The Receiver suggested that a call be placed to Laurie S. Holtz, CPA, senior partner of Holtz & Company, asking Holtz to come immediately to the Receiver's office to see if Holtz's firm was available to conduct an emergency investigation on Saturday, March 2 into ESM's financial condition.

Holtz arrived at the Receiver's office at approximately 3:00 P.M. It was established that Holtz did not represent any known customers of Government and had familiarity with investments in government securities. A decision was made to retain Holtz's firm to conduct such emergency investigation.

On Friday afternoon, the Receiver spoke with James Strothers, in-house counsel for Grant, and requested Grant's assistance in ascertaining the location of customers' securities and other financial matters. Late Friday evening, the Receiver again called Strothers and was advised that it was Grant's intention to assist the Receiver in the weekend investigation. The Receiver was to hear to the contrary, however, from Richard E. Brodsky, Grant's Miami counsel, at approximately 11:30 A.M. Saturday.

Holtz was given a copy of the December 31, 1984 audited statement of financial condition of Government and certain schedules of securities which had been sold to ESM by Home State in reverse repurchase transactions. He was also given a

detailed schedule of municipalities to whom these securities were supposed to have been resold by ESM in term repurchase transactions.

It was apparent to all present that there were serious financial problems at Government. It was the objective of those assembled to determine over the weekend how serious these problems were and if they affected Government's ability to remain in business.

Saturday, March 2, 1985

On Saturday, March 2, at approximately 9:30 A.M., seven partners of Holtz & Company, Collins, Cagney and the Receiver entered the offices of the ESM Companies at 1512 East Broward Boulevard, Fort Lauderdale, Florida. They were met by certain ESM employees who had been asked by Mead to be present to assist in locating books and other records. Holtz's firm was divided into two teams, a balance-sheet team and a profit-and-loss team. They requested general ledgers, other books of account, tax returns and internally prepared reports of Group, Government, Securities and Financial, which were promptly located by ESM's employees and turned over to them. Simultaneously, a draft of the floor plan of the premises was prepared identifying the occupant of each office and desk and the occupant's function. An inventory of the physical location of files was also started. This identification allowed the

Receiver to locate essential records and establish security procedures.

At approximately noon, Holtz and his partners advised the Receiver that, after preparing a consolidated trial balance for Group and its subsidiaries (Government, Securities and ESM Aviation, Inc.), as well as for an affiliated company (Financial), they had concluded that the ESM Companies were hopelessly insolvent, with a combined negative net worth of approximately $200,000,000. The Receiver immediately ordered that all books and records of ESM be secured and had them moved into three interior offices. Locks were changed and 24-hour armed security was arranged for the premises and for warehouses where other accounting records of ESM were located.

Throughout Saturday, further review, analysis and study of accounting records were continued. During the afternoon, schedules were prepared at December 31, 1984 and February 15, 1985 of the customer amounts borrowed from Government and loaned to Government (reverse repos and term repos, respectively). These runs indicated that, as of December 31, 1984, Government had borrowed from customers approximately $1.6 billion and loaned to customers approximately $1.3 billion. Later, a computer run captioned "CUSIP Report" further confirmed customer by customer that borrowings exceeded lendings by more than $300,000,000.

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Sunday, March 3, 1985

During Sunday, further efforts were made to review and study the various records of the ESM Companies and ascertain what information was available as to customers, bank accounts, cash transactions, loan accounts with principals, inter-company and affiliated transactions, tax returns and other data which would be needed to marshall and identify the assets and liabilities of the ESM Companies.

Throughout Sunday, the Receiver attempted to locate counsel for American Savings & Loan Association of Florida ("American"), since it was evident from ESM's records that American had a substantial position with ESM and would lose approximately $60 million. That afternoon, the Receiver reached Richard M. Spector, an attorney at the firm of Broad & Cassel, general counsel for American. The Receiver advised Spector of the discoveries at ESM and invited American to send its auditors and attorneys to ESM's offices so that American's records could be matched against those records found on the premises of ESM. At approximately 7:00 P.M., Morris Broad and partners of the certified public accounting firm of Deloitte, Haskins & Sells came to ESM's offices to review the information that was available.

Finley, Kumble and Holtz & Company also began to identify ESM customers' addresses and phone numbers, in order to advise them that ESM would not open for business on Monday, March 4.

Preliminary information indicated that Bradford Securities Processing Service, Inc. ("Bradford") and Security Pacific Clearing & Services Corp. ("Security Pacific") were the custodians for securities held for customers who had purchased securities from ESM in term repo transactions, but had not given specific instructions as to where their securities should be delivered. Early documents, misidentified as position runs, showed many hundreds of millions of dollars of securities in the possession of Bradford. This, unfortunately, would prove to be false, as what was initially identified as a position run was only an accounting match-up that did not reflect the true location of the securities.

On Sunday evening, on the advice of the Receiver, Government authorized the Receiver to advise the Securities and Exchange Commission ("SEC") and the Florida Division of Securities of the fraud and the fact that Government would not open for business on Monday. At approximately 10:00 P.M., telegrams were sent to all known customers of Government, stating that Government would not open for business on Monday.

Monday, March 4, 1985

On Monday morning, the Receiver released the following press release:

> At 8:00 A.M. on Monday, March 4, 1985, E.S.M. Government Securities, Inc. (ESM), a Fort Lauderdale based government securities dealer, announced that on the morning of

> March 1, 1985, Alexander Grant & Company advised ESM that ESM's Statement of Financial Condition and Auditors' Report thereon, released to ESM by Alexander Grant & Company on February 28, 1985, "may not be relied upon."
>
> On March 1, 1985, ESM retained special counsel to conduct an investigation of its financial and business affairs. The results of such investigation conducted over the weekend of March 2 and 3 by special counsel and auditors retained by special counsel reveal that ESM is unable to meet its financial obligations as they mature to its customers. ESM has terminated operations on the advice of its special counsel and will not open for business on Monday, March 4, 1985.

At 8:30 A.M., the Receiver contacted the SEC and spoke to Charles Hochmuth, a securities compliance examiner at the Miami office of the SEC, advised him of the close of Government, and requested that Charles Harper, Associate Regional Administrator of the Miami Branch of the SEC, contact him immediately.

At approximately 10:00 A.M., investigators and attorneys from the SEC convened in the Receiver's office and were briefed on the weekend's findings. Three investigators were dispatched to Mr. Holtz's office to review the accountants' findings. The SEC attorneys then went back to their office to confer with others as to what action would be taken.

At approximately 10:30 A.M., the Receiver contacted E.C. ("Chris") Anderson, Director of the Florida Division of Securities, and advised him of the events unfolding at ESM. Anderson replied that he would have investigators on the scene Tuesday morning to assist the Receiver.

At approximately noon, the SEC attorneys advised the Receiver that they intended to seek immediate injunctive relief in the United States District Court for the Southern District of Florida and discussed his possible appointment as receiver.

At approximately 4:00 P.M., SEC attorneys and Messrs. Mead, Wallace, and Cagney convened at the Receiver's office. The Commission's proposed complaint for injunctive and other equitable relief was reviewed and a consent to the injunctive relief was executed by Mead and Wallace on behalf of the ESM Companies. After consultation with Cagney, Mead and Wallace consented to Mr. Tew serving either as equity receiver or trustee of the ESM Companies and to Finley, Kumble serving as his counsel, if he was appointed to serve in either capacity.

A few minutes before 5:00 P.M., the SEC filed its complaint for injunctive and other relief in the United States District Court for the Southern District of Florida. At 5:30 P.M., an emergency hearing was obtained before the Honorable Judge William M. Hoeveler who, at approximately 6:30 P.M., entered a Final Judgment of Permanent Injunction and, upon the request of the SEC and supported by Home State, appointed Tew as equity receiver for the ESM Companies. At the hearing, Tew advised Judge Hoeveler of the $500,000 retainer previously paid to his firm by ESM and advised the Court that it would be promptly returned.

Sometime Monday afternoon, Gerald Lewis, Comptroller of the State of Florida and Head of the Department of Banking and

Finance, entered an Immediate Final Order to Cease and Desist and an Emergency Final Order of Suspension of Securities License against Government.

On Monday evening, the following telegram was sent to all known ESM customers, custodial banks and persons and firms suspected of holding assets of the ESM Companies, advising them of the Judge's injunction and freeze order:

> Please be advised that on March 4, 1985, at 6:30 P.M. EST Judge William M. Hoeveler, U.S. District Court Judge for the Southern District of Florida, upon application by the United States Securities and Exchange Commission, entered a final judgment of permanent injunction against ESM Group, Inc., ESM Government Securities, Inc., ESM Securities, Inc. and ESM Financial Group, Inc. (the ESM Companies), permanently enjoining present and future violations of the federal securities law. Judge Hoeveler appointed Miami attorney Thomas Tew as equity receiver for the ESM Companies and ordered that Mr. Tew take custody and control of all of their assets. Judge Hoeveler ordered that all assets of the ESM Companies are immediately frozen, including all securities, clearing deposits, securities in transit, securities accounts, commodities accounts, accounts receivable, securities held for the benefit of others, securities accounts held for others, repurchase agreements, and reverse repurchase agreements.
>
> Judge Hoeveler further ordered that any transactions in progress are halted and frozen, and no further action shall be taken on them, and the status quo shall be maintained on them until further order of the Court.
>
> A copy of the Order is being mailed to you.

> Accordingly, you are directed to fully comply with Judge Hoeveler's order in connection with all securities presently in your possession or control.
>
> Thomas Tew, Receiver
> for the ESM Companies

Early Monday morning, American also issued a press release indicating it expected substantial losses from its dealings with Government. American's release, together with Government's release and telegrams, triggered the immediate liquidation of approximately $900,000,000 of securities by brokerage firms holding open contracts with Government. In addition, Bradford and Security Pacific liquidated $41,000,000 and $9,000,000, respectively, of securities in their possession to pay off loans allegedly owed to them by Government. See "ASSET RECOVERY."

Tuesday, March 5, 1985 through Friday, March 15, 1985

During this eleven-day period, the Receiver and his accountants and attorneys investigated and studied the books and records of the ESM Companies to determine what had occurred. The work accomplished included:

1. Preparing from ESM's books and records consolidated and combined schedules of income and expense for the periods 1978 through 1984.

2. Reviewing and analyzing the tax returns of the ESM Companies.

3. Conducting an intensive search of the records to determine the assets and liabilities of the ESM Companies and the principals thereof and taking possession of, or imposing constructive trusts over, such assets or enjoining their transfer or sale.

4. Compiling information regarding open term repo and reverse repo positions.

5. Closing Government's Memphis, Tennessee office and bringing certain records to Florida.

6. Analyzing what had been done by Government's auditor, Grant, in order to obtain factual information necessary for the preparation of the Receiver's lawsuit against Grant.

7. Meeting with employees of the ESM Companies to ascertain further information about the assets, records and liabilities of the ESM Companies and their principals and to determine which key clerical employees were knowledgeable about the ESM Companies' records and therefore could assist the Receiver in his ongoing investigation.

8. Reviewing the records of the ESM Companies to ascertain the compensation paid, and loans made, to the principals of the ESM Companies.

9. Obtaining court authorization for, and effecting, the closing of open securities transactions.

10. Obtaining from Bradford and Security Pacific records showing what securities they were holding for Government's customers and what securities had been liquidated.

On Wednesday, March 6, the Receiver's attorney filed certified copies of the Court's Final Judgment of Permanent Injunction in every federal district court (93) in the United States in order to grant the Receiver jurisdiction over any and all of ESM's assets, wherever located. The accountants also commenced tracing all wire transfers and cash disbursements in an attempt to freeze any disbursements of the ESM Companies' assets.

On Friday, March 8, Judge Jose A. Gonzalez, the United States District Judge to whom this case was permanently assigned, granted the Receiver the authority (i) to permit customers, upon certain conditions, to liquidate securities in their possession; (ii) to establish constructive trusts over all of the assets of the principal officers and directors of the ESM Companies; and (iii) to amend the Final Judgment to expand the Receiver's authority to obtain immediate discovery and take sworn testimony.

During this investigatory period, the Receiver, his accountants and counsel spent a significant amount of time furnishing federal, state and self-regulatory authorities with information relative to the demise of the ESM Companies. These authorities included the Securities and Exchange Commission, the National Association of Securities Dealers, Inc., the Federal Reserve Bank of New York, the Florida Division of Securities, the Federal Bureau of Investigation and the United States Attorney.

The Receiver, his counsel and accountants sought and obtained from the customers of Government responses as to their trading positions with Government. This audit confirmation process has permitted the Receiver to confirm information contained in Government's books and records.

March 18, 1985 to March 22, 1985

At the March 4, 1985 hearing before Judge Hoeveler, the Receiver advised the Court that he would evaluate whether the ESM Companies should be placed in bankruptcy in order to obtain the broad statutory powers available to trustees of bankrupt entities. Accordingly, once the situation at the ESM Companies was stabilized, the Receiver's accountants and counsel, with representatives of various creditors, began an analysis of whether and when a filing in the Bankruptcy Court was appropriate.

On March 18, 1985, the Receiver and his accountants met with certain officers of American, American's special accountants, Oppenheim, Appel & Dixon, and the attorney for the Conservator of Home State to further explore the issue of whether a bankruptcy filing was in the best interest of ESM's creditors.

After that meeting, Holtz was directed to work with American's special accountants to complete a detailed trade-by-trade analysis, going back three months for general

creditors of Government and one year for those persons who were identified as potential "insiders" of Government. The information sought was necessary to determine whether certain preferences might be lost if a bankruptcy filing were delayed.

Part of this analysis identified four accounts (American's, Marvin L. Warner's, Stephen W. Arky's and Burton Bongard's) where transactions were closed during 1984 and 1985 prior to their maturity. These trades were analyzed for presentation to ESM's creditors.

On Friday, March 22, a six-hour meeting was held between the Receiver, his counsel and auditors, and the ESM Companies' creditors and their counsel to discuss, among other things, the timing of a bankruptcy filing and, if filed, under which bankruptcy chapter to proceed. The main concern of all counsel present was the effect of the recent amendments to the Bankruptcy Code on the closing of certain transactions by Government's customers, both during the recent 90-day period and for the prior year with respect to a trustee's ability to avoid certain preferences. Holtz & Company presented a detailed analysis of all transactions during the applicable preference periods, and a concensus developed among all creditors who elected to be heard on such issues that Government be placed in a Chapter 7 proceeding as soon as possible.

On Sunday, March 24, and Monday, March 25, the Receiver, his counsel and counsel for a group of the principal creditors of Government prepared necessary pleadings (i) to obtain relief from the Final Judgment of Permanent Injunction to permit Government to be placed in bankruptcy; (ii) to withdraw the automatic reference to the Bankruptcy Court (allowing Judge Gonzalez, who was already familiar with the case, to preside over Government's bankruptcy); and (iii) to appoint the Receiver as interim trustee. In addition, a motion was filed by the SEC supporting the above-described motions.

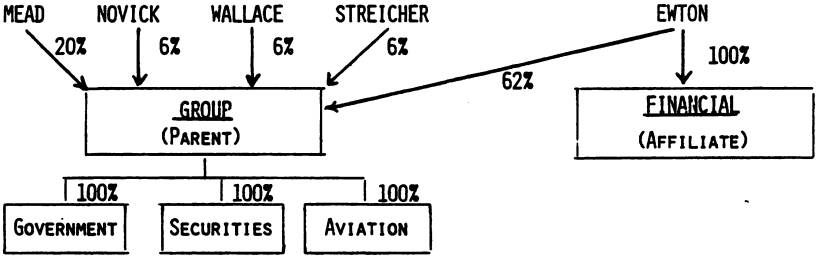
On Tuesday, March 26, 1984, at approximately 1:00 P.M., Judge James C. Paine, acting in Judge Gonzalez's absence from the district, granted the Receiver's motion for relief from the Final Judgment of Permanent Injunction, and at approximately 4:00 P.M., attorneys for certain of Goverment's unsecured creditors filed a petition placing Government in bankruptcy.

On Wednesday morning, March 27, 1985, Nicholas B. Wallace, as president of Government, consented to Government being adjudicated a bankrupt. At 2:00 P.M., Judge Gonzalez entered an order withdrawing the automatic reference to the Bankruptcy Court and appointed this Receiver as interim trustee for Government.

CORPORATE HISTORY OF ESM

Stock Ownership

As of March 4, 1985, the corporate structure of the ESM Companies is believed to have been as follows:



Officers & Directors

ESM Group, Inc. ("Group") was formed on May 31, 1977 to be a holding company for ESM Government Securities, Inc. ("Government"), which was formed on September 26, 1975, and ESM Securities, Inc. ("Securities"), which was formed on October 13, 1975. During 1984, the officers and directors of Group are believed to have been:

Name	Positions
Ronnie R. Ewton	Chairman of the Board[1/]
Alan R. Novick	President, Treasurer and a Director[2/]
George G. Mead	Executive Vice President and a Director
Nicholas B. Wallace	Senior Vice President, Secretary and a Director[3/]
Charles W. Streicher	Vice President and a Director
Thomas F. Saunders	Comptroller

1/ Became President after Alan R. Novick's death; resigned February 11, 1985.

2/ Until his death on November 23, 1984.

3/ Became President after Ronnie R. Ewton's resignation.

During 1984, the officers and directors of Government are believed to have been:

Name	Positions
Ronnie R. Ewton	Chairman of the Board[1/]
Nicholas B. Wallace	President, Secretary and a Director
Alan R. Novick	Vice President and a Director[2/]
George G. Mead	Executive Vice President, Treasurer and a Director
Charles W. Streicher	Vice President
Timothy R. Murphy	Vice President (Finance)
William J. Collier	Vice President (Trading)
Ron Pellerito	Vice President (Sales)
Thomas F. Saunders	Vice President and Comptroller
Stanley Wolfe	Vice President (Clearing)

During 1984, the officers and directors of Securities are believed to have been:-

Name	Positions
Ronnie R. Ewton	Chairman of the Board[1/]
George G. Mead	President, Treasurer and a Director
Alan R. Novick	Vice President and a Director[2/]
Nicholas B. Wallace	Vice President, Secretary and a Director

1/ Resigned February 11, 1985.

2/ Until his death on November 23, 1984.

Securities was a brokerage firm licensed by the SEC and the National Association of Securities Dealers, Inc. The Receiver believes that Securities has been inactive since 1981.

ESM Financial Group, Inc. ("Financial") was formed on February 12, 1976. During 1984, the officers and directors are believed to have been:

Name	Positions
Ronnie R. Ewton	President, Secretary and a Director[1]
Alan R. Novick	Treasurer and a Director[1]
George G. Mead	Vice President and a Director
Nicholas B. Wallace	Vice President and a Director

1/ Resigned February 11, 1985.

2/ Until his death on November 23, 1984.

Management Remuneration

The following tables set forth the compensation paid to the officers and directors of the ESM Companies for the calendar years 1985 through 1980.

1985

	Salary and Commissions	Bonus	Insurance	Total Compensation
Ronnie R. Ewton[1/]	$ ---	$ ---	---	$ ---
Nicholas B. Wallace	50,000.00	250,000.00	---	300,000.00
Alan R. Novick[2/]	---	---	---	---
George G. Mead	50,000.00	250,000.00	---	300,000.00
Charles W. Streicher	50,000.00	250,000.00	---	300,000.00
William J. Collier	189,038.54	225,000.00	---	414,038.54
Timothy R. Murphy	37,500.00	225,000.00	---	262,500.00
Ronald Pellerito	305,189.97	100,000.00	---	405,189.97
Thomas F. Saunders	11,250.00	---	---	11,250.00
	$692,978.51	$1,300,000.00	$0	$1,992,978.51

1/ Borrowed $710,000 from ESM in 1985.

2/ Deceased November 23, 1984. His estate, however, received $1,600,000 from ESM on February 28, 1985.

1984

	Salary and Commissions	Bonus	Insurance	Total Compensation
Ronnie R. Ewton	$16,427.45	$250,000	$47,316	$313,743.45
Nicholas B. Wallace	300,000.00	250,000	13,116	563,116.00
Alan B. Novick	366,666.74	1,005,000	12,518	1,384,184.74
George G. Mead	300,000.00	250,000	17,496	567,496.00
Charles W. Streicher	300,000.00	250,000	9,792	559,792.00
William J. Collier	494,408.35	225,000	2,208	721,616.35
Timothy R. Murphy	100,000.08	150,000	504	250,504.08
Ronald Pellerito	629,392.92	100,000	2,328	731,720.92
Thomas F. Saunders	40,000.08	10,000	248	50,248.08
	$2,546,895.62	$2,490,000	$105,526	$5,142,421.62

1983

	Salary and Commissions	Bonus	Insurance	Total Compensation
Ronnie R. Ewton	$416,666.69	$500,000	$47,316	$963,982.69
Nicholas B. Wallace	253,333.34	250,000	13,116	516,449.34
Alan R. Novick	386,666.69	500,000	11,214	897,880.69
George G. Mead	240,000.00	300,000	17,496	557,498.00
Charles W. Streicher	180,000.00	200,000	10,052	390,052.00
William J. Collier	337,224.87	200,000	2,208	539,432.87
Timothy R. Murphy	75,000.00	100,000	---	175,000.00
Ronald Pellerito	287,174.90	---	2,328	289,502.90
Thomas F. Saunders	26,500.00	10,000	---	36,500.00
	$2,202,566.49	$2,060,000	$103,730	$4,366,296.49

1982

	Salary and Commissions	Bonus	Insurance	Total Compensation
Ronnie R. Ewton	$300,000.00	$250,000.00	$39,451.00	$589,451.00
Nicholas B. Wallace	240,000.00	200,000.00	10,854.00	450,854.00
Alan R. Novick	270,000.00	250,000.00	6,895.50	526,895.50
George G. Mead	200,000.04	150,000.00	14,394.00	364,394.04
Charles W. Streicher	143,000.00	30,000.00	8,420.00	181,420.00
William J. Collier	420,358.82	100,000.00	1,656.00	522,014.82
Timothy R. Murphy	57,500.01	25,000.00	---	82,500.01
Ronald Pellerito	326,077.38	---	1,558.00	327,635.38
Thomas F. Saunders	23,500.00	---	---	23,500.00
	$1,980,436.25	$1,005,000.00	$83,228.50	$3,068,664.75

1981

	Salary and Commissions	Bonus	Insurance	Total Compensation
Ronnie R. Ewton	$210,000.00	$ ---	---	$210,000.00
Nicholas B. Wallace	150,000.00	---	---	150,000.00
Alan R. Novick	180,000.00	---	---	180,000.00
George G. Mead	150,000.00	---	---	150,000.00
Charles W. Streicher	117,000.00	50,000.00	---	167,000.00
William J. Collier[1/]	113,253.36	---	---	113,253.36
Timothy R. Murphy	46,875.03	60,000.00	---	106,875.03
Ronald Pellerito	143,348.35	---	---	143,348.35
Thomas F. Saunders	18,537.11	---	---	18,537.11
	$1,129,013.85	$110,000.00	$0	$1,239,013.85

1/ Started April 1981.

1980

	Salary and Commissions	Bonus	Insurance	Total Compensation
Ronnie R. Ewton	$156,000.00	$400,000.00	---	$556,000.00
Nicholas B. Wallace	120,000.00	200,000.00	---	320,000.00
Alan R. Novick	135,000.00	200,000.00	---	335,000.00
George B. Mead	125,000.04	200,000.00	---	325,000.04
Charles W. Streicher	172,862.16	50,000.00	---	222,862.16
Timothy R. Murphy	32,250.00	7,500.00	---	39,750.00
Ronald Pellerito[1/]	1,254.40	---	---	1,254.40
Thomas F. Saunders	14,550.12	1,500.00	---	16,050.12
	$756,916.68	$1,059,000.00	$0	$1,815,916.72

1/ Started December 1980.

Loans to Officers and Directors

The following loans are believed by the Receiver to be owed by the officers and directors of the ESM Companies, or their affiliates, to the ESM Companies:

	Loan Amount 3/1/85	Accrued Interest Rec. 1/31/85	Total Loan & Int. at 9%
Ronnie R. Ewton "B"1/	$1,139,647.44	$1,012,675.60	
Ronnie R. Ewton "P"	8,482,333.49	2,432,551.94	
Ronnie R. Ewton "E/C"	4,730,486.50	2,379,015.76	
Ronnie R. Ewton "E/G"	1,193,090.73	590,521.91	
	15,545,558.16	6,414,765.21	$21,960,323.37
George G. Mead "E/C"	1,156,340.62	583,603.43	
George G. Mead "E/G"	16,264.71	3,332.44	
George G. Mead "P"	1,470,076.66	246,249.87	
	2,642,681.99	834,185.74	3,476,867.73
Nicholas B. Wallace "E/C"	1,156,340.62	583,603.43	
Nicholas B. Wallace "E/G"	321,372.58	159,575.26	
Nicholas B. Wallace "P"	3,402,393.86	981,168.54	
	4,880,107.06	1,724,347.23	6,604,454.29
Colee Hammock Building2/	155,000.00	70,922.28	225,922.28
Charles W. Streicher "P"	579,284.85	126,927.81	706,212.66
Kenneth R. Hill "P"	25,000.00	13,814.55	38,264.27
Robert C. Seneca "P"	232,884.35	148,379.92	381,264.27
Alan R. Novick "E/C"	1,156,340.62	574,641.79	
Alan R. Novick "E/G"	321,372.58	157,084.63	
Alan R. Novick "P"	581,500.00	1,540,325.97	
	$2,059,213.20	$2,272,052.39	4,331,265.59
			$37,725,124.74

1/ ESM's records indicate that "B" and "P" refer to loans for personal use and "E/C" and "E/G" refer to loans for investment. The Receiver believes that "E/C" refers to Energy/Coal and "E/G" refers to Energy/Gas. The investigation of these investments could not be completed before the filing date of this report.

2/ Appears to be the responsibility of Ronnie R. Ewton.

GOVERNMENT'S OPERATIONS

Government, the ESM company active in government securities trading, engaged principally in the following types of transactions:

(1) Term repurchase agreements (lending to Government);

(2) Reverse repurchase agreements (borrowing from Government); and

(3) Buying and selling of government securities, including forward purchase and sale commitments.

A term repurchase agreement, although structured as a "buy" and "resale" of a security, is actually a method of short-term lending. Customers with excess funds agree to loan money to a company such as Government, such loan to be collateralized with various types of government securities. The customer expects the securities to be held for his benefit for the term of the loan. These agreements are generally renewable for such period as the customer ("buyer") has excess funds. To evidence his collateral, a "buy" confirmation is utilized. When the loan period expires, a "sell" confirmation evidences the termination and payment.

A reverse repurchase agreement, or "reverse repo" is essentially the reverse side of a term repo. In a "reverse repo," the customer, which is often a financial institution, "sells" a quantity of securities to a company such as

Government, which securities the customer ("seller") agrees to buy back at a later date. The customer thus borrows cash.

Appendix A to this report contains a schedule of term repos entered into by Government between July 1982 and December 1984. Appendix B contains a schedule of reverse repos entered into by Government between June 1980 and March 1, 1985. Below is a list of term repos outstanding at March 1, 1985, which list also reflects whether the participants in such repos have been able to locate their securities.

The Receiver can only speculate as to what techniques were used to lure customers to a small, relatively unknown, unregulated government securities firm in Fort Lauderdale, Florida over a period of in excess of seven years. It is clear, however, that billions of dollars were handled by Government in literally thousands of transactions. The Receiver expects that this issue ultimately will be looked into by appropriate government enforcement agencies.

To illustrate the special inducements to be derived from many of the reverse repo transactions between customers and Government, it is necessary to understand that many of these transactions were designed to result in a guaranteed profit to the customer using collateral to buy discount treasury bills on a highly leveraged basis. By so doing, the purchaser would accrue a profit after payment of the fixed interest cost. The following is an example of a $100,000,000 face amount T-Bill transaction between Government and American Savings.

E.S.M. GOVERNMENT SECURITIES, INC.

BILL ARBITRAGE

Settlement Date: 05-24-84

Purchase: 150mm U.S.T. Bills due 05-16-85 @ 10.65 = 89.43875
(357 days)

Collateral: 15.9mm U.S.T. Notes 9.375 05-15-86 @ 94.50 = $15,025,500.00

Cost @ 10.65: $134,158,125.00

Maturity Value:	$150,000,000.00
Cost of Bills:	134,158,125.00
Discount Income:	$ 15,841,875.00

Cost:	$134,158,125.00
Margin:	15,025,500.00
Repo:	$119,132,625.00 X 11.30 ÷ 360 X 357 = $13,349,303.40

Discount Income:	$ 15,841,875.00
Repo Expense:	13,349,803.40
Income:	$ 2,492,071.60

Collateral R.P.
Expense: $ 15,025,500.00 X 11.30 ÷ 360 X 357 = $ 1,683,732.49

Gross Income:	$ 2,492,071.60
Repo Expense:	1,683,732.49
Net Income:	$ 808,339.11

$ 808,339.11 / 357 X 360 = 8.405

$ 15,025,500.00

In connection with its operations, Government utilized the services of Bradford and Security Pacific to act as clearing agent in connection with its securities trades, as well as for data processing services. In a typical transaction, after a trade was made, an ESM Government Securities, Inc. confirmation ticket would be prepared in order to reflect for the customer a transfer of funds against delivery of securities, or the reverse. In order to perfect its security interest in its securities, the party lending to Government had the right to take possession and control of the securities. In many cases, the securities remained at Bradford or Security Pacific, but customers mistakenly believed those securities were segregated and held for their benefit when in fact they were not.

At its Memphis office, Government was also involved in the packaging of mortgages for purchase in the secondary market, for which Government received a brokerage fee.

* * * * *

The following table sets forth term repo holders at March 1, 1985, and whether such holders have been able to locate their securities:

	March 1, 1985	Collateral In Possession or Liquidated
Arizona Retirement System	$210,000,000	Yes
Bank of the South	42,135,000	Yes
Chelan County, WA	630,000	No
City of Allentown, PA	510,000	No
City of Beaumont, TX	20,000,000	No
City of Birmingham, MI	300,000	No
City of Burnsville, MN	--	--
City of Fort Worth, TX	--	--
City of Garden City, MI	300,000	No
City of Harrisburg, PA	3,610,700	No
City of Hayward, CA	1,000,000	No
City of Hopewell, VA	--	--
City of Lompoc, TX	--	--
City of Pompano Beach, FL	11,900,000	No
City of Tamarac, FL	7,000,000	No
City of Tempe, AZ	6,700,000	Yes
City of Toledo, OH	19,200,000	No
City of Tulsa, OK	7,740,000	Yes
Clallam County, P.U.D., WA	1,751,768	No
Clallam County, WA	10,443,861	No
Clark County Treasurer, NV	14,300,000	No
Clark County, WA	--	--
Dauphin County, PA	1,000,000	No
First City Bank, TX	9,645,000	Yes

	March 1, 1985	Collateral In Possession or Liquidated
First Federal S & L, Sanford, FL	--	--
Hamilton Bank, PA	4,910,000	Yes
Hollywood Federal S & L, FL	--	--
Home Savings Assoc. of Florida, Hollywood, FL	--	--
Iowa Public Employees Retirement System	9,600,000	Yes
Jefferson County	5,445,191	No
Kleinwort Benson Government Securities	627,624,989	Yes
Lasser Marshall, Inc.	198,889,250	Yes
Liberty Government Securities Ltd.	23,195,000	Yes
Memphis City School Board Retirement System	8,000,000	No
The Mocatta Corporation	30,550,000	Yes
Moseley, Hallgarten, Estabrook & Weeden	237,663,750	Yes
Mutual Federal S & L, OH	--	--
Ohio State University	3,175,000	---
Oppenheimer & Company	4,400,000	---
Clallam County, WA P.U.D. Self Insurance Fund	303,458	No
William E. Pollock & Co.	29,740,000	Yes
Refco Partners	11,659,600	Yes
Resource Management Associates	30,835,000	Yes
The Town of Cheektowaga, NY	--	--
World Trade Securities	52,750,775	Yes
Total Term Repo Contracts as of 3/1/85	$1,646,908,342	

WHAT KEPT THE ESM COMPANIES AFLOAT

The subsidiary records of Government reflect that there were loans to Government exceeding loans from Government as follows:

	Dec. 31, 1984	Feb. 15, 1985	March 1, 1985
Term Repos	$1,621,000,000	$1,628,000,000	$1,646,908,342
Reverse Repos	1,324,000,000	1,191,000,000	1,192,000,000
Difference	$ 303,000,000	$ 437,000,000	$ 454,908,342

This imbalance was one of the ways that Government remained in business long after substantial deficits had eliminated the possibility of its staying in business without perpetuating a fraud. As improbable as it may sound, it was simple for Government to create the cash revenues necessary to remain in business so long as (1) reverse repo customers were giving Government excess collateral; (2) term repo customers were not effecting possession of their securities, either intentionally or by Government's deceit; and (3) borrowings from customers were greater than loans to customers.

The term repo losers were, by and large, medium to small municipalities, while approximately three-quarters of the term repo participants who were secured and suffered little or no losses were brokerage houses.

In connection with the reverse repos, two institutions, Home State and American (controlled during relevant periods by

Marvin L. Warner), delivered in excess of $200,000,000 in equity to Government. Thus, the approximately $100,000,000 from the term repo lenders who had not perfected their security interest in their securities and the approximately $200,000,000 from Home State and American kept Government in business despite its enormous negative net worth.

ANALYSIS OF INSIDER POSITIONS AND TRADING

In connection with the Receiver's investigation of sources of potential recovery, the Receiver compiled a list of all officers, directors and potential "insiders" and their affiliated companies. This list was used to study cash and trading transactions in 1984 and 1985. Substantial excessive salaries, bonuses and unsecured loans to officers and directors were identified. As a result, the Receiver obtained constructive trusts over the assets of officers and directors of the ESM Companies and injunctions against the transfer of assets. See "ASSET RECOVERY."

It was noted that there were open trading accounts in 1984 and 1985 for Marvin L. Warner, Burton Bongard (former CEO of Home State), and Stephen W. Arky (son-in-law of Marvin L. Warner and the senior member of the firm serving as counsel to the ESM Companies). Such 1984-85 trades and others in prior years are the subject of litigation recently brought by the Conservator of Home State who maintains that their trades were

not arms-length and that these customers have been unjustly enriched. These individuals traded extensively with Government for the last five to seven years. The trades for these early periods have not yet been analyzed by the Receiver. One T-Bill trade by Warner with Government, which began as a $100,000,000 face amount trade (later reduced to $80,000,000), is described below and reflects interest charges to Warner substantially below market resulting in a profit to Warner in excess of $4,000,000.

THOMAS TEV, RECEIVER
ESM GOVERNMENT SECURITIES, INC.
SUMMARY OF INFORMATION
IRVIN E. WARNER ACCOUNT TREASURY BILL PURCHASED TO YIELD 8.96%

	PRICE	BORROWED	INTEREST AT HOUSE RATES	INTEREST CHARGED	WITHDRAWLS	INVESTMENT CASH INVESTED(AHEAD)	INTEREST SHOULD BE	INTEREST CHARGED
			%	%			$	$
11/23/83 1,000,000 (AT 8.96 YIELD)	91,438,222.00							
INVESTED	17,078,958.25	74,359,263.75	9.4862500%	9.7500%		17,078,958.25	1,049,142.74	641,348.65
1/16/84 WIRE	370,000.00	74,729,263.75	9.4893500%	9.7500%	370,000.00	16,708,958.25	159,577.70	95,487.39
1/20/84 ESM BUY BACK 20,000,000 FACE TO YIELD 8.96	(18,576,266.68)	56,152,997.15						
1/24/84 WIRE	3,800,000.00	59,952,997.15	9.4893500%	9.7500%	3,800,000.00	12,908,958.25	911,949.37	210,597.89
2/15/84 WIRE	370,000.00	60,302,997.15	9.4486255%	9.1327%	370,000.00	12,538,958.25	209,935.04	87,994.02
2/28/84 WIRE	3,300,000.00	63,602,997.15	9.4486255%	2.5000%	3,300,000.00	9,238,958.25	272,521.18	70,669.99
3/15/84 WIRE	370,000.00	63,972,997.15	9.9375000%	2.5000%	370,000.00	8,868,958.25	211,910.55	53,319.83
3/27/84 WIRE	2,400,000.00	66,372,997.15	9.9375000%	2.5000%	2,400,000.00	6,468,958.25	366,434.26	92,184.72
4/16/84 WIRE	370,000.00	66,742,997.15	10.2656255%	2.5000%	370,000.00	6,098,958.25	266,451.27	64,889.03
4/30/84 WIRE	2,200,000.00	68,942,997.15	10.2656255%	2.5000%	2,200,000.00	3,898,958.25	291,758.96	71,815.62
5/15/84 WIRE	370,000.00	69,312,997.15	10.1562500%	2.5000%	370,000.00	3,528,958.25	312,671.17	77,814.44
5/31/84 WIRE	1,400,000.00	70,912,997.15	10.1562500%	2.5000%	1,400,000.00	1,928,958.25	300,887.55	73,847.71
6/15/84 WIRE	370,000.00	71,282,997.15	10.7500000%	2.5000%	370,000.00	1,558,958.25	298,082.53	69,382.91
6/29/84 WIRE	1,100,000.00	72,382,997.15	10.7500000%	2.5000%	1,100,000.00	458,958.25	347,444.24	85,452.15
7/16/84 WIRE	370,000.00	72,752,997.15	11.6875000%	2.5000%	370,000.00	88,958.25	354,291.94	75,784.37
7/31/84 WIRE	1,400,000.00	74,152,997.15	11.6875000%	2.5000%	1,400,000.00	(1,311,041.75)	361,189.65	77,245.71
8/15/84 WIRE	370,000.00	74,522,997.15	11.5000000%	2.5000%	370,000.00	(1,681,041.75)	380,895.33	81,833.33
8/31/84 WIRE	1,500,000.00	76,022,997.15	11.5000000%	2.5000%	1,500,000.00	(3,181,041.75)	339,991.74	73,911.25
9/14/84 WIRE	370,000.00	76,392,997.15	12.0000000%	2.5000%	370,000.00	(3,551,041.75)	356,580.65	74,270.97
							6,250,587.86	2,079,947.98
							4,170,639.88	

Cash Ahead	3,551,041.75	Sells back to company at 8.96 Yield	79,223,021.63
Amount Paid	850,676.47		
Warner Cash	4,401,118.22	Owes	76,392,997.15
		Discount Income	2,938,634.45
		Interest Charged	2,079,947.98
		Paid	850,676.47

There was also a $2,000,000 and a $7,000,000 transaction that began in June 1980 for Arky and Bongard, respectively, wherein they invested $20,000 per million in face amount to purchase T-Notes that matured in August 1985. The coupon interest on these notes was 9⅝% and was the only interest paid for the borrowings. These transactions were closed out in January 1985 for Arky and December 1984 for Bongard and their investment returned. The difference between market interest and the coupon rate paid for the financing of these transactions was detrimental to Government by approximately $250,000 in the case of Arky's trade and $800,000 in the case of Bongard's trade.

The Receiver has advised counsel for Warner and Arky of his findings and has requested that they explain their clients' trades, as well as all of their clients' other activities with Government. Counsel for Warner and Arky have agreed to do so. Arky has advised the Receiver that he has records of numerous trades with Government which he feels will show that he suffered an overall loss in his trading with Government. To date the Receiver has not received those records. Neither Bongard nor his counsel has contacted the Receiver to date.

The public SEC filings of American reveal that Marvin Warner and Ronnie R. Ewton were directors and members of American's Executive Committee for a period commencing in January 1984 and ending January 10, 1985 and, therefore, the Receiver has made a special analysis of American's transactions

with Government. This analysis reveals that in the middle of March 1984 American began transacting business with Government. This was shortly after Warner assumed joint control (January 1984) of American with Shepard Broad, with each obtaining the right to nominate five members to American's 10-man Board of Directors. Two of Warner's nominees to the Board were himself and Ewton.

The initial American-Government transaction took the form of a reverse repo, using T-Notes owned by American as collateral, to purchase $40,000,000 face amount of discounted T-Bills. This resulted in a total borrowing to date by American of $62,923,355. This transaction was followed in the middle of May by the acquisition of T-Bills with a face amount of $500,000,000 (supported by collateral in the form of T-Notes with a face amount of $60,000,000) and a transaction in June involving the purchase of T-Bills with a face amount of $500,000,000 (supported by collateral in the form of T-Notes with a face amount of $55,000,000).

The initial $40,000,000 T-Bill transaction terminated at its maturity date in September 1984. The normal termination dates for the two $500,000,000 T-Bill transactions were May and June 1985, respectively. These transactions were at a fixed interest rate from Government and, if held to their maturity, would have yielded American approximately $5,000,000 in profits, which represents the difference between the

discount interest earned and American's interest cost. In September 1984, prior to the maturity of these T-Bill trades, Government agreed to allow American to begin to prematurely close out its T-Bill transactions. The Receiver has obtained an unexecuted copy of a letter agreement between American and Government, Appendix C to this report, reflecting this agreement to "unwind" American's transactions.

The following are the face amounts of the T-Bill transactions between American and Government which were terminated prior to their maturity and the dates of their premature termination:

1984	Face Amount
September 28	$ 50,000,000
October 5	30,000,000
October 12	10,000,000
October 19	10,000,000
October 25	50,000,000
October 31	30,000,000
November 19	20,000,000
November 9	10,000,000
November 23	40,000,000
November 28	30,000,000
1985	
January 4	20,000,000
January 11	10,000,000
January 30	30,000,000
	$340,000,000

These terminations resulted in the return to American by Government of T-Notes in the face amount of approximately $50,000,000.

Due to Ewton's and Warner's positions with American and the ESM Companies, for purposes of the Bankruptcy Code, American may be deemed an "insider" of Government and, thus, payments received by American from Government prior to the maturity of these transactions may be recoverable by Government's Trustee as preferential payments.

THE FRAUD AND ITS ACCOUNTING COVER-UP

The True Losses

Other than 1976, its first year of operations, Group and its subsidiaries, and Financial (its affiliate), were never profitable. The following table reflects operating losses as shown on the Federal income tax returns of Group and its subsidiaries (consolidated) and Financial (separate), as prepared by Grant:

	Group (consolidated)	Financial (separate)
	Taxable Income or (Loss)	
1978	(2,905,000)	(4,291,000)
1979	(2,973,000)	(11,212,000)
1980	(11,535,000)	(81,759,000)
1981	5,682,000	(23,434,000)
1982	9,026,000	Not Filed
1983	932,000	Not Filed
1984	Not Filed	Not Filed

The books of the ESM Companies (consolidating both Group and subsidiaries, and Financial) reflect profits and (losses) as follows:

	Group (consolidated)	Financial (separate)
	Taxable Income or (Loss)	
1982	9,025,000	(12,678,000)
1983	3,412,000	(40,916,000)
1984	719,000	(12,679,000)

Appendix D contains a summarization of the income and expenses of the ESM Companies for calendar years 1978 through 1984 as reflected on their books.

Appendix E contains the audited statements of Government's financial condition prepared by Grant at December 31, 1981, 1982, 1983 and 1984.

Appendix F contains copies of the front pages of the tax returns of Financial for 1980 and 1981, as set forth above.

Journal Entry Switching or How to Hide the Loss and Create an Interest-Bearing Asset

The largest component of the total losses suffered by the ESM Companies was losses from securities trades reflected on the books of Financial. These losses in reality occurred in Government and, commencing before 1980, were transferred to Financial by a series of false journal entries supported by false documentation, creating an inter-company account that became a payable of Financial to Group. In this manner, Government reflected no loss and Group was able to accrue interest income on its loan due from Financial. In effect, the loss of Government was hidden and false income created for Group by interest income accruals.

An example of this use of fraudulent journal entries is shown by the following copy of the financial general ledger page for the account entitled "Sale of Government Securities" for 1980 reflecting a loss of $76,942,000. Also included is a copy of a journal entry setting up a loss by an offsetting credit to an inter-company account.

Account No. 4011

Sheet No. ✓

NAME Sale of U.S. Government Securities

Terms

ADDRESS

Rating

Credit Limit

80	ITEMS	PBR	✓	DEBITS	✓	CREDITS	BALANCE	
3 28	Balance Forward						9 753 754 57	Dr
3 31	JE	22		507 284 54			10 261 039 11	Dr
3 31	✓	25		6 144 150 20			16 405 189 31	DR
4 2	CR					1509	16 405 006 40	DR
4 7	CR					854401	16 404 462 39	DR
4 10	CR					1173	16 404 450 66	DR
4 14	CR					16287	16 404 287 79	DR
4 16	CR					12202	16 404 275 77	DR
4 24	CR					4312748	16 399 963 29	DR
4 28	CR					1701284	16 398 950 45	DR
4 30	JE	46		6 352 462 75			17 751 413 20	DR
5 30	CR					6834 13	17 744 579 07	DR
6 26	C.D			8555 91			17 753 134 98	DR
11 30	J.E	14		58 965 433 51			76 918 568 49	DR

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Account No. Sheet No. 115

NAME JOURNAL ENTRIES Terms

ADDRESS Rating Credit Limit

Date 1966	ITEMS (14)	FOLIO	✓	DEBITS	✓	CREDITS	INT. DIS.	BALANCE
11 30	Sale of U.S. Government Securities	4011		98,965,433.51	✓			
	Inter Company Accounts - Net Payable	2611				98,965,433.51	✓	
	To Recode Purchase of Inventory from							
	E.S.M. Government Securities, Inc. and							
	The Sale Back of Same By E.S.M.							
	Financial Group, Inc. To E.S.M. Government							
	Securities, Inc. This entry records the							
	Net Difference of the Buy / Sale Back							
	Amount Due To Governments. -							
	Detail In Work Paper File.							

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Doing it With Mirrors

The underlying subsidiary records of Government, as reflected on computer runs of Bradford, reflected the true balance loaned to and borrowed from Government. If these term repos and reverse repos had been properly reflected on Government's balance sheet, the discrepancy would have been obvious. In order to eliminate this imbalance and to hide the fraud, opposite positions were created by internal entries between Government and its parent, Group, to the effect that the securities sold on repurchase agreements and securities purchased by resale agreements balanced on Government's books. Ironically, only after one is informed about these fraudulent mirror entries does footnote D to the audited financial statement of Government's condition as prepared by Grant make sense.

Alexander, Grant & Company

On March 15, 1985, the Receiver filed an ancillary complaint against Jose Gomez and John Does one through one hundred d/b/a Alexander Grant & Company, a partnership (Case No. 85-6219-CIV-GONZALEZ), alleging professional negligence on the part of Grant in connection with the services performed by it on behalf of Government. The complaint demands compensatory damages in excess of $300,000,000. The complaint also alleges a claim for gross negligence on the part of Grant and demands punitive damages as a result of such conduct.

On March 20, 1985, the Securities and Exchange Commission brought an action against Jose Gomez, the Grant partner who was the responsible partner on the Government audit. This claim alleges that Grant was not independent (and, therefore, could not issue an opinion relative to Government's financial condition) because Mr. Gomez had received substantial sums from two of ESM's principals.

In addition, the Receiver is advised that no less than three additional lawsuits have been filed against Grant by customers of Government who relied upon its reports of Government's financial condition in investing through Government. These complaints allege not only that Grant was negligent or grossly negligent in its handling of the Government audit, but that it also aided and abetted in the fraud being perpetrated on Government's customers. The Receiver anticipates that ultimately every creditor of Government will file a direct action against Grant.

The Receiver's suit alleges in pertinent part that, at all relevant times, through the performance of its audits of Government and Securities, the preparation of federal income tax returns of Group, Government, Securities, Aviation and Financial, and Grant's access to the internal books and records of account, including trial balances, of these corporations, Grant was in full possession of all material information regarding the true financial condition of the ESM Companies.

As a result, the Receiver believes that Grant was negligent in that, among other things:

(a) Grant failed to ensure that the examination of the statements of financial condition of Government and Securities for the years 1980 through 1984 were conducted by persons having adequate technical training and proficiency as auditors.

(b) Grant failed to take steps which would ensure that their partners, managers and staff members would perform their assignments with appropriate professional independence.

(c) Grant failed to exercise due professional care in the performance of their examinations and the preparation of their statements.

(d) Grant failed to take steps to ensure that the work done would be adequately planned and the partners, managers and staff would be properly supervised.

(e) Grant failed to take steps to ensure that there would be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures were to be restricted.

(f) Grant failed to take steps to ensure that competent evidentiary matter would be obtained through inspection, observation, inquiries and confirmations or reviewed by competent partners so as to provide a reasonable

basis for an opinion regarding the statements of financial condition under examination.

(g) Grant consistently failed to make adequate disclosures in the audited statements of Government and Securities. Further, these statements failed to reflect the true financial condition of these corporations and, in fact, were inadequate, inaccurate, false and misleading.

THE CONFIRMATION PROCESS FAILS

In order to properly describe why the confirmation process apparently failed in this case, it is necessary to distinguish between transaction confirmations and audit confirmations. A transaction confirmation is the confirmation of a "buy" or "sell" generated by the happening of a particular financial transaction. This confirmation goes to the customer, describes the transaction and is a part of the customer's document file. It contains all details of the transaction and includes delivery instructions as to the securities being purchased.

Audit confirmations, on the other hand, are independent requests to substantiate financial transactions which are sent directly to the parties involved in said transactions. Hence, the auditors of Government confirm with customers of Government; the auditors of institutions confirm directly with Government and/or with the apparent holders of the collateral (for term repo holders); and the auditors of term repo holders confirm directly with the holders of their collateral.

For term repo lenders who allowed Government to choose the location of their securities, the misconception by many of them seems to have been the belief that Bradford or Security Pacific (mere clearing agents) were custodians holding the securities for their benefit.

The letter which Government sent to its customers to confirm its repo transaction and which played a major part in the fraud stated:

> These securities will be segregated for you by Bradford Securities Processing Service, Inc. and held by them in our customers security account.

The financial officers of the municipalities who invested through Government seem to have accepted the Government confirmation as coming from Bradford. Normal procedures for brokers and financial institutions regularly involved in term repos are to have their collateral delivered to their agent. The losers on term repos lost because they did not obtain possession of their collateral.

CLEARING BROKERS

The Receiver is investigating the actions of the clearing brokers in connection with their activities as clearing agent for Government. It appears that on several occasions when municipalities attempted to confirm whether securities were in segregated accounts, Bradford did not confirm the segregation, but instead directed the inquiry to Government.

As an illustration, Appendix G to this report is a continuous series of such correspondence between Bradford and the City of Fort Worth, Texas and between Bradford and Anoka County, Minnesota.

BANKRUPTCY CONSIDERATIONS

The analysis of whether the ESM Companies should be placed in bankruptcy was a complex one. As part of the Bankruptcy Code's system for the marshalling of assets for the benefit of creditors, property of the estate of a debtor is broadly defined (11 U.S.C. §541) and a bankruptcy trustee is given extraordinary "avoidance" powers. For example, the Bankruptcy Code empowers a trustee to avoid and recover preferential and fraudulent transfers pursuant to 11 U.S.C. §§547 and 548, respectively. Under the preference provision (11 U.S.C. §547), transfers of the debtor's interests in property, including liens and security interests, to non-insider creditors of the debtor for or on account of antecedent debts generally are avoidable if made during the 90-day period preceding bankruptcy at a time when the debtor is insolvent, while such transfers made to creditors who are "insiders" (as defined in the Bankruptcy Code) may be avoided if made during the one-year period preceding bankruptcy. In contrast, the fraudulent transfer provision (11 U.S.C. §548) empowers a bankruptcy trustee to avoid all fraudulent transfers made within one year

prior to bankruptcy, including transfers which were made for less than a reasonably equivalent value at a time when the debtor was insolvent or became insolvent as a result of such transfers.

Section 544(b) of the Bankruptcy Code also empowers a bankruptcy trustee to avoid and recover any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an allowable unsecured claim. Thus, a bankruptcy trustee is empowered to pursue, for example, state law fraudulent conveyance claims under the applicable state's statute of limitations, which is often longer than one year.

A wrinkle in this system for marshalling assets was created, however, by recent amendments to the Bankruptcy Code. That is, most transfers made by or to "repo participants" pursuant to settlements under "repurchase agreements" are now insulated from avoidance by a bankruptcy trustee under 11 U.S.C. §546(f). These most recent amendments have not yet been construed by the courts and thus their particular applicability to this case is unknown. As a result, the ESM Companies' creditors have advanced differing interpretations of the Bankruptcy Code provisions as applied to the known facts about the ESM Companies.

Nevertheless, the ESM Companies' creditors and the SEC agreed that an analysis must be undertaken to determine whether

the ESM Companies had made any transfers prior to its cessation of business operations that could be avoidable by a bankruptcy trustee. Unless such transfers had been made, there was no apparent necessity to place the ESM Companies in bankruptcy.

Thus, the Receiver and his accountants, together with various creditor representatives, conducted an in-depth analysis of the nature, amounts and timing of all transfers made by the ESM Companies during the 90-day period before they ceased doing business and, in the cases of certain parties thought to be "insiders," transfers made during the past year. The analysis revealed that there were transfers made to both insiders and non-insiders within the 90-day period prior to the appointment of the Receiver. In addition, there appeared to be transfers made to insiders between 90-days and one year prior to the appointment of the Receiver. Most of the transfers to non-insiders within 90-days, however, were pursuant to repurchase agreements and, therefore, might have been insulated from most avoidance actions by 11 U.S.C. §546(f).

After being apprised of these analyses, certain creditors wanted to wait until after the expiration of 90-days subsequent to the transfers before filing a bankruptcy petition. The argument advanced by these creditors was that, under a literal reading of 11 U.S.C. §546(f), transfers arising from repo settlements to insiders within 90 days of bankruptcy would possibly not be subject to avoidance, whereas such transfers to

the same insiders made more than 90 days but less than one year prior to bankruptcy could be subject to avoidance. The validity of this argument was unknown and subject to dispute; it was clear, however, that, if the creditors were to wait until the expiration of 90 days after the cessation of business to file the bankruptcy, approximately $2 million of possible avoidable transfers by Government would be lost.

At a creditors' meeting held on March 22, 1985, as well as at subsequent meetings, these issues were fully discussed and analyzed by the creditors. The consensus of the creditors attending those meetings, who represented in excess of two-thirds of known claims against the ESM Companies, was to attempt to recover the avoidable transfers of approximately $2 million. Accordingly, the creditors voted to file an involuntary petition against Government no later than March 26, 1985. Since it appeared that any avoidable transfers which were made by Group, Financial and Securities would be recovered as easily in the receivership proceedings, the creditors decided to leave those entities in receivership at the present time and to file only against Government. Thus, on March 26, 1985, the creditors filed a petition to place Government in Chapter 7 bankruptcy proceedings. On March 27, 1985, after notice and hearings, the United States District Court for the Southern District of Florida withdrew the reference of the bankruptcy case and all related proceedings from the Bankruptcy

Court, entered an order for relief under Chapter 7 against Government, and appointed the Receiver as interim Chapter 7 trustee.

The decision to file for Chapter 7 liquidation rather than Chapter 11 reorganization was made by creditors after determining that the liquidation of Government was proper. Although a debtor can liquidate in Chapter 11, the creditors chose to institute an involuntary Chapter 7 proceeding because there existed no reasonable possibility of reorganization or rehabilitation of Government. The investigation as to whether and when to place Government's affiliates in Bankruptcy is continuing.

ASSET RECOVERY

As previously mentioned, the Receiver, his accountants and attorneys have taken steps they deem reasonable and necessary to marshall, locate and identify assets and potential assets of the ESM companies and their principals. Constructive trusts have been instituted and established over assets of such principals, and additional lawsuits are under consideration.

The assets as disclosed or discovered to this date which have been frozen are listed in Appendices H, I, J, and K of this report.

It is obvious from the assets recovered to date that creditors will receive a substantial recovery only in the event

the Receiver/Trustee is successful in direct actions against those who have caused injury to the ESM Companies and if creditors are successful in their actions against persons who caused their losses. To date, the Receiver has filed an ancillary claim for negligence and gross negligence against Grant and has under consideration suits against the officers and directors of the ESM Companies to collect outstanding loans and excessive compensation. The Receiver also has under consideration suits to recover damages caused to Government by owners of less than arms-length trading accounts who may have been unjustly enriched at the expense of Government. As Trustee for Government, the Receiver will explore the extent to which preferential payments were made to American and others and whether actions should be taken against Bradford and Security Pacific for the liquidation of securities in their possession as an alleged set-off against their loans to Government.

ACKNOWLEDGMENT

The Receiver wants to acknowledge the efforts, under demanding time pressures, of the staff members of the Securities and Exchange Commission, the Federal Reserve Bank of New York, and the various partners, associates and staff of the accounting firm of Holtz & Company and the law firm of Finley,

Kumble, Wagner, Heine, Underberg, Manley & Casey, which have assisted in the investigation of the ESM Companies and the preparation of this report.

IN WITNESS WHEREOF, the undersigned, THOMAS TEW, as Receiver for the ESM Companies, hereby files this report with the United States District Court for the Southern District of Florida, this 2nd day of April, 1985.

Thomas Tew

Thomas Tew, as Receiver for
the ESM Companies

cc: All counsel of record.

APPENDIX A

THOMAS TEW, RECEIVER
ESN GOVERNMENT SECURITIES
TERM REPO - MONTH END BALANCES

	JANUARY 1984	FEBRUARY 1984	MARCH 1984	APRIL 1984	MAY 1984	JUNE 1984
A G. BECKER	24,488,000 00	20,958,000 00	25,995,000 00	25,187,000 00	24,510,000.00	24,250,000.00
ACLI GOVERNMENT SECURITIES	81,353,000 00	205,602,500 00	132,454,500.00	0 00	0.00	0.00
AIMS COMMUNITY COLLEGE	0 00	0.00	0 00	500,000.00	0.00	0.00
ALDEN CITY SCHOOL DISTRICT	0.00	0.00	0.00	500,000 00	500,000.00	0.00
ALEXANDRIA CITY SCHOOL DIST.	109,000.00	109,000.00	0.00	270,000.00	0.00	0.00
ALTMAR PARISH WILLIAMS CITY SCHOOL	0 00	0.00	1,650,000 00	1,038,000.00	1,038,000.00	0 00
AMHERST CITY SCHOOL	0 00	0 00	0 00	500,000.00	1,538,050.00	0.00
AMITYVILLE UNION FREE SCHOOL DIST	0 00	1,400,000.00	1,400,000.00	1,400,000 00	1,100,000.00	0.00
AMITYVILLE UNION SCHOOL DIST.	0 00	2,360,000 00	0 00	0.00	0.00	0.00
ANOKA COUNTY COURTHOUSE	7,850,000 00	7,450,000.00	7,150,000 00	4,200,000.00	11,350,000.00	3,000,000.00
APPLETON AREA SCHOOL DIST.	0.00	0 00	0.00	0.00	0.00	0.00
ARDSLEY UNION FREE SCHOOL DIST.	1,600,000 00	3,287,000 00	3,399,296.00	2,350,000.00	0.00	0.00
ARIZONA RETIREMENT SYSTEM	170,000,000.00	250,000,000.00	260,000,000.00	285,000,000.00	315,000,000.00	350,000,000.00
ARLINGTON COUNTY TREASURERS	0.00	3,000,000.00	3,000,000.00	2,000,000.00	2,000,000.00	1,000,000.00
ATTICA CENTRAL SCHOOL	788,248.70	588,248.70	0 00	500,000.00	500,000.00	0.00
BANK OF THE SOUTH	17,380,000 00	32,285,000.00	22,570,000.00	28,815,000.00	31,100,000.00	18,040,000.00
BD OF ED - NORTH TONAWANDA	500,000.00	350,000.00	0.00	2,000,000.00	0 00	0.00
BENTON COUNTY PUBLIC UTILITY	0 00	0.00	0.00	570,000.00	0 00	0.00
BETHESDA HEALTH GROUP	100,000.00	100,000.00	850,000.00	700,000 00	800,000.00	0.00
BRUSHTON MOIRA CENTRAL SCH. DIST.	500,000.00	500,000 00	500,000.00	500,000 00	500,000.00	0.00
BYRAM HILLS CITY SCHOOL	0.00	0 00	2,388,486.61	0.00	0.00	0.00
CANAJOHARIE CITY SCHOOL DIST.	500,000.00	304,266.67	508,456.99	677,000 00	0.00	0.00
CARLEPLACE UNION FREE SCHOOL	0 00	0.00	0.00	0 00	150,000.00	0.00
CANUTAUGA CITY SCHOOL DIST.	0 00	0.00	514,968.56	519,110 81	0 00	0.00
CHELAN COUNTY	0.00	0 00	1,000,291.67	6,503,299.17	400,000 00	0.00
CHILTON MEMORIAL HOSPITAL	0 00	0.00	1,000,000.00	400,000 00	0 00	0.00
CITY OF ALEXANDRIA	0 00	0 00	0 00	18,449,339.27	18,449,338.00	18,449,338.00
CITY OF ALLENTOWN, PA	0 00	0 00	0 00	0 00	0.00	0.00
CITY OF AUSTIN, TEXAS	2,000,000,00	5,000,000.00	5,000,000.00	0 00	0.00	0.00
CITY OF BATH	0 00	0 00	100,000 00	400,000.00	0.00	0.00
CITY OF BEAUMONT	0 00	0.00	9,000,000.00	10,000,000.00	3,500,000.00	8,500,000.00
CITY OF BIRMINGHAM, MICHIGAN	0 00	0.00	0 00	0 00	0.00	0.00
CITY OF BRADENTON	0 00	0 00	0 00	2,500,000 00	2,500,000.00	1,500,000.00
CITY OF BREMER	0.00	0.00	400,000 00	100,000 00	0.00	0.00
CITY OF BURNSVILLE, MINNESOTA	1,049,994 43	1,049,994 43	1,049,994.00	1,073,472.00	1,073,472.00	1,073,472.00
CITY OF CADILLAC	0 00	0 00	269,000 00	269,000.00	269,000.00	0.00
CITY OF CAMBRIDGE	0.00	0 00	0 00	0 00	1,675,000.00	500,000 00
CITY OF CLEVELAND HEIGHTS	0 00	0 00	0 00	0 00	0 00	0 00
CITY OF FORT WORTH	0 00	0 00	0 00	0 00	7,000,000 00	7,000,000.00
CITY OF FT. PIERCE	0 00	0 00	450,000 00	225,000 00	225,000 00	225,000.00
CITY OF GARDEN CITY	0.00	0 00	500,000 00	500,000.00	500,000.00	0.00
CITY OF HARRISBURG, PA.	0 00	1,987,000.00	3,494,000 00	3,812,000 00	3,606,000.00	3,775,000 00
CITY OF HAYWARD	8,143,000 00	7,645,000.00	7,645,000.00	7,645,000 00	6,123,375.00	2,000,000.00
CITY OF HICKORY	0 00	2,000,000.00	4,250,000 00	4,250,000.00	2,250,000.00	0.00
CITY OF HOPEWELL	0 00	0.00	0 00	0 00	0 00	0.00
CITY OF KINGSTON	385,850 00	104,000 00	104,000 00	104,000.00	0.00	0.00
CITY OF LOMPOC	0 00	0 00	0.00	500,000 00	500,000.00	500,000.00
CITY OF LUDINGTON	0 00	0 00	900,000 00	900,000.00	600,000.00	900,000.00
CITY OF NEWARK	0 00	0 00	0 00	1,650,000 00	2,130,000.00	250,000 00
CITY OF PLANO, TEXAS	1,100,000 00	1,100,000 00	1,100,000 00	1,100,000.00	1,100,000.00	400,000 00
CITY OF POMPANO BEACH	0 00	0 00	0 00	0.00	0.00	0.00

THOMAS TEW, RECEIVER
ESM GOVERNMENT SECURITIES
TEW REPO - MONTH END BALANCES

	JANUARY 1984	FEBRUARY 1984	MARCH 1984	APRIL 1984	MAY 1984	JUNE 1984
CITY OF REDWOOD CITY	0.00	0.00	0.00	0.00	600,000.00	600,000.00
CITY OF RENO	0.00	0.00	0.00	3,320,000.00	3,600,000.00	3,600,000.00
CITY OF RIVERBANK	0.00	0.00	0.00	100,000.00	0.00	0.00
CITY OF SOLVAY	0.00	0.00	0.00	1,140,000.00	1,100,000.00	940,000.00
CITY OF SUNNYVILLE	0.00	0.00	0.00	1,000,000.00	1,000,000.00	500,000.00
CITY OF TAWAWAC	0.00	0.00	2,000,000.00	2,170,000.00	1,170,000.00	0.00
CITY OF TEMPE, ARIZONA	21,400,000.00	17,200,000.00	20,800,000.00	18,000,000.00	18,000,000.00	14,000,000.00
CITY OF TOLEDO	0.00	0.00	0.00	0.00	0.00	4,200,000.00
CITY OF TULSA, OKLAHOMA	31,609,335.56	34,240,000.00	26,140,000.00	29,135,000.00	28,140,000.00	18,365,000.00
CITY OF WATERVLIET CITY HALL	100,000.00	100,000.00	100,000.00	300,000.00	0.00	0.00
CLALLAM COUNTY P U.D.	0.00	0.00	0.00	0.00	0.00	0.00
CLALLAM COUNTY TREASURES	10,470,780.40	12,300,795.66	10,044,007.82	12,979,936.50	11,705,000.00	9,214,957.00
CLARK COUNTY TREASURER	7,000,000.00	12,500,000.00	16,035,000.00	17,730,000.00	16,300,000.00	13,000,000.00
CLARK COUNTY, WASHINGTON	20,812,900.00	18,868,000.00	20,760,000.00	17,971,000.00	17,670,000.00	12,007,000.00
CLYDE-SAVANNAH CITY SCHOOL	0.00	0.00	0.00	400,000.00	0.00	0.00
COMMACK UNION FREE SCHOOL	0.00	0.00	0.00	1,918,899.00	18,899.00	0.00
COMMONWEALTH SBL	10,000,000.00	5,000,000.00	5,000,000.00	0.00	0.00	0.00
CONNETQUET CENTRAL SCHOOL DIST.	4,000,000.00	5,300,000.00	4,500,000.00	4,000,000.00	4,000,000.00	0.00
COUNTY OF HILLSBORO	6,000,000.00	4,000,000.00	4,000,000.00	0.00	0.00	0.00
COUNTY OF MERRIMACK	300,000.00	0.00	0.00	0.00	0.00	0.00
COUNTY OF PRINCE WILLIAM	0.00	0.00	0.00	0.00	0.00	0.00
COUNTY OF PUTNAM	0.00	300,000.00	300,000.00	0.00	0.00	0.00
COUNTY OF ROCKINGHAM	3,000,000.00	2,000,000.00	1,000,000.00	0.00	0.00	0.00
COUNTY OF SARATOGA	0.00	0.00	0.00	250,000.00	0.00	0.00
CREIGHTON UNIVERSITY	2,000,000.00	2,500,000.00	2,000,000.00	2,000,000.00	0.00	0.00
DAUPHIN COUNTY, PA.	0.00	1,000,000.00	0.00	0.00	2,000,000.00	0.00
DEER PARK UNION FREE SCH. DIST.	1,000,000.00	0.00	0.00	0.00	0.00	0.00
DELAWARE VALLEY CITY SCHOOL	0.00	0.00	0.00	150,000.00	359,965.00	150,000.00
DL. GOVERNMENT SECURITIES	79,381,250.00	29,272,500.00	38,850,750.00	0.00	0.00	0.00
DOBBS FERRY UNION FREE SCH. DIST.	0.00	700,000.00	700,000.00	700,000.00	0.00	0.00
EAST AURORA UNION FREE SCHOOL	0.00	0.00	0.00	1,070,000.00	720,000.00	0.00
EAST MEADOW	0.00	0.00	0.00	6,350,000.00	0.00	0.00
EAST ROCHESTER PUBLIC SCHOOLS	1,150,000.00	0.00	0.00	300,000.00	250,000.00	0.00
ELMSFORD UNION FREE SCHOOL DIST.	0.00	300,000.00	1,073,000.00	1,225,000.00	1,100,000.00	800,000.00
EMT. FEDERAL CREDIT UNION	0.00	0.00	0.00	0.00	2,000,000.00	0.00
ESCAMBIA COUNTY CONTROLLERS	1,425,000.00	1,740,918.75	12,330,000.00	1,016,835.00	517,336.00	0.00
ESST RAMAPO CITY SCHOOL	0.00	0.00	0.00	3,000,000.00	3,000,000.00	0.00
FIRST CITY BANK	16,750,000.00	14,825,000.00	14,900,000.00	16,225,000.00	18,775,000.00	24,485,000.00
FIRST FEDERAL SBL OF MADISON	0.00	0.00	1,500,000.00	1,500,000.00	500,000.00	0.00
FIRST FEDERAL SAVINGS & LOAN	1,000,300.00	0.00	0.00	0.00	0.00	0.00
FLORENCE NIGHTINGALE NURSERY	0.00	0.00	0.00	150,000.00	0.00	0.00
FORSYTH COUNTY, N.C.	0.00	0.00	0.00	0.00	400,000.00	0.00
FOX VALLEY CORP.	0.00	3,600,000.00	2,576,000.00	1,868,818.00	0.00	0.00
FRONTIER CENTRAL SCHOOL DIST	0.00	1,850,000.00	2,225,000.00	4,600,000.00	3,600,000.00	2,200,000.00
GA. INSTITUTE OF TECHNOLOGY	4,949,000.00	3,283,428.00	7,769,398.00	8,765,631.00	3,765,631.00	0.00
GENEVA CITY SCHOOL DIST	0.00	0.00	0.00	850,798.00	445,000.00	0.00
GIBSON TUBE, INC.	400,000.00	300,030.00	200,000.00	0.00	0.00	0.00
GLOVERSVILLE CITY SCHOOL DIST.	100,000.00	120,000.00	0.00	0.00	0.00	0.00
GOLDEN EGG FARM, INC.	0.00	0.00	0.00	300,000.00	300,000.00	300,000.00
GRAND ISLAND CENTRAL SCHOOL	0.00	0.00	0.00	200,000.00	0.00	0.00
GRAND ISLAND CENTRAL SCHOOL DIST	400,000.00	0.00	325,000.00	0.00	0.00	0.00

THOMAS TEN, RECEIVER
ESM GOVERNMENT SECURITIES
TERM REPO - MONTH END BALANCES

	JANUARY 1984	FEBRUARY 1984	MARCH 1984	APRIL 1984	MAY 1984	JUNE 1984
GREENBURGH SCHOOL DIST 07	213,053.61	2,245,607.97	1,456,128.00	1,312,700.00	810,000.00	0.00
GREENWICH CAPITAL MARKETS, INC.	0.00	0.00	0.00	0.00	0.00	0.00
GUILDERLAND CITY SCHOOL	0.00	0.00	0.00	750,000.00	500,000.00	0.00
HAMBURG CENTRAL SCHOOL DIST.	2,500,000.00	2,000,000.00	1,000,000.00	0.00	0.00	0.00
HAMILTON BANK	0.00	0.00	0.00	0.00	0.00	0.00
HEALTHCARE PLAN OF N.J.	0.00	0.00	300,000.00	300,000.00	300,000.00	300,000.00
HEMPSTEAD UNION FREE SCHOOL	0.00	4,200,000.00	3,300,000.00	2,300,000.00	1,000,000.00	0.00
HENRICK HUDSON - CENTRAL SCHOOL	640,000.00	645,146.66	1,620,146.66	1,995,147.00	1,995,147.00	0.00
HOLLAND CENTRAL SCHOOL DISTRICT	600,000.00	0.00	0.00	0.00	0.00	0.00
HOME SAVINGS ASSOCIATION OF FL.	12,330,000.00	12,330,000.00	0.00	11,983,000.00	10,883,000.00	30,168,750.00
INC. VILLAGE OF LACE SUCCESS	0.00	0.00	640,000.00	0.00	0.00	0.00
INDEPENDENT INSURANCE AGENTS	0.00	0.00	100,000.00	0.00	0.00	0.00
IOWA PUBLIC EMPLOYEES RETIREMENT	6,220,000.00	6,220,000.00	4,220,000.00	4,220,000.00	0.00	0.00
IRVINGTON UNION FREE SCHOOL	0.00	0.00	0.00	1,250,000.00	0.00	0.00
ISLAND PARK UNION FREE SCHOOL	445,000.00	445,000.00	440,000.63	440,000.63	430,899.00	0.00
JEFFERSON COUNTY, WASHINGTON	2,485,000.00	2,700,025.00	2,460,025.00	2,700,025.00	2,016,025.00	2,670,025.00
JOHNSON CITY SCHOOL DIST.	120,000.00	500,000.00	120,000.00	120,000.00	0.00	0.00
KAMAN CORPORATION	0.00	0.00	500,000.00	500,000.00	0.00	0.00
KENMORE-TOWN OF TONAWANDA	485,000.00	0.00	0.00	0.00	0.00	0.00
KLEINWORT BENSON GOVERNMENT SEC.	0.00	0.00	0.00	841,096,750.00	848,730,000.00	316,800,144.00
KODIAK ISLAND BOROUGH	0.00	0.00	1,000,000.00	1,000,000.00	0.00	0.00
L.A. COUNTY EMPLOYEES RETIREMENT	70,900,000.00	25,000,000.00	45,700,000.00	21,573,000.00	88,910,000.00	69,800,000.00
LAKE PLACID CITY SCHOOL DIST.	0.00	108,173.34	108,173.34	108,173.34	108,173.00	0.00
LAKESHORE CITY SCHOOL	0.00	0.00	0.00	1,400,000.00	600,000.00	0.00
LANCASTER CITY SCHOOL	0.00	0.00	0.00	1,500,000.00	0.00	0.00
LASSER MARSHALL, INC.	290,453,000.00	281,484,250.00	282,000,500.00	164,879,500.00	284,377,500.00	700,657,875.00
LAUDARUS CITY SCHOOL	0.00	0.00	0.00	150,000.00	150,000.00	0.00
LIBERTY GROUP	0.00	0.00	0.00	0.00	900,000.00	900,000.00
MACON SAVINGS & LOAN	0.00	0.00	700,000.00	705,920.38	0.00	0.00
MAHOPAC CITY SCHOOL	0.00	0.00	0.00	172,000.00	0.00	0.00
MEMPHIS CITY SCHOOL BOARD	13,500,000.00	13,000,000.00	0.00	475,000.00	2,500,000.00	2,500,000.00
MERCHANTS NATIONAL BANK	0.00	0.00	0.00	0.00	2,000,000.00	2,400,000.00
MINISTERS BENEFIT ASSOCIATION	0.00	0.00	1,200,000.00	1,700,000.00	0.00	0.00
MODINE FINANCIAL, INC.	0.00	2,903,782.13	3,106,497.00	1,000,000.00	0.00	0.00
MODINE LAKE AUTO RADIATOR	0.00	0.00	0.00	332,729.00	0.00	0.00
MOSELEY, HALLGARTEN, ESTABROOK	0.00	47,395,300.00	29,112,300.00	40,887,500.00	6,140,000.00	40,848,750.00
MUTUAL FED. SAL	0.00	0.00	0.00	0.00	0.00	0.00
NANUET UNION FREE SCHOOL	0.00	150,000.00	150,000.00	0.00	0.00	0.00
NEW YORK HANSEATIC CORP	143,389,500.00	64,332,500.00	103,873,112.50	31,279,500.00	64,857,750.00	57,996,000.00
NIAGARA FALLS CITY SCHOOLS	0.00	7,673,000.00	5,323,000.00	7,200,000.00	4,100,000.00	200,000.00
OHBAYASHI-GUMI LTD	0.00	0.00	0.00	0.00	700,000.00	0.00
OHIO STATE UNIVERSITY	6,480,000.00	5,500,000.00	3,800,000.00	5,460,000.00	4,700,000.00	3,235,000.00
OHIO STATE UNIVERSITY MEDICAL	0.00	0.00	0.00	0.00	0.00	300,000.00
OPPENHEIMER & CO.	0.00	0.00	0.00	0.00	0.00	0.00
OSSINING UNION FREE SCHOOL	1,100,000.00	3,100,000.00	4,250,000.00	3,272,000.00	1,250,000.00	0.00
P.U.D. SELF INS. FUND	0.00	0.00	0.00	0.00	0.00	0.00
PAINE WEBBER JACKSON CURTIS	3,194,000.00	3,146,000.00	4,981,000.00	0.00	0.00	0.00
PAWLING CENTRAL SCHOOL	340,000.00	340,000.00	0.00	150,000.00	150,000.00	0.00
PIONEERS YORKSHIRE CENTRAL	900,000.00	900,000.00	900,000.00	1,900,000.00	1,900,000.00	0.00
PLATTSBURGH CITY SCHOOL DIST	0.00	100,000.00	0.00	0.00	0.00	0.00
PORT BYRON CITY SCHOOL	0.00	0.00	0.00	133,000.00	0.00	0.00

THOMAS TEW, RECEIVER
ESH GOVERNMENT SECURITIES
TERM REPO - MONTH END BALANCES

	JANUARY 1984	FEBRUARY 1984	MARCH 1984	APRIL 1984	MAY 1984	JUNE 1984
POPKIN, LEBSON & BERGSTEIN	0.00	0.00	0.00	100,500.00	101,346.00	0.00
PORTLAND WATER DIST	0.00	0.00	0.00	0.00	4,000,000.00	0.00
POUGHKEEPSIE CITY SCHOOL DIST.	1,200,000.00	1,300,000.00	3,000,000.00	3,000,000.00	0.00	0.00
PUTNAM WESTCHESTER B.O.C.E.S.	0.00	0.00	0.00	172,500.00	0.00	0.00
REFCO PARTNERS	8,213,000.00	8,155,000.00	7,090,000.00	6,989,000.00	10,403,000.00	13,290,000.00
RESOURCE MANAGEMENT	0.00	0.00	0.00	0.00	0.00	0.00
RESOURCE MANAGEMENT II	136,335,000.00	119,935,000.00	166,111,250.00	207,648,750.00	102,727,500.00	336,259,416.00
RESOURCE MANAGEMENT III	91,290,625.00	47,849,750.00	24,656,250.00	0.00	0.00	0.00
RESOURCE MANAGEMENT IV	10,380,000.00	9,425,000.00	9,475,000.00	0.00	0.00	0.00
ROCHESTER CITY HALL	2,100,000.00	3,000,000.00	2,000,000.00	500,000.00	0.00	0.00
ROCHESTER INDIVID. PRACTICE	0.00	0.00	0.00	400,000.00	400,000.00	400,000.00
ROYAL PALM S&L	0.00	1,000,000.00	0.00	0.00	0.00	0.00
SAYVILLE UNION FREE SCHOOL	0.00	0.00	100,000.00	120,000.00	0.00	0.00
SCHOOL DIST OF GREENVILLE, S.C.	0.00	0.00	0.00	0.00	200,000.00	0.00
SEAFORD UNION FREE SCHOOL	0.00	0.00	900,000.00	900,000.00	0.00	0.00
SHASTA COUNTY	0.00	0.00	0.00	2,000,000.00	0.00	0.00
SHAWNEE FEDERAL S&L	0.00	2,500,000.00	2,500,000.00	5,500,000.00	2,300,000.00	2,300,000.00
SHERBURNE EARLVILLE CITY	0.00	0.00	220,000.00	220,000.00	0.00	0.00
SOUTH COLONIE CENTRAL SCHOOL	2,200,000.00	0.00	0.00	0.00	0.00	0.00
ST. LAWRENCE-LEWIS	0.00	0.00	0.00	300,000.00	0.00	0.00
STATE OF NEW MEXICO	9,605,000.00	14,210,000.00	7,175,000.00	6,460,000.00	6,627,500.00	0.00
STATE OF WEST VIRGINIA	15,200,000.00	16,230,000.00	0.00	0.00	0.00	0.00
STEPHENS, INC.	0.00	0.00	0.00	0.00	0.00	0.00
SWEETHOM CENTRAL SCHOOL	350,000.00	358,000.00	665,000.00	2,935,000.00	2,790,000.00	0.00
THE GEN. COUNCIL OF ASSEMBLIES OF	400,000.00	0.00	2,100,000.00	1,400,000.00	0.00	0.00
THE MOCATTA CORPORATION	36,642,000.00	31,323,000.00	26,393,000.00	30,738,000.00	28,879,000.00	34,139,000.00
THE WILSHER GROUP	0.00	0.00	0.00	0.00	0.00	22,187,300.00
TOWN OF CHEEKTOWAGA	0.00	1,050,277.78	1,050,277.78	1,050,278.00	1,050,278.00	1,050,278.00
TOWN OF CORYMANS	0.00	0.00	0.00	500,000.00	0.00	0.00
TOWN OF FALLSBURG	0.00	1,300,000.00	1,300,000.00	1,300,000.00	0.00	0.00
TOWN OF GREENBUSH	0.00	0.00	0.00	300,000.00	0.00	0.00
TOWN OF RUMFORD	0.00	0.00	0.00	1,000,000.00	0.00	0.00
TOWN OF SENECA	0.00	5,200,000.00	6,100,000.00	6,100,000.00	3,700,000.00	800,000.00
VILLAGE OF ARDSLEY	0.00	350,000.00	0.00	0.00	0.00	0.00
VILLAGE OF BELLPORT	0.00	0.00	290,000.00	393,000.00	0.00	0.00
VILLAGE OF E. AURORA	5,000,000.00	4,900,000.00	4,715,000.00	4,715,000.00	4,715,000.00	4,715,000.00
VILLAGE OF OAK PARK	0.00	0.00	0.00	0.00	0.00	650,000.00
VILLAGE OF OAKLAWN	0.00	0.00	100,000.00	100,000.00	100,000.00	0.00
VILLAGE OF SANDS POINT	0.00	0.00	0.00	102,412.50	0.00	0.00
VOLUSHIA COUNTY	0.00	1,000,000.00	0.00	0.00	0.00	0.00
VOLUSIA COUNTY	0.00	0.00	1,000,000.00	1,000,000.00	0.00	0.00
WALLANCE INTERNATIONAL LTD.	500,000.00	400,000.00	0.00	0.00	0.00	0.00
WESTCHESTER BOCES	0.00	0.00	1,000,000.00	1,750,000.00	0.00	0.00
WICHITA FEDERAL S&L	0.00	0.00	2,900,000.00	3,500,000.00	3,400,000.00	2,400,000.00
WILLIAM POLLACK & CO.	0.00	0.00	0.00	0.00	0.00	0.00
WORLD TRADE SECURITIES	0.00	0.00	0.00	0.00	0.00	0.00
	1,448,175,852.70	1,410,745,769.09	1,574,993,229.50	1,513,209,651.04	1,517,083,331.00	2,403,540,320.00

THOMAS TEN, RECEIVER
ESN GOVERNMENT SECURITIES
TEN REPO - MONTH END BALANCES

	JULY 1984	AUGUST 1984	SEPTEMBER 1984	OCTOBER 1984	NOVEMBER 1984	DECEMBER 1984
A.G. BECKER	21,000,000.00	0.00	0.00	0.00	0.00	0.00
ACLI GOVERNMENT SECURITIES	0.00	0.00	0.00	0.00	0.00	0.00
ADAMS COMMUNITY COLLEGE	0.00	0.00	0.00	0.00	0.00	0.00
ALDEN CITY SCHOOL DISTRICT	0.00	0.00	0.00	0.00	0.00	0.00
ALEXANDRIA CITY SCHOOL DIST.	0.00	0.00	0.00	0.00	0.00	0.00
ALTAVA PARISH WILLIAMS CITY SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
AMHERST CITY SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
AMITYVILLE UNION FREE SCHOOL DIST.	0.00	0.00	0.00	0.00	0.00	0.00
AMITYVILLE UNION SCHOOL DIST.	0.00	0.00	0.00	0.00	0.00	0.00
ANDRA COUNTY COURTHOUSE	0.00	0.00	0.00	0.00	0.00	0.00
APPLETON AREA SCHOOL DIST.	0.00	500,000.00	0.00	0.00	0.00	0.00
ARDSLEY UNION FREE SCHOOL DIST.	0.00	0.00	0.00	0.00	0.00	0.00
ARIZONA RETIREMENT SYSTEM	940,000,000.00	214,000,000.00	295,000,000.00	309,960,000.00	270,100,000.00	284,935,000.00
ARLINGTON COUNTY TREASURERS	0.00	0.00	0.00	0.00	0.00	0.00
ATTICA CENTRAL SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
BANK OF THE SOUTH	12,100,000.00	9,250,000.00	23,040,000.00	27,210,000.00	43,000,000.00	20,045,000.00
BD OF ED - NORTH TONAWANDA	0.00	0.00	0.00	0.00	0.00	0.00
BENVER COUNTY PUBLIC UTILITY	0.00	0.00	0.00	0.00	0.00	0.00
BETHESDA HEALTH GROUP	0.00	0.00	0.00	0.00	0.00	0.00
BRUNSTON HOOKA CENTRAL SCH. DIST.	0.00	0.00	0.00	0.00	0.00	0.00
BYRAN HILLS CITY SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
CANAJOHARIE CITY SCHOOL DIST.	0.00	0.00	0.00	0.00	0.00	0.00
CARLEPLACE UNION FREE SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
CHAUTAUQUA CITY SCHOOL DIST.	0.00	0.00	0.00	0.00	0.00	0.00
CHELAN COUNTY	0.00	0.00	0.00	0.00	950,000.00	800,000.00
CHILTON MEMORIAL HOSPITAL	0.00	0.00	0.00	0.00	0.00	0.00
CITY OF ALEXANDRIA	17,449,288.27	20,894,897.34	9,894,198.88	2,894,198.88	0.00	0.00
CITY OF ALLENTOWN, PA.	0.00	0.00	0.00	0.00	0.00	0.00
CITY OF AUSTIN, TEXAS	11,000,000.00	11,000,000.00	12,000,000.00	6,000,000.00	0.00	0.00
CITY OF BATH	0.00	0.00	0.00	0.00	0.00	0.00
CITY OF BEAUMONT	11,000,000.00	15,200,000.00	7,500,000.00	3,000,000.00	13,000,000.00	13,200,000.00
CITY OF BIRMINGHAM, MICHIGAN	0.00	0.00	0.00	0.00	0.00	800,000.00
CITY OF BRADENTON	1,200,000.00	1,200,000.00	1,200,000.00	300,000.00	0.00	0.00
CITY OF BREMER	0.00	0.00	0.00	0.00	0.00	0.00
CITY OF BURNSVILLE, MINNESOTA	1,078,491.70	0.00	9,300,000.00	7,500,000.00	5,300,000.00	5,300,000.00
CITY OF CADILLAC	0.00	0.00	0.00	0.00	0.00	0.00
CITY OF CAMBRIDGE	2,300,000.00	0.00	0.00	0.00	0.00	0.00
CITY OF CLEVELAND HEIGHTS	0.00	0.00	0.00	1,000,000.00	1,000,000.00	0.00
CITY OF FORT WORTH	7,000,000.00	3,000,000.00	0.00	12,000,000.00	12,000,000.00	12,000,000.00
CITY OF FT. PIERCE	0.00	0.00	0.00	0.00	0.00	0.00
CITY OF GARDEN CITY	0.00	0.00	1,250,000.00	1,250,000.00	1,250,200.00	650,000.00
CITY OF HARRISBURG, PA.	3,949,000.00	4,401,000.00	4,770,000.00	5,672,200.00	3,716,200.00	3,896,250.00
CITY OF HAYWARD	1,300,000.00	1,000,000.00	1,000,000.00	1,000,000.00	1,000,000.00	1,000,000.00
CITY OF HICKORY	0.00	0.00	0.00	0.00	0.00	0.00
CITY OF HOPEWELL	0.00	800,000.00	0.00	0.00	0.00	800,000.00
CITY OF KINGSTON	0.00	0.00	0.00	0.00	0.00	0.00
CITY OF LONDOC	800,000.00	500,000.00	500,000.00	500,000.00	500,000.00	500,000.00
CITY OF LUDOWICK	400,000.00	400,000.00	100,000.00	100,000.00	0.00	0.00
CITY OF MIAMI	0.00	0.00	0.00	0.00	0.00	0.00
CITY OF PLANO, TEXAS	0.00	0.00	0.00	0.00	0.00	0.00
CITY OF POMPANO BEACH	0.00	0.00	0.00	0.00	0.00	3,200,000.00

THOMAS TEH, RECEIVER
EDH GOVERNMENT SECURITIES
TERM REPO - MONTH END BALANCES

	JULY 1984	AUGUST 1984	SEPTEMBER 1984	OCTOBER 1984	NOVEMBER 1984	DECEMBER 1984
CITY OF REDWOOD CITY	400,000.00	400,000.00	400,000.00	0.00	0.00	0.00
CITY OF RENO	2,450,000.00	2,400,000.00	0.00	0.00	0.00	0.00
CITY OF RENSSELAER	0.00	0.00	0.00	0.00	0.00	0.00
CITY OF SELMA	700,000.00	0.00	0.00	0.00	0.00	0.00
CITY OF SUNNYVILLE	0.00	0.00	0.00	0.00	0.00	0.00
CITY OF TAWAMC	0.00	1,000,000.00	2,000,000.00	2,000,000.00	2,000,000.00	2,000,000.00
CITY OF TEMPE, ARIZONA	2,250,000.00	4,500,000.00	2,250,000.00	2,250,000.00	9,700,000.00	2,200,000.00
CITY OF TOLEDO	2,000,000.00	12,000,000.00	14,200,000.00	14,104,005.56	13,650,000.00	10,710,000.00
CITY OF TULSA, OKLAHOMA	17,200,000.00	14,200,000.00	10,475,000.00	14,200,000.00	17,100,000.00	13,945,005.00
CITY OF WATERVLIET CITY HALL	0.00	0.00	0.00	0.00	0.00	0.00
CLALLAM COUNTY P.U.D.	0.00	0.00	0.00	1,200,000.00	2,457,201.49	2,007,200.56
CLALLAM COUNTY TREASURER	9,200,904.50	9,102,700.56	10,077,172.67	10,106,299.02	12,007,771.57	12,704,207.75
CLARK COUNTY TREASURER	14,070,000.00	22,700,000.00	12,200,000.00	14,050,000.00	17,700,000.00	4,200,000.00
CLARK COUNTY, WASHINGTON	5,410,000.00	4,700,000.00	14,041,207.01	11,700,207.01	6,545,200.00	1,402,000.00
CLYDE-SAVANNAH CITY SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
COHOCK UNION FREE SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
COMMONWEALTH SBL	0.00	0.00	0.00	0.00	0.00	0.00
COMMERCIAL CENTRAL SCHOOL DIST.	0.00	0.00	0.00	0.00	0.00	0.00
COUNTY OF HILLSBORO	0.00	0.00	0.00	0.00	0.00	0.00
COUNTY OF HERRIMACK	0.00	0.00	0.00	0.00	0.00	0.00
COUNTY OF PRINCE WILLIAM	0.00	3,000,200.00	3,000,000.00	3,000,000.00	3,000,000.00	0.00
COUNTY OF PUTNAM	0.00	0.00	0.00	0.00	0.00	0.00
COUNTY OF ROCKINGHAM	0.00	0.00	0.00	0.00	0.00	0.00
COUNTY OF SARATOGA	0.00	0.00	0.00	0.00	0.00	0.00
CREIGHTON UNIVERSITY	0.00	0.00	0.00	0.00	0.00	0.00
DAUPHIN COUNTY, PA.	2,000,000.00	2,200,000.00	2,000,000.00	4,001,275.00	4,001,275.00	2,000,000.00
DEER PACK UNION FREE SCH. DIST.	0.00	0.00	0.00	0.00	0.00	0.00
DELAWARE VALLEY CITY SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
DLJ GOVERNMENT SECURITIES	0.00	0.00	0.00	0.00	0.00	0.00
DOBBS FERRY UNION FREE SCH. DIST.	0.00	0 20	0.00	0.00	0.20	0.00
EAST AURORA UNION FREE SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
EAST MEADOW	0.00	0.00	0.00	0.00	0.00	0.00
EAST ROCHESTER PUBLIC SCHOOLS	0.00	0.00	0.00	0.00	0.00	0.00
ELMSFORD UNION FREE SCHOOL DIST.	650,000.00	0.00	0.00	0.00	0.00	0.00
ENT. FEDERAL CREDIT UNION	0.00	0.00	0.00	0.00	0.00	0.00
ESCAMBIA COUNTY CONTROLLERS	0.00	0.00	0.00	0.00	0.00	0.00
EUST RAPIDS CITY SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
FIRST CITY BANK	15,400,000.00	14,305,000.00	13,375,000.00	10,005,000.00	12,670,000.00	20,415,000.00
FIRST FEDERAL SBL OF MADISON	0.00	0.00	0.00	0.00	0.00	0.00
FIRST FEDERAL SAVINGS & LOAN	0.00	0.00	0.00	0.00	0.00	0.00
FLORENCE HIGHTENDALE NURSERY	0.00	0.00	0.00	0.00	0.00	0.00
FORSYTH COUTNY, N.C.	0.00	0.00	500,000.00	0.00	0.00	0.00
FOX VALLEY CORP.	0.00	0.00	0.00	0.00	0.00	0.00
FRONTIER CENTRAL SCHOOL DIST.	1,500,000.00	0.00	0.00	0.00	0.00	0.00
GA. INSTITUTE OF TECHNOLOGY	0.00	0.00	0.00	0.00	0.00	0.00
GENEVA CITY SCHOOL DIST	0.00	0.00	0.00	0.00	0.00	0.00
GIBSON TUBE, INC.	0.00	0.00	0.00	0.00	0.00	0.00
GLOVERSVILLE CITY SCHOOL DIST.	0.00	0.00	0.00	0.00	0.00	0.00
GOLDEN EGG FARM, INC.	0.00	0.00	0.00	0.00	0.00	0.00
GRAND ISLAND CENTRAL SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
GRAND ISLAND CENTRAL SCHOOL DIST.	0.00	0.00	0.00	0.00	0.00	0.00

THOMAS TEN, RECEIVER
ESH GOVERNMENT SECURITIES
TERM REPO - MONTH END BALANCES

	JULY 1984	AUGUST 1984	SEPTEMBER 1984	OCTOBER 1984	NOVEMBER 1984	DECEMBER 1984
GREENBURGH SCHOOL DIST 07	0.00	0.00	0.00	0.00	0.00	0.00
GREENWICH CAPITAL MARKETS, INC.	86,200,000.00	0.00	0.00	0.00	0.00	0.00
GUILDERLAND CITY SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
HAMBURG CENTRAL SCHOOL DIST.	0.00	0.00	0.00	0.00	0.00	0.00
HAMILTON BANK	0.00	0.00	5,000,000.00	4,705,000.00	5,000,000.00	4,990,000.00
HEALTHCARE PLAN OF N.J.	200,000.00	0.00	0.00	0.00	0.00	0.00
HEMPSTEAD UNION FREE SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
HENROCK HUDSON - CENTRAL SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
HOLLAND CENTRAL SCHOOL DISTRICT	0.00	0.00	0.00	0.00	0.00	0.00
HOME SAVINGS ASSOCIATION OF FL.	29,285,000.00	7,210,000.00	7,750,000.00	19,970,000.00	82,970,000.00	82,970,000.00
INC. VILLAGE OF LACE SUCCESS	0.00	0.00	0.00	0.00	0.00	0.00
INDEPENDENT INSURANCE AGENTS	0.00	0.00	0.00	0.00	0.00	0.00
IOWA PUBLIC EMPLOYEES RETIREMENT	6,915,000.00	10,495,000.00	10,085,000.00	5,000,000.00	8,600,000.00	9,600,000.00
IRVINGTON UNION FREE SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
ISLAND PARK UNION FREE SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
JEFFERSON COUNTY, WASHINGTON	2,725,225.00	2,770,490.70	2,840,090.70	5,170,190.70	4,946,527.34	4,165,669.92
JOHNSON CITY SCHOOL DIST.	0.00	0.00	0.00	0.00	0.00	0.00
KAMAN CORPORATION	0.00	0.00	0.00	0.00	0.00	0.00
KENMORE-TOWN OF TONAWANDA	0.00	0.00	0.00	0.00	0.00	0.00
KLEINWORT BENSON GOVERNMENT SEC.	301,360,893.75	494,345,275.00	387,086,125.00	461,381,645.84	388,988,288.38	355,488,048.95
KODIAK ISLAND BOROUGH	0.00	0.00	0.00	0.00	0.00	0.00
L.A. COUNTY EMPLOYEES RETIREMENT	90,850,000.00	0,000,000.00	0.00	0.00	0.00	0.00
LAKE PLACID CITY SCHOOL DIST.	0.00	0.00	0.00	0.00	0.00	0.00
LAKEMORE CITY SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
LANCASTER CITY SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
LASSER MARSHALL, INC.	880,899,125.00	665,684,750.00	579,975,700.00	567,985,750.00	886,270,000.00	159,446,250.00
LAURIUS CITY SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
LIBERTY GROUP	0.00	20,886,000.00	20,475,000.00	41,080,000.00	32,075,000.00	22,140,000.00
MACON SAVINGS & LOAN	0.00	0.00	0.00	0.00	0.00	0.00
MAMOPAC CITY SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
MEMPHIS CITY SCHOOL BOARD	0.00	0.00	6,085,000.00	13,300,000.00	11,300,000.00	4,000,000.00
MERCHANTS NATIONAL BANK	1,000,000.00	0.00	0.00	0.00	0.00	0.00
MINISTERS BENEFIT ASSOCIATION	0.00	0.00	0.00	0.00	0.00	0.00
MOORE FINANCIAL, INC.	0.00	0.00	0.00	0.00	0.00	0.00
MOORE LAKE AUTO RADIATOR	0.00	0.00	0.00	0.00	0.00	0.00
MOSELEY, HALLGARTEN, ESTABROOK	113,465,000.00	138,666,250.00	154,891,300.00	141,785,000.00	889,841,250.00	210,168,750.00
MUTUAL FED. SAL	0.00	0.00	0.00	0.00	0.00	0.00
MARKET UNION FREE SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
NEW YORK HANSEATIC CORP.	7,370,000.00	0.00	0.00	0.00	0.00	0.00
NIAGARA FALLS CITY SCHOOLS	200,000.00	800,000.00	0.00	0.00	0.00	0.00
OHBAYASHI-GUMI LTD	0.00	0.00	0.00	0.00	0.00	0.00
OHIO STATE UNIVERSITY	3,400,000.00	2,190,000.00	2,000,000.00	2,960,000.00	3,885,000.00	2,750,000.00
OHIO STATE UNIVERSITY MEDICAL	0.00	0.00	0.00	0.00	0.00	0.00
OPPENHEIMER & CO.	32,900,000.00	40,640,000.00	41,875,000.00	0.00	0.00	0.00
OSSINING UNION FREE SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
P.U.D. SELF INS. FUND	0.00	0.00	0.00	0.00	300,000.00	300,000.00
PAINE WEBBER JACKSON CURTIS	0.00	0.00	0.00	0.00	0.00	0.00
PAWLING CENTRAL SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
PIONEERS YORKSHIRE CENTRAL	0.00	0.00	0.00	0.00	0.00	0.00
PLATTSBURGH CITY SCHOOL DIST.	0.00	0.00	0.00	0.00	0.00	0.00
PORT BRYON CITY SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00

THOMAS TEH, RECEIVER
EBH GOVERNMENT SECURITIES
TERM REPO - MONTH END BALANCES

	JULY 1984	AUGUST 1984	SEPTEMBER 1984	OCTOBER 1984	NOVEMBER 1984	DECEMBER 1984
POPKIN, LEIBOW & BERGSTEIN	0.00	0.00	0.00	0.00	0.00	0.00
PORTLAND WATER DIST	0.00	0.00	0.00	0.00	0.00	0.00
POUGHKEEPSIE CITY SCHOOL DIST.	0.00	0.00	0.00	0.00	0.00	0.00
PUTNAM WESTCHESTER B.O.C.E.S.	0.00	0.00	0.00	0.00	0.00	0.00
REPCO PARTNERS	13,131,000.00	9,200,000.00	2,405,000.00	0.00	0.00	0.00
RESOURCE MANAGEMENT	0.00	85,906,250.00	87,766,250.00	13,940,500.00	68,102,250.00	0.00
RESOURCE MANAGEMENT II	545,850,700.00	0.00	0.00	0.00	0.00	0.00
RESOURCE MANAGEMENT III	0.00	0.00	0.00	0.00	0.00	0.00
RESOURCE MANAGEMENT IV	0.00	0.00	0.00	0.00	0.00	0.00
ROCHESTER CITY HALL	0.00	0.00	0.00	0.00	0.00	0.00
ROCHESTER INSTVD. PRACTICE	400,000.00	400,000.00	400,000.00	0.00	0.00	0.00
ROYAL PALM SBL	0.00	0.00	0.00	0.00	0.00	0.00
SAYVILLE UNION FREE SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
SCHOOL DIST OF GREENVILLE, S.C.	0.00	0.00	0.00	0.00	0.00	0.00
SEAFORD UNION FREE SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
SENECA COUNTY	0.00	0.00	0.00	0.00	0.00	0.00
SHAWNEE FEDERAL SBL	2,000,000.00	2,230,000.00	0.00	0.00	0.00	0.00
SHERBURNE EARLVILLE CITY	0.00	0.00	0.00	0.00	0.00	0.00
SOUTH COLONIE CENTRAL SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
ST. LAWRENCE-LEWIS	0.00	0.00	0.00	0.00	0.00	0.00
STATE OF NEW MEXICO	0.00	0.00	22,722,000.00	14,230,000.00	0.00	0.00
STATE OF WEST VIRGINIA	0.00	0.00	0.00	0.00	0.00	0.00
STEPHENS, INC.	0.00	0.00	0.00	0,000,000.00	0.00	0.00
SWEETHOM CENTRAL SCHOOL	0.00	0.00	0.00	0.00	0.00	0.00
THE GEN. COUNCIL OF ASSEMBLIES OF	0.00	0.00	0.00	0.00	0.00	0.00
THE HOCHTTA CORPORATION	74,736,500.00	188,799,000.00	188,494,000.00	37,722,500.00	94,974,000.00	94,644,000.00
THE WELSHER GROUP	94,881,050.00	0.00	56,161,250.00	38,490,750.00	0.00	0.00
TOWN OF CHEEKTOWAGA	1,050,277.72	1,050,277.72	1,050,277.72	1,050,277.72	1,050,277.72	1,051,341.62
TOWN OF CORTLAND	0.00	0.00	0.00	0.00	0.00	0.00
TOWN OF FALLSBURG	0.00	0.00	0.00	0.00	0.00	0.00
TOWN OF GREENBURGH	0.00	0.00	0.00	0.00	0.00	0.00
TOWN OF RUMFORD	0.00	0.00	0.00	0.00	0.00	0.00
TOWN OF SENECA	400,000.00	400,000.00	0.00	0.00	0.00	0.00
VILLAGE OF ANDERLEY	0.00	0.00	0.00	0.00	0.00	0.00
VILLAGE OF BELLPORT	0.00	0.00	0.00	0.00	0.00	0.00
VILLAGE OF E. AURORA	3,940,000.00	3,940,000.00	3,940,000.00	3,940,000.00	3,940,000.00	0.00
VILLAGE OF OAK PARK	600,000.00	500,000.00	0.00	0.00	0.00	0.00
VILLAGE OF OAKLAWN	0.00	0.00	0.00	0.00	0.00	0.00
VILLAGE OF SANDS POINT	0.00	0.00	0.00	0.00	0.00	0.00
VOLUSIA COUNTY	0.00	0.00	0.00	0.00	0.00	0.00
WELSIA COUNTY	0.00	0.00	0.00	0.00	0.00	0.00
WALLANCE INTERNATIONAL LTD.	0.00	0.00	0.00	0.00	0.00	0.00
WESTCHESTER DOCKS	0.00	0.00	0.00	0.00	0.00	0.00
WICHITA FEDERAL SBL	3,765,000.00	3,765,065.00	3,765,000.00	0,165,200.00	0.00	0.00
WILLIAM POLLACK & CO.	0.00	14,710,750.00	5,200,250.00	5,470,747.00	12,449,000.00	21,484,000.00
WORLD TRADE SECURITIES	0.00	0.00	0.00	0.00	32,750,774.94	32,750,774.94
	2,273,144,480.00	2,115,104,897.46	2,171,710,899.62	1,884,990,974.57	1,790,485,885.00	1,681,480,611.74

THOMAS TEN, RECEIVER
ESH GOVERNMENT SECURITIES, INC.
END OF MONTH BALANCES - 1988
TERM REPO

	JANUARY 1988	FEBRUARY 1988	MARCH 1988	APRIL 1988	MAY 1988	JUNE 1988
RESOURCE MANAGEMENT II	57,855,000.00	59,240,000.00	20,945,000.00	35,948,000.00	35,484,458.12	72,705,000.00
ACLI GOVERNMENT SECURITIES	9,742,500.00	10,977,500.00	24,080,750.00	9,870,000.00	127,212,250.00	216,467,375.00
ARIZONA RETIREMENT SYSTEM	173,500,000.00	170,000,000.00	145,000,000.00	115,000,000.00	114,000,000.00	104,000,000.00
CITY OF TEMPE ARIZONA	5,300,000.00	5,300,000.00	5,000,000.00	8,200,000.00	4,900,000.00	21,345,000.00
CITY OF HAYWARD	5,850,000.00	5,829,000.00	3,000,000.00	5,850,065.00	5,850,000.00	5,888,000.00
OFFICE OF FINANCIAL MANAGEMENT WASH	48,600,000.00	14,300,000.00	4,300,000.00	72,300,000.00	35,719,000.00	151,300,000.00
BANK OF THE SOUTH	30,000,000.00	46,040,000.00	3,000,000.00	46,070,000.00	6,070,000.00	4,730,000.00
IOWA PUBLIC EMPLOYEES RET. SYS.	10,000,000.00	24,000,000.00	14,000,000.00	0.00	0.00	0.00
KECHATA FEDERAL SSL	1,500,000.00	1,500,000.00	0.00	0.00	0.00	0.00
CLARK COUNTY TREAS.	45,115,000.00	29,715,000.00	17,750,000.00	21,010,000.00	18,450,000.00	12,700,000.00
STATE INDUSTRIAL SYSTEM	5,250,000.00	27,070,000.00	20,760,000.00	9,000,000.00	4,040,000.00	0.00
STATE OF NEW MEXICO	5,965,000.00	5,845,000.00	5,975,000.00	0.00	0.00	0.00
MPH PARTNERS	25,485,000.00	0.00	0.00	0.00	0.00	0.00
CITY OF TULSA	21,880,000.44	21,880,000.44	22,100,499.00	21,870,499.00	68,371,245.21	24,880,455.21
CITY OF HARRISBURG	4,345,000.00	5,921,000.00	9,077,000.00	8,345,000.00	7,355,000.00	6,345,488.28
DAUPHIN COUNTY, PA.	1,730,000.00	0.00	0.00	5,000,000.00	2,000,000.00	3,300,000.00
SALT LAKE COUNTY	2,345,330.48	2,346,711.84	2,346,711.84	2,346,711.84	2,346,711.84	2,346,711.84
CLALLUM COUNTY TREASURER	615,000.00	2,815,000.00	1,415,000.00	5,440,597.48	4,440,000.00	4,040,000.00
CLARK COURY WASH.	19,400,000.00	19,406,000.00	7,465,000.00	19,760,000.00	9,580,000.00	12,870,000.00
LEWIS COUNTY TREASURER	2,400,000.00	1,700,000.00	500,000.00	5,000,000.00	4,900,000.00	4,840,000.00
OLAJ GOVERNMENT SECURITIES	0.00	10,025,000.00	31,200,750.00	29,157,500.00	107,735,000.00	42,197,500.00
LASSER MARSHALL	0.00	87,277,500.00	88,587,500.00	21,400,750.00	29,100,750.00	948,702,750.00
N.Y. MANSEATIC	0.00	15,018,750.00	87,275,000.00	74,170,964.09	14,345,000.00	0.00
SALO RIVER PROJECT	0.00	17,300,000.00	17,300,000.00	10,000,000.00	10,000,000.00	10,000,000.00
COMBANK INVESTMENT ACCOUNT	0.00	21,000,000.00	0.00	0.00	0.00	0.00
HAMILTON COUNTY	0.00	250,000.00	250,000.00	0.00	0.00	0.00
REFCO PARTNERS	0.00	0.00	48,023,000.00	0.00	0.00	0.00
MANATEE COUNTY	0.00	0.00	5,300,000.00	5,300,000.00	5,300,000.00	4,030,000.00
SHAWNEE FEDERAL SSL	0.00	0.00	2,000,000.00	3,000,000.00	10,000,000.00	14,000,000.00
MP INDUSTRIAL TRADERS	0.00	0.00	5,031,250.00	0.00	21,017,500.00	0.00
HAMILTON BANK	0.00	0.00	3,000,000.00	0.00	1,925,000.00	4,940,000.00
FIRST CITY BANK, DALLAS	0.00	0.00	10,000,000.00	5,900,000.00	0.00	24,700,000.00
RESOURCE MANAGEMENT SERVICES	0.00	0.00	0.00	7,640,000.00	9,550,000.00	9,145,000.00
RESOURCE MANAGEMENT III	0.00	0.00	0.00	47,500,000.00	42,000,000.00	30,000,000.00
CITY OF MESA	0.00	0.00	0.00	4,000,000.00	4,700,000.00	3,300,000.00
MICHIGAN STATE TREASURER	0.00	0.00	0.00	4,000,000.00	0.00	0.00
MPH PARTNERS N.Y.	0.00	0.00	0.00	8,718,750.00	0.00	0.00
BANCOHIO NATIONAL BK TRUST DEP'T.	0.00	0.00	0.00	1,000,000.00	1,000,000.00	0.00
OHIO STATE UNIVERSITY	0.00	0.00	0.00	8,900,000.00	2,715,000.00	5,300,000.00
RAUSCHER,PIERCE,REFSNES,INC.	0.00	0.00	0.00	0.00	0.00	800,000.00
CITY OF FT. WORTH, TEXAS	0.00	0.00	0.00	0.00	0.00	0.00
OHIO STATE UNIVERSITY MEDICAL	0.00	0.00	0.00	0.00	0.00	0.00
ANOKA COUNTY COURTHOUSE	0.00	0.00	0.00	0.00	2,105,000.00	16,300,000.00
JEFFERSON COUNTY, WASH.	0.00	0.00	0.00	0.00	3,000,000.00	3,000,000.00
A.G. BECKER	0.00	0.00	0.00	0.00	0.00	0.00
MORGAN STANLEY	0.00	0.00	0.00	0.00	0.00	0.00
MOSIE,HALGARDEN ESTABROOK	0.00	0.00	0.00	0.00	0.00	0.00
PAINE WEBBER JACKSON CURTIS	0.00	0.00	0.00	0.00	0.00	0.00
L.A. COUNTY EMPLOYEE RETIREMENT	0.00	0.00	0.00	0.00	0.00	0.00

THOMAS TEU, RECEIVER
ESH GOVERNMENT SECURITIES, INC.
END OF MONTH BALANCES - 1988
TERM REPO

	JANUARY 1988	FEBRUARY 1988	MARCH 1988	APRIL 1988	MAY 1988	JUNE 1988
ESCAMBIA COUNTY CONTROLLERS	0.00	0.00	0.00	0.00	0.00	0.00
HOME SAVINGS ASSOC. OF FLA.	0.00	0.00	0.00	0.00	0.00	0.0
CITY OF BURNSVILLE, MINN.	0.00	0.00	0.00	0.00	0.00	0.00
ANGLO AMERICAN FINANCIAL	0.00	0.00	0.00	0.00	0.00	0.00
ANGLO AMERICAN FINANCIAL	0.00	0.00	0.00	0.00	0.00	0.00
THE WILMER GROUP	0.00	0.00	0.00	0.00	0.00	0.00
THE HECATTA CORPORTATION	0.00	0.00	0.00	0.00	0.00	0.00
CITY OF AUSTIN	0.00	0.00	0.00	0.00	0.00	0.0
TOWN OF ADDISON, TEXAS	0.00	0.00	0.00	0.00	0.00	2,000,000.00
STATE OF WEST VA.	0.00	0.00	0.00	0.00	0.00	0.00
MASS. BAY TRANSIT AUTHORITY	0.00	0.00	0.00	0.00	0.00	0.00
MORGAN,KEEGAN & CO.	0.00	0.00	0.00	0.00	0.00	0.00
BEVERLY HILLS SAVINGS & LOAN	0.00	0.00	0.00	0.00	0.00	0.00
MEMPHIS CITY SCHOOL BOARD	0.00	0.00	0.00	0.00	0.00	0.00
CITY OF PLANO, TEXAS	0.00	0.00	0.00	0.00	0.00	0.0
PHOENIX CAPITAL GROUP, INC.	0.00	0.00	0.00	0.00	0.00	0.00
RESOURCE MANAGEMENT IV	0.00	0.00	0.00	0.00	0.00	0.00
ROYAL PALM SAVINGS & LOAN	0.00	0.00	0.00	0.00	0.00	0.00
GEORGIA INSTITUTE OF TECHNOLOGY	0.00	0.00	0.00	0.00	0.00	0.00
THE GN'RL COUNCIL OF THE ASSEMBLIES	0.00	0.00	0.00	0.00	0.00	0.00
GIBSON TUBE, INC.	0.00	0.00	0.00	0.00	0.00	0.0
	473,889,189.89	338,150,330.50	547,990,440.92	647,948,772.44	699,986,688.17	1,966,698,189.48

THOMAS TEN, RECEIVER
ESH GOVERNMENT SECURITIES, INC.
END OF MONTH BALANCES - 1988
TERM REPO

	JULY 1988	AUGUST 1988	SEPTEMBER 1988	OCTOBER 1988	NOVEMBER 1988	DECEMBER 1988
RESOURCE MANAGEMENT II	70,415,000.00	36,265,000.00	46,760,000.00	42,791,250.00	27,946,250.00	38,691,250.00
ACLI GOVERNMENT SECURITIES	126,465,650.00	118,044,456.25	189,147,031.25	164,737,812.50	178,129,812.50	282,789,487.50
ARIZONA RETIREMENT SYSTEM	189,000,000.00	899,000,000.00	294,000,000.00	294,000,000.00	896,000,000.00	216,000,000.00
CITY OF TEMPE ARIZONA	29,249,000.00	29,490,000.00	29,130,000.00	18,250,000.00	28,750,000.00	29,300,000.00
CITY OF HAYWARD	5,829,000.00	6,320,000.00	7,145,000.00	9,145,000.00	7,145,000.00	9,145,000.00
OFFICE OF FINANCIAL MANAGEMENT WASH	44,300,000.00	0.00	0.00	0.00	0.00	0.00
BANK OF THE SOUTH	38,921,000.00	22,429,000.00	41,114,125.00	30,730,000.00	25,419,000.00	42,893,000.00
IOWA PUBLIC EMPLOYEES RET. SYS.	2,410,000.00	5,000,000.00	6,050,000.00	10,945,000.00	10,000,000.00	6,050,000.00
WICHATA FEDERAL SAL	3,000,000.00	13,300,000.00	2,600,000.00	0.00	0.00	0.00
CLARK COUNTY TREAS.	5,400,000.00	3,275,000.00	3,220,000.00	7,045,000.00	7,300,000.00	6,850,000.00
STATE INDUSTRIAL SYSTEM	0.00	0.00	0.00	0.00	0.00	0.00
STATE OF NEW MEXICO	0.00	3,685,000.00	3,570,000.00	8,995,000.00	9,220,000.00	7,200,000.00
MPH PARTNERS	0.00	0.00	0.00	0.00	0.00	0.00
CITY OF TULSA	22,417,483.31	28,302,483.31	29,394,973.13	25,483,977.19	24,345,918.29	28,850,918.29
CITY OF HARRISBURG	3,032,488.38	3,482,488.38	1,874,000.00	1,874,000.00	1,874,000.00	0.00
DAUPHIN COUNTY, PA.	3,000,000.00	1,000,000.00	0.00	0.00	0.00	0.00
SALT LAKE COUNTY	2,304,711.84	2,304,711.84	0.00	0.00	0.00	0.00
CLALLUM COUNTY TREASURER	2,240,000.00	2,240,000.00	2,440,000.00	3,040,000.00	12,090,484.38	9,940,335.56
CLARK COURY WASH.	3,489,700.00	7,202,000.00	6,308,000.00	7,720,000.00	17,648,000.00	14,488,448.44
LEWIS COUNTY TREASURER	3,440,000.00	1,960,000.00	300,000.00	300,000.00	300,000.00	0.00
DLEJ GOVERNMENT SECURITIES	25,112,300.00	59,610,000.00	34,081,250.00	47,023,000.00	79,787,300.00	84,488,000.00
LASSER MARSHALL	376,998,812.50	487,484,750.00	484,288,750.00	488,871,250.00	493,361,875.00	413,971,750.00
N.Y. HANSEATIC	49,542,300.00	74,750,000.00	108,377,875.00	101,376,042.50	112,495,750.00	25,000,000.00
SALO RIVER PROJECT	10,000,000.00	10,000,000.00	10,000,000.00	0.00	0.00	0.00
COMBANK INVESTMENT ACCOUNT	0.00	0.00	0.00	0.00	0.00	0.00
HAMILTON COUNTY	0.00	0.00	0.00	0.00	0.00	0.00
REFCO PARTNERS	9,870,000.00	9,665,000.00	0.00	0.00	0.00	8,165,000.00
MAHATSE COUNTY	1,000,000.00	2,500,000.00	0.00	0.00	0.00	0.00
SHAWNEE FEDERAL SAL	11,300,000.00	11,825,000.00	2,300,000.00	0.00	0.00	0.00
MP INDUSTRIAL TRADERS	0.00	0.00	0.00	0.00	0.00	0.00
HAMILTON BANK	2,940,000.00	2,940,000.00	0.00	0.00	0.00	0.00
FIRST CITY BANK, DALLAS	7,000,000.00	12,000,000.00	14,000,000.00	10,940,000.00	12,000,000.00	3,000,000.00
RESOURCE MANAGEMENT SERVICES	8,255,000.00	14,789,000.00	10,675,000.00	0.00	0.00	2,700,000.00
RESOURCE MANAGEMENT III	102,488,671.88	102,488,671.88	98,858,671.88	139,488,671.88	97,618,000.00	129,762,500.00
CITY OF MESA	5,500,000.00	2,900,000.00	2,900,000.00	2,900,000.00	2,900,000.00	0.00
MICHIGAN STATE TREASURER	0.00	1,004,000.00	0.00	0.00	0.00	0.00
MPH PARTNERS N.Y.	0.00	0.00	0.00	0.00	0.00	0.00
BANCOHIO NATIONAL BK TRUST DEP'T.	0.00	0.00	0.00	0.00	0.00	0.00
OHIO STATE UNIVERSITY	5,075,000.00	4,125,000.00	6,225,000.00	4,540,000.00	4,735,000.00	5,000,000.00
RAUSCHER,PIERCE,REFSNES,INC.	33,976,150.00	0.00	0.00	0.00	0.00	0.00
CITY OF FT. WORTH, TEXAS	8,000,000.00	8,000,000.00	8,000,000.00	0.00	0.00	0.00
OHIO STATE UNIVERSITY MEDICAL	475,000.00	750,000.00	1,000,000.00	0.00	0.00	0.00
ANOKA COUNTY COURTHOUSE	4,300,000.00	4,300,000.00	4,000,000.00	5,815,000.00	13,000,000.00	9,050,000.00
JEFFERSON COUNTY, WASH.	3,000,000.00	2,400,000.00	1,700,000.00	2,000,000.00	2,000,000.00	3,100,000.00
A.G. BECKER	0.00	32,411,000.00	29,971,000.00	32,413,000.00	11,300,000.00	28,448,000.00
MORGAN STANLEY	0.00	0.00	0.00	8,988,000.00	8,988,000.00	0.00
MOSIE,HALDARDON ESTABROOK	0.00	0.00	0.00	16,057,500.00	10,150,000.00	25,300,000.00
PAINE WEBBER JACKSON CURTIS	0.00	0.00	0.00	5,236,000.00	5,186,000.00	5,000,000.00
L.A. COUNTY EMPLOYEE RETIREMENT	0.00	29,200,000.00	19,000,000.00	20,600,000.00	0.00	0.00

THOMAS TEW, RECEIVER
ESM GOVERNMENT SECURITIES, INC.
END OF MONTH BALANCES - 1988
TERM REPO

	JULY 1988	AUGUST 1988	SEPTEMBER 1988	OCTOBER 1988	NOVEMBER 1988	DECEMBER 1988
ESCAMBIA COUNTY CONTROLLERS	0.00	1,370,680.65	2,554,046.67	1,594,200.00	0.00	488,000.00
HOME SAVINGS ASSOC. OF FLA.	0.00	18,775,000.00	18,750,000.00	19,126,000.00	19,126,000.00	19,126,000.00
CITY OF BURNSVILLE, MINN.	1,000,000.00	1,000,000.00	1,000,000.00	1,025,125.01	1,025,125.01	1,025,125.01
ANGLO AMERICAN FINANCIAL	0.00	15,947,300.00	6,897,300.00	940,000.00	19,190,000.00	10,688,098.96
ANGLO AMERICAN FINANCIAL	0.00	0.00	0.00	11,146,000.00	0.00	0.00
THE WILSHER GROUP	45,097,500.00	57,618,750.00	31,918,750.00	29,875,000.00	10,200,000.00	31,125,000.00
THE MOCATTA CORPORTATION	7,200,000.00	22,365,000.00	48,679,000.00	47,154,000.00	88,299,000.00	35,762,000.00
CITY OF AUSTIN	0.00	1,275,000.00	3,794,000.00	12,402,000.00	5,300,000.00	2,000,000.00
TOWN OF ADDISON, TEXAS	2,335,000.00	2,335,000.00	2,335,000.00	1,235,000.00	385,000.00	0.00
STATE OF WEST VA.	0.00	19,420,000.00	30,000,000.00	25,000,000.00	0.00	0.00
MASS. BAY TRANSIT AUTHORITY	0.00	0.00	4,290,000.00	0.00	0.00	0.00
MORGAN,KEEGAN & CO.	0.00	0.00	4,400,000.00	0.00	0.00	0.00
BEVERLY HILLS SAVINGS & LOAN	0.00	0.00	0.00	0.00	3,000,000.00	0.00
MEMPHIS CITY SCHOOL BOARD	0.00	0.00	0.00	0.00	2,000,000.00	3,000,000.00
CITY OF PLANO, TEXAS	0.00	0.00	0.00	0.00	11,000,000.00	1,160,000.00
PHOENIX CAPITAL GROUP, INC.	0.00	0.00	0.00	0.00	0.00	31,114,747.35
RESOURCE MANAGEMENT IV	0.00	0.00	0.00	0.00	0.00	9,225,000.00
ROYAL PALM SAVINGS & LOAN	0.00	0.00	0.00	0.00	0.00	1,000,000.00
GEORGIA INSTITUTE OF TECHNOLOGY	0.00	0.00	0.00	0.00	0.00	900,850.00
THE GN'RL COUNCIL OF THE ASSEMBLIES	0.00	0.00	0.00	0.00	0.00	400,000.00
GIBSON TUBE, INC.	0.00	0.00	0.00	0.00	0.00	478,988.1
	1,323,843,399.84	1,484,481,844.26	1,497,988,592.78	1,497,385,269.08	1,349,138,515.78	1,512,699,286.54

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THOMAS TEV, RECEIVER ESH GOVERNMENT SECURITIES , INC. TERM REPOS END OF MONTH BALANCE 1982	JULY 1982	AUGUST 1982	SEPTEMBER 1982	OCTOBER 1982	NOVEMBER 1982	DECEMBER 1982
N.Y HANSEATIC	30,844,000.00	30,145,000.00	4,347,500.00	0.00	39,812,500.00	0.00
RESOURCE MANAGEMENT II	17,421,875.00	0.00	0.00	8,438,000.00	34,440,000.00	34,440,000.00
ACLI GOVERNMENT SECURITIES	47,425,000.00	8,153,750.00	0.00	0.00	0.00	0.00
ARIZONA RETIREMENT SYSTEMS	90,000,000.00	0.00	0.00	0.00	0.00	119,000,000.00
CITY OF TEMPE, ARIZONA	3,370,000.00	8,438,000.00	8,405,000.00	7,535,000.00	8,240,000.00	6,875,000.00
CITY OF HAYWARD	6,875,000.00	6,875,000.00	6,875,000.00	5,875,000.00	5,828,000.00	5,828,000.00
OFFICE OF FINANCIAL MGT.	74,500,000.00	44,000,000.00	84,100,000.00	77,100,000.00	38,700,000.00	51,750,000.00
PRINCE GEORGE COUNTY	1,777,000.01	0.00	0.00	0.00	0.00	0.00
CITY OF FLINT MICHIGAN	1,700,000.00	1,300,000.00	1,400,000.00	2,500,000.00	0.00	0.00
ANOKA COUNTY COURTHOUSE	8,150,000.00	4,150,000.00	1,450,000.00	0.00	0.00	0.00
NORTHWEST NATIONAL BANK	11,340,000.00	4,400,000.00	3,855,000.00	11,990,000.00	22,875,000.00	38,650,000.00
CLARK COUNTY TREASURER	72,500,000.00	81,000,000.00	0.00	0.00	47,915,000.00	57,415,000.00
STATE TREASURER OF NEVADA	4,550,000.00	0.00	58,875,000.00	47,700,000.00	0.00	0.00
CITY OF TULSA	20,423,050.20	28,710,199.44	2,300,000.00	21,525,583.41	19,529,444.45	21,315,444.45
FM BANK OF TULSA	3,400,000.00	3,400,000.00	1,750,000.00	1,300,000.00	0.00	0.00
CITY OF HARRISBURG PA.	1,750,000.00	1,750,000.00	0.00	1,750,000.00	1,750,000.00	0.00
CONRAIL	52,605,000.00	0.00	0.00	0.00	0.00	0.00
DAUPHIN CITY TREASURER	2,000,000.00	1,811,600.56	0.00	0.00	0.00	0.00
SALT LAKE CITY & COUNTY	8,444,333.75	8,444,333.75	3,444,333.75	3,374,333.75	13,763,330.43	3,365,330.43
FIRST CITY BANK	4,000,000.00	0.00	0.00	0.00	0.00	0.00
CLALLUM COUNTY TREASURER	1,115,000.00	415,000.00	415,000.00	415,000.00	415,000.00	415,000.00
CLARK COUNTY TREASURER	12,344,000.00	7,811,000.00	8,837,000.00	17,341,000.00	13,079,000.00	13,976,000.00
LEWIS COUNTY TREASURER	1,000,000.00	1,000,000.00	0.00	1,000,000.00	3,400,000.00	300,000.00
LASSER MARSHALL	0.00	13,370,750.00	0.00	7,710,000.00	0.00	0.00
SALT RIVER PROJECT	0.00	4,000,000.00	4,000,000.00	4,000,000.00	0.00	0.00
BANK OF THE SOUTH	0.00	5,000,000.00	17,735,000.00	24,438,000.00	23,411,500.00	13,000,000.00
FIRST SECURITY BANK OF IDAHO	0.00	5,000,000.00	5,000,000.00	5,000,000.00	7,350,000.00	0.00
PRINCE GEORGE COUNTY	0.00	1,399,500.00	0.00	0.00	0.00	0.0
REPCO PARTNERS	0.00	51,135,000.00	51,135,000.00	0.00	0.00	0.0
STATE OF NEW MEXICO	0.00	0.00	3,330,000.00	0.00	5,330,000.00	10,665,000.0
DL & J. GOVERNMENT SECURITIES	0.00	0.00	0.00	0.00	11,530,000.00	0.0
IOWA PUBLIC EMPLOYEES	0.00	0.00	0.00	0.00	3,000,000.00	4,040,000.0
STATE INDUSTRIAL INSURANCE SYSTEM	0.00	0.00	0.00	0.00	2,000,000.00	0.0
MCG GOVERNMENT SEC CORP.	0.00	0.00	0.00	0.00	0.00	165,213,443.3
MPH PARTNERS	0.00	0.00	0.00	0.00	0.00	9,710,750.0
	530,843,767.34	329,844,843.75	313,885,733.75	349,137,737.34	298,453,744.88	516,379,280.1

APPENDIX B

THOMAS TEV, RECEIVER
ESH GOVERNMENT SECURITIES
REVERSE REPOS - AMOUNTS FINANCED SUMMARY
MONTH END BALANCE

	JANUARY 1985	MARCH 1 1985
RESOURCE MANAGEMENT II	27,500,000.00	23,455,000.00
CITY OF HAYWARD	0.00	0.00
THE LIBERTY GROUP	0.00	0.00
AMERICAN S&L ASSOCIATION	508,513,070.20	508,513,070.20
MR. STEPHEN ARKY	0.00	0.00
HOLLYWOOD FEDERAL S&L	0.00	0.00
HOME SAVINGS ASSOCIATION OF FLORIDA	0.00	0.00
SUN FEDERAL SAVINGS & LOAN ASSOCIATION	0,190,000.00	3,490,000.00
BANK OF THE SOUTH	0.00	0.00
QUEEN CITY SAVINGS & LOAN	4,989,662.50	0.00
MR. BURTON BONGARD	0.00	0.00
HOME STATE FINANCIAL SERVICE	3,357,497.76	3,346,872.76
HOME SAVINGS ASSOCIATION	513,421,973.20	589,956,248.00
HOME STATE SAVINGS & ASSOC. DAYTON	125,550,666.40	125,297,666.40
OHIO STATE UNIVERSITY	0.00	0.00
MR. MARVIN L. WARNER	0.00	0.00
FIRST FEDERAL SAVINGS & LOAN	10,800,649.76	8,732,000.00
MT. WHITNEY S&L ASSOCIATION	0.00	0.00
MIDLAND COMMODITIES, INC.	8,933,277.70	8,933,277.70
KLEINWORT BENSON GOV'T SECURITIES	0.00	0.00
BARABOO FEDERAL S&L ASSOCIATION	0.00	0.00
STATE OF NEW MEXICO	0.00	0.00
HOMESTEAD S&L	0.00	0.00
	1,216,456,115.00	1,191,523,363.12

THOMAS TEN, RECEIVER ESH GOVERNMENT SECURITIES REVERSE REPOS - AMOUNTS FINANCED SUMMARY MONTH END BALANCE	JANUARY 1984	FEBRUARY 1984	MARCH 1984	APRIL 1984	MAY 1984	JUNE 1984
RESOURCE MANAGEMENT II	28,250,000.00	1,040,000.00	1,040,000.00	0.00	0.00	0.00
CITY OF HAYWARD	4,123,373.00	4,123,373.00	4,123,373.00	4,123,373.00	4,123,373.00	0.00
THE LIBERTY GROUP	0.00	9,450,000.00	22,888,300.00	27,888,300.00	46,648,300.00	54,788,750.00
AMERICAN S&L ASSOCIATION	0.00	0.00	48,983,835.89	48,983,835.89	309,889,668.00	954,981,100.00
MR. STEPHEN ARKY	2,088,665.77	2,088,665.77	2,088,665.77	2,088,665.77	2,088,665.77	2,088,665.77
HOLLYWOOD FEDERAL S&L	0.00	13,694,394.07	17,376,000.00	17,036,000.00	13,848,000.00	11,818,000.00
HOME SAVINGS ASSOCIATION OF FLORIDA	22,108,882.38	22,108,882.38	22,108,882.38	22,108,882.38	22,108,882.38	22,108,882.38
SUN FEDERAL SAVINGS & LOAN ASSOCIATION	49,888,777.50	48,791,777.50	48,544,777.50	48,289,777.50	7,085,000.00	6,948,000.00
BANK OF THE SOUTH	9,945,000.00	9,945,000.00	10,290,000.00	10,289,000.00	19,488,000.00	0.00
QUEEN CITY SAVINGS & LOAN	9,268,000.00	9,268,000.00	8,885,000.00	0.00	0.00	4,989,048.50
MR. BURTON BONDARD	6,967,396.13	6,967,396.13	7,258,396.13	7,258,396.13	7,258,396.13	7,258,396.13
HOME STATE FINANCIAL SERVICE	3,841,827.78	3,849,844.38	3,849,844.38	3,217,036.38	3,884,681.78	3,239,789.78
HOME SAVINGS ASSOCIATION	468,313,088.88	398,788,278.38	888,976,489.85	379,865,858.97	478,851,471.38	349,669,280.38
HOME STATE SAVINGS & ASSOC. DAYTON	85,841,318.21	78,945,448.18	74,908,889.38	74,908,889.38	126,678,666.48	126,388,666.48
OHIO STATE UNIVERSITY	8,268,000.00	8,268,000.00	8,898,000.00	8,648,000.00	1,288,000.00	1,168,000.00
MR. MARVIN L. WARNER	59,908,188.15	48,578,188.15	66,872,997.15	66,742,997.15	94,988,621.95	95,388,621.95
FIRST FEDERAL SAVINGS & LOAN	41,295,655.88	91,549,655.86	91,549,655.86	91,549,655.86	188,481,655.86	188,481,655.28
MT. WHITNEY S&L ASSOCIATION	0.00	0.00	0.00	2,788,888.88	2,788,888.88	2,788,888.88
MIDLAND COMMODITIES, INC.	0.00	0.00	0.00	0.00	8,948,259.18	8,988,277.78
KLEINWORT BENSON GOV'T SECURITIES	0.00	0.00	0.00	0.00	0.00	0.00
BANWOOD FEDERAL S&L ASSOCIATION	0.00	0.00	0.00	0.00	0.00	0.00
STATE OF NEW MEXICO	0.00	0.00	0.00	0.00	0.00	0.00
HOMESTEAD S&L	0.00	0.00	0.00	0.00	0.00	0.00
	988,131,866.41	968,588,845.28	1,085,871,847.49	1,088,868,854.21	1,645,981,748.84	1,958,888,888.68

THOMAS TEW, RECEIVER ESM GOVERNMENT SECURITIES REVERSE REPOS - AMOUNTS FINANCED SUMMARY MONTH END BALANCE	JULY 1984	AUGUST 1984	SEPTEMBER 1984	OCTOBER 1984	NOVEMBER 1984	DECEMBER 1984
RESOURCE MANAGEMENT II	0.00	269,081,700.00	796,242,835.00	747,499,085.00	641,984,085.00	0.0
CITY OF HAYWARD	0.00	0.00	0.00	0.00	0.00	0.0
THE LIBERTY GROUP	54,581,250.00	24,071,250.00	9,863,750.00	1,970,000.00	0.00	0.0
AMERICAN S&L ASSOCIATION	958,981,100.00	958,981,100.00	847,415,313.80	651,119,266.00	562,158,577.80	562,158,577.8
MR. STEPHEN ARKY	2,088,605.77	2,088,605.77	2,088,605.77	2,088,605.77	2,088,605.77	2,088,605.7
HOLLYWOOD FEDERAL S&L	11,895,000.00	0.00	5,000,000.00	0.00	4,000,000.00	0.0
HOME SAVINGS ASSOCIATION OF FLORIDA	22,103,382.38	22,103,382.38	22,103,382.38	14,003,271.28	0.00	0.0
SUN FEDERAL SAVINGS & LOAN ASSOCIATION	7,018,000.00	7,230,000.00	11,730,000.00	11,730,000.00	11,730,000.00	8,190,000.0
BANK OF THE SOUTH	0.00	0.00	0.00	0.00	0.00	0.0
QUEEN CITY SAVINGS & LOAN	4,989,062.50	4,989,062.50	4,989,062.50	4,989,062.50	4,989,062.50	4,989,062.5
MR. BURTON BONGARD	7,252,596.15	7,252,596.15	7,252,596.15	7,252,596.15	7,252,596.15	0.0
HOME STATE FINANCIAL SERVICE	3,176,981.04	3,305,832.94	3,353,686.79	2,251,349.68	2,251,349.68	2,357,407.7
HOME SAVINGS ASSOCIATION	350,366,622.08	353,342,201.22	366,016,334.95	363,978,303.47	354,899,758.47	342,350,973.2
HOME STATE SAVINGS & ASSOC. DAYTON	126,380,666.40	126,239,666.40	126,121,666.40	126,024,666.40	125,869,666.40	125,655,666.4
OHIO STATE UNIVERSITY	0.00	1,190,000.00	0.00	0.00	0.00	0.0
MR. MARVIN L. WARNER	98,172,621.95	100,042,621.95	24,019,624.80	24,019,624.80	24,019,624.80	36,897,758.1
FIRST FEDERAL SAVINGS & LOAN	100,481,055.26	95,443,055.26	100,481,055.26	100,481,055.26	82,306,344.26	27,888,627.6
MT. WHITNEY S&L ASSOCIATION	0.00	5,038,000.00	0.00	0.00	0.00	0.0
MIDLAND COMMODITIES, INC.	8,933,277.70	8,933,277.70	8,933,277.70	8,933,277.70	8,933,277.70	8,988,277.7
KLEINWORT BENSON GOV'T SECURITIES	0.00	0.00	0.00	20,000.00	20,000.00	0.0
BARABOO FEDERAL S&L ASSOCIATION	0.00	0.00	0.00	0.00	1,017,500.00	1,017,500.0
STATE OF NEW MEXICO	0.00	0.00	0.00	4,200,000.00	0.00	0.0
HOMESTEAD S&L	0.00	0.00	0.00	0.00	0.00	2,000,000.0
	1,931,315,221.23	2,180,497,372.27	2,337,334,378.50	2,292,445,363.96	2,035,463,448.48	1,324,472,456.9

THOMAS TEH, RECEIVER ESH GOVERNMENT SECURITIES, INC. END OF MONTH BALANCES - 1988 REVERSE REPO	JANUARY 1988	FEBRUARY 1988	MARCH 1988	APRIL 1988	MAY 1988	JUNE 1988
FORMULA VALUE	289,908,289.28	284,125,114.22	477,712,159.47	727,870,615.88	784,188,721.24	1,054,488,411.88
EXCESS VALUE - ALL	121,758,612.28	127,341,273.08	150,998,525.75	184,230,730.55	119,022,875.64	113,874,551.04
TOTAL FINANCED	168,149,616.85	156,383,841.19	326,713,688.72	543,639,885.38	665,159,845.60	941,138,860.76
EXCESS VALUE:						
HOMESTATE SAVINGS ASSOC.	117,947,615.28	128,521,349.92	128,121,713.78	128,648,398.74	78,269,790.12	57,885,648.48
HOMESTATE OF DAYTON	0.00	0.00	0.00	10,499,084.22	10,988,986.15	12,586,012.47
	117,947,615.28	128,521,349.92	128,121,713.78	138,399,479.96	84,178,716.27	69,421,675.89
HOME STATE SAVINGS ASSOCIATION	88,461,788.08	88,942,868.48	88,121,891.66	88,941,548.37	285,961,725.14	289,710,179.47
HOME STATE FINANCIAL SERVICES	3,627,347.16	3,611,728.16	3,591,742.96	3,578,885.56	3,549,187.56	3,525,942.96
HOME STATE SAVING ASSOC. OF DAYTON	0.00	0.00	0.00	38,294,148.81	85,268,088.88	88,488,888.88
BURTON BONDARD	4,967,596.15	4,967,596.15	4,967,596.15	4,967,596.15	4,967,596.15	4,967,596.15
STEPHEN ABEY	2,088,685.77	2,038,685.77	2,038,685.77	2,088,685.77	2,088,685.77	2,088,685.77
MARVIN L. WARNER	4,773,948.84	4,773,948.84	4,773,948.84	91,999,732.28	88,388,948.84	122,819,297.57
OTHER CUSTOMERS:						
SUBURBAN SAL ASS'N.	54,213,888.88	32,588,888.88	44,988,888.88	48,685,888.88	48,985,888.88	19,873,888.88
SALT LAKE COUNTY	2,265,389.48	2,586,711.84	178,467,488.84	178,467,488.84	138,481,599.84	89,485,461.34
MP INDUSTRIAL TRADER	0.00	0.00	0.00	15,968,888.88	15,288,888.88	0.00
CITY OF HAYWARD	3,888,888.88	3,888,888.88	3,888,888.88	3,888,888.88	3,888,888.88	3,888,888.88
ACLI GOVERNMENT SECURITIES	1,987,388.88	0.00	0.00	0.00	0.00	0.00
QUEEN CITY SAL.	0.00	0.00	0.00	0.00	6,378,888.88	6,868,888.88
LASSER MARSHALL	0.00	0.00	0.00	0.00	0.00	4,773,888.88
THE MOCATTA CORP.	0.00	0.00	0.00	0.00	10,285,787.38	0.00
SUN FEDERAL SAL	0.00	0.00	0.00	0.00	0.00	48,888,777.58
RESOURCE MANAGEMENT II	0.00	0.00	0.00	0.00	0.00	0.00
MIDLAND COMODITIES	0.00	0.00	0.00	0.00	0.00	0.00
OHIO STATE UNIVERSITY	0.00	0.00	0.00	0.00	0.00	0.00
RESOURCE MANAGEMENT III	0.00	0.00	0.00	0.00	0.00	0.00
HOME SAVINGS FLA.	0.00	0.00	0.00	0.00	0.00	0.00
OLAJ GOVERNMENT SECURITIES	0.00	0.00	0.00	0.00	0.00	0.00
PHOENIX CAPITAL GROUP, INC.	0.00	0.00	0.00	0.00	0.00	0.00
FIRST FEDERAL SAL BIG SPRINGS, TX	0.00	0.00	0.00	0.00	0.00	0.00
	168,149,616.88	156,383,841.19	326,713,688.72	588,639,885.38	665,159,845.60	941,138,860.76

THOMAS TEH, RECEIVER ESH GOVERNMENT SECURITIES, INC. END OF MONTH BALANCES - 1988 REVERSE REPO	JULY 1988	AUGUST 1988	SEPTEMBER 1988	OCTOBER 1988	NOVEMBER 1988	DECEMBER 1988
FORMULA VALUE	1,187,968,866.90	1,106,100,434.45	1,110,646,417.09	1,188,849,614.42	1,183,329,284.15	1,078,172,029.39
EXCESS VALUE - ALL	141,664,965.90	161,672,968.12	171,285,310.88	161,655,172.10	159,660,754.15	150,011,006.91
TOTAL FINANCED	1,046,299,901.00	944,427,471.88	939,411,106.26	1,027,194,442.32	1,023,668,530.00	928,161,022.48
EXCESS VALUE:						
HOMESTATE SAVINGS ASSOC.	80,738,086.02	105,462,879.47	117,712,081.13	104,868,574.02	105,426,085.26	98,164,301.39
HOMESTATE OF DAYTON	19,506,859.53	20,704,114.73	22,375,568.56	21,814,089.23	21,842,967.65	20,928,388.27
	100,244,945.55	126,166,994.20	140,087,649.69	126,679,663.25	126,999,012.11	119,492,684.86
HOME STATE SAVINGS ASSOCIATION	600,518,128.03	597,173,309.59	620,210,411.35	628,336,677.58	625,825,948.57	610,089,996.44
HOME STATE FINANCIAL SERVICES	3,329,998.96	3,306,998.96	3,439,311.74	3,488,328.78	3,421,388.58	3,374,229.73
HOME STATE SAVING ASSOC. OF DAYTON	75,287,000.00	74,802,500.00	76,117,201.71	77,124,578.28	77,717,255.92	88,918,057.26
BURTON BONDARD	4,967,596.15	4,967,596.15	4,967,596.15	4,967,596.15	4,967,596.15	4,967,596.15
STEPHEN ARKY	2,088,605.77	2,088,605.77	2,088,605.77	2,088,605.77	2,088,605.77	2,088,605.77
MARVIN L. WARNER	117,647,897.57	88,829,949.84	88,150,348.84	119,414,464.38	117,866,899.08	74,894,374.75
OTHER CUSTOMERS:						
SUBURBAN SBL ASS'N.	10,800,000.00	10,200,000.00	6,800,000.00	0.00	0.00	0.00
SALT LAKE COUNTY	89,483,461.84	45,446,572.84	0.00	0.00	0.00	0.00
MP INDUSTRIAL TRADER	0.00	0.00	0.00	0.00	0.00	0.00
CITY OF HAYWARD	3,298,375.00	2,883,375.00	4,123,375.00	4,123,375.00	4,123,375.00	4,123,375.00
ACLI GOVERNMENT SECURITIES	4,765,000.00	0.00	0.00	0.00	0.00	0.00
QUEEN CITY SBL	9,285,000.00	9,060,000.00	9,120,000.00	9,273,000.00	9,210,000.00	9,060,000.00
LASSER MARSHALL	22,985,000.00	0.00	13,687,500.00	57,381,250.00	0.00	0.00
THE MOCATTA CORP.	0.00	10,500,000.00	0.00	5,358,000.00	5,358,000.00	5,358,000.00
SUN FEDERAL SBL	49,328,777.50	49,328,777.50	49,328,777.50	49,328,777.50	49,328,777.50	49,328,777.50
RESOURCE MANAGEMENT II	47,088,671.88	47,088,671.88	47,088,671.88	52,382,421.88	52,048,750.00	52,250,000.00
MIDLAND COMODITIES	9,790,194.40	9,790,194.40	9,778,861.10	9,778,861.10	9,778,861.10	0.00
OHIO STATE UNIVERSITY	2,150,000.00	1,200,000.00	2,650,000.00	2,650,000.00	2,285,000.00	5,288,050.00
RESOURCE MANAGEMENT III	0.00	0.00	13,406,250.00	0.00	14,875,000.00	0.00
HOME SAVINGS FLA.	0.00	0.00	0.00	8,100,111.10	22,188,888.88	22,188,382.36
DLEJ GOVERNMENT SECURITIES	0.00	0.00	0.00	0.00	0.00	22,250,000.00
PHOENIX CAPITAL GROUP, INC.	0.00	0.00	0.00	0.00	0.00	9,679,527.70
FIRST FEDERAL SBL BIG SPRINGS, TX	0.00	0.00	0.00	0.00	0.00	1,700,000.00
	1,046,299,901.00	944,427,471.88	939,411,106.26	1,027,194,442.32	1,023,668,530.00	928,161,022.48

THOMAS TEV, RECEIVER ESH GOVERNMENT SECURITIES, INC. END OF MONTH BALANCE - 1983 REVERSE REPO	JULY 1983	AUGUST 1983	SEPTEMBER 1983	OCTOBER 1983	NOVEMBER 1983	DECEMBER 1983
FORMULA VALUE	458,093,035.41	308,195,311.45	357,035,293.73	308,690,489.18	301,577,140.47	308,794,349.55
EXCESS VALUE - ALL	533,630,259.66	190,830,889.71	267,815,079.30	208,140,470.15	191,438,636.05	187,381,711.25
TOTAL FINANCED	125,254,795.75	189,357,201.74	90,020,214.43	100,549,731.03	110,138,514.41	121,292,638.30
EXCESS VALUE:						
HOMESTATE SAVINGS ASSOC.	98,339,127.01	111,195,022.11	109,771,941.67	116,017,986.76	116,315,013.72	118,519,496.89
HOME STATE SAVINGS ASSOCIATION	83,011,570.35	81,115,799.31	83,447,382.43	82,613,964.36	81,490,343.38	81,431,440.17
HOME STATE FINANCIAL SERVICES	3,488,715.76	7,371,622.92	3,675,765.15	3,669,833.76	3,632,115.76	3,640,135.36
BURTON HANGARD	9,924,471.15	9,924,471.15	9,924,471.14	8,868,232.40	8,868,232.40	8,368,391.12
STEPHEN ARET	3,833,485.77	3,833,485.77	3,833,485.77	3,833,485.77	3,833,485.77	3,833,485.77
MARVIN L. WARNER	9,730,218.84	9,730,218.84	9,730,218.84	7,848,488.11	7,848,488.11	7,848,488.11
OLAJ GOVERNMENT SECURITIES	0.00	0.00	10,000,000.00	0.00	0.00	0.00
LASSER MARSHALL	0.00	0.00	44,788,888.88	0.00	0.00	0.00
SUBURBAN VALLEY S&L ASSOC.	61,297,888.88	48,199,888.88	37,838,888.88	57,365,888.88	73,835,888.88	67,753,888.88
RETCO PARTNERS	0.00	0.00	11,484,782.88	0.00	0.00	0.00
QUEEN CITY S&L	9,577,888.88	4,438,888.88	0.00	3,888,888.88	3,888,888.88	9,348,742.29
ACLI GOVERNMENT SECURITIES	0.00	0.00	11,242,588.88	0.00	0.00	0.00
UNITY SAVINGS ASSOCIATION (CHICAGO)	42,851,888.88	0.00	0.00	0.00	0.00	0.00
FIRST S&L ASSOC. OF SEMINOLE	0.00	0.00	0.00	0.00	3,745,888.88	0.00
OLYMPIC SAVINGS ASSOC.	677,588.88	0.00	0.00	0.00	0.00	0.00
GUARDIAN FEDERAL S&L ASSOC.	3,719,888.88	0.00	0.00	0.00	0.00	0.00
CITY OF HOLLYWOOD	3,875,888.88	3,875,888.88	3,875,888.88	3,875,888.88	3,838,888.88	3,838,888.88
RESOURCE MANAGEMENT ASSOCIATES	139,815,948.63	0.00	0.00	0.00	0.00	0.00
RESOURCE MANAGEMENT II	178,191,887.21	98,731,258.88	33,435,888.88	21,788,888.88	0.00	0.00
STANDARD FEDERAL S&L	1,888,888.88	1,888,888.88	1,888,888.88	1,888,888.88	1,888,888.88	0.00
SALT LAKE CITY & COUNTRY	2,646,283.75	2,786,283.75	2,646,233.75	2,646,233.75	2,265,538.43	2,265,538.43
SUN FEDERAL S&L	0.00	4,858,888.88	1,848,888.88	4,138,888.88	2,388,888.88	0.00
	533,639,259.66	191,497,201.74	267,815,079.30	208,140,470.15	191,438,636.05	187,381,711.25
INTER CO. SEC. SOLD	538,728,817.84		187,368,878.35	251,598,737.36		
	1,072,358,177.38			459,739,215.51		
REMOVE RESOURCE MANAGEMENT	299,284,935.84					
PER G/L	773,351,341.46					

THOMAS TEW, RECEIVER
E.S.M. GOVERNMENT SECURITIES, INC.

REVERSE REPO - AMOUNTS FINANCED

A/C#	Name	End of Month Balance June 30, 1981	December 31, 1981
00131	D, L & J Government Securities	$ 15,393,750.00	$ 34,615,625.00
00520	N.Y. Hanseatic	880,000.00	---
00570	Charles E. Quincey & Co.	75,500,000.00	16,477,500.00
00585	Resource Mangement	55,012,500.00	---
00673	W. E. Pollock	10,550,000.00	---
04025	Crocker National Bank	9,968,750.00	---
14022	City of Beverly Hills, CA	118,567,157.00	78,790,769.00
14044	Monterey County, CA	9,241,666.00	---
14060	San Diego Navy Fed. Credit Union	12,000,000.00	---
19002	Stephen Arky	3,093,605.00	3,093,605.00
19120	ComBank Winter Park	14,145,346.00	4,517,945.00
19275	Leonard L. Farber	8,307,777.00	---
19500	Home Savings Assoc. of Fla.	23,794,316.00	---
22004	American Heritage S&L	4,041,277.00	---
22137	Macomb Savings Association	5,420,000.00	---
22193	Olympic Savings Association	855,000.00	825,000.00
22260	Unity Savings Association	45,951,000.00	28,538,000.00
26038	S. E. Fed. S&L	13,294,333.00	13,294,333.00
26060	Southern Fed. S&L	8,854,416.00	4,274,527.00
30010	Brigham & Woman's Hospital	15,789,916.00	---
39010	Capital S&L	16,197,640.00	10,573,814.00
39020	Crestmont S&L	17,431,263.00	---
39080	First Fed. S&L - Westfield, N.Y.	8,924,041.00	---
39090	Queen City S&L	26,539,690.00	23,229,041.00
44008	Burton Bongard	10,024,471.00	10,024,471.00
44040	Home State Financial	3,995,837.00	2,945,371.00
44060	Home State Savings Assoc.	182,989,586.00	147,268,052.00
44080	Marvin L. Warner	24,950,623.00	9,730,218.00
44900	Western Savings Assoc.	12,150,000.00	---
51020	Athens Federal S&L	16,968,111.00	---
51057	Fidelity Federal S&L	2,073,650.00	---
51140	Knox Fed. S&L	630,000.00	---
51160	Morristown Fed. S&L	4,425,149.00	1,613,450.00
51220	Security Federal	4,804,233.00	---
51260	United Southern Bank	4,319,741.00	---
52056	Government Employees Credit Union	7,570,000.00	---
53780	Salt Lake City & County	108,253,088.00	70,108,569.00
53903	Utah State Retirement System	8,200,000.00	---
14024	City of Hayward	---	2,950,000.00
18320	Guardian Fed. Savings	---	3,790,000.00
19200	ComBanks, Winter Park, FL	---	8,552,352.00
19451	Great American Bank	---	9,380,694.00
22112	First Financial Savings	---	8,980,000.00
22138	Manning S&L	---	1,515,000.00
41145	M.P.H. Partners	---	5,425,000.00
		$914,211,197.00	$500,513,336.00

THOMAS TEW, RECEIVER
E.S.M. GOVERNMENT SECURITIES, INC.

REVERSE REPOS - AMOUNTS FINANCED

A/C#	Name	End of Month Balance June 30, 1980	December 31, 1980
00520	N.Y. Hanseatic	$ 34,048,735.00	$ 8,020,000.00
02097	02097	7,642,131.00	7,642,131.00
10010	Fidelity Federal S&L	850,000.00	---
19002	Stephen Arky	8,650,334.00	5,893,626.00
19453	Bruce Greer	2,933,036.00	4,882,254.00
19555	Richard Osias	3,815,555.00	---
19556	Richard Osias - Trustee	2,328,000.00	---
19660	Suncoast Federal Credit Union	500,000.00	300,000.00
19680	United Federal S&L	880,000.00	---
22004	American Heritage S&L	2,461,853.00	4,041,277.00
22020	Central DuPage Federal S&L	4,000,000.00	---
22137	Macomb Savings Association	2,349,463.00	5,682,580.00
22193	Olympic Savings Association	820,000.00	855,000.00
22260	Unity Savings Association	132,321,000.00	137,532,000.00
39010	Capital Savings & Loan	3,177,000.00	12,111,468.00
39020	Crestmont S&L	11,049,000.00	26,813,263.00
39080	First Federal S&L-Westfield, N.J.	4,187,738.00	8,924,041.00
41200	Southold Savings Bank	8,064,329.00	12,326,383.00
44008	Burton Bongard	4,555,997.00	14,555,997.00
44040	Homestate Financial	15,380,477.00	17,533,159.00
44060	Homestate Savings Association	232,363,475.00	204,475,743.00
44080	Marvin Warner	17,274,913.00	17,274,913.00
51020	Athens Federal S&L	4,154,958.00	---
51140	Knox Federal S&L	755,000.00	640,000.00
51220	Security Federal	435,000.00	5,039,233.00
51260	United Southern Bank	125,000.00	---
14023	City of San Diego	---	1,947,111.00
14044	Monterey County, CA	---	6,972,819.00
19120	ComBanks, Winter Park, FL	---	14,494,075.00
19275	Leonard Farber	---	8,557,958.00
19500	Home Federal S&L	---	28,655,055.00
39090	Queen City S&L	---	22,531,775.00
41180	Seneca Federal S&L	---	8,240,375.00
51160	Morrison Federal S&L	---	9,531,446.00
		$515,122,994.00	$595,473,682.00

APPENDIX C

E.S.M. GOVERNMENT SECURITIES, INC.
Suite 100
Colee Hammock Executive Plaza
1512 East Broward Boulevard
Fort Lauderdale, Florida 33301

September 28, 1984

Mr. Robert A. Luther
Executive Vice President and
Chief Financial Officer
American Savings & Loan Association
of Florida
17801 N.W. Second Avenue
Miami, Florida 33169

Dear Mr. Luther:

This letter will set forth our agreement with respect to the "unwinding" of the leveraged, self-liquidating, arbitrage transaction (the "Original Transaction") effected by American Savings & Loan Association of Florida, a Florida savings and loan association ("American Savings"), through E.S.M. Government Securities, Inc., a Florida corporation ("ESM"), in May 1984 and described in the confirmations attached hereto as Exhibit A (the "Original Confirmations").

1. American Savings and ESM have agreed to terminate the Original Transaction and close out all open positions relating thereto effective as of the date hereof and, accordingly, to designate the date hereof, and not the date set forth in the Original Confirmations, as the settlement date under all repurchase agreements entered into in connection therewith. Subject to the provisions of paragraph 4 hereof, American Savings and ESM have further agreed that, in connection with such termination and close out, ESM (i) will return to American Savings all securities delivered by American Savings to ESM in connection with such transaction, (ii) will cause or will have caused to be paid to American Savings all interest and other distributions made or to be made with respect to such securities between the trade date set forth in the Original Confirmations and the date on which such securities are returned to American Savings, and (iii) will pay to American Savings an amount equal to that portion of the net income (shown on the settlement sheet attached hereto as

Exhibit B) which American Savings would have earned if the Original Transaction had not been terminated as contemplated hereby as the number of days from the trade date set forth in the Original Confirmations to the date hereof bears to the number of days from such original trade date to the original settlement date set forth in the Original Confirmations.

2. Based on the foregoing, ESM has effected, on behalf of itself and American Savings, the transactions (the "Termination Transactions") described in the confirmations attached hereto as Exhibit C (the "Supplemental Confirmations"), and (i) represents and warrants to American Savings that the Termination Transactions are sufficient in all respects to terminate all liabilities and obligations which American Savings had, has or would have had in connection with the Termination Transaction , (ii) hereby releases and discharges American Savings, its successors and assigns, from all causes of actions, debts, covenants, agreements, promises, damages, claims and demands whatsoever in law or in equity which ESM, its successors and assigns and any person, firm or entity claiming by, through or under any of them had, now have or hereafter can, shall or may have by reason of any matter, cause or thing whatsoever arising out of or related to the Original Transaction, and (iii) hereby agrees to indemnify American Savings against and to save American Savings harmless from any and all claims, demands (including those made by third parties), judgments, liabilities, costs, expenses and losses (including lost profits, basis points, spreads or interest or any other type of economic loss and reasonable attorneys fees) relating to or arising out of the Original Transaction or the inaccuracy in any respect of ESM's representation and warranty contained herein.

3. In consideration of ESM's representation, warranty and agreements, and subject to the accuracy, validity and enforceability thereof, American Savings hereby releases and discharges ESM from all causes of actions, debts covenants, agreements, promises, damages, claims and demands whatsoever in law or in equity against ESM which American Savings, its successors and assigns, ever had, now has or hereafter can, shall or may have by reason of any matter, cause or thing whatsoever arising out of or relating to the Original Transaction.

4. American Savings understands that ESM has effected, on behalf of ESM and American Savings, the transactions described in the confirmations attached hereto as Exhibit D, and agrees that (i) the creation and existence of American Savings' obligations and liabilities in connection therewith shall not be deemed to be a breach of the terms hereof and (ii) the portion of the net income payable to American Savings pursuant to clause (iii) of the second

sentence of paragraph 1 hereof shall be based exclusively on that part of the Original Transaction which has not been so reinstated.

If the foregoing correctly sets forth our understanding, please execute the enclosed copy of this letter in the space provided below for that purpose, whereupon this letter will constitute a valid and binding agreement between ESM and American Savings.

Sincerely,

E.S.M. GOVERNMENT SECURITIES, INC.

By:_____
Alan Novick, President

Accepted and agreed to as of the day and year first above written.

AMERICAN SAVINGS & LOAN ASSOCIATION OF FLORIDA

By:_____
Robert A. Luther, Executive Vice President and Chief Financial Officer

APPENDIX D

THOMAS TEW, RECEIVER
ESH GROUP, INC.
FOR THE YEAR ENDED DECEMBER 31, 1984

	ESH GROUP INC. CONSOLIDATED	ESH GROUP INC. PARENT	ESH GOV'T. SECURITIES INC. MEMPHIS	ESH SECURITIES INC.	ESH AVIATION INC.	ESH GOV'T. SECURITIES INC.	ESH FINANCIAL GROUP, INC.	COMBINED WITHOUT ELIMINATIONS
SECURITY INCOME (LOSS)	($38,136,366)	($31,971,988)	$953,306	$1,613	$0	$12,882,325	($446,394)	($56,388,938)
OTHER INCOME	4,884,384	(12,635,898)	702,930	0	333,695	15,542,779	1,622,948	9,677,349
INTEREST INCOME	390,277,017	344,663,623	0	0	0	346,333,394	0	390,277,017
TOTAL INCOME RECEIVED & ACCRUED	356,176,777	177,686,568	1,736,436	1,613	333,695	374,640,498	1,176,381	337,373,328
BOND PROCESSING EXPENSES	4,113,387	0	0,279	5,130	1,000	4,097,988	0	4,113,387
OPERATING EXPENSES:								
OFFICERS SALARIES	4,861,244	941,427	0	13,452	0	3,104,365	0	4,861,244
OTHER SALARIES	1,406,378	90,000	948,414	2,811	86,750	278,393	0	1,406,378
SALESMEN COMMISSION	1,121,920	96,121	0	0	0	1,025,749	0	1,121,920
OTHER EXPENSES	4,469,163	1,023,541	213,681	19,446	1,016,871	1,395,603	21,815,635	26,384,817
TOTAL OPERATING EXPENSES	11,858,696	2,951,139	1,162,095	35,709	1,103,621	5,804,132	21,815,635	33,974,351
INTEREST - REPURCHASE REPO	330,306,778	192,883,384	0	0	0	346,333,394	0	330,306,778
TOTAL EXPENSES	333,477,861	195,834,523	1,170,376	40,839	1,104,621	350,137,514	21,815,635	377,393,514
NET INCOME(LOSS)	718,916	(15,577,978)	566,832	(39,216)	(730,926)	14,330,984	(20,639,104)	(19,920,188

Reference

1. The above numbers were input from internally prepared summaries of Net Profit/Loss schedules by ESH prior management.

2. Column (1) ESH Group, Inc. Consolidated is obtained by adding columns 2-6 together.

3. Column (8) is obtained by adding either columns 1 and 7, or 2-7 together.

THOMAS TEV, RECEIVER
ESM GROUP, INC.
FOR THE YEAR ENDED DECEMBER 31, 1988

	ESM GROUP INC. CONSOLIDATED	ESM GROUP INC. PARENT	ESM GOV'T. SECURITIES INC.	ESM SECURITIES INC.	ESM AVIATION INC.	ESM FINANCIAL GROUP, INC.	COMBINED WITHOUT ELIMINATIONS
SECURITY INCOME (LOSS)	($36,288,642)	($42,291,249)	$4,880,107	$2,500	$0	($25,562,500)	($61,771,142)
OTHER INCOME	53,855,277	25,314,032	28,111,743	0	429,482	3,460,744	56,324,023
INTEREST INCOME	284,581,205	109,319,130	175,262,075	0	0	0	284,581,205
TOTAL INCOME RECEIVED & ACCRUED	302,227,840	92,341,913	209,453,925	2,500	429,482	(23,093,754)	279,134,086
BOND PROCESSING EXPENSES	9,159,667	0	9,152,436	6,499	732	0	9,159,667
OPERATING EXPENSES:							
OFFICERS SALARIES	3,224,667	370,000	2,845,602	11,065	0	0	3,224,667
OTHER SALARIES	865,222	98,000	713,845	3,877	57,500	0	865,222
SALESMEN COMMISSION	592,710	115,226	477,484	0	0	0	592,710
OTHER EXPENSES	9,449,319	592,647	7,706,273	15,831	1,135,568	17,822,738	27,272,257
TOTAL OPERATING EXPENSES	14,134,118	1,167,873	11,743,204	29,773	1,193,068	17,822,738	31,956,856
INTEREST - REPURCHASE REPO	275,322,174	109,319,130	166,203,044	0	0	0	275,322,174
TOTAL EXPENSES	298,815,959	110,487,003	187,098,684	36,272	1,193,798	17,822,738	314,438,697
NET INCOME(LOSS)	3,411,881	(18,145,090)	22,355,239	(33,772)	(764,316)	(40,916,492)	(37,304,611)

Reference

1. The above numbers were input from internally prepared summaries of Net Profit/Loss schedules by ESM prior management.

2. Column (1) ESM Group, Inc. Consolidated is obtained by adding columns 2-6 together.

3. Colvna (8) is obtained by adding either columns 1 and 7, or 2-7 together.

THOMAS TEW, RECEIVER
ESH GROUP, INC.
FOR THE YEAR ENDED DECEMBER 31, 1982

	ESH GROUP INC. CONSOLIDATED	ESH GROUP INC. PARENT	ESH GOV'T. SECURITIES INC.	ESH SECURITIES INC.	ESH AVIATION INC.	ESH FINANCIAL GROUP, INC.	COMBINED WITHOUT ELIMINATIONS
SECURITY INCOME (LOSS)	($17,975,775)	($45,456,358)	$27,415,466	$65,189	$0	$0	($17,975,775)
OTHER INCOME	45,831,286	16,494,824	27,039,336	2,230	294,596	2,352,749	48,183,753
INTEREST INCOME	201,618,499	48,479,774	132,938,725	0	0	0	201,618,499
TOTAL INCOME RECEIVED & ACCRUED	229,473,930	19,518,240	189,393,747	67,339	294,596	2,352,749	231,826,679
BOND PROCESSING EXPENSES	9,724,465	0	9,711,826	13,194	245	0	9,724,465
OPERATING EXPENSES:							
OFFICERS SALARIES	2,057,800	240,000	1,806,825	10,975	0	0	2,057,800
OTHER SALARIES	613,180	60,000	499,848	4,252	48,880	0	613,180
SALESMEN COMMISSION	609,778	29,858	579,913	0	0	0	609,778
OTHER EXPENSES	2,441,831	0	1,141,175	19,258	1,288,598	15,831,343	17,472,374
TOTAL OPERATING EXPENSES	5,719,981	329,858	4,026,760	34,485	1,328,598	15,831,343	20,751,344
INTEREST - REPURCHASE REPO	205,004,769	72,066,044	132,938,725	0	0	0	205,004,769
TOTAL EXPENSES	220,449,135	72,395,902	144,676,711	47,679	1,328,843	15,831,343	235,480,478
NET INCOME(LOSS)	9,024,795	(52,877,654)	42,717,036	19,660	(1,034,247)	(12,478,594)	(3,653,799)

Reference

1. The above numbers were input from internally prepared summaries of Net Profit/Loss schedules by ESH prior management.

2. Column (1) ESH Group, Inc. Consolidated is obtained by adding columns 2-6 together.

3. Column (8) is obtained by adding either columns 1 and 7, or 2-7 together.

THOMAS TEW, RECEIVER
ESH GROUP, INC.
FOR THE YEAR ENDED DECEMBER 31, 1981

	ESH GROUP INC. CONSOLIDATED	ESH GROUP INC. PARENT	ESH GOV'T. SECURITIES INC.	ESH SECURITIES INC.	ESH AVIATION INC.	ESH FINANCIAL GROUP, INC.	COMBINED WITHOUT ELIMINATIONS
SECURITY INCOME (LOSS)	945,124,745	9144,811	944,854,969	$103,765	$0	$0	945,124,745
OTHER INCOME	(5,628,813)	23,462,193	(29,550,628)	3,884	461,819	863,442	(4,757,871)
INTEREST INCOME	151,495,885	28,245,530	128,250,365	0	0	0	151,495,885
TOTAL INCOME RECEIVED & ACCRUED	211,001,817	46,873,723	143,556,706	107,649	461,819	863,442	211,865,239
BOND PROCESSING EXPENSES	6,635,029	0	6,620,657	14,321	51	0	6,635,029
OPERATING EXPENSES:							
OFFICERS SALARIES	1,054,250	240,000	800,719	13,531	0	0	1,054,250
OTHER SALARIES	520,871	40,000	487,874	4,330	54,447	0	520,871
SALESMEN COMMISSION	464,145	0	438,596	25,549	0	0	464,145
OTHER EXPENSES	2,138,393	0	980,558	25,842	1,132,881	25,847,171	27,185,564
TOTAL OPERATING EXPENSES	4,184,879	300,000	2,626,941	70,478	1,187,468	25,847,171	29,238,050
INTEREST - REPURCHASE REPO	196,626,889	68,376,444	128,250,365	0	0	0	196,626,889
TOTAL EXPENSES	207,446,717	68,676,444	137,497,963	84,791	1,187,519	25,847,171	232,493,888
NET INCOME(LOSS)	3,555,100	(21,802,721)	24,058,743	24,778	(725,700)	(24,183,729)	(20,628,629)

Reference

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THOMAS TEW, RECEIVER
ESH GROUP, INC.
FOR THE YEAR ENDED DECEMBER 31, 1980

	ESH GROUP INC. CONSOLIDATED	ESH GROUP INC. PARENT	ESH GOV'T. SECURITIES INC.	ESH SECURITIES INC.	ESH AVIATION INC.	ESH FINANCIAL GROUP, INC.	COMBINED WITHOUT ELIMINATIONS
SECURITY INCOME (LOSS)	$3,172,483	$0	$2,684,791	$489,694	$0	($76,962,568)	($73,778,085)
OTHER INCOME	30,359,396	5,832,341	13,745,683	179,953	381,469	3,499,293	23,858,679
INTEREST INCOME	178,313,479	53,643,661	124,869,818	0	0	0	178,313,479
TOTAL INCOME RECEIVED & ACCRUED	202,845,358	59,476,002	141,300,292	667,647	381,469	(74,463,275)	127,402,073
BOND PROCESSING EXPENSES	3,703,131	2,150,000	1,363,682	189,325	382	0	3,703,131
OPERATING EXPENSES:							
OFFICERS SALARIES	3,123,250	788,888	1,299,306	42,944	0	11,612	3,134,862
OTHER SALARIES	694,982	42,000	546,881	13,979	92,843	14,881	709,783
SALESMEN COMMISSION	245,111	0	135,388	109,723	0	0	245,111
OTHER EXPENSES	2,057,843	0	1,008,627	39,696	1,018,739	4,538,845	6,595,927
TOTAL OPERATING EXPENSES	6,120,325	822,888	2,990,202	197,343	1,110,781	4,565,338	11,685,683
INTEREST - REPURCHASE REPO	205,003,400	88,125,178	124,867,818	8,384	0	0	205,003,400
TOTAL EXPENSES	213,826,856	83,097,178	129,233,633	395,851	1,110,984	4,565,338	220,392,184
NET INCOME(LOSS)	(11,781,506)(23,681,176)		12,076,669	272,596	(329,575)	(81,888,603)	(92,790,189)

Reference

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THOMAS TEV, RECEIVER
ESH GROUP, INC.
FOR THE YEAR ENDED DECEMBER 31, 1979

	ESH GROUP INC. CONSOLIDATED	ESH GROUP INC. PARENT	ESH GOV'T. SECURITIES INC.	ESH SECURITIES INC.	ESH AVIATION INC.	FOXTON SECURITIES INC.	ESH FINANCIAL GROUP, INC.	COMBINED WITHOUT ELIMINATIONS
SECURITY INCOME (LOSS)	911,017,422	90	911,022,146	(14,724)	90	90	(510,057,705)	9959,717
OTHER INCOME	9,730,947	1,080,365	7,090,532	12,521	546,091	1,438	1,773,189	11,504,136
INTEREST INCOME	23,127,164	23,127,164	0	0	0	0	0	23,127,164
TOTAL INCOME RECEIVED & ACCRUED	43,875,533	25,207,529	18,112,678	7,797	546,091	1,438	(8,284,516)	35,591,017
BOND PROCESSING EXPENSES	875,325	0	867,389	8,858	158	0	0	875,325
OPERATING EXPENSES:								
OFFICERS SALARIES	502,571	102,000	396,567	4,004	0	0	0	502,571
OTHER SALARIES	569,188	19,200	463,887	4,481	81,588	0	14,941	584,129
SALESMEN COMMISSION	130,356	0	148,699	1,657	0	0	1,978	732,334
OTHER EXPENSES	1,631,496	0	993,511	13,146	843,714	625	2,458,583	4,309,679
TOTAL OPERATING EXPENSES	3,073,211	121,200	1,802,584	23,288	925,214	625	2,475,494	5,748,705
INTEREST - REPURCHASE REPO	43,137,420	31,400,740	11,734,880	0	0	0	251,772	43,389,392
TOTAL EXPENSES	47,086,356	31,521,940	14,406,773	31,444	925,372	625	2,727,266	50,013,632
NET INCOME(LOSS)	(3,210,823)	(4,314,411)	3,505,905	(23,849)	(379,281)	813	(11,211,782)	(14,422,615)

Reference

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THOMAS TEW, RECEIVER
ESH GROUP, INC.
FOR THE YEAR ENDED DECEMBER 31, 1978

	ESH GROUP INC. CONSOLIDATED	ESH GROUP INC. PARENT	ESH GOV'T. SECURITIES INC.	ESH SECURITIES INC.	ESH AVIATION INC.	POTTON SECURITIES INC.	ESH FINANCIAL GROUP, INC.	COMBINED WITHOUT ELIMINATIONS
SECURITY INCOME (LOSS)	$1,586,508	$0	$1,575,742	($16,999)	$0	$27,565	($4,895,935)	($2,389,427)
OTHER INCOME	1,235,157	722,454	281,171	9,274	277,282	46,976	2,384,748	3,639,925
INTEREST INCOME	53,496,509	14,125,780	36,585,225	0	0	2,785,584	0	53,496,509
TOTAL INCOME RECEIVED & ACCRUED	56,338,174	14,848,134	38,362,338	(7,725)	277,282	2,858,125	(1,711,187)	54,627,007
BOND PROCESSING EXPENSES	221,921	0	220,548	1,953	0	12,418	0	221,921
OPERATING EXPENSES:								
OFFICERS SALARIES	350,876	84,000	163,861	3,815	0	0	0	350,876
OTHER SALARIES	778,879	14,400	618,565	9,704	20,851	124,159	1,100	788,979
SALESMEN COMMISSION	514,610	0	501,810	12,127	0	673	0	514,610
OTHER EXPENSES	1,842,047	0	1,140,327	19,592	493,864	188,264	1,177,575	3,819,622
TOTAL OPERATING EXPENSES	3,486,412	98,400	2,515,763	45,238	513,715	313,096	1,179,675	4,666,887
INTEREST - REPURCHASE REPO	56,907,703	16,375,241	37,743,358	0	0	1,789,904	1,399,944	58,307,647
TOTAL EXPENSES	60,616,036	16,473,641	40,458,869	56,193	513,715	3,115,418	2,579,619	63,195,655
DEFERRED TAXES (STATE & FEDERAL)	(697,980)	(697,980)	0	0	0	0	0	(697,980)
NET INCOME(LOSS)	(3,579,962)	(927,527)	(2,096,531)	(61,918)	(236,433)	(257,293)	(4,290,786)	(7,878,748)

Reference

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2. Column (1) ESH Group, Inc. Consolidated is obtained by adding columns 2-6 together.

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APPENDIX E

Exhibit C

STATEMENT OF FINANCIAL CONDITION AND AUDITORS' REPORT

E.S.M. GOVERNMENT SECURITIES, INC.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

December 31, 1984

Alexander Grant & COMPANY

Alexander Grant
& COMPANY
CERTIFIED PUBLIC ACCOUNTANTS

MEMBER FIRM
GRANT THORNTON INTERNA

Board of Directors
E.S.M. Government Securities, Inc.

We have examined the statement of financial condition of E.S.M. Government Securities, Inc. (a Florida corporation and wholly-owned subsidiary of E.S.M. Group, Inc.) as of December 31, 1984. 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 statement referred to above presents fairly the financial condition of E.S.M. Government Securities, Inc. at December 31, 1984 in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Alexander Grant & Company

Fort Lauderdale, Florida
January 30, 1985

E.S.M. Government Securities, Inc.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

STATEMENT OF FINANCIAL CONDITION

December 31, 1984

ASSETS

Cash	$ 421,000
Deposits with clearing organizations and others (note B)	182,000
Receivable from brokers and dealers (note C)	3,643,000
Receivable from customers (note C)	73,050,000
Securities purchased under agreement to resell (notes A and D)	2,945,953,000
Accrued interest	406,000
Securities purchased not sold - at market (note A)	26,059,000
Due from parent	2,550,000
Other	61,000
	$3,052,325,000

LIABILITIES AND STOCKHOLDERS' EQUITY

Short-term bank loans (note E)	$ 47,258,000
Payable to brokers and dealers (note C)	12,266,000
Payable to customers (note C)	9,304,000
Securities sold under agreement to repurchase (notes A and D)	2,945,953,000
Accounts payable and accrued expenses	799,000
Commitment and contingencies (notes F and G)	-
Stockholders' Equity	
Common stock - authorized, issued and outstanding 500 shares of $1.00	1,000
Additional contributed capital	4,160,000
Retained earnings	32,584,000
	36,745,000
	$3,052,325,000

The accompanying notes are an integral part of this statement.

E.S.M. Government Securities, Inc.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

NOTES TO STATEMENT OF FINANCIAL CONDITION

December 31, 1984

NOTE A - SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies applied in the preparation of the financial statements follows.

Security Transactions

Security transactions are recorded on a settlement date basis, generally the first business day following the transaction date.

Purchases of securities under agreements to resell and sales of securities under agreements to repurchase are considered financing transactions and represent the amount of purchases and sales which will be resold or reacquired at amounts specified in the respective agreements.

Securities Purchased, Not Sold

Securities inventory, which consists of marketable federal government or government agency securities, is carried at market value.

Furniture and Equipment

Furniture and equipment are stated at cost. Depreciation is provided in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives, principally on a straight-line basis over 5 years.

Income Taxes

The company participates in the filing of a consolidated income tax return with its parent. Any tax liability of the affiliated group is allocated to each member company based on its contribution to taxable income.

NOTE B - DEPOSITS WITH CLEARING ORGANIZATIONS AND OTHERS

The company has deposits of cash and securities with commodity brokers to meet margin requirements. The company also has cash escrow deposits with its securities clearing agent.

E.S.M. Government Securities, Inc.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

NOTES TO STATEMENT OF FINANCIAL CONDITION - CONTINUED

December 31, 1984

NOTE C - BROKER, DEALER AND CUSTOMER ACCOUNTS

Receivables from brokers, dealers and customers at December 31, 1984, include outstanding securities failed to deliver. Payables to brokers, dealers and customers at December 31, 1984, include outstanding securities failed to receive. "Fails," all of which have been outstanding less than 30 days, represent the contract value of securities which have not been received or delivered by settlement date. Fails to receive and fails to deliver from brokers and customers were $7,291,426 and $9,993,081 respectively at December 31, 1984.

NOTE D - SECURITY TRANSACTIONS

The company entered into repurchase and resale agreements with customers whereby specific securities are sold or purchased for short durations of time. These agreements cover securities, the rights to which are usually acquired through similar purchase/resale agreements. The company has agreements with an affiliated company for securities purchased under agreements to resell amounting to approximately $1,621,481,000 and securities sold under agreements to repurchase amounting to approximately $1,324,472,000 at December 31, 1984. Accrued interest receivable from and payable to the affiliated company at year end were $11,174,000 and $64,410,000 respectively.

NOTE E - SHORT-TERM BANK LOANS

Short-term bank loans at December 31, 1984 are collateralized by securities purchased not sold.

NOTE F - RELATED PARTY TRANSACTIONS

Certain common expenses paid by the parent company, including depreciation, are allocated to the subsidiary companies based on transaction volume. The company paid a dividend of $10,000,000 to its parent company as of December 31, 1984. The company occupies premises leased by the parent company from a partnership of which one of the officers is a partner. Rent expense paid the partnership amounted to $112,000 for the year ended December 31, 1984 (note G).

(continued)

E.S.M. Government Securities, Inc.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

NOTES TO STATEMENT OF FINANCIAL CONDITION - CONTINUED

December 31, 1984

NOTE G - COMMITMENTS

The company conducts its operations in leased facilities under noncancellable operating leases expiring at various dates through 2010. The minimum lease payment for one location has been calculated based on current transaction volume (note F) under a 30 year lease. The minimum rental commitments under the operating lease are as follows:

Year ended December 31,	
1985	$ 162,900
1986	162,900
1987	141,900
1988	112,400
1989	112,400
1990 and thereafter	2,332,400
	$3,024,900

Rental expense charged to operations approximated $137,000 for the year ended December 31, 1984.

STATEMENT OF FINANCIAL CONDITION AND AUDITORS' REPORT

E.S.M. GOVERNMENT SECURITIES, INC.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

December 31, 1983

Alexander Grant
& COMPANY

Alexander Grant

CERTIFIED PUBLIC ACCOUNTANTS

MEMBER FIRM
GRANT THORNTON INTERNATIONAL

Board of Directors
E.S.M. Government Securities, Inc.

We have examined the statement of financial condition of E.S.M. Government Securities, Inc. (a Florida corporation and wholly-owned subsidiary of E.S.M. Group, Inc.) as of December 31, 1983. 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 statement referred to above presents fairly the financial condition of E.S.M. Government Securities, Inc. at December 31, 1983 in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Alexander Grant & Company

Fort Lauderdale, Florida
February 14, 1984

E.S.M. Government Securities, Inc.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

STATEMENT OF FINANCIAL CONDITION

December 31, 1983

ASSETS

Cash	$ 339,000
Deposits with clearing organizations and others (note B)	25,000
Receivable from brokers and dealers (note C)	2,192,000
Receivable from customers (note C)	16,163,000
Securities purchased under agreement to resell (notes A and D)	2,252,555,000
Accrued interest	7,375,000
Securities purchased not sold - at market (note A)	402,004,000
	$2,680,653,000

LIABILITIES AND STOCKHOLDERS' EQUITY

Short-term bank loans (note E)	$ 91,832,000
Payable to brokers and dealers (note C)	4,815,000
Payable to customers (note C)	3,683,000
Securities sold under agreement to repurchase (notes A and D)	2,457,555,000
Accounts payable and accrued expenses	927,000
Accounts payable - parent and affiliates	92,183,000
Commitment and contingencies (note F)	-
Stockholders' Equity	
Common stock - authorized, issued and outstanding 500 shares of $1.00	1,000
Additional contributed capital	4,160,000
Retained earnings	25,497,000
	29,658,000
	$2,680,653,000

The accompanying notes are an integral part of this statement.

E.S.M. Government Securities, Inc.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

NOTES TO STATEMENT OF FINANCIAL CONDITION

December 31, 1983

NOTE A - SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies applied in the preparation of the financial statements follows.

Security Transactions

Security transactions are recorded on a settlement date basis, generally the first business day following the transaction date.

Purchases of securities under agreements to resell and sales of securities under agreements to repurchase are considered financing transactions and represent the amount of purchases and sales which will be resold or reacquired at amounts specified in the respective agreements.

Securities Purchased, Not Sold

Securities inventory, which consists of marketable federal government or government agency securities, is carried at market value.

Income Taxes

The company participates in the filing of a consolidated income tax return with its parent. Any tax liability of the affiliated group is allocated to each member company based on its contribution to taxable income.

NOTE B - DEPOSITS WITH CLEARING ORGANIZATIONS AND OTHERS

The company has deposits of cash and securities with commodity brokers to meet margin requirements. The company also has cash escrow deposits with its securities clearing agent.

E.S.M. Government Securities, Inc.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

NOTES TO STATEMENT OF FINANCIAL CONDITION - CONTINUED

December 31, 1983

NOTE C - BROKER, DEALER AND CUSTOMER ACCOUNTS

Receivables from brokers, dealers and customers at December 31, 1983, include outstanding securities failed to deliver. Payables to brokers, dealers and customers at December 31, 1983, include outstanding securities failed to receive. "Fails," all of which have been outstanding less than 30 days, represent the contract value of securities which have not been received or delivered by settlement date. Fails to deliver and fails to receive from brokers and customers were $1,867,000 and $981,602 respectively at December 31, 1983.

NOTE D - SECURITY TRANSACTIONS

The company entered into repurchase and resale agreements with customers whereby specific securities are sold or purchased for short durations of time. These agreements cover securities, the rights to which are usually acquired through similar purchase/resale agreements. The company has agreements with an affiliated company for securities purchased under agreements to resell amounting to approximately $1,308,199,000 and securities sold under agreements to repurchase amounting to approximately $944,356,000 at December 31, 1983. Accrued interest receivable from and payable to the affiliated company at year end were $6,932,000 and $16,454,000 respectively.

NOTE E - SHORT-TERM BANK LOANS

Short-term bank loans at December 31, 1983 are collateralized by securities purchased not sold.

NOTE F - RELATED PARTY TRANSACTIONS

Certain common expenses paid by the parent company, including depreciation, are allocated to the subsidiary companies based on transaction volume. The company paid a dividend of $18,000,000 to its parent company as of December 31, 1983. The company occupies premises leased by the parent company from a partnership of which one of the officers is a partner.

(continued)

E.S.M. Government Securities, Inc.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

NOTES TO STATEMENT OF FINANCIAL CONDITION - CONTINUED

December 31, 1983

NOTE F - continued

Rent expense charged to operations approximated $72,000 for the year ended December 31, 1983. Based on current transaction volume, the approximate aggregate minimum rental commitments under the 30 year lease is as follows:

Year ended December 31,	
1984	$ 70,070
1985	70,070
1986	70,070
1987	70,070
1988	70,070
1989 and thereafter	1,524,040
	$1,874,390

STATEMENT OF FINANCIAL CONDITION AND AUDITORS' REPORT

E.S.M. GOVERNMENT SECURITIES, INC.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

December 31, 1982

Alexander Grant
& COMPANY
CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors
E.S.M. Government Securities, Inc.

We have examined the statement of financial condition of E.S.M. Government Securities, Inc. (a Florida corporation and wholly-owned subsidiary of E.S.M. Group, Inc.) as of December 31, 1982. 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 statement referred to above presents fairly the financial condition of E.S.M. Government Securities, Inc. at December 31, 1982 in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Alexander Grant & Company

Fort Lauderdale, Florida
January 25, 1983

E.S.M. Government Securities, Inc.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

STATEMENT OF FINANCIAL CONDITION

December 31, 1982

ASSETS

Cash	$ 1,046,000
Deposits with clearing organizations and others (note B)	25,000
Receivable from brokers and dealers (note C)	1,084,000
Receivable from customers (note C)	21,073,000
Securities purchased under agreement to resell (notes A and D)	738,924,000
Accrued interest	1,257,000
Securities purchased not sold - at market (note A)	182,674,000
	$946,083,000

LIABILITIES AND STOCKHOLDERS' EQUITY

Short-term bank loans (note E)	$ 80,350,000
Payable to brokers and dealers (note C)	3,624,000
Payable to customers (note C)	1,426,000
Securities sold under agreement to repurchase (notes A and D)	738,924,000
Accounts payable and accrued expenses	596,000
Accounts payable - parent and affiliates	95,861,000
Commitment and contingencies (note F)	-
Stockholders' Equity	
Common stock - authorized, issued and outstanding 500 shares of $1.00	1,000
Additional contributed capital	4,160,000
Retained earnings	21,141,000
	25,302,000
	$946,083,000

The accompanying notes are an integral part of this statement.

E.S.M. Government Securities, Inc.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

NOTES TO STATEMENT OF FINANCIAL CONDITION

December 31, 1982

NOTE A - SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies applied in the preparation of the financial statements follows.

Security Transactions

Security transactions are recorded on a settlement date basis, generally the first business day following the transaction date.

Purchases of securities under agreements to resell and sales of securities under agreements to repurchase are considered financing transactions and represent the amount of purchases and sales which will be resold or reacquired at amounts specified in the respective agreements.

Securities Purchased, Not Sold

Securities inventory, which consists of marketable federal government or government agency securities, is carried at market value.

Income Taxes

The company participates in the filing of a consolidated income tax return with its parent. Any tax liability of the affiliated group is allocated to each member company based on its contribution to taxable income.

NOTE B - DEPOSITS WITH CLEARING ORGANIZATIONS AND OTHERS

The company has deposits of cash and securities with commodity brokers to meet margin requirements. The company also has cash escrow deposits with its securities clearing agent.

E.S.M. Government Securities, Inc.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

NOTES TO STATEMENT OF FINANCIAL CONDITION - CONTINUED

December 31, 1982

NOTE C - BROKER, DEALER AND CUSTOMER ACCOUNTS

Receivables from brokers, dealers and customers at December 31, 1982, include outstanding securities failed to deliver. Payables to brokers, dealers and customers at December 31, 1982, include outstanding securities failed to receive. "Fails," all of which have been outstanding less than 30 days, represent the contract value of securities which have not been received or delivered by settlement date. Fails to deliver and fails to receive from customers were $1,010,000 and $3,067,000 respectively at December 31, 1982.

NOTE D - SECURITY TRANSACTIONS

The company entered into repurchase and resale agreements with customers whereby specific securities are sold or purchased for short durations of time. These agreements cover securities, the rights to which are usually acquired through similar purchase/resale agreements. The company has agreements with an affiliated company for securities purchased under agreements to resell amounting to approximately $516,656,000 and securities sold under agreements to repurchase amounting to approximately $222,267,000 at December 31, 1982. Accrued interest receivable from and payable to the affiliated company at year end were $1,972,000 and $7,773,000 respectively.

NOTE E - SHORT-TERM BANK LOANS

Short-term bank loans at December 31, 1982 are collateralized by securities purchased not sold.

NOTE F - RELATED PARTY TRANSACTIONS

Certain common expenses paid by the parent company, including depreciation, are allocated to the subsidiary companies based on transaction volume. The company paid a dividend of $31,500,000 to its parent company as of December 31, 1982. The company occupies premises leased by the parent company from a partnership of which one of the officers is a partner.

(continued)

E.S.M. Government Securities, Inc.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

NOTES TO STATEMENT OF FINANCIAL CONDITION - CONTINUED

December 31, 1982

NOTE F - continued

Rent expense charged to operations approximated $105,000 for the year ended December 31, 1982. Based on current transaction volume, the approximate aggregate minimum rental commitments under the 30 year lease is as follows:

Year ended December 31,	
1983	$ 105,000
1984	105,000
1985	105,000
1986	105,000
1987	105,000
1988 and thereafter	2,387,000
	$2,912,000

STATEMENT OF FINANCIAL CONDITION AND AUDITORS' REPORT

E.S.M. GOVERNMENT SECURITIES, INC.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

December 31, 1981

Alexander Grant & COMPANY

Alexander Grant
A COMPANY
CERTIFIED PUBLIC ACCOUNTANTS

MEMBER FIRM
GRANT THORNTON INTERNATIONAL

Board of Directors
E.S.M. Government Securities, Inc.

We have examined the statement of financial condition of E.S.M. Government Securities, Inc. (a Florida corporation and wholly-owned subsidiary of E.S.M. Group, Inc.) as of December 31, 1981. 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 statement referred to above presents fairly the financial condition of E.S.M. Government Securities, Inc. at December 31, 1981 in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Alexander Grant & Company

Fort Lauderdale, Florida
February 4, 1982

E.S.M. Government Securities, Inc.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

STATEMENT OF FINANCIAL CONDITION

December 31, 1981

ASSETS

Cash	$ 1,767,000
Deposits with clearing organizations and others (note B)	25,000
Receivable from brokers and dealers (note C)	60,000
Receivable from customers (note C)	40,523,000
Securities purchased under agreement to resell (notes A and D)	1,323,340,000
Accrued interest	433,000
Securities purchased not sold - at market (note A)	161,484,000
	$1,527,632,000

LIABILITIES AND STOCKHOLDERS' EQUITY

Short-term bank loans (note E)	$ 57,282,000
Payable to brokers and dealers (note C)	478,000
Payable to customers (note C)	4,047,000
Securities sold under agreement to repurchase (notes A and D)	1,323,340,000
Accounts payable and accrued expenses	796,000
Accounts payable - parent and affiliates	127,604,000
Commitment and contingencies (note F)	-
Stockholders' Equity	
Common stock - authorized, issued and outstanding 500 shares of $1.00	1,000
Additional contributed capital	4,160,000
Retained earnings	9,924,000
	14,085,000
	$1,527,632,000

The accompanying notes are an integral part of this statement.

E.S.M. Government Securities, Inc.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

NOTES TO STATEMENT OF FINANCIAL CONDITION

December 31, 1981

NOTE A - SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies applied in the preparation of the financial statements follows.

Security Transactions

Security transactions are recorded on a settlement date basis, generally the first business day following the transaction date.

Purchases of securities under agreements to resell and sales of securities under agreements to repurchase are considered financing transactions and represent the amount of purchases and sales which will be resold or reacquired at amounts specified in the respective agreements.

Securities Purchased, Not Sold

Securities inventory, which consists of marketable federal government or government agency securities, is carried at market value.

Income Taxes

The company participates in the filing of a consolidated income tax return with its parent. Any tax liability of the affiliated group is allocated to each member company based on its contribution to taxable income.

NOTE B - DEPOSITS WITH CLEARING ORGANIZATIONS AND OTHERS

The company has deposits of cash and securities with commodity brokers to meet margin requirements. The company also has cash escrow deposits with its securities clearing agent.

E.S.M. Government Securities, Inc.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

NOTES TO STATEMENT OF FINANCIAL CONDITION - CONTINUED

December 31, 1981

NOTE C - BROKER, DEALER AND CUSTOMER ACCOUNTS

Receivables from brokers, dealers and customers at December 31, 1981, include outstanding securities failed to deliver. Payables to brokers, dealers and customers at December 31, 1981, include outstanding securities failed to receive. "Fails," all of which have been outstanding less than 30 days, represent the contract value of securities which have not been received or delivered by settlement date. Fails to deliver and fails to receive from customers were $775,000 and $550,000 respectively at December 31, 1981.

NOTE D - SECURITY TRANSACTIONS

The company entered into repurchase and resale agreements with customers whereby specific securities are sold or purchased for short durations of time. These agreements cover securities, the rights to which are usually acquired through similar purchase/resale agreements. The company has agreements with an affiliated company for securities purchased under agreements to resell amounting to approximately $822,827,000 and securities sold under agreements to repurchase amounting to approximately $500,513,000 at December 31, 1981. Accrued interest receivable from and payable to the affiliated company at year end were $3,773,000 and $22,720,000 respectively.

NOTE E - SHORT-TERM BANK LOANS

Short-term bank loans at December 31, 1981 are collateralized by securities purchased not sold.

NOTE F - RELATED PARTY TRANSACTIONS

Certain common expenses paid by the parent company, including depreciation, are allocated to the subsidiary companies based on transaction volume. The company paid a dividend of $20,500,000 to its parent company as of December 31, 1981. The company occupies premises leased by the parent company from a partnership of which one of the officers is a partner.

(continued)

ONE FINANCIAL PLAZA · FORT LAUDERDALE, FL 33394 (305) 764-1235

E.S.M. Government Securities, Inc.
(a wholly-owned subsidiary of E.S.M. Group, Inc.)

NOTES TO STATEMENT OF FINANCIAL CONDITION - CONTINUED

December 31, 1981

NOTE F - continued

Rent expense charged to operations approximated $96,000 for the year ended December 31, 1981. Based on current transaction volume, the approximate aggregate minimum rental commitments under the 30 year lease is as follows:

Year ended December 31,	
1982	$ 94,641
1983	94,641
1984	94,641
1985	94,641
1986	94,641
1987 and thereafter	2,247,724
	$2,720,929

APPENDIX F

Form 1120 — Department of the Treasury, Internal Revenue Service

U.S. Corporation Income Tax Return

For calendar year 1980 or other tax year beginning ..., 1980, ending ..., 19

1980

Check if —
A. Consolidated return ☐
B. Personal Holding Co. ☐
C. Business Code No. (See page 5 of instructions) 6511

Use IRS label. Other-wise please print or type.

Name: E.S.M. Financial Group, Inc.
Number and street: 1512 East Broward Boulevard, Suite 100
City or town, State, and ZIP code: Fort Lauderdale, Florida 33301

D. Employer identification number (see Specific Instructions): 59-1699222
E. Date incorporated: 2/12/76
F. Total assets (see Specific Instructions): $ 30,311,907

Gross Income	1 (a) Gross receipts or sales $ ... (b) Less returns and allowances $ ... Balance ▶		1(c)	131,860
	2 Cost of goods sold (Schedule A) and/or operations (attach schedule)		2	
	3 Gross profit (subtract line 2 from line 1(c))		3	131,860
	4 Dividends (Schedule C)		4	
	5 Interest on obligations of the United States and U.S. instrumentalities		5	1,606,592
	6 Other interest		6	
	7 Gross rents		7	
	8 Gross royalties		8	
	9 (a) Capital gain net income (attach separate Schedule D)		9(a)	
	(b) Net gain or (loss) from Form 4797, line 11(a), Part II (attach Form 4797)		9(b)	(4,649)
	10 Other income (see instructions—attach schedule)		10	(76,942,502)
	11 TOTAL income—Add lines 3 through 10		11	(75,208,699)
Deductions	12 Compensation of officers (Schedule E)		12	
	13 (a) Salaries and wages 11,612 (b) Less WIN and jobs credit(s) ... Balance ▶		13(c)	11,612
	14 Repairs (see instructions)		14	12,675
	15 Bad debts (Schedule F if reserve method is used)		15	
	16 Rents		16	144,610
	17 Taxes		17	42,944
	18 Interest		18	5,274,931
	19 Contributions (not over 5% of line 30 adjusted per instructions—attach schedule)		19	
	20 Amortization (attach schedule)		20	16,587
	21 Depreciation from Form 4562 (attach Form 4562) 53,484 less depreciation claimed in Schedule A and elsewhere on return ... Balance ▶		21	53,484
	22 Depletion		22	
	23 Advertising		23	13,838
	24 Pension, profit-sharing, etc. plans (see instructions)		24	
	25 Employee benefit programs (see instructions)		25	
	26 Other deductions (attach schedule)		26	979,224
	27 TOTAL deductions—Add lines 12 through 26		27	6,549,905
	28 Taxable income before net operating loss deduction and special deductions (subtract line 27 from line 11)		28	(81,758,604)
	29 Less: (a) Net operating loss deduction (see instructions—attach schedule)	29(a) 16,006,592		
	(b) Special deductions (Schedule I)	29(b)	29	16,006,592
	30 Taxable income (subtract line 29 from line 28)		30	(97,765,196)
Tax	31 TOTAL TAX (Schedule J)		31	None
	32 Credits: (a) Overpayment from 1979 allowed as a credit			
	(b) 1980 estimated tax payments			
	(c) Less refund of 1980 estimated tax applied for on Form 4466	( )		
	(d) Tax deposited: Form 7004 ... Form 7005 (attach) ... Total ▶			
	(e) Credit from regulated investment companies (attach Form 2439)			
	(f) Federal tax on special fuels and oils (attach Form 4136 or 4136-T)		32	
	33 TAX DUE (subtract line 32 from line 31). See instruction C3 for depositary method of payment. (Check ▶ ☐ if Form 2220 is attached. See instruction D.) ▶ $ ...		33	None
	34 OVERPAYMENT (subtract line 31 from line 32)		34	
	35 Enter amount of line 34 you want: Credited to 1981 estimated tax ▶ ... Refunded ▶		35	

Please Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Signature of officer: [signature] Date: 9/9/83 Title: TREASURER

Paid Preparer's Use Only

Preparer's signature and date: Martha Guerra, CPA 9/26/83
Check if self-employed ▶ ☐
Preparer's social security no. 089 96 5381
Firm's name (or yours, if self-employed) and address
E.I. No. ▶
ZIP code ▶

S-(00015), 0200100002 650232-2466
1C1110, ' .19678 07/18/8

Form **1120** — Department of the Treasury, Internal Revenue Service

U.S. Corporation Income Tax Return

For calendar year 1981 or other tax year beginning ending

▶ For Paperwork Reduction Tax Notice, see page 1 of the IRS instructions

OMB No. 1545-0123

1981

Check if a — A. Consolidated return ☐ B. Personal Holding Co. ☐ C. Business Code No. (See Page 8 of Instructions)

6511

Use IRS label. Other-wise, please print or type

Name: R.S.M. FINANCIAL GROUP, INC.

Number and street: 1512 E. BROWARD BLVD.

City or town, State, and ZIP code: FORT LAUDERDALE, FLORIDA 33301

D. Employer identification number: 59-1699222

E. Date incorporated: 02-12-76

F. Total assets (see Specific Instructions): 27,972,830.

Gross Income	1 (a) Gross receipts or sales ____ (b) Less returns & allowances ____ Balance ▶		1(a)	
	2 Cost of goods sold (Schedule A) and/or operations (attach schedule)		2	
	3 Gross profit (subtract line 2 from line 1(a))		3	
	4 Dividends (Schedule C)		4	
	5 Interest on obligations of the United States and U.S. instrumentalities		5	
	6 Other interest		6	2,234,198.
	7 Gross rents		7	
	8 Gross royalties		8	
	9 (a) Capital gain net income (attach separate Schedule D)		9(a)	
	(b) Net gain or (loss) from Form 4797, line 11(a), Part II (attach Form 4797)		9(b)	-15,838.
	10 Other income (see instructions - attach schedule) SEE STATEMENT 1		10	-135,750.
	11 TOTAL income - Add lines 3 through 10		11	2,082,610.
Deductions	12 Compensation of officers (Schedule E)		12	
	13 (a) Salaries and wages ____ (b) Less WIN and jobs credit(s) ____ Balance ▶		13(a)	
	14 Repairs (see instructions)		14	81,165.
	15 Bad debts (Schedule F if reserve method is used)		15	469,167.
	16 Rents		16	50,526.
	17 Taxes SEE STATEMENT 1		17	30,076.
	18 Interest		18	24,324,112.
	19 Contributions (not over 5% of line 30 adjusted per instructions)		19	
	20 Amortization (attach schedule)		20	
	21 Depreciation from Form 4562 (attach Form 4562) ____ less depreciation claimed in Schedule A and elsewhere on return ____ Balance ▶		21	
	22 Depletion		22	
	23 Advertising		23	14.
	24 Pension, profit-sharing, etc. plans (see instructions)		24	
	25 Employee benefit programs (see instructions)		25	
	26 Other deductions (attach schedule) SEE STATEMENT 1		26	561,278.
	27 TOTAL deductions - Add lines 12 through 26		27	25,516,338.
	28 Taxable income before net operating loss deduction and special deductions (subtract line 27 from line 11)		28	-23,433,728.
	29 Less: (a) Net operating loss deduction (see instructions - attach schedule) 29(a) 97,765,196.			
	(b) Special deductions (Schedule C) 29(b)		29	97,765,196.
	30 Taxable income (subtract line 29 from line 28)		30	-121,198,924.
Tax	31 TOTAL TAX (Schedule J)		31	NONE
	32 Credits: (a) Overpayment from 1980 allowed as a credit ____ (b) 1981 estimated tax payments ____ (c) Less refund of 1981 estimated tax applied for on Form 4466 ____ (d) Tax deposited Form 7004 ____ Form 7005(estimate) ____ Total ▶ ____ (e) Credit from regulated investment companies (attach Form 2439) ____ (f) Federal tax on special fuels and oils (attach Form 4136 or 4136-T) ____		32	
	33 TAX DUE (subtract line 32 from line 31). See instruction C3 for depositary method of payment		33	NONE
	(Check ▶ ☐ If Form 2220 is attached. See instruction D.) ▶ $			
	34 OVERPAYMENT (subtract line 31 from line 32)		34	
	35 Enter amount of line 34 you want: Credited to 1982 estimated tax ▶ Refunded ▶		35	

Please Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Signature of officer ▶ Allen R. Mound — Date: 4/9/83 — Title ▶ TREASURER

Paid Preparer's Use Only

Preparer's signature ▶ Kirtha Gunn CMA — Date: 8/24/83 — Check if self-employed ▶ ☐ — Preparer's social security no. 089-36-5318

Firm's name (or yours, if self-employed) and address ▶ ALEXANDER GRANT & CO., 1900 ONE FINANCIAL PLAZA, FT. LAUDERDALE, FLORIDA — E.I. No. ▶ 36-6055558 — ZIP code ▶ 33394

APPENDIX G

CITY OF FORT WORTH, TEXAS

FINANCE ADMINISTRATION
1000 THROCKMORTON STREET
FORT WORTH, TEXAS 76102
870-8331 / AREA CODE 817

May 10, 1984

BradFord Trust Co.
67 Broad
9th Floor
New York, New York 10004

Attn: Howard Feiner

Dear Mr. Feiner:

Please provide the City of Fort Worth with confirmation of collateral held at Bradford Securities Processing Services, Inc. for the transactions with E.S.M. Government Securities, Inc. on May 1, 1984 as identified on the enclosed correspondence.

This confirmation should be addressed as follows:

A. Judson Bailiff, Treasurer
1000 Throckmorton Street
Fort Worth, Texas 76102

Yours truly,

A. Judson Bailiff
Treasurer

AJB:vkm

Enclosures

cc: Mr. Leonard Kahn,
First Money Managers, Inc.

BRADFORD TRUST COMPANY
67 BROAD STREET
NEW YORK, N. Y. 10004

STEPHEN M. SHARKEY
TREASURER
530-2630

May 24, 1984

Mr. Alan Novick
E.S.M. Government Securities, Inc.
Colee Hammock Executive Plaza
1512 E. Broward Blvd.
Suite 100
Ft. Lauderdale, FL 33301

RE: CITY OF FT. WORTH, TEXAS

Dear Alan:

Purusant to our conversation today, enclosed herewith please find a copy of the letter which we received from A. Judson Bailiff, Treasurer of the City of Ft. Worth, Texas, concerning certain securities which he asks if we are holding in connection with transactions between E.S.M. Government Securities, Inc. ("E.S.M.") and the City of Ft. Worth and our May 24, 1984 response thereto. As I informed you in our telephone conversation today, our agreement with E.S.M. provides that we render services to E.S.M. in accordance with your instructions and do not deal directly with your customers. Accordingly, we have declined to respond to the City of Ft. Worth's request for confirmation but have suggested that they communicate directly with you. Would you please communicate directly with them and inform them as to the location of whatever securities they are entitled to.

You also informed me that you are investigating the erroneous reference in E.S.M.'s May 1, 1984 letter to the City of Ft. Worth, which states that the securities are segregated at "Bradford Securities Processing Services, Inc." (predecessor to the SPS Clearing Division of Bradford Trust Company) and that you will send us a letter confirming that E.S.M. does not inform its customers that Bradford Trust Company segregates and holds securities for them in a customer securities account.

At my request, you also stated you would provide us with E.S.M.'s financial statements on a quarterly basis. Please send them to my attention.

If I can be of any assistance, please feel free to call on me.

Very truly yours,

Stephen M. Sharkey
Treasurer

BRADFORD TRUST COMPANY
67 BROAD STREET
NEW YORK, N. Y. 10004

STEPHEN M. SHARKEY
TREASURER
530-2000

May 24, 1984

A. Judson Bailiff
Treasurer
City of Ft. Worth, Texas
1000 Throckmorton St.
Ft. Worth, Tx 76102

RE: E.S.M. GOVERNMENT SECURITIES INC.

Dear Mr. Bailiff:

This is in response to your letter of May 10, 1984 in which you request that we confirm that we hold enumerated securities with respect to transactions of E.S.M. Government Securities, Inc. ("E.S.M.") on May 1, 1984. You should be aware that Bradford Trust Company ("BTC") offers services to its clients pursuant to duly executed agreements which provide that BTC will act only on behalf and upon the instructions of its clients. Therefore, BTC cannot respond to instructions or requests for confirmation from, and accepts no responsibility to, customers of its clients. Accordingly, we are unable to confirm or deny possession of the enumerated securities, but suggest that you communicate directly with E.S.M.

In order to apprise E.S.M. of your concern, we have forwarded a copy of your letter of May 10, 1984 and this reply to E.S.M. and requested that they communicate directly with you.

Very truly yours,

Stephen M. Sharkey
Treasurer

/kjl

E.S.M. GOVERNMENT SECURITIES, INC.

June 4, 1984

Mr. Stephen M. Sharkey
Treasurer
Bradford Trust Company
67 Broad Street
New York, New York 10004

Dear Stephen:

This is to confirm what I told you at our meeting on Thursday, May 31, 1984. E.S.M. Government Securities does not confirm to our customers that Bradford Trust Services segregates and holds securities for them.

Additionally, I would like to confirm that as far as we are concerned, the total problem of the City of Fort Worth has been taken care of to the satisfaction of the customer. This has been communicated to us by the money broker who had the account directly.

If I can be of any further assistance, please do not hesitate to contact me.

Sincerely,

Alan R. Novick
Vice President

ARN/kmo

I 1.

Oolee Hammock Executive Plaza
1512 East Broward Boulevard, Suite 100, Fort Lauderdale, Florida 33301 • 305/ 764-2600

Office of
ANOKA COUNTY TREASURER
DONALD C. BAILEY
Court House - Anoka, Minnesota 55303 612-421-4760

May 1, 1984

Bradford Trust Company, SPS
67 Broad Street
New York, NY 10004

Dear Sir or Madam:

Our auditors, Office of the State Auditor, State of Minnesota, . performing their regular examination of our financial statements. Accordingly, please confirm to them that:

A. The securities as described on the enclosed safekeeping receipt copies were held in the customer securities account of E.S.M. Government Securities, Inc. and were segregated exclusively for Anoka County on April 30, 1984.

B. Bradford Trust Company would recognize Anoka County as having a perfected interest in these securities in the event of the financial failure of E.S.M. Government Securities, Inc.

Please mail your reply directly to our auditors at the following address:

Office of the State Auditor
Suite 400
555 Park Street
St. Paul, MN 55103
Attention: John Egan

Sincerely,

Donald C. Bailey
Anoka County Treasurer

DCB

Encl.

BRADFORD TRUST COMPANY
67 BROAD STREET
NEW YORK, N. Y. 10004

STEPHEN M. SHARKEY
TREASURER
530-2830

July 9, 1984

Mr. Alan Novick
E.S.M. Government Securities, Inc.
Colee Hammock Executive Plaza
1512 E. Broward Blvd.
Suite 100
Ft. Lauderdale, FL 33301

RE: ANOKA COUNTY, MINNESOTA

Dear Alan:

Pursuant to our telephone conversation on July 6, 1984, enclosed herewith please find a copy of the letter which we received from Mr. Donald C. Bailey, Treasurer of Anoka County, Minnesota, concerning certain securities which he asks if we are holding in connection with transactions between E.S.M. Government Securities, Inc. ("E.S.M.") and the County of Anoka and our July 9, 1984 response thereto. We have declined to respond to this request for confirmation but have suggested that they communicate directly with you. Would you please communicate directly with them and inform them as to the location of whatever securities they are entitled to.

If I can be of any assistance, please feel free to call on me.

Very truly yours,

Stephen M. Sharkey
Treasurer

/kjl
encl.

BRADFORD TRUST COMPANY
67 BROAD STREET
NEW YORK, N. Y. 10004

STEPHEN M. SHARKEY
TREASURER
530-2830

July 9, 1984

Mr. Donald C. Bailey
Anoka County Treasurer
Anoka, Minnesota 55303

RE: E.S.M. GOVERNMENT SECURITIES, INC.

Dear Mr. Bailey:

This is in response to your letter of May 1, 1984 in which you requested that we confirm that we held enumerated securities on April 30, 1984 with respect to transactions of E.S.M. Government Securities, Inc. ("E.S.M."). You should be aware that Bradford Trust Company ("BTC") offers services to its clients pursuant to duly executed agreements which provide that BTC will act only on behalf and upon the instructions of its clients. Therefore, BTC cannot respond to instructions or requests for confirmation from, and accepts no responsibility to, customers of its clients. Accordingly, we are unable to confirm or deny possession of the enumerated securities, but suggest that you communicate directly with E.S.M.

In order to apprise E.S.M. of your concern, we have forwarded a copy of your letter of May 1, 1984 and this reply to E.S.M. and requested that they communicate directly with you.

Very truly yours,

Stephen M. Sharkey
Treasurer

APPENDIX H

BANK ACCOUNTS ATTACHED AND TRANSFERRED TO THE RECEIVERSHIP ESTATE ACCOUNTS AT SUN BANK OF MIAMI, N.A.

Entity	Account	Date Opened	Date Closed	Balance Attached	Comments
ESM Group Inc.	90-231-5108	0807/28/77	03/07/85	$642,987.78	Present hold on $1,800 balance
ESM Group, Inc.-Payroll Account	90-231-5284	12/22/77	11/13/81	$ -0-	
ESM Group, Inc.-Savings Account	90-090-5091	08/03/78	03/30/84	$ -0-	
ESM Government Securities, Inc.	90-231-4767	08/27/76	03/21/85	$499,426.91	
ESM Financial Group, Inc.	90-231-4712	05/18/76	03/08/85	$ 15,103.40	
ESM Financial Group, Inc.	N/A	03/08/78	10/04/80	$ -0-	
ESM Securities, Inc.	90-231-4602	10/02/75	03/07/85	$258,509.19	
ESM Securities, Inc.	90-231-4624	02/13/76	01/06/78	$ -0-	
ESM Aviation, Inc.	90-231-5196			No further information available as of 3/31/85	

E.S.M. ACCOUNTS ESTABLISHED
AT COMMERCE UNION BANK OF MEMPHIS

Name	Account No.	Comments
E.S.M. Group, Inc.- Payroll Account	03-0611491	Zero Balance as of 3/30/85
E.S.M. Government Securities, Inc. Petty cash	01-0609610	Balance of $46.94 as of 3/30/85

SCHEDULE OF AUTOMOBILES
LEASED OR OWNED BY
E.S.M. GROUP, INC.

YEAR	MAKE	FAIR MARKET VALUE	LEASED FOR THE BENEFIT OF
1985	Olds 98 Regency	$ 13,500.00	Howard Bass
1984	Buick Regal	11,500.00	Thomas Saunders
1982	Mercedes 380 SEL	49,000.00	Charles Streicher
1982	Mercedes 380 SEL	54,000.00	Ron Ewton
1983	Jaguar XJ6	38,500.00	Timothy Murphy
1982	Mercedes 380SL	45,000.00	Nicholas Wallace
1984	Jaguar XJS	32,500.00	George Mead
1983	Dodge Van[1/]	$ 5,000.00	N/A
		$249,000.00	

1/ Company Owned.

ADDITIONAL ASSETS OF ESM GROUP, INC.

1. River Reach Condominum - Fair Market Value: $64,000.

2. Miami Dolphins Sky Box - Amount of deposit unknown.

ADDITIONAL ASSETS OF ESM GOVERNMENT SECURITIES, INC.

1. Account at Stotler & Co. - $358,000.

IDENTIFIED ASSETS OF ESM AVIATION, INC.

1. Rockwell Commander Aircraft - Estimated fair market value: $800,000.

2. One (1) Leased Westwind Aircraft, Model 1124 with equipment from Omni International - Appraised value: $2,495,972.

3. Landmark Bank account and Landmark Certificate of Deposit - $7,066.20, maturing September 1985.

INSURANCE OVERVIEW
E.S.M. GROUP, INC.

TOPIC: CORPORATE FUNDED, CORPORATE OWNED/BENEFICIARY
(E.S.M. GROUP, INC.)

STOCK REDEMPTION AND DEBT INDEMNIFICATION COVERAGE[1/]

INSURED	POLICY #	FACE AMOUNT	TYPE CONTRACT	MONTHLY PREMUIM
EWTON, R.	75485833	$ 100,000	TERM	$ 30.00
	76387217	400,000	TERM	111.00
	77421119	1,000,000	TERM	243.00
	82331244	5,000,000	TERM	603.00
MEAD, G.	76219061	100,000	TERM	76.00
	78264745	150,000	TERM	102.00
	82326293	1,048,800	TERM	558.87
	*82374375	1,951,200	TERM	920.06
STREICHER, C.	82326273	500,000	TERM	53.00
WALLACE, N.	82351557	1,800,000	TERM	417.00
	82326281	1,200,000	TERM	303.00
		$13,250,000		$3,416.93

1/ None of the policies have a cash value of outstanding loan balance.

* Owner/Beneficiary Designation changed 6/84 to Larry Bishins, Trustee

INSURANCE OVERVIEW
E.S.M. GROUP, INC.

TOPIC: CORPORATE FUNDED, PERSONALLY OWNED LIFE INSURANCE
(Included in W-2)

CARRIER: THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE U.S.

INSURED and OWNER	POLICY NUMBER	FACE AMOUNT	TYPE CONTRACT	MONTHLY PREMUIM	CASH VALUE	LOAN BALANCE
COLLIER, W.	82327170	$ 100,000	W.L.	$ 184.00	$ 3,942.51	$ 0.00
EWTON, R.	77421060	1,000,000	W.L.	1,960.00	122,324.09	109,260.25
EWTON, R.*	82331246	1,000,000	W.L.	1,983.00	44,585.31	29,644.99
MEAD, G.	77421141	250,000	W.L.	682.50	40,234.64	33,962.50
MEAD, G.	82326444	250,000	W.L.	775.50	15,677.72	8,640.13
MURPHY, T.	34610544	80,000	TERM	63.00	23.78	0.00
PELLERTIO, R.	82327002	100,000	W.L.	194.00	4,379.71	0.00
SAUNDERS, T.	34614407	30,000	TERM	31.00	11.95	0.00
STREICHER, C.	80285197	250,000	W.L.	393.00	16,771.27	13,590.66
STREICHER, C.	82326436	250,000	W.L.	423.00	9,025.36	5,845.13
WALLACE, N.	77421137	250,000	W.L.	527.50	32,932.64	25,125.00
WALLACE, N.	82326423	250,000	W.L.	565.50	11,602.96	0.00
WOLFE, S.	34614430	30,000	TERM	20.00	24.80	0.00
		$3,840,000		$7,802.00	$301,536.74	$226,068.66

*Owned by J. Ewton

INSURANCE OVERVIEW
E.S.M. GROUP, INC.

TOPIC: ALAN R. NOVICK, DECEASED

SUBJECT: PREVIOUS LIFE INSURANCE COVERAGE

CARRIER: THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE U.S.

POLICY #	DEATH BENEFIT	PAID TO	DATE OF DRAFT
77,421,125	$ 222,073.61	SONYA NOVICK	12/18/84
77,421,133	100,465.61	SONYA NOVICK	12/18/84
83,161,915	253,038.29	SONYA NOVICK	02/05/85
83,162,007	1,428,383.60	E.S.M. GROUP, INC.	02/05/85
83,186,707	1,632,438.40	E.S.M. GROUP, INC.	02/05/85
84,014,230	2,550,886.84	E.S.M. GROUP, INC.	02/05/85
84,120,306	204,790.64	SONYA NOVICK	02/22/85
TOTAL PAID:	$ 6,392,076.99		

APPENDIX I

ASSETS OF RONNIE R. EWTON FROZEN PURSUANT TO COURT ORDER AS DISCLOSED OR DISCOVERED TO DATE

I. REAL ESTATE

Location	Description	Fair Market Value	Mortgage
Boca Raton, Florida	Personal residence at the sanctuary Purchased 1982	$1,650,000	$ None
Conyers Farm Greenwich, Connecticut	2 parcels Purchased 1984	1,100,000	770,000 (approx.)
Fox Hollow Farm, Inc. Aiken, S.C.	5600 acres; two carriage horses, four hunters and one farm horse	-Unknown-	-Unknown-
Fox Hollow, Inc. Lake Worth, FL	Polo pony stable 17 horses on 10 acres	1,000,000	300,000
Boone, N.C.	House and two vacant lots	-Unknown-	-Unknown-
Ocean Reef, Key Largo, FL	Boatslip	-Unknown-	-Unknown-
Aiken, SC	House and 57 acres unimproved	-Unknown-	-Unknown-
Aiken, SC	1/15 ownership in Hounds Lake Country Club	-Unknown-	-Unknown-
Linville, NC	5 lots in Elk River Country Club	-Unknown-	-Unknown-

II. STOTLER & COMPANY ACCOUNT

Trading Account - Fair Market value: $126,147.68

III. AUTOMOBILES AND BOATS

1. Aston Martin Laconda - Fair market value: $151,000.
2. 1984 Chevrolet Corvette - Fair market value: $20,000.
3. 1984 Hatteras 70-foot yacht - Fair market value: $1,350,000.
4. 1/2 interest in vessel owned by Ennix Research, Inc. - Value unknown.
5. Mercedes
6. Toyota
7. Cadillac
8. Jeeps and trucks located at Aiken, SC and Lake Worth, FL farms.

IV. INVESTMENTS

1. WEN Partnership; Description: Partnership of Marvin Warner, Alan Novick and Ronnie Ewton relative to investments and horse breeding. Fair market value unknown.
2. Provident Securities Account with a balance of $400,000.
3. Merrill Lynch Cash Management Account - balance unknown (J. Ewton).
4. Letter of Credit of $200,000 being held at Provident Bank relative to Tampa Bay Bandits.
5. Partnership interest in Senton & Company, a Florida general partnership, holding 5,600 acres of property in Jasper, Tennessee; fair market value unknown.
6. Fifty percent (50%) partnership interest in Colee Hammock Building; approximate value: $400,000 with $200,000 in mortgages.

7. $1,797,279.00 in mortgages receivable presently being serviced by Columbus Mortgage Company (J. Ewton).

8. $100,000 mortgage receivable on farm and house in Aiken, S.C.

9. $98,000 receivables in unsecured loans.

10. One partnership interest in Football Partners, Ltd. (Tampa Bay Bandits); fair market value unknown.

11. Partnership interest in S-J Minerals Partnership; value of claim unknown.

12. Claims pending in the United States Bankruptcy Court, Memphis, Tennessee in the matter of Robert Vincent and in the matter of Sequatchie Power Company.

V. ADDITIONAL CORPORATE INTERESTS
(value and extent of ownership interest under investigation)

1. AIMEE of Alabama (coal mining project).

2. Grundy Gas Company.

3. Midland Commodities, Inc.

4. RRE Gas Co.

5. RRE Mining Co.

6. Southeast Energy Company (Tennessee coal project).

7. Tennessee Drilling Company.

8. Tennessee Exploration and Development Company.

9. Tennessee Hydrocarbon Company.

10. U. S. Commercial Properties, Inc.; owned jointly by Ronnie Ewton and Marvin Warner.

ASSETS OF THE ESTATE OF ALAN NOVICK FROZEN PURSUANT TO COURT ORDER AS DISCLOSED OR DISCOVERED TO DATE

I. REAL ESTATE

Location	Description	Fair Market Value	Mortgage
Plantation Acres, FL	Residence, 22.5 acres	Not available ($500,000 equity)	Not available
Rustic Woods Farm, Lexington, KY	Horse farm	Not available	Not available

II. BANK ACCOUNTS

1. Citizens Union Bank, Lexington Kentucky: balance $8,000.
2. Citizens Fidelity Bank, Lexington, Kentucky: balance not available.
3. Landmark First National Bank, Fort Lauderdale, Florida: balance $20,000.
4. Merrill Lynch Cash Management Account: balance not available.
5. Sun Bank, Ft. Lauderdale, Florida account of Mrs. Novick for the Estate of Alan Novick: balance $75,000.
6. NCNB, Tampa, Florida: balance $67,000.
7. First Security Bank, Lexington, Kentucky: balance $245,000.

III. INVESTMENTS

1. One partnership interest in Football Partners, Ltd.: Tampa Bay Bandits.
2. $200,000 Letter of Credit, Provident Bank relative to Tampa Bay Bandits investment.
3. Two (2) show dogs - fair market value: $80,000.

4. Seven (7) horses insured for $435,000 loss payees: Ronnie Ewton and Alan Novick.

5. Spendthrift Farms, Inc., 133,333 shares fair market value: $200,000.

6. Notes receivable, $45,000.

7. Wine cellar inventory fair market value: $30,000.

8. Farm equipment fair market value: $20,000.

9. Rustic Woods, Inc., 500 shares, value unknown.

10. 1/4 interest in WEN Partnership, value unknown.

IV. ADDITIONAL CORPORATE INTERESTS
(value and extent of ownership under investigation)

1. AIMEE of Alabama (coal mining project).

2. Grundy Gas Company.

3. Midland Commodities, Inc. 17,500 shares. Fair market value unknown.

4. ARN Gas Company

5. ARN Mining Company.

6. Southeast Energy Company (Tennessee coal project).

7. Senton & Company.

8. S-J Minerals Partnership, value of interest unknown.

9. Tennessee Drilling Company.

10. Tennessee Exploration and Development Company.

11. Tennessee Hydrocarbon Company.

12. Claims pending in the United States Bankruptcy Court, Memphis, Tennessee in the matter of Robert Vincent and in the matter of Sequatchie Power Company.

ASSETS OF GEORGE MEAD FROZEN PURSUANT TO
COURT ORDER AS DISCLOSED OR DISCOVERED TO DATE

1. Personal residence Fort Lauderdale, Florida: fair market value not available.

2. 40-foot Burnscraft - sport fisherman model: fair market value not available.

ASSETS OF CHARLES STREICHER PURSUANT TO
COURT ORDER AS DISCLOSED OR DISCOVERED TO DATE

1. Quail Run Farm, Athens, Georgia: fair market value not available.

2. Merrill Lynch Cash Management Account: balance not available.

3. Residence, Ft. Lauderdale, Florida: fair market value not available.

ASSETS OF WILLIAM COLLIER FROZEN PURSUANT TO
COURT ORDER AS DISCLOSED OR DISCOVERED TO DATE

1. Personal Residence, Fort Lauderdale, Florida; Fair market value: $550,000.

ASSETS OF ROBERT SENECA FROZEN PURSUANT TO
COURT ORDER AS DISCLOSED OR DISCOVERED TO DATE

The identity and location of the assets of Mr. Seneca have not yet been disclosed or identified.

ASSETS OF TIMOTHY MURPHY FROZEN PURSUANT TO COURT ORDER AS DISCLOSED OR DISCOVERED TO DATE

I. REAL ESTATE

Location	Description	Fair Market Value	Mortgage
Ft. Lauderdale, FL	Residence	$170,000	$112,000

II. BANK ACCOUNTS

1. NCNB, Ft. Lauderdale, Florida: balance $3,200.
2. NCNB Money Market account: balance $148,000.
3. Georgia St. Bank: IRA $3,500.
4. NCNB: IRA $1,125

III. AUTOMOBILES

Description	Fair Market Value	Amount Financed
1979 Mercedes 450SL	$21,000	$7,600

IV. INVESTMENTS

1. 10,000 shares Syncom; fair market value: $10,500.
2. 16,000 shares Computer Investment Security, (no market value); purchase price $10,000.
3. Orangebury Realty, $81,250 cost; $46,000 note payable.
4. Jacksonville Associates, $300,000 cost; $287,500 note payable.

ASSETS OF NICHOLAS B. WALLACE FROZEN PURSUANT TO COURT ORDER AS DISCLOSED OR DISCOVERED TO DATE

I. PERSONAL ASSETS

1. Personal residence; fair market value: $600,000; $300,000 mortgage.
2. Two (2) automobiles owned free and clear; fair market value: $25,000.
3. Stotler & Company commodities Account balance: $86,705.07.
4. Boat; fair market value: $70,000.

II. ADDITIONAL CORPORATE INTERESTS
(VALUE AND EXTENT OF OWNERSHIP UNDER INVESTIGATION)

1. AIMEE of Alabama (coal mining project).
2. Grundy Gas Company.
3. Midland Commodities, Inc.
4. N.B.W. Gas Company.
5. N.B.W. Mining Company.
6. Senton Company.
7. Southest Energy Company (Tennessee Coal project).
8. Tennessee Drilling Company.
9. Tennessee Exploration & Drilling Company
10. Tennessee Hydrocarbon Company.

APPENDIX J

GNMA PRINCIPAL AND INTEREST PAYDOWNS
PAID TO ESM AND DEPOSITED IN
RECEIVER'S ACCOUNT AT SUN BANK

Check Date	Received From	Reporting Month	Certificate Number	Amount
3/14/85	Colonial Savings	Feb.	2040692 SF	$ 2,509.51
2/27/85	Paine Webber	Jan.	K 151	6,048.55
3/15/85	Pfeffer Korn Co.	Feb.	2035052 SF	198.63
3/15/85	Fleet Mortgage	Feb.	1801747 SF	8,541.49
3/08/85	Midatlantic	Feb.	1670915 SF	913.18
3/11/85	Barnett Mortgage	Feb.	91888356	9,221.82
3/15/85	Nowlin Mortgage	Feb.	1700479	3,411.21
3/15/85	Banker's Funding	Feb.	2055274	5,129.67
3/15/85	Banker's Funding	Feb.	2054202	5,131.50
3/15/85	Banker's Funding	Feb.	2055101	5,131.50
3/15/85	Lomas & Nettleton	Feb.	2055099	10,288.54
3/15/85	Lomas & Nettleton	Feb.	2055100	10,288.54
3/12/85	Knutson Mortgage	Feb.	1926181 SF	522.07
3/11/85	Talman Home	Feb.	1784071 SF	29,705.90
3/12/85	M & T Mortgage	Feb.	2035053 SF	166.67
3/08/85	Kissell Company	Feb.	1670916	4,548.52
3/12/85	Liberty	Feb.	2055273	5,141.44
				$106,928.74

GNMA PRINCIPAL AND INTEREST PAYDOWNS
RECEIVED BY ESM AND CLAIMED BY
THIRD PARTIES; DEPOSITED IN RECEIVER'S
ACCOUNT AT SUN BANK

Check Date	Received From	Claimed By	Reporting Month	Certificate Number	Amount Received & Claimed
3/15/85	First Invest.	No claim received	Feb.	1973518 SF	$ 1,068.36
3/15/85	First Invest.	No claim received	Feb.	1973509 SF	986.17
3/15/85	Criterion Corp.	No claim received	Feb.	1981999	341.35
3/4/85	Chase Manhattan	Resource Management Associates	Jan.	2020158	4,919.62
3/6/85	Chase Manhattan	Resource Management Associates	Jan.	2020165	5,371.65
3/12/85	M & T Mtg.	No claim received	Feb.	1982000 SF	775.45
3/12/85	First Family Mtg.	No claim received	Feb.	1973510 SF	2,865.52
3/11/85	Homestead Saving	No claim received	Feb.	1974601 SF	969.22
3/12/85	FBS Mortgage	No claim received	Feb.	1973511 SF	1,247.16
3/15/85	Sovran Mtg.	No claim received	Feb.	1974332 SF	789.91
3/8/85	Alliance Mtg.	Salomon Bros.	Feb.	2008892 SF	285.87
3/11/85	STM Mtg.	No claim received	Feb.	1973512 SF	782.18
3/12/85	J.I. Kislak	No claim received	Feb.	2035054 SF	419.02
					$20,821.48

ESM GOVERNMENT SECURITIES, INC.
ACTING AS AGENT
COMMITMENT FEES PRESENTLY OUTSTANDING

	TRADE DATE	CUSTOMER	BUYER (B)/ SELLER (S)	DESCRIPTION	COMMITMENT FEE
1.	01/15	Century Mortgage	S	10,000,000.00, 10% one year adjustable rate, residential owner occupied mtg	$ 12,459.90
	01/31	First Fed'l S&L, Sanford	B		
2.	02/25	Standard Fed'l S&L, Gaithersburg, MD	S	20,000,000.00, 10 1/4% one-year adjustable rate, residential, owner occupied mtg	12,500.00
	02/25	Roosevelt Fed'l S&L	B		
3.	02/07	Heritage Fed'l S&L	S	5,000,000.00, 10 1/2% one-year adjustable rate, owner occupied and true second homes	12,500.00
	02/07	First Fed'l S&L, Sandford	B		
4.	01/24	Horizon Financial Corp.	S	5,000,000.00, 11 7/8% three-year adjustable rate, single family	12,500.00
	01/24	Seneca Fed'l S&L	B	owner occupied properties	
5.	01/24	Vining-Sparks Sec.	S	967,460.80, one-year adjustable rate, single family owner occupied detached properties	3,566.25
	01/24	Stockton, Whatley, Davin and Co.	B		
6.	01/24	Vining-Sparks Sec.	S	579,774.46, four 30-year and one 15-year fixed rate mtg loan	2,319.21
	01/24	Stockton, Whatley, Davin and Co.	B		
7.	01/28	Vining-Sparks Sec	S	22,400,000.00 Mtg. Service with weighted avg coupon of 11.02 and a weighted avg. maturity of 22.56 yrs.	39,261.75

	TRADE DATE	CUSTOMER	BUYER (B)/ SELLER (S)	DESCRIPTION	COMMITMENT FEE
	01/28	Stockton, Whatley, Davin and Co.	B		
8.	02/25	Diamond Savings & Loan	S	8,000,000.00, 12 1/4% three-year adjustable rate single family residential and 2-4 unit properties, 12.25.	$ 20,000.00
	02/25	Seneca Fed'l S&L	B		
9.	01/29	Home Fed'l S&L Memphis, TN	S	90% participation of 3,900,000 permanent loan on Brock Residential Inn-Memphis, TN, 25 yr (10 yr call) 1 yr Treasury pays 2 1/2%	13,500.00
	01/29	Home Fed'l S&L Xenia, Ohio	B		
				Total Commitment Fees accruing to the Receivership Estate	$128,607.11

SUMMARY OF PROCEEDS TO THE ESTATE UPON
CLOSING THE OPEN SECURITY TRANSACTIONS

CUSTOMER	COUPON	QUANTITY	PROCEEDS	COST	PROFIT
Twin City S&L	12.50	$2,000,000.00	$2,029,577.07	$1,989,744.25	$ 39,832.82
Ambassador S&L	11.50	1,000,000.00	992,873.81	953,454.40	39,419.41
St. Louis S&L	11.50	1,000,000.00	995,451.30	952,532.87	42,918.43
United S&L	12.00	5,000,000.00	4,853,125.00	4,778,125.00	75,000.00
Guarantee S&L	12.00	1,000,000.00	991,250.00	955,625.00	35,625.00
American S&L	12.00	1,000,000.00	991,250.00	955,625.00	35,625.00
U.M. I.C.	12.00	2,000,000.00	1,933,473.37	1,912,212.67	21,260.70
	12.00	1,000,000.00	982,994.51	956,105.98	26,888.53
		$14,000,000.00	$13,769,995.06	$13,453,425.17	$316,569.89

POTENTIAL CLAIMS IDENTIFIED AS OF
3/25/85 AGAINST THE RECEIVERSHIP ESTATE FOR
LOSSES INCURRED BY CUSTOMERS UPON LIQUIDATION
OF OPEN CONTRACTS

Claimant	Amount in Controversy	Open contracts which upon closing gave rise to a loss
First City Bank	$187,619.18	Liquidation of collateral, treasury notes; principal loss of $162,749.82 and interest loss of $24,869.36.
First Interstate Bancorp	1,034.53	Incomplete transactions and pair-offs of GNMA's.
Iowa Public Employees	111,806.77	Liquidation of $9,600,000 in GNMA's.
Kleinwort-Benson Government Sec.	19,698.30	Resales; forward settlements; sale of options on treasury bonds and stand-bys GNMA's.
Lasser Marshall	148,873.98	Balance due to Lasser following the liquidation of positions.
Liberty Government Securities, Inc.	600,000.00 (approx.)	$700,000 in Repo contracts maturing 3/12 and $14,000,000 maturing 3/18; Also margin of $250,000 on bills.
Mocatta Corp.	78,000.00	Loss from closing out position on 3/4 and 3/5.
Pollock, William & Co.	1,127,225.73	Liquidation of reverse repurchase position; Repo interest loss and total loss for GNMA pools $197,845.21 and failed sale loss of $14,269.42.
Refco Partners	224,489.51	Loss from liquidation.
Resource Management Associates	250,000.00 (approx.)	Potential loss assuming liquidated position on 3/8.
World Trade Securities	20,075.02	Loss from closing out positions.
TOTAL CLAIMS	$2,768,823.02	

LIQUIDATION OF SECURITIES BY
CUSTOMERS WHICH SHOULD RESULT IN
A CREDIT TO THE RECEIVERSHIP ESTATE

Arizona Retirement System	$235,645.13
Oppenheimer & Co.	amount unknown
Moseley, Hallgarten, Estabrook & Weeden, Inc.	400,000.00 (approx.)
City of Tulsa	178,648.66
TOTAL	$814,293.79

POTENTIAL CREDITORS OF THE RECEIVERSHIP ESTATE
ARISING FROM DAY TO DAY OPERATIONS OF THE ESM COMPANIES
PRIOR TO THE RECEIVER'S APPOINTMENT[1/]

Claimant	Description of Services	Invoice Amount	Company Against Whom Claim is Made
AMPCO Electric Inc.	Installation of two circuits for computer	$ 431.64	ESM Government Securities, Inc.
Burlington Northern Air Freight	Delivery of computer parts from Sparks, Nevada	75.97	N/A
The Bond Buyer	Fannie Mae and Jennie Mae printed reports	155.00	ESM Government Securities, Inc.
Chevron, U.S.A., Inc.		146.20	ESM Government Securities, Inc.
Commerce Clearing House, Inc.	Federal Banking and Security Laws Reports	832.50	ESM Securities, Inc.
Computer Distributing Co.	Computer equipment	26,872.00	ESM Government Securities, Inc.
Federal Express Corp.	Air bills	1,224.50	ESM Group, Inc.
Financial Programing, Inc.	Computer equipment	205.15	N/A

1/ This list is not intended to be an exhaustive list of the ESM Companies creditors.

POTENTIAL CREDITORS OF THE ESTATE, continued

Claimant	Description of Services	Invoice Amount	Company Against Whom Claim is Made
First Money Managers, Inc.	Referral fees	66,088.72	ESM Government Securities, Inc.
Great Lake Business Forms, Inc.	Business forms	35.97	ESM Government Securities, Inc.
Hale Systems, Inc.		75.00	ESM Government Se- Inc.
Lend-Leaf	Plant maintenance	194.25	ESM Group, Inc.
Munifacts News Service	News'wire monthly service charge	695.00	ESM Securities, Inc.
NASD	Registration fees	71.75	
National Business Communications Corp.	Removing computer line	45.00	ESM Securities, Inc.
Pitney-Bowes	Postage	107.10	ESM Group, Inc.
Priority Services, Inc.	Deliveries of packages from Bradford	477.00	ESM Securities, Inc.
Reuters Limited	Subscriber news service	816.20	ESM Group, Inc.
Riverside Press, Inc.	Letterhead envelopes and business cards	1,411.31	ESM Government Securities, Inc.
Shell Oil Company	Gasoline products	234.51	ESM Government Securities, Inc.

POTENTIAL CREDITORS OF THE ESTATE, continued

Claimant	Description of Services	Invoice Amount	Company Against Whom Claim is Made
Southern Bell and AT&T Communications	Watts lines	5,657.51	ESM Securities, Inc.
Tri-continental Leasing Corporation	Equipment leasing	3,099.96	ESM Government Securities, Inc.
U.S. Transmission Systems, Inc.		8.76	ESM Group, Inc.
Watson, Hubert & Clark	Legal fees	495.50	$437.50 by Senton & Company, $58.00 by ESM Financial Group, Inc.
Total Claims To Date		$109,456.50	

APPENDIX K

BANK ACCOUNTS ESTABLISHED BY THE RECEIVER
AT SUN BANK OF MIAMI, N.A.

ENTITY	Account #	Balance as of 3/28/85
E.S.M. Government Securities, Inc.	5899	$1,104,282.43
E.S.M. Group, Inc.	5910	680,387.24
E.S.M. Securities, Inc.	5921	259,627.12
E.S.M. Financial Group	5932	15,168.83
		$3,559,465.62[1]

1 Includes $1,500,000 to be delivered to the Receiver on April 1, 1985, which is the maturity date of certain securities presently being held by the attorney for one of ESM's principals.

ASSETS ACCRUING TO THE ESTATE OF
THE E.S.M. COMPANIES UPON LIQUIDATION
OF SECURITIES TRANSFERRED TO THE ESTATE
FROM BRADFORD TRUST AND SECURITY PACIFIC
AND INVESTMENT BY RECEIVER OF SAME

SECURITY PACIFIC CLEARING & SERVICES CORP.

CASH	$9,105,710.44
SECURITIES	2,761,557.07
	$11,867,267.51

BRADFORD TRUST COMPANY

CASH	-0-
SECURITIES	10,401,754.11
GRAND TOTAL	$22,269,021.62

These funds and securities, aggregating $22,269,021.62 in cash, were transferred by the Receiver to Merrill Lynch Government Securities, Inc. Pursuant to Court order dated March 18, 1985, Merrill Lynch Government Securities, Inc., as an accommodation to the Receiver and the Securities and Exchange Commission and without renumeration, liquidated the securities and purchased on behalf of the Receiver $22,770,620 of June Treasury Notes at a cost of $22,265,821.61, leaving a cash balance of $3,200.01, which balance was transferred to the Receiver's account at Sun Bank.

SECURITIES TRANSFERRED FROM
BRADFORD TRUST COMPANY
TO THE RECEIVER'S ACCOUNT AT
MANUFACTURERS HANOVER TRUST
AND LIQUIDATED BY
MERRILL LYNCH GOVERNMENT SECURITIES, INC.

$ 506,894	GNMA P/T PL #61738 11.500 03/15/13
975,004	GNMA P/T PL #62090 11.500 05/15/13
996,083	GNMA P/T PL #62383 11.500 04/15/13
1,000,000	GNMA P/T PL #63557 11.500 04/15/13
505,149	GNMA P/T PL #63912 11.500 04/15/13
500,000	GNMA P/T PL #63925 11.000 4/15/13
509,360	GNMA P/T PL #64602 11.500 04/15/13
505,827	GNMA P/T PL #64932 11.5000 04/15/13
999,811	GNMA P/T PL #65138 11.500 06/15/13
493,663	GNMA P/T PL #65229 11.000 03/15/13
500,000	GNMA P/T PL #65229 11.000 03/15/13
511,708	GNMA P/T PL #67115 11.000 05/15/13
502,387	GNMA P/T PL #67248 11.000 04/15/13
330,000	GNMA P/T PL #67963 11.000 05/15/13
930,853	GNMA P/T PL #68161 11.500 05/15/13
1,000,000	GNMA P/T PL #68977 11.500 06/15/13
500,000	GNMA P/T PL #69099 11.500 06/15/13
500,000	GNMA P/T PL #121812 12.00 01/15/15
$11,766,739	

SECURITIES TRANSFERRED FROM
SECURITY PACIFIC CLEARING & SERVICES CORP.
TO THE RECEIVER'S ACCOUNT AT
MANUFACTURERS HANOVER TRUST AND LIQUIDATED
BY MERRILL LYNCH GOVERNMENT SECURITIES, INC.
ON BEHALF OF THE RECEIVER

FACE VALUE	AMORTIZED VALUE (1)	SECURITIES DESCRIPTION	MARKET VALUE (2)
$ 225,000	$103,634	GNMA P/T PL #12368 8.50% 08/15/86 362038W56	79.876
100,000	91,658	GNMA P/T PL #399932 11.00% 03/15/10 362070LM4	93.781
200,000	185,731	GNMA P/T PL #40187 11.00% 07/15/10 362070UL6	93.781
57,862	67,374	GNMA P/T PL #66564 11.00% 04/15/13 362099SZ2	93.781
2,325,000	n/a	U.S. TREASURY NOTES 10.I25% 02/15/88	99.344
$2,907,862	$438,397		

(1) As of February 28, 1985

(2) As of February 28, 1985 (IDSI Pricing Service)

PROCEEDS TO THE RECEIVERSHIP ESTATE UPON
LIQUIDATION OF SECURITIES BY MERRILL LYNCH
GOVERNMENT SECURITIES, INC. ON BEHALF OF
THOMAS TEW, RECEIVER, E.S.M. GOVERNMENT SECURITIES, INC.

TD	SD	DESCRIP-TION	COUPON	ORIGINAL FACE	AMORTIZED VALUE	PRICE	NET PROCEEDS	SOURCE
03/14	03/15	67963	11.000	$ 330,000.00	$ 326,741.00	89.000	$ 292,197.65	Bradford
03/14	03/15	67248	11.000	502,387.00	498,306.00	89.000	445,624.72	Bradford
03/14	03/15	67115	11.000	511,708.00	506,875.00	89.000	453,288.08	Bradford
03/14	03/15	65229	11.000	500,000.00	481,179.00	89.000	430,308.07	Bradford
03/14	03/15	63925	11.000	500,000.00	495,637.00	89.000	443,237.42	Bradford
03/14	03/15	65229	11.000	493,663.00	475,080.00	89.000	424,854.34	Bradford
03/14	03/15	62383	11.000	996,083.00	948,302.00	89.000	848,046.20	Bradford
03/14	03/15	68161	11.500	930,853.00	923,562.00	91.375	848,035.27	Bradford
03/14	03/15	68977	11.500	1,000,000.00	963,659.00	91.375	884,853.94	Bradford
03/14	03/15	65138	11.500	999,811.00	979,652.00	91.375	899,539.07	Bradford
03/14	03/15	63912	11.500	505,149.00	465,775.00	91.375	427,685.59	Bradford
03/14	03/15	63557	11.500	1,000,000.00	954,972.00	91.375	876,877.35	Bradford
03/14	03/15	61738	11.500	506,894.00	484,974.00	91.375	445,313.97	Bradford
03/14	03/15	64602	11.500	509,360.00	504,750.00	91.375	463,473.26	Bradford
03/14	03/15	64932	11.500	505,827.00	476,868.00	91.375	437,871.12	Bradford
03/14	03/15	62090	11.500	975,004.00	940,105.00	91.375	863,225.83	Bradford
03/14	03/15	69099	11.500	500,000.00	485,001.00	91.375	445,338.79	Bradford
03/14	03/15	121812	12.000	500,000.00	499,629.00	94.000	471,983.45	Bradford
03/14	03/18	12368	08.500	$ 225,000.00	$ 103,488.00	76.750	$ 79,842.99	SPC
03/14	03/18	40187	11.000	200,000.00	185,619.00	88.500	165,237.44	SPC
03/14	03/18	39932	11.000	100,000.00	91,598.00	88.500	81,540.35	SPC
03/14	03/18	66564	11.000	57,862.00	57,862.00	88.500	51,050.75	SPC
03/14	03/18	TN02-15-88	10.125	2,425,000.00	2,425,000.00	97.4375	2,383,885.54	SPC
				$14,774,601.00	$14,274,634.00		$13,163,311.19	

[Recess taken.]

Mr. BARNARD. Will the subcommittee come to order.

At this particular time in the hearing, we were scheduled to have appear before us, Mr. Steve Arky. Mr. Arky is the registered agent and attorney for ESM Government Securities. We were interested in hearing Mr. Arky's testimony because of his very close association with the firm since 1977, including his legal representation of ESM against the SEC's investigations in 1977.

However, last evening, the subcommittee received a call from a criminal lawyer in Chicago, whom Mr. Arky has just retained. He advises us that Mr. Arky would not appear voluntarily today.

The committee, then, will assess the importance of Mr. Arky's testimony and if it is found to be essential, a subpoena will be issued requiring his appearance.

At this time I would like to ask our last panel to come to the witness stand. Ms. Linda Schreiber-Baker, director of finances of the city of Pompano Beach, FL., and Mr. William E. Neild, mayor of the city of Beaumont, TX.

Ladies and gentlemen, we, indeed, apologize that we have kept you all day long in this committee hearing, but I am sure that you can see from the importance of the testimony that you have heard yourselves, that this is something that required a lot of time and a lot of attention.

It certainly doesn't mean that the involvement of cities such as yours, was any less important than Home State or American Savings and Loan or any of the rest of them. But Home State Savings & Loan, as you know, crippled an entire insurance system in Ohio and therefore that seemed of paramount importance. We likewise realize that you, along with other communities in America, have been victimized by this situation and we would certainly welcome your testimony about this situation.

Ms. Baker, we would like to hear from you first and then we will hear from Mr. Neild. I am sure that in the meantime, other members will be returning from the vote and will be wanting to ask you some questions.

So, we will hear from you first, Ms. Baker.

STATEMENT OF LINDA SCHREIBER-BAKER, FINANCE DIRECTOR, CITY OF POMPANO BEACH, FL

Ms. BAKER. Thank you, Mr. Chairman.

My name is Linda Baker, and I am currently the finance director of Pompano Beach, as you have said, Florida. I am still trying to recover from what Mr. Tew has just told us. I am particularly honored though that I have been given the greatest opportunity that has ever been given to me, to be able to have the chance to speak to you, the people who have the power to change the regulations for the betterment of society and to insure that the people are truly protected against unscrupulous securities dealers.

I first became introduced to ESM Government Securities in March 1984, about a year ago, at the city of Tamarac, FL. I received a brochure in my in basket, as people have been mentioning and, as I was passing it from my mail into my trash, I noticed that it contained an audited financial statement. I examined the state-

ment and found that the company appeared to be sound and even took an additional precaution of calling the local auditing partner—of Alexander Grant—to confirm my confidence. After a "by the way" casual telephone conversation, I had a second feeling of reassurance in ESM. Alexander Grant & Co. was no stranger to me. Their opinion was on the brochure. They weren't a small local accounting firm, in fact, they were the firm that audited the city of Tamarac and I had been doing business with them for several years. I had a great deal of respect for the local partner and his auditing staff. Because of this trust, I placed them on the city's bidders list.

If I can't trust one of the Big 10 auditing firms, which Alexander Grant & Co. was at the time, then who am I supposed to turn to? Where was the Big 10 who audited Home State Savings? Where was the Big 10 who audited American Savings? Where is the Big 10 that audited my city? And, what about Bradford Trust?

We didn't wire money from Florida. We didn't wire money from Pompano or Tamarac to ESM. We wired it to Bradford Trust. Where do they fit into the puzzle? I haven't heard.

Every wire that was ever sent, included the instructions and I have proof of this, that read, to the further benefit of or to be credited to the city of Tamarac or the city of Pompano. These wires were sent from our banks to Bradford and the money was always received from Bradford. I don't know what role they had, what role they played in this.

Repurchase agreements weren't new to me either or to the city of Tamarac. The city had been using repo's for many years prior to my hire in 1981. Attached to my statement is a listing of the repurchase investments I made during my tenure with the city of Tamarac. The list shows only repurchase agreements and excludes the overnight repo's that are made through the banks where many cities usually keep their demand deposit operating accounts. As you will note, only four repo's were with ESM. The list contains the names of two primary dealers, three secondary dealers and a bank. This list represents the winners of these bids. Many other banks, savings and loans and brokers were included in the bidding process. I would bid as often as 12 times each month, depending on maturities and cash flow. On many other investment days, I had purchased certificates of deposit as well as direct purchases of Government-backed securities such as GNMA bonds, Treasury bonds and Treasury notes, with other banks and brokers.

While I was at Tamarac I presented the city's investment portfolio to an Investment Advisory Committee. The committee was composed of the mayor, a retired C.P.A. who was also on the board of directors of a hospital, a bank and a savings and loan and experts that were appointed by the elected officials of Tamarac because of their investment expertise. They were pillars of their community and of our society. They met with me at least monthly to review, discuss and make recommendations on the city's portfolio.

On September 17, 1984, I started my position as finance director with the city of Pompano Beach. The city's code of ordinance's specifically included repurchase agreements as one of the allowable investments. Many bankers, brokers, savings and loans, et cetera,

telephoned my office when I first began working there, which was a little less than 6 months ago.

My secretary was instructed to have them send me information or to be patient with me until I settled in to my position. Again, ESM's brochure appeared on my desk. I had absolutely no reason to believe, I do now, that there were any problems with any of the names on the bidder's list. On December 5, 1984, Pompano Beach awarded their first bid to ESM. The rest is history. I had never experienced any problems with any of the firms on either of my bidder's lists in 4 years until March 4, 1985, when the SEC closed the doors to ESM. That is what brought me here today.

We are discussing municipal investments. This is the "grass roots" money. I am hopeful that after numerous lawsuits and several years, the cities will sustain recovery. But, how could this have happened in the United States? I am dismayed.

In this year, 1985, over 50 years after the establishment of the SEC, I find that an investor can still be duped by conspiracy and fraud in what the investor assumes to be a regulated market. I find this incomprehensible. I have read in the newspapers over the last few weeks that Government securities are unregulated investments, however what about the dealers of Government securities? Evidently they are not regulated. Do they have a license? If they have a license, who controls their license? Can a person deal in securities without a license? Do they have a license to deal or a license to steal? Who is watching them? At the city level, how do I know who is who? Who has told me who I am supposed to be watching out for? Everybody complains about too much Government regulation and I don't know where it is.

When we place money in repurchase agreements, we specify that the collateral has to be backed by the full faith and credit of the U.S. Government. If the underlying collateral had been Chrysler or General Motors bonds rather than GNMA bonds, I wouldn't be sitting here talking about this, it would have been regulated by the SEC. Don't you think it is strange that these losses to the city are today's subject because I insisted on my collateral being backed by my own Government. Please allow the SEC to regulate the dealers. I am not talking about regulating securities, but the dealers. The mechanisms are somewhere in place. Turn on the switch and let them do their job. Give them the power to regulate security dealers.

I have heard about voluntary registration. I can't understand, after what we have heard today, why we would ask people who are apparently perpetrating fraud to voluntarily decide to join forces with the Government. Mandatory registration is a suggestion.

I believe that this is just the tip of the iceberg and I know you all believe it too or we wouldn't be sitting here and discussing all of this. ESM was not the first or the only company to perpetrate a catastrophic disaster, financial disaster, nor will they be the last unless we do something about it.

There are hundreds of Government security dealers, dealing with people as we speak. Are they all honest? Is there another ESM? Did the SEC know? I don't know, but there was a problem with ESM. Could they have warned the investors? It's apparent to me that there are many agencies that had knowledge of this problem.

Why didn't they inform the investors? Who else might they know about? I would like to know. Please correct this grievous wrong.

I understand, all to well, and I sympathize with the selling of U.S. debt. In fact, I have to leave very shortly because I have to be at Standard and Poors and Moodys tomorrow to explain to them how I am going to continue to be able to sell the city of Pompano Beach debt.

Mr. BARNARD. Ms. Baker, do I understand that possibly you are a double victim? Were you victimized from your previous position?

Ms. BAKER. No; I left my previous position with Tamarac and then joined Pompano. There were no outstanding investments with ESM, however, I placed them on that bidders list.

Mr. BARNARD. In other words, you put ESM on the Tamarac bidders list?

Ms. BAKER. That's correct.

Mr. BARNARD. Have they, in turn, purchased any securities from ESM?

Ms. BAKER. Oh yes.

Mr. BARNARD. So they have been victimized as well?

Ms. BAKER. Yes; they are a victim.

Mr. BARNARD. Excuse me, did I interrupt your testimony?

Ms. BAKER. I am almost done.

Mr. BARNARD. Excuse me. Go right ahead.

Ms. BAKER. I am going before Standard and Poors and Moodys tomorrow, as I just said, because I have to reassure them and demonstrate to them how something like this will never happen again and how can I do that? Can you do that for me? Do you think it's time now for the Federal Government to tell me how this will never happen again, to restore our confidence in the financial system.

I think that perhaps the Government, this is only my opinion because I was asked per your request what I would suggest for the Government to do. I think they ought to take the reins. Someone has to do something about this. They have to regulate security dealers.

I will be happy to answer any questions about the detailed procedures of the wire transfers we made. I gave copies to your staff of the bank with the instructions that said, for the further credit of and to the benefit of, to Bradford Trust and as I stated before, all the wires were received from Bradford Trust. We did not deal directly with ESM by wiring them funds.

It was our understanding, from the beginning, that they were segregated securities. I have tickets, rather confirmation slips, that I have also given your staff for Paine, Weber, Jackson & Curtis; Marcus, Stowell & Beye and other dealers that I have dealt with and they appear to me to be the same as any other repurchase agreement that I have done and you do have a list of all the agreements that I have done.

Mr. BARNARD. Ms. Baker, how did your dealings with ESM differ from dealings with other securities dealers?

Ms. BAKER. They did not differ, sir. In fact, February 28, 1985, which was what Mr. Tew was just speaking of was the day they called him in and Alexander Grant & Co. apparently reversed their opinion which was unknown to me, of course.

I had a maturing investment with ESM for $2.5 million on a $5 million bidding day. Luckily they lost the bid by two basis points which, as you know, is a very small percentage.

That's another thing I wanted to say. There was not a bid that would have made me suspicious. I was not induced.

Mr. BARNARD. Where did you think that your securities were being held?

Ms. BAKER. At Bradford Trust.

Mr. BARNARD. Did you have in hand the same types of trust receipts that you had from Paine Weber and these others?

Ms. BAKER. Paine Weber, who deals through Morgan Guaranty, I had the same confirmation slips as I had with the banks I dealt with, with Paine Weber, Jackson & Curtis, with Marcus, Stowell & Beye, with Merrill Lynch, with ESM. That's what I held.

Mr. BARNARD. Did they indicate that the bonds were being held by a third party?

Ms. BAKER. That was the indication from the dealer, yes.

Mr. BARNARD. I am going to recognize our distinguished chairman of the Government Operations Committee for an introduction at this time.

Mr. BROOKS. Thank you, Mr. Chairman. On behalf of the full committee, I want to welcome the Honorable Bill Neild, the mayor of Beaumont, TX. Mayor Neild is an outstanding city official who currently serves on the national league of cities community and economic development committee.

Before his election as mayor, Bill was active in many Beaumont civic organizations, served on the Beaumont Planning and Zoning Commission and is past president of the Beaumont Chamber of Commerce. He's a builder and a developer. Currently a partner in the Neild Development Co. He serves as vice president of H.B. Neild & Sons, general contracting firm.

Mayor, all of us appreciate your appearance here today and we look forward to your testimony on our city and our city's involvement with ESM Government Securities Co.

I did want to make one observation. Could I ask Miss Baker one question.

Mr. BARNARD. Sure.

Mr. BROOKS. Miss Baker, why is it that you, as a financial consultant did not follow the practice that maybe 15 other people followed of having a separate securities receipt. I note that Lasser Marshall, they recovered $198 million, they didn't lose a nickel. Moseley Hallgartten, $237 million, William Pollock & Co. $29 million, Kleinwort Benson Government Securities, $627 million. Arizona Retirement System picked up their $210 million because they had a receipt.

Did it ever occur to you, as it must have to them that you ought to have something that says we are going to get it back from somebody like Bradford Trust instead of some company who may or may not have them in hand.

Ms. BAKER. Well, Mr. Brooks, if you had been dealing with someone, primary or secondary dealers, banks, savings and loans, et cetera for hundreds and hundreds of transactions and never had a problem with them—the only time I took actual possession of or safekeeping of a third party bank was when I made a direct pur-

chase of a GNMA bond, Treasury note, bond or bill. These are short-term investments and I do want to impress upon this panel one specific fact.

Most cities do overnight repurchase agreements. Where do they hold them, with the bank they do the overnight? That's not a third party. Every morning are they to transfer the delivery to a third party bank and do a book entry? Does a book entry mean that I have a receipt?

By the time I get the receipt, I have already entered into another agreement because that is an overnight repurchase agreement.

Mr. BROOKS. In the future, for example——

Ms. BAKER. Oh well, in the future——

Mr. BROOKS [continuing]. Will you get a security receipt whenever you turn over any of those city funds?

Ms. BAKER. In the future? You mean knowing what I know now?

Mr. BROOKS. You're going to get one?

Ms. BAKER. First of all, I am not going to do repurchase agreements until I have a third party collateral bank. I have attempted, when I worked with the city of Tamarac to have a custodial bank in New York City so I could do transactions on a very quick delivery verus payment basis. I called Irving Trust. I don't know if I called Bradford. I may have. There is a list if I go look for it somewhere in Tamarac.

Mr. BROOKS. Do you check on the people that you do business with to find out what their stability is or their credibility or their fiscal solvency and so forth?

Ms. BAKER. ESM's brochure, which was their financial statement which has on the face of it, an opinion by the auditing company, Alexander Grant & Co., who was my auditor at the city of Tamarac and until just recently was my auditor at Pompano Beach.

Mr. BROOKS. Have you thought about suing the auditor at Grant that got that $125,000 bribe?

Ms. BAKER. We certainly are.

Mr. BROOKS. One of their good auditors.

Ms. BAKER. We certainly are.

Mr. BROOKS. Is it strange that just one auditor would look at a firm that size? Wouldn't you think that more than two or three people would be on a team?

Ms. BAKER. My deputy, at the city of Pompano Beach used to work for Alexander Grant & Co. and I asked him the same question.

Mr. BROOKS. And what did he say?

Ms. BAKER. He said that that was a senior regional partner of Alexander Grant & Co. and I believe that Mr. Tew brought up the point also that the peer review that DAICPA, I believe you all discussed this in another subcommittee, that there is peer review, but they are not regulated. They aren't even audited, to my knowledge.

Mr. BROOKS. Did you say that they had no peer reviews?

Ms. BAKER. To my understanding, there are peer reviews, but there is no outside regulation.

Mr. BROOKS. No; there is not. I was asking about Alexander Grant, which is an outside audit that they paid for and that they bribed to be skewed to make them look good, is that the effect of it?

Ms. BAKER. That's right.

Mr. BROOKS. And my question was—did they have one person that did that whole audit?

Ms. BAKER. They had a senior partner, this Jose Gomez and then they had a few, I think they call them juniors, junior partners, fresh young auditors.

Mr. BROOKS. Well it just seemed to me strange that one person could control that entire audit. You would think there would be two or three.

Ms. BAKER. What my deputy told me is that the reason that it wasn't strange, which frightens me, is because it was just a small little account and I don't call these numbers small.

Mr. BROOKS. A small little account?

Ms. BAKER. Right.

Mr. BROOKS. $300 million?

Ms. BAKER. Right.

Mr. BROOKS. Thank you.

[Ms. Baker's prepared statement follows:]

City of Pompano Beach Florida

P. O. Drawer 1300 . 330t

To The Honorable Doug Barnard, Jr., Chairman of the Subcommittee of Commerce. Consumer and Monetary Affairs, Committee on Government Operations, the United States House of Representatives.

Dear Mr. Chairman:

My name is Linda Baker, and I am currently the Finance Director for the City of Pompano Beach. I am particularly HONORED that I have been given the greatest opportunity that has ever been granted to me. I have been given the chance to speak to you, the people, that have the power to change the regulations for the betterment of our society, to insure that the People are truly protected against unscrupulous Securities Dealers.

I first became introduced to E.S.M. Government Securities, Inc. in March of 1984 at the City of Tamarac, Florida. I received a brochure in my "in" basket and as I was passing it from my mail to my trash, I noticed that it contained an Audited Financial Statement. I examined the statement and found that the company appeared to be sound and even took the additional precaution of calling the local Auditing Partner to confirm my confidence. After a "by the way", casual telephone conversation, I had a second feeling of reassurance in E.S.M. Alexander Grant & Company, who's opinion was on the brochure, was not a stranger to me. They were not a small local accounting firm, they were one of the "Big Ten". They were also the auditors for the City of Tamarac, and I had been working with them for several years. I had a great deal of respect for the local partner and his auditing staff. I placed E.S.M. on the City's bidders list.

Repurchase agreements were not new to me, or to the City of Tamarac. The City had been using repo's for many years prior to my hire. Attached to this statement is a listing of the repurchase investments I made during my tenure with the City of Tamarac. The list shows only repurchase agreements and excludes the "overnight repo's" that are made through the Banks where many Cities usually keep their demand deposit operating accounts. As you will note, only four repo's were with E.S.M. The list contains the names of two Primary Dealers, three secondary dealers, and a bank. This list represents the "winners" of these bids. Many other Banks, Savings and Loans, and Brokers were included in the bidding process. I would bid as often as twelve times each month, depending on maturities and cash flow. On many other Investment days I had purchased Certificates of Deposit as well as Direct purchases of Government backed securities such as GNMA Bonds, Treasury Bonds, and Treasury Notes.

While at Tamarac I presented the City's investment portfolio to an Investment Advisory Committee. The Committee was composed of the Mayor, a retired C.P.A. who was also on the Board of Directors of a Hospital, Bank and Savings and Loan, and "experts" that were appointed by the elected officials of Tamarac because of their investment expertise. They were the "pillars" of their community. They met with me at least monthly to review, discuss and make recommendations on the City's Portfolio. Repo's were a common place item in that portfolio, which also showed where each investment had been purchased. E.S.M.'s name appeared on those lists as did all the other investments.

On September 17, 1984, I started my position as Finance Director with the City of Pompano Beach. After discovering many pre-existing problem areas in their accounting systems I concentrated my efforts in areas other than investing. The Assistant to the Finance Director was performing the task of investments for three years and, although I knew that funds were not always being bid, due to time restraints, I put this area on a back burner. I did, however, produce an Investment Manual about three weeks after I was hired. I had reviewed the City's Code of Ordinance's and found that, among other investments the Code specifically included repurchase agreements as one of my allowable investments. My Investment Manual was distributed to the City Commission, City Manager, and my assistant. The manual outlined the procedures that I planned to implement, including the use of a bidder's list. This list was prepared and implemented in November 1984. In the interim many bankers, brokers, and savings and loans telephoned my office. My secretary was instructed to have them send information or to be patient with me until I became settled in my new position. Again, E.S.M.'s brochure appeared in my basket. I had absolutely no reason to believe that there were any problems with any of the names on the bidder's list due to my past experience which had all been good. The list was given to my assistant in November and on December 5, 1984, Pompano Beach awarded their first bid with E.S.M. The rest is history. I had never experienced any problems with any of the firms on either of my bidder's lists until March 4, 1985 when the S.E.C. closed the doors of E.S.M. That is what has brought me here today.

We are discussing Municipal Investments. The "grass roots" money. I believe that after numerous law suits and several years the Cities will have sustained substantial recovery. But how could this have happened in the United States?

In this year, 1985, over 50 years after the establishment of the S.E.C. I find that an experienced investor can still be duped by conspiracy and fraud in what the investor assumes to be a regulated industry. I find this incomprehensible. I have read in the newspapers over the last few weeks that Government Securities are unregulated investments, however, the DEALERS of Government Securities are regulated, aren't they? Do they have a license to deal in securities or a license to steal what they can? Who is watching them? Everyone complains about "too much" government regulation. Where is it when we need it?

When we place money in repurchase agreements we specify that the collateral must be backed by the full faith and credit of the United States Government.

If the underlying collateral had been General Motors or Chrysler Bonds rather than GNMA Bonds then that broker would be regulated by the Securities and Exchange Commission. Don't you think that it is strange that these losses to the cities would not have been a discussion if we were asking for a different collateral than that of our own Government? PLEASE allow the S.E.C. to regulate this market! The mechanisms are in place----turn on the switch, give them the power, REGULATE GOVERNMENT SECURITIES DEALERS.

I believe that this is just the tip of the iceberg, and I know that you believe it too. E.S.M. was not the first or only company to perpetrate this catastrophic disaster, nor will they be the last unless we do something about it. There are hundreds of Government Securities Dealers robbing the public as we speak, and there are honest dealers. Regulate this market and eliminate the perpetrators. If the S.E.C. knew there was a problem with E.S.M. why couldn't they warn the investors? Who else do they know about? You must correct this grevious wrong to society after 50 YEARS, you have to stop the little "grass roots" guy from getting kicked in the teeth.

I understand and certainly sympathize with the Governments problem of selling U.S. debt. I understand it all too well since I must appear at Moody's and Standard and Poors tomorrow to help continue to sell the City of Pompano's debt. I must reassure them, and demonstrate to them how something like this will never happen again in order to retain our bond ratings. Now, don't you think it's about time the Federal Government has to do the same thing? Tell us how this will never happen again, restore our confidence.

I would like nothing more than for you to go back to your constituents and say to them "THIS IS WHAT I DID TO PROTECT YOUR MONEY, YOU NO LONGER HAVE TO WORRY ABOUT PUTTING YOUR MONEY INTO YOUR LOCAL SAVINGS AND LOAN, OR BANK, AND YOU DON'T HAVE TO WORRY ABOUT THEM BEING THERE WHEN YOU WANT TO TAKE IT OUT."

I know this may sound ludicrous, but Congress has been discussing the MX missile to deter the eradication of life on earth, I am only asking you for regulation to insure the quality of life on earth.

My hope is that, in some small way, this written testimony may help your efforts in correcting this unspeakable problem. If I can serve you in any way, please call upon me.

Sincerely,

Linda Schreiber-Baker
Director of Finance

LSB/ph
85-560
Enclosures

CITY OF TAMARAC

DEALER/ INSTITUTION	AMOUNT	DATE OF TRANSACTION
Payne Weber	$ 550,000	04/04/81
Merrill Lynch	1,000,000	05/26/81
Payne Weber	250,000	06/17/81
Merrill Lynch	500,000	07/08/81
Payne Weber	500,000	07/08/81
Payne Weber	500,000	07/13/81
Merrill Lynch	400,000	07/22/81
Payne Weber	200,000	07/24/81
Comark	1,000,000	08/17/81
Comark	1,100,000	08/20/81
Comark	2,000,000	02/17/82
Marcus, Stowell & Beye	1,000,000	02/19/82
Payne Weber	1,000,000	02/22/82
Marcus, Stowell & Beye	2,000,000	02/25/82
Payne Weber	2,000,000	02/26/82
Marcus, Stowell & Beye	1,000,000	03/15/82
Gulfstream	1,000,000	03/19/82
Gulfstream	1,000,000	03/19/82
Gulfstream	1,000,000	03/19/82
Marcus, Stowell & Beye	2,000,000	03/25/82
Payne Weber	2,000,000	03/30/82
Marcus, Stowell & Beye	2,000,000	04/29/82
Marcus, Stowell & Beye	2,000,000	04/30/82
Marcus, Stowell & Beye	2,000,000	06/07/82
Marcus, Stowell & Beye	1,500,000	06/17/82
Marcus, Stowell & Beye	2,000,000	06/28/82
Payne Weber	2,000,000	07/07/82
Marcus, Stowell & Beye	1,000,000	07/13/82
Marcus, Stowell & Beye	1,000,000	07/28/82
Payne Weber	1,000,000	08/06/82

DEALER/ INSTITUTION	AMOUNT	DATE OF TRANSACTION
Marcus, Stowell & Beye	$1,000,000	06/13/83
Marcus, Stowell & Beye	1,000,000	11/04/83
Marcus, Stowell & Beye	1,000,000	12/07/83
Payne Weber	3,000,000	12/28/83
Payne Weber	2,000,000	01/03/84
Marcus, Stowell & Beye	2,000,000	02/27/84
Payne Weber	1,000,000	03/02/84
Payne Weber	1,000,000	03/14/84
E. S. M.	2,000,000	03/29/84
E. S. M.	1,000,000	04/02/84
E. S. M.	1,000,000	04/18/84
E. S. M.	1,000,000	05/02/84
Marcus, Stowell & Beye	1,000,000	05/16/84
Marcus, Stowell & Beye	1,000,000	06/07/84
Payne Weber	1,000,000	06/29/84
Marcus, Stowell & Beye	1,000,000	07/25/84

MARCUS, STOWELL & BEYE
GOVERNMENT SECURITIES, INC.

1156 NORTH FEDERAL HIGHWAY
FORT LAUDERDALE, FL 33304
(305) 764-7171

WE CONFIRM ACCORDING TO THE TERMS STATED HEREON.

THIS IS THE CLOSING SIDE OF YOUR REVERSE REPURCHASE AGREEMENT FOR THE TERM INDICATED

SALES										
6	22		12	1	90572.	1	12	0	12/07/83	01/03/84	01/03/84

IDENTIFICATION NO.: 105391

CITY OF TAMARAC
MS.L.BAKER,DEPUTY FI
5811 N.W. 88TH AVENUE
TAMARAC, FLORIDA
33321

5105391 1111
WIRE FUNDS

REPURCHASE AGREEMENT

WE

BOT 1000000. 000041046

S.B.A. FMHA 13-54-362469137
MARK TO MARKET AT ANY TIME
97.80 FROM 1247 TO 01/03/84

INTEREST ACCRUED

FROM: 10/ 1 TO: 12/ 2
FOR 62 DAYS

11.000% DUE 04/01/96

PRICE						NET AMOUNT
0.000000	1000000.00	7350.00				1,007,350.00

Under certain circumstances these securities may be hypothecated or commingled until payment is received.

THIS IS A REVERSE REPURCHASE AGREEMENT.

YIELD

665

MARCUS, STOWELL & BEYE
GOVERNMENT SECURITIES, INC.

1150 NORTH FEDERAL HIGHWAY
FORT LAUDERDALE, FL. 33304
(305) 764-7171

WE CONFIRM ACCORDING TO THE TERMS STATED HEREON.

THIS IS A REVERSE REPURCHASE AGREEMENT
WITH INTEREST AT THE RATE SHOWN BELOW
AND FOR THE PERIOD STATED

SALES								SETTLEMENT DATE		
6 22		12	1	90571.	1	10	0	12/07/83	12/07/83	12/07/83

IDENTIFICATION NO.

105391

CITY OF TAMARAC
MS.L.BAKER,DEPUTY FI
5811 N.W. 88TH AVENUE
TAMARAC, FLORIDA
33321

105391 1111
WIRE FUNDS

REPURCHASE AGREEMENT

WE

SLD 1000000. 00041046

S.B.A. FMHA 13-56-362469137
MARK TO MARKET AT ANY TIME
89.80 FROM 12/7 TO 01/03/84

INTEREST ACCRUED

FROM: TO:

10/ 1 12/ 7 11.600% DUE 04/01/96

FOR 66 DAYS

PRICE					NET AMOUNT
0.000000	1000000.00				1,000,000.00

Under certain circumstances these securities may be hypothecated or commingled until payment is received.

THIS IS A REVERSE REPURCHASE AGREE

YIELD

999

MARCUS, STOWELL & BEYE
GOVERNMENT SECURITIES, INC.

1150 NORTH FEDERAL HIGHWAY
FORT LAUDERDALE, FL. 33304
(305) 764-7171

WE CONFIRM ACCORDING TO THE TERMS STATED HEREON.

THIS IS THE CLOSING SIDE OF YOUR
REVERSE REPURCHASE AGREEMENT FOR THE
TERM INDICATED

SALES			A	B	TRANS. NO.	TR	CAP	SETT.	TRADE DATE	SETTLEMENT DATE	
6	22		12	1	98710.	1	12	0	05/16/84	06/15/84	06/15/84

IDENTIFICATION NO.	CONTRA PARTY	SPECIAL DELIVERY INSTRUCTIONS
105391	CITY OF TAMARAC MS.L.BAKER,DEPUTY FI 5811 N.W. 88TH AVENUE TAMARAC, FLORIDA 33321	5105391 391 WIRE FUNDS

WE	QUANTITY	CUSIP	SECURITY DESCRIPTION
BOT	1000000.	362136YP2	G.N.M.A. POOL#97918 @10.75 FROM 5/16 TO 6/15/84 MARK TO MARKET AT ANY TIME 12.000% DUE 12/15/12

INTEREST ACCRUED
FROM: TO:

PRICE	PRINCIPAL	INTEREST	*SPECIAL CHARGES			NET AMOUNT
0.000000	850000.00	7614.58				857,614.58

YIELD

Under certain circumstances these securities may be hypothecated or commingled until payment is received.

THIS IS A REVERSE REPURCHASE AGREEMENT.

667

MARCUS, STOWELL & BEYE
GOVERNMENT SECURITIES, INC.

1150 NORTH FEDERAL HIGHWAY
FORT LAUDERDALE, FL 33304
(305) 764-7171

WE CONFIRM ACCORDING TO THE TERMS STATED HEREON.

THIS IS A REVERSE REPURCHASE AGREEMENT
WITH INTEREST AT THE RATE SHOWN BELOW
AND FOR THE PERIOD STATED

6	22		12	1	98709.	1	10	0	05/16/84	05/16/84	05/16/84

105391	CITY OF TAMARAC MS.L.BAKER,DEPUTY T 5811 N.W. 88TH AVENUE TAMARAC, FLORIDA 33321	5105391 391 WIRE FUNDS HOLD IN SEG.ACCT

SLD	1000000. 912136YP2	G.N.M.A. POOL#97918 10.75 FROM 5/16 TO 8/15/84 MARK TO MARKET AT ANY TIME
INTEREST ACCRUED FROM:	TO:	12.000% DUE 12/15/12

PRICE	PRINCIPAL	INTEREST	SPECIAL CHARGES			NET AMOUNT
0.000000	850000.00					850,000.00

Under certain circumstances these securities may be hypothecated or commingled until payment is received.

THIS IS A REVERSE REPURCHASE AGREEMENT.

YIELD

[redacted]

REPURCHASE AGREEMENT

668

PaineWebber GOVERNMENT SECURITIES COMMERCIAL PAPER CONFIRMATION

Paine, Webber, Jackson & Curtis Incorporated

GOVERNMENT SECURITIES DEPARTMENT
25 BROAD STREET, NEW YORK, N.Y. 10004
TELEPHONE: (212) 437-2121

TO BE DELIVERED

CITY OF TAMARAC CITY HALL
3811 N W 88TH AVENUE
TAMARAC FLORIDA 33321
UTIL WEST PSC REFUND
ATTN MR STEVEN A WOOD

TO MORGAN GUARANTY TRUST COMPANY
15 BROAD ST. 17TH FLOOR
ATT: GOVT SECURITIES CUST.

AGAINST PAYMENT OF **FEDERAL FUNDS** UNLESS OTHERWISE NOTED. NC

AS PRINCIPAL WE HEREBY CONFIRM PURCHASE FROM YOU TODAY OF THE FOLLOWING SECURITIES

CLIENT NUMBER	TRADE I.D. #	REF. #	TRADE DATE	AS OF DATE	SETTLEMENT DATE	
BX-033730-1-08	76329	12330	05/26/81		05/27/81	REPO CONTRACT

PAR VALUE	SECURITY	DISCOUNT/BASIS	PRICE
101,333.33	GNMA MTGE BCKD SECURITIES SEGREGATED FOR REPURCHASE WITH RIGHT OF SUBSTITUTION		100.050000000

PRINCIPAL	INTEREST/DISCOUNT PERIOD	INTEREST/DISCOUNT	CHARGES	TOTAL
101,333.33	1 DAYS 17.000%	47.85	0.00	101,381.18

SECURITY NO.	HOUSE ACCOUNT NO.	CUSIP NO.
FG13M9	YY-012100-922	

DELIVERY INSTRUCTIONS

☐ WE BOUGHT

☐ WE SOLD

GNS-1298 (12-77)

CONFIRMATION

669

PaineWebber GOVERNMENT SECURITIES COMMERCIAL PAPER CONFIRMATION

Paine, Webber, Jackson & Curtis Incorporated

GOVERNMENT SECURITIES DEPARTMENT
25 BROAD STREET, NEW YORK, N.Y. 10004
TELEPHONE: (212) 437-2121

TO BE DELIVERED

CITY OF TAMARAC CITY HALL
5811 N W 88TH AVENUE
TAMARAC FLORIDA 33321
UTIL WEST PSC REFUND
ATTN MR STEVEN A WOOD

BY MORGAN GUARANTY TRUST COMPANY
15 BROAD ST. 17TH FLOOR
ATT: GOVT SECURITIES CUST.
AGAINST PAYMENT OF FEDERAL FUNDS UNLESS OTHERWISE NOTED.

AS PRINCIPAL WE HEREBY CONFIRM SALE TO YOU TODAY OF THE FOLLOWING SECURITIES

CLIENT NUMBER	TRADE I.D. #	REF. #	TRADE DATE	AS OF DATE	SETTLEMENT DATE	
BX-033730-1-09	76328	12330	05/26/81		05/26/81	REPO CONTRACT

PAR VALUE	SECURITY	DISCOUNT/BASIS	PRICE
101,333.33	GNMA MTGE BCKD SECURITIES SEGREGATED FOR REPURCHASE WITH RIGHT OF SUBSTITUTION		100.0000000%

PRINCIPAL	INTEREST/DISCOUNT PERIOD	INTEREST/DISCOUNT	CHARGES	TOTAL
101,333.33		17.000%	0.00	101,333.33

SECURITY NO.	HOUSE ACCOUNT NO.	CUSIP NO.
F01JM9	YY-013100-922	

☐ WE BOUGHT

☒ WE SOLD

DELIVERY INSTRUCTIONS

PAINE WEBBER MAINTAINS
THE RIGHT TO SUBSTITUTE
SECURITIES OF THE SAME
TYPE AND EQUIVALENT VALUE

GNS-1298 (12-77)

CONFIRMATION

670

PAINE, WEBBER, JACKSON & CURTIS INCORPORATED

CONFIRMATION

AS YOUR AGENT, WE HAVE PURCHASED (SOLD) THE SECURITIES DESCRIBED BELOW FROM (TO) OUR AFFILIATE, PAINE WEBBER REAL ESTATE SECURITIES INC., AND POSITIONS IN THESE SECURITIES WILL BE MAINTAINED WITH PAINE WEBBER REAL ESTATE SECURITIES INC.

TRADE NO 09594

TRADE DATE 3/02/84

SETTLEMENT DATE 3/0 /84

WE CONFIRM SALE TO YOU TODAY

FACE VALUE	SECURITY DESCRIPTION			PRICE	AMOUNT	
.00	SEG SECURITIES				PRINCIPAL	1,000,000.00
					INTEREST	.00
AMORTIZED VALUE	COUPON	MATURITY	ISSUED	FACTOR	TOTAL	1,000,000.00
.00	N.A.	12/31/99	12/31/99	N.A.		

INTEREST FROM: 3/02/84 TO: 3/02/84

DELIVERY INSTRUCTIONS:

BX032830

CITY OF TAMARAC, CITY HALL
5811 N W 88TH AVENUE
ATTN MR STEVEN A WOOD
TAMARAC, FLA 33321

REPURCHASE @ 9.500%

3/02/84
DELIVERY MORGAN GUARANTY TRUST CO. 15-BROAD ST. N.Y., VS. FEDERAL FUNDS.

GMA 2439 9/82 PTG. 6-83

671

CONFIRMATION

PAINE, WEBBER, JACKSON & CURTIS INCORPORATED
AS YOUR AGENT, WE HAVE PURCHASED (SOLD)
THE SECURITIES DESCRIBED BELOW FROM (TO)
OUR AFFILIATE, PAINE WEBBER REAL ESTATE
SECURITIES INC., AND POSITIONS IN THESE
SECURITIES WILL BE MAINTAINED WITH
PAINE WEBBER REAL ESTATE SECURITIES INC.

TRADE NO. [illegible]

TRADE DATE 3/ 2/84

SETTLEMENT DATE 4/ 2/84

WE CONFIRM BUY FROM YOU TODAY

FACE VALUE	SECURITY DESCRIPTION			PRICE	AMOUNT	
[illegible]	[illegible] GNMA'S				PRINCIPAL	[illegible]
					INTEREST	[illegible].56
AMORTIZED VALUE	COUPON	MATURITY	ISSUED	FACTOR	TOTAL	[illegible].56
[illegible]	N.A.	12/31/99	12/31/99	N.A.		

INTEREST FROM: 3/02/84 TO: 4/ 2/84

DELIVERY INSTRUCTIONS:

3/03283 CITY OF TAMARAC, CITY HALL REPURCHASE AT 9.5[illegible]PCT
5811 N W 88TH AVENUE
ATTN MR STEVEN A GOOD
TAMARAC, FLA

[illegible]3301

3/02/84
DELIVERY MORGAN GUARANTY TRUST CO. 55 BROAD ST. N.Y., VS. FEDERAL FUNDS.

GMA 2439 9/82 PTG. 6-83

672

Mr. BARNARD. Mr. Neild.

STATEMENT OF WILLIAM E. NEILD, MAYOR, CITY OF BEAUMONT, TX

Mr. NEILD. Thank you, Mr. Chairman, members of the committee. I appreciate the kind remarks of our Congressman who has shown true leadership through our crisis. I thank the committee for the opportunity to appear before you today and to explain the impact of the collapse of ESM on our city.

The city of Beaumont, TX, has been defrauded by the firm of ESM Government Securities, Inc. In the process of this defrauding activity, we have learned of the inadequacies of the Securities and Exchange Commission's investigation practices, the freewheelingness of the Government securities market displayed by ESM Government Securities, the apparent ability of persons to purchase their independent audit firms such as Alexander Grant & Co., the inadequacies of the custodial relationship by a firm such as Bradford Trust, the inadequate confirmation of our investments by our own auditing firm of Touche Ross & Co., the possible negligent behavior by First Money Managers as a broker in the Government securities market and the lack of appropriate safekeeping receipt arrangements by our own finance department.

While it is appropriate to look internally at times like these, as we are currently doing in the finance department of the city of Beaumont, specifically aimed at custodial relationships and safekeeping receipts, it is also important to recognize that our city, along with a number of others across this country, have been defrauded because of the lack of regulation and audit provisions in the marketplace.

The city of Beaumont has utilized the Government securities market for acquisition of U.S. Government Treasury notes and Treasury bonds since May 1984 through the firm of First Money Managers in New York City. Prior to May 1984, the city utilized the firm of E.F. Hutton & Co. Our actions in both situations were very similar in that we acquired securities through those firms which were held by the firms. The original transaction was one in which the city would get quotes from First Money Managers, who served as a broker in the securities market. I might point up at this time we had absolutely no relationship with ESM, only that First Money Managers took those as a broker obtained prices, I suppose, from several people such as ESM and advised us where we sent the money to Bradford Trust later and we'll get into that.

If First Money Managers bid the highest rate for short-term money and the repurchase agreements, the city would place an order with this firm. The firm would, in turn, place an order with the specific Government securities dealer which tended to be ESM Government Securities in a predominance of the cases.

The city would receive copies of a confirmation form from First Money Managers, as well as a copy of the confirmation from ESM Government Securities, Inc. The form from ESM would indicate that sale of the U.S. Treasury note was subject to a repurchase agreement, due at a specific time. The finance officer of the city took precautions to guarantee the security of the investment by es-

tablishing what he felt was a custodial relationship with Bradford Trust Co. in New York City.

Based upon specific directions from First Money Managers, the finance officer had money wired from First City Bank in Beaumont directly to Bradford Trust in New York City, specifically for "ESM Government Securities for the City of Beaumont." It was his understanding that Bradford Trust was serving as a custodian to the city and was holding the securities in an account in our name. Copies of the confirmation firms from First Money Managers, ESM Government Securities and the wire transfer are all attached to this testimony.

When the term of security would be completed, the process would reverse itself as it relates to ESM and Bradford Trust, at least in the finance officer's understanding. The security would transfer back to ESM with the money being transferred to Bradford Trust. A wire transfer sending the money from Bradford Trust to the city of Beaumont was accomplished, in addition to an amount of money equal to the interest payment.

And I might point out, that since 1984, we have had somewhere in the range of $60 million that had been successfully sold and transferred back which the city received something over $800,000 in interest payments. All this was done successfully.

It was not until the ESM failure occurred that the city was made aware that Bradford Trust did not admit to serving as a custodian for the city funds. The audit firm of Touche Ross & Co. served as auditors for the city of Beaumont. On September 30, 1984, they did a thorough examination of the city's books and gave us a clean audit opinion. At that time, the city held 7.5 million dollars' worth of Treasury notes through the repurchase agreements with ESM. The auditors did not comment on the lack of safekeeping receipts, custodianship of the funds and did not specifically confirm the existence of the securities with Bradford Trust.

Prior to May of 1984, the city purchased securities from E.F. Hutton & Co. A copy of the E.F. Hutton confirmation form is also attached to this testimony. The city did not receive anything different from E.F. Hutton & Co. than was received from ESM Government Securities. In the case of E.F. Hutton, it was acknowledged that they were holding the securities in the street name, rather than in the specific name of the city of Beaumont.

The city was relying upon the financial security of E.F. Hutton in this regard, the same as it ultimately came to rely upon the financial security of ESM Government Securities, even though that was not the original intention. The problem of safekeeping of the securities in the market is the same, regardless of the size of the dealer and can only be differentiated because of the financial capability of the larger investment firms.

The failure of ESM Government Securities and the resultant revelation that Bradford Trust was not serving in a custodial relationship had made a large impact on the city's financial picture. Standard and Poors has placed the city on a credit watch situation. Moody's has asked for a complete review of the city's financial status. In addition, a $32 million bond sale, scheduled for March 12, had to be canceled due to the uncertainty of this issue. The cancel-

lation of the bond sale will have an impact on necessary improvements in the city's infrastructure.

The financial plan which the city has been able to put together allocates potential of $20 million of losses to the general fund of the city, the water utilities fund, and the transportation improvement program. The losses will be spread $7.3 million to the general fund, $6.2 million to the water utilities fund and $6.5 million to the transportation improvement program.

The general fund losses will be absorbed through cancellations of major repair and enhancement projects, equipment purchase cancellations, some reverse balance, and a hiring and purchasing freeze on other than emergency items.

In addition, the city of Beaumont has requested legislation from the State of Texas which would allow us to borrow $2.3 million in this current fiscal year ending September 30, 1985, against 1986 fiscal year revenues. The State senate passed that bill and it currently resides in the house of representatives. We are anticipating passage in the week of April 8 and we have received full cooperation from the legislature on this matter.

The water utilities fund losses will be absorbed through a reserve balance of $4.3 million and additional borrowing from the Texas Water Development Board of $1.8 million. The $1.8 million will be paired with an additional $5.6 million of borrowing for new projects in order to continue extremely important water and sewer projects in the city. The loss of $6.5 million in the transportation improvement program will defer much needed street projects despite the willingness of citizens of Beaumont to impose larger tax rates upon themselves to financially afford those projects. While the financial aspect of the city is manageable, the potential loss of $20 million out of a $102-million budget, is a significant setback to the city's financial picture.

The city of Beaumont has joined in the Securities and Exchange Commission suit against ESM Government Securities, as in intervenor. We have hired the law firm of Shuts and Bowen in Miami for the purpose of representing us in that law suit. In addition, the city has supported the ESM Government Securities receivers claim against Alexander Grant & Co. in the amount of $300 million due to the apparent fraudulent and collusive activities between ESM and Alexander Grant.

The city has subsequently filed suit against Alexander Grant to recover the $20 million loss plus attorneys fees. In addition, the city has filed a claim required under the Texas Deceptive Trade Practices Act against Touche Ross & Co. for triple damages alleged that the auditing firm engaged in deceptive trade practices in the audit of the city's books for the year ending September 30, 1984. A claim must be filed 30 days in advance of any litigation under the Texas statute. The city is looking into additional litigation against firms involved in the dealings surrounding ESM.

It is imperative that the Federal Government provide some regulation to the securities industry to prevent obvious fraud and collusive activities such as the one which our community has faced. It is virtually impossible for a community of our size and scope to totally prevent collusive activities of this sort from having a financial impact on us. The city of Beaumont would not suggest specific

means of providing that regulation in light of our lack of total knowledge of the Government securities markets.

However, we feel it is imperative that your committee thoroughly review the potential actions which can be taken in light of the damages and losses which municipalities such as ours have experienced. If it is proven that it's more expensive to regulate this industry than the total amount of the losses, then the feasibility of an insurance fund should be established or could be explored which would provide some protection for those affected by these situations. The institutional investors, such as the city of Beaumont, in this country, will have their faith in the securities industry significantly undermined unless assuraces are given to them in the near future.

We appreciate your willingness to hold this hearing and know that you will help us municipalities who are at the mercy of those that have been discussed today and yesterday and we thank you very much.

[The prepared statement of Mr. Neild follows:]

Testimony Submitted

By

Honorable William E. Neild

Mayor

City of Beaumont

Mr. Chairman and Members of the Committee:

The City of Beaumont, Texas has been defrauded by the firm of ESM Government Securities, Inc. In the process of this defrauding activity, we have learned of the inadequacies of the Securities and Exchange Commission's investigatory practices, the freewheelingness of the governmental securities market displayed by ESM Government Securities, the apparent ability of persons to purchase their independent audit firms such as Alexander Grant and Company, the inadequacies of the custodial relationship by a firm such as Bradford Trust, the inadequate confirmation of our investments by our own auditing firm of Touche Ross and Company, the possible negligent behavior by First Money Managers as a broker in the government securities market, and the lack of appropriate safekeeping receipt arrangements by our own Finance Department. While it is appropriate to look internally at times like these, as we are currently doing in the Finance Department of the City of Beaumont, specifically aimed at custodial relationships and safekeeping receipts, it's also important to recognize that our City, along with a number of others across this country, have been defrauded because of lack of regulation and audit provisions in the market place.

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quotes from First Money Managers, who served as a broker in the securities market. If First Money Managers bid the highest rate for short-term money and the repurchase agreements, the City would place an order with this firm. The firm would, in turn, place an order with a specific governmental securities dealer which tended to be ESM Government Securities, Inc., in a predominance of the cases. The City would receive copies of a confirmation form from First Money Managers, as well as a copy of a confirmation form ESM Government Securities, Inc. The form from ESM would indicate that the sale of the U. S. Treasury Note was subject to a repurchase agreement, due at a specific time. The Finance Officer of the City took precautions to guarantee the security of the investment by establishing what he felt was a custodial relationship with Bradford Trust Company in New York City. Based upon specific directions from First Money Managers, the Finance Officer had money wired from First City Bank in Beaumont directly to Bradford Trust in New York City, specifically for "ESM Government Securities for City of Beaumont". It was his understanding that Bradford Trust was serving as a custodian to the City and was holding the securities in an account in our name. Copies of the confirmation forms from First Money Managers, ESM Government Securities and the wire transfer are all attached to this testimony.

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complete review of the City's financial status. In addition, a $32 million bond sale, scheduled for March 12th, had to be cancelled due to the uncertainty of this debacle. The cancellation of the bond sale will have an impact on necessary improvements in the City's infrastructure. The financial plan which the City has been able to put together allocates the potential of $20 million of losses to the General Fund of the City, the Water Utilities Fund and the Transportation Improvement Program. The losses will be spread $7.3 million to the General Fund, $6.2 million to the Water Utilities Fund and $6.5 million to the Transportation Improvement Program. The General Fund losses will be absorbed through cancellations of major repair and enhancement projects, equipment purchase cancellations, some reserve balance, and a hiring and purchasing freeze on other than emergency items. In addition, the City of Beaumont has requested legislation from the State of Texas which would allow us to borrow $2.3 million in this current fiscal year ending September 30, 1985 against 1986 fiscal year revenues. The State Senate passed that bill and it currently resides in the House of Representatives. We're anticipating passage in the week of April 8th. The Water Utilities Fund losses will be absorbed through a reserve balance of $4.3 million and additional borrowing from the Texas Water Development Board of $1.8 million. The $1.8 million will be paired with an additional $5.6 million of borrowing for new projects in order to continue extremely important water and sewer projects in the City. The loss of $6.5 million in the Transportation Improvement Program will defer much-needed street projects despite the willingness of citizens of Beaumont to impose larger tax rates upon themselves to financially afford those projects. While the financial aspect of the City is manageable, the potential loss of $20 million out of a $102 million budget, is a significant setback to the City's financial picture.

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It is imperative that the federal government provide some regulation to the securities industry to prevent obvious fraud and collusive activities such as the one which our community has faced. It is virtually impossible for a community of our size and scope to totally prevent collusive activities of this sort from having a financial impact on us. The City of Beaumont would not suggest specific means of providing that regulation in light of our lack of total knowledge of the government securities markets. However, we feel it is imperative that your committee thoroughly review the potential actions which can be taken in light of the damages and losses which municipalities such as ours have experienced. If it proves that it's more expensive to regulate this industry than the total amount of losses,

then an insurance fund should be established which would provide some protection to those effected by these situations. The institutional investors, such as the City of Beaumont in this country, will have their faith in the securities industry significantly undermined unless assurances are given to them in the near future.

We appreciate your willingness to hold this hearing and hope that future debacles of this sort can be prevented.

William E. Neild
Mayor

225058

CUSTOMER COPY

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*
*        TRANSFER OF FUNDS     *      OUTGOING      *
* DUE TO -    026008400  TYPE - 12
* DUE FROM - 113100240          REF-3020      $500,000.00 IND ADVICE
*
FIRST CITY BEAU/CITY OF BEAUMONT
BRADFORD NYC/SPS CLEARING DIVISION/ ESM GOVERNMENT SECURITIES FOR CITY OF BEAUMO
NT
                                                          APPROVED BY
                                          DEBIT
                                          AMOUNT          500,000.00
* DATE 02/01  TIME 12:21  TERM BJ02   OPER  249
*
**************************02011321 KBJ02 0020**02011221 KBJ04 0020 14982
```

FIRST MONEY MANAGERS, INC.
17 BATTERY PLACE
NEW YORK, N.Y. 10004

TELEPHONE: (212) 269-6604
(800) 221-7111

REF.	TRADE DATE	SETTLEMENT DATE	MATURITY DATE	TERM
☐ REPO ☒ REV/RP	02 01 85	02 01 85	04 10 85	68 days

ACCOUNT	QUANTITY	DESCRIPTION	PRICE	PRINCIPAL AMOUNT
City Beaumont	500,000.	US Treasury Notes 9 3/4 11/15/85		$500,000.00

RATE	COMM.
9.20	$.00

☐ SOLD TO ☒ BOUGHT FROM
ESM Government Securities

E.S.M. GOVERNMENT SECURITIES, INC.

Colee Hammock Executive Plaza 305/764-2600 800/327-3725
1512 E. Broward Boulevard, Suite 100, Ft. Lauderdale, Fl. 33301-2191

REFERENCE NO.		ACCOUNT NUMBER	REG. REP. NO.	CAPACITY CODE			TRADE DATE	SETTLEMENT DATE	AS OF DATE
0120324043		C12 C52040 C2	C68		1		C2 C1 85	04 1C 85	

CUSTOMER NAME	DELIVERY INSTRUCTIONS
CITY OF BEAUMONT P.O. BOX 3827 EEAUMONT, TEXAS 777C4 ATTN: R.J. NACHLINGER FINANCE DIRECTOR	SFS C/D BTC A/C ESM GCVT. SEC. INC. 67 EROAD STREET NEW YORK,N.Y. 1CCC4

WE	QUANTITY	CUSIP NUMBER	SECURITY DESCRIPTION
BOT	5CC,CCC	912827NL2	UNITED STATES TREAS NTS 09.75C 11-15-85

TERM REPC PTD C2-C1-85 DUE C4-1C-85 DAYS 68 RATE 9.2CCC PAY IN FED FUNDS

PRICE	PRINC. AMOUNT	INTEREST			MISC. AMOUNT	NET AMOUNT
	500,000.00	8,688.89				5C8,688.89

4 2 5 9 2 7

CAPACITY CODES
1. AS PRINCIPAL FOR OUR OWN ACCOUNT WE HAVE BOUGHT FROM YOU.
1A. AS PRINCIPAL FOR OUR OWN ACCOUNT WE HAVE SOLD TO YOU.
2. AS AGENT FOR PURCHASER WE HAVE BOUGHT FROM YOU.
2A. AS YOUR AGENT WE HAVE SOLD FOR YOUR ACCOUNT AND RISK.

WE APPRECIATE YOUR BUSINESS

CONFIRMATION
SUBJECT TO CORRECTION

BY Ronald Colleo Jr.

CUSTOMER COPY

E.S.M. GOVERNMENT SECURITIES, INC.
Colee Hammock Executive Plaza 305/764-2600 800/327-3725
1512 E. Broward Boulevard, Suite 100, Ft. Lauderdale, Fl. 33301-2191

REFERENCE NO.		ACCOUNT NUMBER	REG. REP. NO.	CAPACITY CODE			TRADE DATE	SETTLEMENT DATE	AS OF DATE
0123324042		C12 C52040 C1	068		1A		C2 C1 85	C2 C1 85	

CUSTOMER NAME	DELIVERY INSTRUCTIONS
CITY CF BEAUMONT P.O. BOX 3827 BEAUMONT, TEXAS 77704 ATTN: R.J. NACHLINGER. FINANCE DIRECTOR	FIRST CITY BANK OF BEAUMONT CREDIT CITY OF BEAUMONT- OPERATING FUNDS ACCT#C290-3431

WE	QUANTITY	CUSIP NUMBER	SECURITY DESCRIPTION
SLD	500,000	912827NU2	UNITED STATES TREAS NTS 09.75C 11-15-85

TERM REPO DTD C2-C1-85 DUE C4-10-85 DAYS 68 RATE 9.2000 PAY IN FED FUNDS

PRICE	PRINC. AMOUNT	INTEREST				MISC. AMOUNT	NET AMOUNT
	500,000.00	.00					500,000.00

425927

CAPACITY CODES
1. AS PRINCIPAL FOR OUR OWN ACCOUNT WE HAVE BOUGHT FROM YOU.
1A. AS PRINCIPAL FOR OUR OWN ACCOUNT WE HAVE SOLD TO YOU.
2. AS AGENT FOR PURCHASER WE HAVE BOUGHT FROM YOU.
2A. AS YOUR AGENT WE HAVE SOLD FOR YOUR ACCOUNT AND RISK.
WE APPRECIATE YOUR BUSINESS

CONFIRMATION
SUBJECT TO CORRECTION

BY Ronald LeBlanc

CUSTOMER COPY

E.S.M. GOVERNMENT SECURITIES, INC.

Colee Hammock Executive Plaza 305/764-2600 800/327-3725
1512 E. Broward Boulevard, Suite 100, Ft. Lauderdale, Fl. 33301-2191

REFERENCE NO.		ACCOUNT NUMBER	REG. REP. NO.	CAPACITY CODE			TRADE DATE	SETTLEMENT DATE	AS OF DATE
J120099636		012 052040 02	068		1		01 09 85	03 11 85	

CUSTOMER NAME	DELIVERY INSTRUCTIONS
CITY OF BEAUMONT P.O. BOX 3827 BEAUMONT, TEXAS 77704 ATTN: R.J. NACHLINGER FINANCE DIRECTOR	SPS C/D BTC A/C ESM GOVT. SEC. INC. 67 BROAD STREET NEW YORK, N.Y. 10004

WE	QUANTITY	CUSIP NUMBER	SECURITY DESCRIPTION
BOT	540,000	912827PM8	UNITED STATES TREAS NTS 10.125 05-15-93

TERM REPO DTD 01-09-85 DUE 03-11-85 DAYS 61 RATE 9.0100 PAY IN FED FUNDS

PRICE	PRINC. AMOUNT	INTEREST				MISC. AMOUNT	NET AMOUNT
	500,000.00	7,633.47					507,633.47

5 2 9 2 1 3

CAPACITY CODES
1. AS PRINCIPAL FOR OUR OWN ACCOUNT WE HAVE BOUGHT FROM YOU.
1A. AS PRINCIPAL FOR OUR OWN ACCOUNT WE HAVE SOLD TO YOU.
2. AS AGENT FOR PURCHASER WE HAVE BOUGHT FROM YOU.
2A. AS YOUR AGENT WE HAVE SOLD FOR YOUR ACCOUNT AND RISK.

WE APPRECIATE YOUR BUSINESS

CONFIRMATION
SUBJECT TO CORRECTION

BY Ronald Goldstein

CUSTOMER COPY

E.F. HUTTON & COMPANY INC. 588 PARK ST BEAUMONT TEXAS 77701

EFHutton

We confirm the following transaction subject to the agreement on the reverse side.

YOU	QUANTITY *	CUSIP NUMBER FOR EFH USE ONLY	PRICE	AMOUNT	COMMISSION OR SERVICE FEE	INTEREST OR STATE TAX	REG. AND/OR MAILING FEE	NET AMOUNT
B	OT3596000	912827QJ4		365274938		1727516		367002254

U S TREAS NOTES

JJ 11 3/4 01 15 1991

PRICE 101.578125 08401600689

Trade Date
011684
011984
Settlement Date

THE CITY OF BEAUMONT
INTEREST & SINKING FUNDS
GRA
ATTN R J NACHLINGER
P O BOX 3827
BEAUMONT TX 77704

ACCOUNT NO.	A	A.E.	B	C	E
N909885488			002		

REFERENCE NUMBER
8401600799283

U - Indicates unsolicited order

See reverse side for explanation of codes A, B, C & E.

USE DUPLICATE COPY TO CHANGE ADDRESS

On odd lots we will indicate above if an odd lot fee was charged. The amount of any such odd lot fee, if charged, will be provided upon oral or written request

We hold for your account securities purchased and proceeds of sales unless otherwise instructed.

If this confirmation is not correct, please advise us at once.

* AN "M" IN THE QUANTITY FIELD DENOTES "000".

Payment for securities bought and delivery of securities sold are due promptly and in any event on or before settlement date in order to avoid interest and premium charges.

FORM 8008 (REV. 3/81) [illegible] this copy for your records

Mr. BARNARD. Mr. Neild, as I listened to your testimony, I followed very closely where you said that you had an audit by Touche Ross last fall, I think it was.

Mr. NEILD. Our year ended September 30, so we did have an audit in the fall.

Mr. BARNARD. And I was going to ask you and then I think that you explained it. Did they conduct a verification of your holdings?

Mr. NEILD. Yes, sir.

Mr. BARNARD. And they certified as to the fact that they did exist?

Mr. NEILD. Yes, sir.

Mr. BARNARD. And yet they didn't exist?

Mr. NEILD. Yes, sir.

Mr. BARNARD. What did they verify?

Mr. NEILD. Apparently what has happened is that they sent the verification to First Money Managers and First Money Managers did the verification back to them.

I have not personally read the letter that came back, the verification letter, I have not seen that, however, I understand that it had some markings on it and it should have triggered somebody's thought process as to what's going on here.

Mr. BARNARD. Have you made an attempt to secure any settlement from Touche Ross rather than a lawsuit?

Mr. NEILD. We have not filed a law suit. We have to file a letter of notification 30 days in advance and we have sent that letter, yes, sir.

Mr. BARNARD. You have notified Touche Ross of this loss?

Mr. NEILD. Yes, sir.

Mr. BARNARD. Have you done the same thing, Ms. Baker?

Ms. BAKER. I believe our special counsel has, but not for Touche Ross, of course. I believe, I don't know if I am the only——

Mr. BARNARD. Who are your auditors?

Ms. BAKER. Alexander Grant.

Mr. BARNARD. Oh, that's right, you were dealing with the fox.

Ms. BAKER. I don't think it's a double dipper or double victim. I wanted to make mention of one other little thing.

In the State of Florida, we have something called the Uniform Depository Act which includes banks and savings and loans and perhaps the people from the State of Florida, the department of insurance, the division of the treasury, could come to speak with you. They do have, I don't know how they regulate those banks and savings and loans, but after today, I'm sure I'll find out.

Mr. BARNARD. Before I turn this over to the other members of the committee, I want to say that your testimony is very important. We heard today from the Chairman of the SEC, that there are so many securities dealers that they don't know how they would be able to go about regulating them.

Well, you know we can't tolerate this kind of condition to exist and I just think that your testimony and your experiences, along with others who have lost so much money, is going to have to be taken into serious consideration when this group, the SEC, the Federal Reserve, and the others get together to discuss what the future holds for securities dealers.

Mr. Chairman, I tell you, we certainly understand the law of caveat emptor, but on the other hand, that is just going too far as far as innocent purchasers are concerned in this regard.

Mr. Chairman, would you like to begin the questioning?

Mr. BROOKS. I just want to thank them and say that I think they have both made a contribution to an understanding of the problem by coming up here and I think that the mayor is right to sue everybody that touched it.

Mr. BARNARD. Absolutely. Mr. Craig.

Mr. CRAIG. I too would like to thank both of you for your testimony. It is very insightful because, in this instance, I don't know that one could apply the old adage of buyer beware, not with the signals that you were getting. The fact that you had people doing audits for you, you appeared to be operating in a prudent manner to your responsibility and yet, the approach that ESM was using was so artful that, in fact, they appeared to be under a reasonable overview in checks and balance systems that you obviously employed a responsible entity. I have to agree with my chairman, these kinds of things have such phenomenal magnitude that three or four sharks from Florida can send financial repercussions around the world as they did in this instance through the domino effect.

It is amazing in itself and, of course, it is something that we have to be concerned about here in the Congress. I do appreciate your testimony.

Mr. BARNARD. Thank you very much and we appreciate your being here. As the chairman has said, you have brought valuable testimony to these hearings and we are certainly indebted to you.

Mr. NEILD. Thank you, Mr. Chairman.

Mr. BARNARD. With that, the committee is adjourned.

[Whereupon, at 7 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

A. SUMMARY CHART, CHARACTERISTICS OF STATE/PRIVATE INSURANCE FUNDS AS OF APRIL 1, 1985

Insurance Fund	Types & Number of Covered Institutions	States	Coverage	Deposits Insured; Fund Size; Ratio	Access to State Treasury?	Assess Other Inst. to Cover Fund Losses? Max. Amount	Lines of Credit	Reinsurance	Do You Set Capital or Other Requirements?	Independent Authority to Examine? # Examiners	Members Audited? Statements Certified?	Powers to Correct Problems	Authority to Cancel Insurance? # Canceled	Methods for Handling Insolvencies	Number of Insolvencies by Year
Maryland Savings-Share Insurance Corp., Baltimore, MD	Savings & loan assoc. 101	Maryland	$100,000	$7.2 billion $166 million (reserves) 2.31 %	No	Yes	$60 million: 1st Chicago, Riggs, Mellon, Union Trust MD, Equitable, MA	(none)	Yes - net worth 4.7%, liquidity 6%, others	Yes - 8 staff "review member operations"	Yes, if size above $5 million	Issue cease-and-desist orders; remove officers; remove/appoint dir.'s; require oper. agreemt, merger, cap. infusion	Yes (none)	Transfer of accounts, arrange merger, liquidation	(none)
The Co-operative Central Bank, Boston, MA	Co-operative banks 100	Mass.	Insured in full	$4.8 billion $170 million 3.55 %	No	Requires legislation	$63 million, 4 commercial banks & Nat. Coop. Bank	(none)	No - (set by state statute)	Yes (none)	Yes Yes	Recommend corrections	No	Loan assistance, arrange merger, purch. & assump., liquidation	(none)
Mutual Savings Central Fund, Inc., Woburn, MA	Savings banks 145	Mass.	Insured in full	$12.3 billion $398 million 3.23 %	No	Yes $240 million	$40 million, 5 commercial banks	(none)	No	No	Yes Yes	Recommend Corrections	No	Loan assistance, arrange merger, purch. & assump., liquidation	(none)
Ohio Deposit Guaranty Fund, Cincinnati, OH	Savings & loan assoc.	Ohio	Insured in full	$4.3 billion $127 million 2.94 % (at 12-31-84)	No	Yes	$1 million, Bank for S&L Assoc., Chicago	$2 million, Ins. Co. of No. America; $25 million, retention rider	Yes	Yes (none)	No	No direct authority; works with Dept. of Supervision and/or Div. of S&L's for problems / mergers	Yes (none)	P&A, with ODGF member approval; assist/merge, with approval of Supt.; liquidate	1985: 1
Pennsylvania Savings Assoc. Insurance Corp., Camp Hill, PA	Savings & loan assoc. 68	Penn.	$100,000	$209 million $ 5 million 2.46 %	No	Yes $4 million (more by vote)	(none)	(none)	No - State code requires 10 percent net worth	Yes (none)	Yes Yes	Issue cease-and-desist orders; appoint supervisor; remove officers, directors; require capital infusion	Yes (none)	Loan assistance, arrange merger, liquidation	(none)

Insurance Fund	Types & Number of Covered Institutions	States	Coverage	Deposits Insured; Fund Size; Ratio	Access to State Treasury?	Assess Other Inst. to Cover Fund Losses? Max. Amount	Lines of Credit	Reinsurance	Do You Set Capital or Other Requirements?	Independent Authority to Examine? # Examiners	Members Audited? Statements Certified?	Powers to Correct Problems	Authority to Cancel Insurance? # Canceled	Methods for Handling Insolvencies	Number of Insolvencies by Year
FIAC - Financial Institutions Assurance Corp., Raleigh, NC	S&L's: 34 CU's : 25 T&L's: 9	N.C. Minn. W.Va. Ind.	$100,000 incl. brokered	$3.5 billion $ 79 million 2.24 %	No	Yes $26 million	$75 million, Wachovia B&T & First NB of Chicago	$25 million, AEtna Casualty; $ 2 million, Svenska Kr.	Yes - net worth at least 5% of deposits	Yes (not reported)	Yes Yes	Require changes in investment/operating practices; remove officers, directors	Yes (none)	Arrange merger or sale; give infusion; take control; liquidation	(none)
Georgia Credit Union Deposit Insurance Corp., Atlanta, GA	Credit unions: 129 Savings & loans: 8	Georgia	$100,000 incl. brokered	$900 million $7.6 million 0.84 %	No	Yes $9 million	$5.4 million, NCUA CLF; $1 million - soon $10 mil., NB of Georgia	(none)	Adopted Ga. Banking Department policies	Yes (none)	Yes - (may be internal)	Issue corrective orders; remove officers or directors; estab. conservatorship; merge or liquidate	Yes (none)	Rehabilitation, arrange merger, purch.& assump., liquidation	1980: 3 1981: 1 1983: 1
National Deposit Guaranty Corp., Dublin, OH	Credit unions 442	AZ,CA,ID, IL,IN,IA, LA,MN,MO, NV,NH,NJ, OH,OK,PA, WV	no limit (not brokered)	$3.15 billion $33.6 million 1.07 %	No	Yes (not stated)	$100 million, Bank One, Columbus; $5 million, Central NB, Cleveland	$12 million - $4 million per occurrence, $2 million deductible	Underwriting & solvency requirements; Monthly reports	Yes 4 examiners	No No	(none)	Yes (none)	Extend loans, buy assets, take operating control, arrange merger, liquidate	1980: 2 1981: 4 1982: 11 1983: 5 1984: 7
State Credit Union Share Insurance Corp., Chattanooga, TN	Credit unions 424	Indiana, Iowa, Kansas, Missouri, Tennessee	$100,000	$1.2 billion $ 17 million 1.35 %	No	Yes (not stated)	$15 milllion, First American NB, Nashville; $14 million, Nat. Coop. Bank	(none)	Underwriting standards	Yes (none)	No No	(none)	Yes (none)	Take operating control, arrange merger, purch. & assump., liquidate	1980: 1 1981: 3 1982: 7 1983: 5 1984: 2

Insurance Fund	Types & Number of Covered Institutions	States	Coverage	Deposits Insured; Fund Size; Ratio	Access to State Treasury?	Assess Other Inst. to Cover Fund Losses? Max. Amount	Lines of Credit	Reinsurance	Do You Set Capital or Other Requirements?	Independent Authority to Examine? # Examiners	Members Audited? Statements Certified?	Powers to Correct Problems	Authority to Cancel Insurance? # Canceled	Methods for Handling Insolvencies	Number of Insolvencies by Year
California Credit Union Share Guaranty Cp. Pomona, CA	Credit unions 23	Calif.	$150,000	$877 million $9.7 million 1.13 %	No	Yes $8.8 million	$9 million, NCUA Central Liquidity Facility	(none)	Yes	Yes (none)	Yes Yes	Make recommendations to Commissioner of Corporations	Yes (none)	Infuse capital, exercise control, merge, do P&A, liquidate	(none)
Florida Credit Union Guaranty Corp., Orlando, FL	Credit unions 172	Florida	$100,000	$813 million $6.2 million 0.76 %	No	Yes (not stated)	NCUA Central Liquidity Facility	(none)	No	Yes (none)	Not required; done by 36 members	Recommend corrections to management; involve board of directors	Yes (none)	Take operating control, merge, do P&A, liquidate	1980-84: 9
Maryland Credit Union Insurance Corp., Baltimore, MD	Credit unions 25	Maryland	$250,000	$548 million $6.8 million 1.24 %	No	Yes (with approval of supervisory authority)	$5 million, NCUA Central Liquidity Facility	(none)	Yes	Yes 1 auditor available	14 CU's get independent CPA audits	Upon direction of supervisory authority, assume control of CU; assist in merger, stabilization, etc.	Yes (none)	Take operating control, merge, do P&A, liquidate	1981: 1 1985: 1
Massachusetts Credit Union Share Insurance Corp., Worcester, MA	Credit unions 224	Mass.	$75,000/ 100,000 sngl/joint (double if CU > $4MM)	$2.8 billion $ 40 million 1.45 %	No	Yes	$5 million, NCUA CLF; $2 million, Century B&T	(none)	No	No (legislation pending)	Yes, if assets $5 mil. or more	Can seek permission for intervention from Commissioner of Banks	Yes, with Bank Commissioner's approval (none)	Capital loans, rehabilitation, merger, liquidation	1980: 4 1981: 4 1982: 2 1983: 0 1984: 2
Rhode Island Share and Deposit Indemnity Corp., Cranston, RI	Credit unions: 50 Loan & Inv.Co.: 13 Banks : 1	R.I., (1 ind. thrift in Minn.)	$100,000 not brokered	$1.6 billion $ 24 million 1.53 %	No	Yes	$10 million, Fleet NB; $5 million, RI Corp. Central CU	(none)	Yes	Yes 12 examiners	Yes	Operate institution; arrange merger	Yes (none)	Operate inst., arrange merger, purch.& assuop., liquidation	(several, costing $367,650 for mergers)

Insurance Fund	Types & Number of Covered Institutions	States	Coverage	Deposits Insured; Fund Size; Ratio	Access to State Treasury?	Assess Other Inst. to Cover Fund Losses? Max. Amount	Lines of Credit	Reinsurance	Do You Set Capital or Other Requirements?	Independent Authority to Examine? # Examiners	Members Audited? Statements Certified?	Powers to Correct Problems	Authority to Cancel Insurance? # Canceled	Methods for Handling Insolvencies	Number of Insolvencies by Year
Texas Share Guaranty Credit Union, Austin, TX	Credit unions 366	Texas	$100,000 not brokered	$2.0 billion $ 25 million 1.26 %	No	Yes $20 million	$3 million - soon $20 mil., Southwest Corp. Central Credit Union	(none)	No	Only if authorized by State Commissioner (none)	Not required	Request action by Commissioner of Credit Union Dept.	Yes (none)	Operate inst., arrange merger, purch.& assump., liquidation	1980: 4 1981: 3 1982: 5 1983: 2 1984: 0
Utah Credit Union Guaranty Corp., Salt Lake City	Credit unions 163	Utah	No limit	$406 million $3.2 million 0.80 %	No	Yes $2.2 million	$2 million, Corporate Credit Union	(none)	No	Yes 2 auditors	No	Removal of officers, employees, committee members	Yes	Operate inst., arrange merger, purch.& assump., liquidation	1980: 8 1981: 8 1982: 9 1983: 4 1984: 4
Virginia Credit Union Share Insurance Corp., Lynchburg, VA	Credit unions 111	Virginia	$100,000	$280 million $4.7 million 1.68 %	No	Yes	$3.6 million, NCUA Central Liq. Facility; $750,000, Bank of Virginia	(none)	Yes	Yes (none)	No	Require audits; assume control	Yes (none)	Take operating control, arrange merger, purch.-assump., liquidate	1983: 1 1 pending
Washington Credit Union Share Guaranty Association, Bellevue, WA	Credit unions 137	Wash.	$100,000 $250,000, retirement accounts	$1.1 billion $10.7 million 0.99 %	No	Only in subsequent years	$350,000, bank & corp. credit union	(none)	Yes - Minimum solvency 1.02 share value	Yes (none)	No	Cancel coverage	Yes 1	Take operating control, arrange merger, purch.-assump., liquidate	1980: 1 1981: 5 1982: 4 1983: 1
Wisconsin Credit Union Savings Insurance Corp., Madison, WI	Credit unions 562	Wisc.	$100,000	$2.5 billion $27 million 1.12 %	No	Yes	$20 million, NCUA Central Liq. Facility; $1 million, bank	(none)	No	Yes 4 "follow-up staff"	Not required	Recommend merger, liquidation	No	Take operating control, arrange merger, purch.-assump., liquidate	1980: 5 1981: 2 1982: 3 1983: 2

Insurance Fund	Types & Number of Covered Institutions	States	Coverage	Deposits Insured; Fund Size; Ratio	Access to State Treasury?	Assess Other Inst. to Cover Fund Losses? Max. Amount	Lines of Credit	Reinsurance	Do You Set Capital or Other Requirements?	Independent Authority to Examine? # Examiners	Members Audited? Statements Certified?	Powers to Correct Problems	Authority to Cancel Insurance? # Canceled	Methods for Handling Insolvencies	Number of Insolvencies by Year
Thrift Guaranty Corporation of California, Beverly Hills	Industrial loan companies 47	Calif.	$50,000 incl. brokered	$1.5 billion $ 15 million 1.0 %	No	No	(none)	(none)	No	Yes (none)	Yes	None, except recommend actions to state authorities	No	Liquidation only	
Industrial Banks Savings Guaranty Corporation of Colorado, Denver	Industrial banks 111	Colorado	$40,000	$347 million $8.2 million 2.36 %	No	Yes	(none)	(none)	Rules set by law and Div. of Banking	Yes 1 part-time	Yes	None, except recommend actions to state authorities	Yes	Arrange merger, purch.& assump., liquidation	3 liquidations: no dates
Industrial Loan Thrift Guaranty Corporation of Iowa, Des Moines, IA	Industrial loan companies 14	Iowa	$10,000	$212 million incl.uninsured $360,000 0.17 %	No	Yes - advance of regular assessments	(none)	(none)	Rules set by Iowa code	Yes (none)	Yes	None, except recommend actions to state authorities	Unclear	Authority only for liquidation	2 liquidations: 1 in 1984
Pennsylvania Deposit Insurance Corp., Harrisburg, PA	Private banks 4	Penn.	$100,000	$120 million (9-30-84) $743,000 0.62 %	Yes	No	(none)	(none)	Rules set by Dept. of Banking	No	Yes	None	Yes, for nonpayment of assessment	Dept. of Banking decides	(none)
Industrial Loan Guaranty Corp., Salt Lake City, Utah	Industrial loan corporations 26	Utah	$15,000	$441 million $3.5 million 0.79 %	No	Yes - advance of regular assessments	(none)	(none)	Rules set by law	Yes	Yes	None, except recommend actions to state authorities	Yes	Assisted merger, purch.& assump., liquidation	none since 1977; some mergers

B. SURVEY OF STATE/PRIVATE INSURANCE FUNDS

B. 1. MARCH 20, 1985, QUESTIONNAIRE TO STATE/PRIVATE DEPOSIT INSURANCE FUNDS REGARDING POLICIES, OPERATIONS, AND POWERS

March 20, 1985

SAME LETTER AND ENCLOSURE SENT TO THE ATTACHED LIST:

Dear

On April 3, 1985, the Commerce, Consumer, and Monetary Affairs Subcommittee will begin congressional hearings into the Ohio deposit insurance problem and the adequacy of the federal response. Specifically, the subcommittee will be examining the impact of the Home State Savings collapse on the Ohio Deposit Guaranty Fund and on the other state-insured thrifts; the adequacy of the response to the crisis by the Federal Home Loan Bank Board and the Federal Reserve System; the condition of other state/private deposit insurance systems; and, whether there is a need to strengthen the current system of state/private deposit insurance.

In preparation for these hearings, the subcommittee requires certain information regarding the policies and operations of your agency. We would greatly appreciate your responses to the attached questionnaire by March 29, 1985. I apologize for the relatively short timeframe of the request. If there are any questions, please call the subcommittee staff director, Peter S. Barash.

In the interests of time, your handwritten responses directly on the questionnaire form will be entirely satisfactory.

Sincerely,

Doug Barnard, Jr.
Chairman

Enclosures

DB:psb:b

Mr. Robert Rose
Operations Officer
California Credit Union Share
Guaranty Corporation
2350 South Garey Avenue
Pomona, CA 91766-5898

Mr. Richard Young
President
Thrift Guaranty Corporation
9916 Santa Monica Blvd.
Beverly Hills, CA 90212

Mr. Michael T. Liucci
The Connecticut Credit Union
Share Insurance Corporation
P. O. Box 477
Enfield, CT 06082

Mr. Larry S. Matsuda
President
Thrift Guaranty Corporation of Hawaii
Pacific Tower, S. 985
1001 Bishop Street
Honolulu, Hawaii 96813

Mr. John D. Wolfe, President
Industrial Loan Thrift
Guaranty Corp. of Iowa
228 Insurance Exchange Building
505 - Fifth Avenue
Des Moines, Iowa 50309

Mr. Charles L. Benton
Maryland Credit Union Insurance Corp.
8501 LaSalle Road
Baltimore, Maryland 21204

Mr. James Burns
Executive Vice President
The Co-operative Central Bank
225 Franklin Street
Boston, MA 02110

Mr. Thomas F. Gaines
President
The State Credit Union Share
Insurance Corporation
P. O. Box 21130
Chattanooga, TN 37421

Mr. Samuel Rizzo
President
National Deposit Guaranty Corporation
555 Metro Place, North, S. 325
Dublin, Ohio 43017

Mr. Steven Hellerstein
Industrial Bank Savings Guaranty Corporation
c/o Hellerstein, Hellerstein & Shore
1139 Delaware Street
P. O. Box 5637
Denver, Colorado 80217

Mr. Donald F. Willis
President
Florida Credit Union Guaranty Corp.
8000 S. Orange Avenue, S. 108
Orlando, FL 32809

Mr. Donald R. Beason
Financial Institutions Assurance Corporation
222 South Wilmington Street
P. O. Drawer 2688
Raleigh, North Carolina 27602

Mr. John D. Faulkner
President & Chairman of the Board
Maryland Savings Share Insurance Corp.
901 North Howard Street
Baltimore, Maryland 21201

Mr. Leonard Lapidus
Executive Vice President
Mutual Savings Central Fund, Inc.
One Linscott Road
Woburn, MA 01801

Mr. Robert J. Maietta
President
Massachusetts Credit Union
Share Insurance Corp.
950 Mechanics Bank Tower
Worcester, MA 01608

Mr. Jim Moylan
Executive Vice President
Nebraska Depository Insurance
Guaranty Corporation
1640 Woodmen Tower
Omaha, Nebraska 68102

Mr. Donald R. Hunsche
Executive Vice President
The Ohio Deposit Guarantee Fund
1001 TriState Building
Cincinnati, Ohio 45202

Ms. Pamela A. Hathaway
Executive Vice President
Pennsylvania Savings Association
Insurance Corporation
3600 Old Gettysburg Road
Camp Hill, PA 17011

Mr. Peter Nevola
President
Rhode Island Share and
Deposit Indemnity Corporation
1220 Pontiac Avenue, S. 101
Cranston, RI 02920

Mr. Jack Young
Washington Credit Union Share
Guaranty Association
P. O. Box WCUL
Bellevue, WA 98009

Mr. Don Schaefer
Wisconsin Credit Union
Savings Insurance Corp.
5011 Manona Drive
Madison, Wisconsin 53716

Ms. Irene Jorgensen
The Industrial Loan Guaranty
Corp. of Utah
10 West Third South, S. 530
Salt Lake City, Utah 84101

Mr. John Martin
Georgia Credit Union Deposit
Insurance Corporation
2990 Brandywine Rd., S. 220
Atlanta, Georgia 30341-5565

Mr. Paul F. Gastrock
Chairman
Pennsylvania Deposit Insurance Corp.
3208 Meadow Lane
Harrisburg, PA 17109

Mr. Manuel Dones Pinero
Inspector of Cooperatives of Puerto Rico
G. P. O. Box 4108
San Juan, Puerto Rico 00936-4108

Mr. Giles E. Wood
Executive Vice President
The Virginia Credit Union Share Insurance Corp.
1207 Fenwick Drive
P. O. Box 11469
Lynchburg, Virginia 24506

Mr. Billy F. Spivey
Texas Share Guarantee Credit Union
Box 14584
Austin, Texas 78761

Mr. Donald B. Duncan
Utah Credit Union Guaranty Corp.
P. O. Box 26008
Salt Lake City, Utah 84126

Mr. Mervin Selle
Glacier General Assurance Co.
Box 4626
Missula, MT 59806

1

NAME OF DEPOSIT INSURANCE FUND_____

I. General Information:

1. Type(s) of Financial Institution(s) whose deposits you insure:

2. In which state(s) do you insure:

3. A. Cost of initial membership in your fund, if any:

   B. Annual premium:

   C. Continuing equity contribution or membership deposit:

4. Maximum coverage per account or per depositor:

5. Do you insure brokered deposits:

6. Number of insured institutions, by type:

   A. Under $100 million:

   B. $100 million to $500 million:

   C. $500 million to $1 billion:

   D. Over $1 billion:

7. Aggregate amount of deposits insured, by type of institution:

8. Your fund's total useable assets:

9. Ratio of usable insurance fund assets to deposits insured:

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

   a. access to the treasuries of the state(s) in which you operate; and/or

   b. authority to assess other insured institutions enough to cover the losses?

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

6. Do you reinsure your risks with any other insurance carriers? Please provide details.

7. Regarding your board of directors:

   a. How is your board of directors selected?

   b. What rules govern the size and composition of the board?

   c. Who are the present members of your board? (Please provide names and principal affiliations.)

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

2. Please respond separately for each state in which you insure deposits:

   a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

   b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

   c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

3. Please respond separately for each state in which you insure deposits:

   a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

   b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?

   c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

   b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

   c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date:

   a. The name, location, and size of the institution;

   b. The total dollar cost of the insolvency to your fund;

   c. The dollar amount of insured deposits in the institution at time of closing;

   d. The dollar amount of uninsured deposits in the institution;

   e. The percentage recovery to date to depositors on uninsured deposits;

   f. The gross dollar amount of outstanding unpaid depositor claims; and

   g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

5. Please provide a copy of your latest annual report.

2. QUESTIONNAIRE RESPONSES

March 27, 1985

The Honorable Doug Barnard, Jr.
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Barnard:

I have, in response to your request, completed your questionnaire. Also enclosed are copies of SGC bylaws, SGC OPS, 1984 annual report and our most recent financial statement. I hope this information will help you in your preparation for April 3, 1985. If you have any questions please feel free to contact me.

Sincerely,

R. Rose

Robert Rose
Chief Operations Officer

RR:tj

Enclosures

NAME OF DEPOSIT INSURANCE FUND California Credit Union Share Guaranty Corporation (SGC)

I. General Information:

1. Type(s) of Financial Institution(s) whose deposits you insure: state licensed credit unions

2. In which state(s) do you insure: California

3. A. Cost of initial membership in your fund, if any: 1% of total shares deposited as capital contribution with SGC

   B. Annual premium: none

   C. Continuing equity contribution or membership deposit: Capital contribution of 1% adjusted annually for growth

4. Maximum coverage per account or per depositor: $150,000/separate; $150,000 on IRA, KEOGH, trust accounts

5. Do you insure brokered deposits: No, brokers would not be eligible for credit union membership

6. Number of insured institutions, by type:

   A. Under $100 million: 21 credit unions

   B. $100 million to $500 million: 2 credit unions

   C. $500 million to $1 billion: ø

   D. Over $1 billion: ø

7. Aggregate amount of deposits insured, by type of institution: $876,896,251 state credit unions

8. Your fund's total useable assets: $9,713,800 as of 2/28/85

9. Ratio of usable insurance fund assets to deposits insured: This would be our equity (capital contributions + retained earnings) to insured risk ratio of 1.13% as of 2/28/85

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

SGC is a private guaranty corporation, created by authority of the California State Legislature. The State of California has no fiscal liability for the affairs of the corporation, but does regulate its activities. See California Financial Code Sections 16100 through 16154, enclosed. Adequate disclosure as to the status of the corporation is made in all informational and promotional materials.

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

California Department of Corporations, (Business and Transportation Agency)

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or

No

b. authority to assess other insured institutions enough to cover the losses?

Yes. The board may raise the normal operating level to 2% of insured risk (from current normal level of 1%) and to require additional capital contributions from the insured institutions to that level. See also Section 16142 of California Financial Code re Commissioner's authority.

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

Yes. Statute requires a minimum operating level of fund equity to insured risk of 1%. See 3b above.

5. Do you have lines of credit already established by contract on which you can can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

A line of credit equal to 90% of hypothecated assets is established with the National Credit Union Administration Central Liquidity Facility (CLF). NCUA is a federal agency charged with regulating federally chartered and/or insured credit unions. CLF is an agency of the federal government with access to the U.S. Treasury. Current line of credit amounts to $9 million.

Insured institutions themselves have access to CLF in the event of liquidity crisis, either as direct members of CLF or as members of Western Corporate Federal Credit Union, an agent of the CLF. Amounts of access would vary with the assets of the insured institution.

6. Do you reinsure your risks with any other insurance carriers? Please provide details.

No.

7. Regarding your board of directors:

a. How is your board of directors selected?

Refer to Article IV, Membership in the Corporation, of the Bylaws, enclosed.

b. What rules govern the size and composition of the board?

The Bylaws of the Corporation.

c. Who are the present members of your board? (Please provide names and principal affiliations.)

Fredric Durham, Chair
General Manager, Santa Ana City Employees Credit Union

Mary Lindner, Vice Chair
General Manager, California State Employees Credit Union of San Jose

Anthony Cole, Secretary-Treasurer
General Manager, Firestone Staff Credit Union

James P. Jordan III, Director
Vice President of Operations, Telephone Employees Credit Union of Southern California, Ltd.

Wesley Nugent, Director
Senior Vice President, Sierra Central Credit Union

*Marla Shepard, Director
President/Chief Executive Officer, San Diego Telephone Employees Credit Union

Note: One position on the board is vacant, occasioned by the resignation of Hugh Page, director of Provident Central Credit Union, in February 1985.

*Corporation bylaws provide that 2 directors may be elected who do not represent insured institutions. San Diego Telephone ECU is not insured by SGC.

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure reserve, capital, or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements to you impose?

Refer to Article VII, Participation Criteria, of the Bylaws. See also Chapter 3, Participant Reporting and Monitoring, of the Operating Procedures and Standards Manual, enclosed.

SGC has denied or deferred the applications of 35% of applicants because of higher risk than standards allow.

2. Please respond separately for each state in which you insure deposits:

a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

Yes. See California Financial Code Section 16120(a) and corporate Bylaws, Article IX, Section 2(a).

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

1. Failure to comply with SGC Operating Procedures and Standards
2. Failure to comply with SGC Bylaws.
3. Failure to comply with California law or regulation.
4. Unsafe or unsound practices in conduct of business.
5. Violation of any law, rule, regulation or order when violation imposes a risk of insolvency for the institution and a potential financial risk to the SGC.
6. Violation of any requirement imposed on the institution by SGC.
7. Existence of any condition or circumstance which indicates a reasonably foreseeable possibility of the institution's becoming insolvent.

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

None.

3. Please respond separately for each state in which you insure deposits:

   a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

      Yes. See California Financial Code Section 16120(c).

   b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?

      SGC analyzes the financial statements and supporting records of each insured institution at least quarterly, assessing trends in such areas as yield on assets, expenses, investment structure and quality, liquidity, delinquency, reserves, net worth and other criteria. In addition, the Department of Corporations each year either examines the books and records of the insured institution on site, or accepts an in-lieu CPA audit from the insured institution. Two employees perform the financial analyses for the 23 member institutions; the size of the Department of Corporation's examination staff is unknown to us.

   c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

      Yes, the right of access is contained within Section 16120(b). Reports are provided on a regular basis by the Commissioner of Corporations.

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

   Yes. Refer to Section 14553 of the California Financial Code (California Credit Union Law). In addition, the insured institution must have either a CPA in-lieu audit or Department of Corporations examination annually.

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

   See Section 16120(a) of California Financial Code. The SGC may submit reports and make recommendations to the Commissioner of Corporations for cause. See also Chapter 4 of Operating Procedures and Standards.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

No insured institution has failed. The Department of Corporations has authority to name SGC as liquidating agent. See Section 16141 of California Financial Code.

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?

It is the intent of SGC to follow the federal precedent for immediate payout. To date, no claims have been made against the fund.

3a. If an institution whose deposits you insure becomes insolvent, is liquidation and payout of insured deposits your only alternative?

No. If an insured institution fails to correct situations of which they are notified by SGC, the institition may be merged, or a purchase-assumption of the institution may be arranged in whole or in part. Receivership with capital infusion is another alternative.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

Yes, with the concurrence of the Commissioner of Corporations. See Section 16120(a) of the California Financial Code.

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

Yes, with the concurrence of the Commissioner of Corporations in a plan of operation and merger. See Section 16120(a) of the California Financial Code.

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980 to date:

Not applicable; no losses or liquidations since creation of SGC on 1/2/81.

a. The name, location and size of the institution;

b. The total dollar cost of the insolvency to your fund;

c. The dollar amount of insured deposits in the institution at time of closing;

d. The dollar amount of uninsured deposits in the institution;

e. The percentage recovery to date to depositors on uninsured deposits;

f. The gross dollar amount of outstanding unpaid depositor claims; and

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

As of fiscal years ending June 30:
1981/$1,754,680 (SGC incorporated January 2, 1981)
1982/$2,497,719
1983/$3,460,495
1984/$7,017,221
As of Feb. 28, 1985/$9,893,816

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

As of Feb. 28, 1985

WesCorp FCU	$1,052,852	(cash flow/liquidity, daily interest bearing
	210,000	(Time Certificates-CD's) accts)
Banks/Savings & Loans	1,500,000	(limited to $100,000 per institution)
Tax-free Securities	6,950,948	(short term maturities/high quality emphasis)
	$9,713,800	

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

none

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

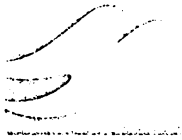
As of fiscal years ending June 30:

1981/16.79% annualized
1982/15.89% annualized
1983/10.77% annualized
1984/10.40% annualized

as of 2/28/85/9.27% annualized inclusive of taxable & non-taxable investment yield

5. Please provide a copy of your latest annual report.

Enclosed:
1) fiscal year end June 30, 1984 Annual Report including Certified Public Accountant Report for same period ending.
2) February 28, 1985 financial statement/unaudited.



March 28, 1985

The Honorable Doug Barnard, Jr.
Chairman
Commerce, Consumer, and Monetary
Affairs, Subcommittee of the
Committee on Government Operations
Rayburn House Office Building, Room B-377
Washington, DC 20515

Dear Congressman Barnard:

Reference is made to your questionnaire and your letter dated March 20, 1985. The answers given in that questionnaire reflect the status of Thrift Guaranty Corporation as of this date. On March 20th the California State Senate passed Senate Bill #20 as an emergency measure, which will be in effect on or about June 1, 1985.

The Bill replaces the existing statute with respect to Thrift Guaranty Corporation of California giving the Corporation a whole new range of authority and powers very similar to those held now by FDIC or FSLIC.

Amongst other changes, Thrift Guaranty Corporation will have the authority to:

a) Create a special assessment authority.

b) Purchase reinsurance.

c) Examine and investigate the affairs of a member Company.

d) Expend its fund to make loans, deposits in, purchase assets or securities of, assume liabilities of, or make contributions to any member to minimize specified efficiency payments.

e) Specify the composition of the Board of Directors to include members from outside the Industry.

f) Revise requirements for audit reports and make submission of the annual Audit Report a condition of continued licensure.

g) Require the Corporation to develop guidelines and criteria for membership and prohibit the licensure of additional industrial loan companies until these guidelines of criteria are approved for the Commissioner or until January 1, 1986, which ever is earlier.

h) Approve membership or suspend or revoke the right to participate in Guaranty Corporation by any member for a cause.

i) Borrow funds, if necessary, to effectuate the provisions of the Bill.

j) Organize a new thrift company to assume the thrift obligations and temporarily perform the functions of the closed Company.

k) Act as a conservator or receiver of a member company that the Commissioner has taken possession of.

The Bill has the full support of the Thrift Guaranty Corporations Board of Directors and the California Association of Thrift and Loan Companies.

Sincerely,

RICHARD D. YOUNG
President
Thrift Guaranty Corporation
of California

RDY:dgs

1

NAME OF DEPOSIT INSURANCE FUND: THRIFT GUARANTY CORPORATION OF CALIFORNIA

I. General Information:

1. Type(s) of Financial Institution(s) whose deposits you insure: INDUSTRIAL LOAN COMPANIES

2. In which state(s) do you insure: CALIFORNIA

3. A. Cost of initial membership in your fund, if any: $100,000

   B. Annual premium: .215 of previous year (12/31) deposits

   C. Continuing equity contribution or membership deposit: none

4. Maximum coverage per account or per depositor: $50,000

5. Do you insure brokered deposits: yes

6. Number of insured institutions, by type:

   A. Under $100 million: 40

   B. $100 million to $500 million: 1

   C. $500 million to $1 billion: 0

   D. Over $1 billion: 0

7. Aggregate amount of deposits insured, by type of institution: 1.5 billion

8. Your fund's total useable assets: 15 Million

9. Ratio of usable insurance fund assets to deposits insured: 1%

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

Private Agency created by State law.
See attached for text of statutory authority.

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

Department of Corporations.

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or

no

b. authority to assess other insured institutions enough to cover the losses?

no

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

no

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

no lines of credit

6. Do you reinsure your risks with any other insurance carriers? Please provide details.

no

7. Regarding your board of directors:

a. How is your board of directors selected?

by members of Thrift Guaranty Corporation

b. What rules govern the size and composition of the board?

California Financial Code and corporation By-laws -

c. Who are the present members of your board? (Please provide names and principal affiliations.)

RICHARD D. YOUNG, President
Topa Thrift & Loan Association

NEAL AVELLAR, Vice President
First Thrift of America

ED SMITH, Treasurer
Morris Plan

DANIEL SCHRAMM, Secretary
Corona Thrift

TOM CUNNINGHAM, Director
Tustin Thrift & Loan

KEN HULL, Director
Commercial Credit Thrift

DALE PICKNEY, Director
Town & Country Thrift

GORDON TAUBENHEIM, Director
San Francisco Bancorp

J.P. ELZAS, Director
Imperial Thrift & Loan

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

NO

2. Please respond separately for each state in which you insure deposits:

a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

NC

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

failure to pay assessment

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

None

3. Please respond separately for each state in which you insure deposits:

a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

Yes, such authority is by statute.

b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?

In cases of suspected impairment of capital, with consent of Department of Banking, examinations are performed by employment auditors. The Insurance Fund has no staff.

c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

Yes access
Yes examination reports

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

Yes

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

None except report to State Supervisory authority for action.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?
No

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?
Must wait.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?
Fund has no alternatives, Department of Corporations has the power and the alternatives as outlined to date.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?
No

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?
No

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date:

a. The name, location, and size of the institution; Golden Commonwealth Savings Bank, San Diego

b. The total dollar cost of the insolvency to your fund; 10 Million

c. The dollar amount of insured deposits in the institution at time of closing;

d. The dollar amount of uninsured deposits in the institution;

e. The percentage recovery to date to depositors on uninsured deposits;

f. The gross dollar amount of outstanding unpaid depositor claims; and

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.
Not Yet

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

See attached statement

Due to the special nature of this we may not provide the information requested

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

See attached statement

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

No

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

About 11%

5. Please provide a copy of your latest annual report.

Attached

HELLERSTEIN, HELLERSTEIN AND SHORE, P. C.
ATTORNEYS AT LAW
1139 DELAWARE STREET
P. O. BOX 5637
DENVER, COLORADO 80217

LOUIS A. HELLERSTEIN
STEPHEN A. HELLERSTEIN
MARTIN H. SHORE
CHRISTIAN CARL ONSAGER
JANICE HOFMANN CLARK
MARIA J. FLORA
EDWARD P. O'BRIEN
MARTI R. BAREN
CHRISTINA A. FIFLIS
BEVERLY L. RUTENBECK
JOHN M. WIEGAND
JOSEPH A. MURR
GWEN S. ANDERSON

March 28, 1985

Representative Doug Barnard, Jr., Chairman
Commerce, Consumer, and Monetary Affairs Subcommittee
of the Committee on Government Operations
Rayburn House Office Building, Room B-377
Washington, D. C. 20515

In Re: Industrial Banks Savings Guaranty Corporation of Colorado

Dear Representative Barnard:

This law firm acts as general counsel for the Industrial Banks Savings Guaranty Corporation of Colorado. Pursuant to your request, enclosed is the Guaranty Corporation's response to the questionnaire distributed by your subcommittee.

Very truly yours,

HELLERSTEIN, HELLERSTEIN AND SHORE, P.C.

Stephen A. Hellerstein

SAH/bls
Enclosures
cc: E. J. Gabriel, Esquire

VIA FEDERAL EXPRESS

NAME OF DEPOSIT GUARANTY FUND: Industrial Bank Savings Guaranty Corporation of Colorado

I. General Information: NOTE: THE ABOVE FUND DOES NOT PROVIDE INSURANCE. BY STATUTE THE FUND PROVIDES A GUARANTY TO DEPOSITORS IN COLORADO INDUSTRIAL BANKS WHICH DO NOT HAVE FDIC COVERAGE. References herein and questions are deemed to refer to protection.

1. Type(s) of Financial Institutions(s) whose deposits you insure:

Industrial banks chartered in Colorado which take deposits.

2. In which state(s) do you insure:

Colorado

3. A. Cost of initial membership in your fund, if any:

$50,000 for banks with paid-in capital of $500,000 or more and $30,000 for those with less.

B. Annual premium:

One quarter (1/4) of one percent of total deposits of each member bank as of December 31 of each year.

C. Continuing equity contribution or membership deposit:

N/A

4. Maximum coverage per account or per depositor:

$40,000.00

5. Do you insure brokered deposits:

Not aware of any such accounts in Colorado industrial banks.

6. Number of insured institutions, by type:

A. Under $100 million: 111

B. $100 million to $500 million: - 0 -

C. $500 million to $1 billion: - 0 -

D. Over $1 billion: - 0 -

7. Aggregate amount of deposits insured, by type of institution:

Industrial banks - $346,600,000 as of December 31, 1984

8. Your fund's total usable assets:

$8,193,367 (plus nonliquid assets of $2,810,000)

9. Ratio of usable insurance fund assets to deposits insured:

2.36%

II. Background

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

Creation of state law (see brochure attached).

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

Division of Banking, Department of Regulatory Agencies, State of Colorado

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

A. Access to the treasuries of the state(s) in which you operate; and/or

No

B. authority to assess other insured institutions enough to cover the losses?

No - however, Guaranty Corporation empowered to make double assessments of member industrial banks.

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

No

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

No

6. Do you reinsure your risks with any other insurance carriers? Please provide details.

No

7. Regarding your board of directors:

A. How is your board of directors elected?

Vote of member banks at annual meeting under by-laws and recommendations of nominating committee.

B. What rules govern the size and composition of the board?

By-laws of Corporation.

C. Who are the present members of your board? (Please provide names and principal affiliations.)

	IBSGC Position
Mr. Arthur Bronstein, President Mellon Boulder Industrial Bank P. O. Box 1069 Boulder, Colorado 80302	
Mr. Buel Clifton, Sr. Executive Vice President Household Finance Corporation 2700 Sanders Road Chicago, Illinois 60070	
Mr. W. Harold Dobson Zions Utah Bancorporation P. O. Box 2165 Salt Lake City, Utah 84110	
Mr. Gerald E. Donahue Manufacturers Hanover Industrial Bancorporation 770 West Hampden Avenue, Suite 100 Englewood, Colorado 80151	Treasurer
Mr. E. J. Gabriel, Sr. Vice President and General Counsel GEIBank Industrial Bank P. O. Box 5555 Denver, Colorado 80217	President
Mr. Lester Gold Investment Banker Omnibank Southeast Center 3600 South Yosemite, Suite 888 Denver, Colorado 80237	
Mr. Henry I. Kester, Professor Graduate School of Business University of Colorado Boulder, Colorado 80309	

Mr. D. Robert Kominski
Fort Lupton Industrial Bank
415 Denver Avenue, Suite A
P. O. Box 159
Fort Lupton, Colorado 80621

Mr. Charles Miller
First Industrial Bank
300 North Main Street
Rocky Ford, Colorado 81067

Mr. Carl U. O'Neill — Vice President
Mountain Industrial Bank
521 Main Street
Montrose, Colorado 81401

Mr. Fred V. Sherman — Executive Vice President
Independent Banker and Investor
53 Polo Drive
Colorado Springs, Colorado 80906

Mr. Marvin L. Stone, Partner Emeritus
Coopers & Lybrand
2500 Anaconda Tower
Denver, Colorado 80202

Mr. Richard C. Tucker
Tri-State Bank
616 East Speer Boulevard
Denver, Colorado 80203

Ms. Brooke Wunnicke — Secretary
Chief Appellate Deputy District Attorney
175 South Eudora
Denver, Colorado 80222

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

Requirements imposed by Colorado law and rules, regulations and orders of Division of Banking, State of Colorado and of Guaranty Corporation.

2. Please respond separately for each state in which you insure deposits:

A. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

Yes

B. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

As set forth in statute - see Attachment 1.

C. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

Delta Industrial Bank - closed by Bank Commissioner.

First Savings Industrial Bank - closed by Bank Commissioner.

Gunnison Industrial Bank - closed by Bank Commissioner.

3. Please respond separately for each state in which you insure deposits:

A. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

Yes, by statute - see Attachment 2.

B. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have? What is your examination operating budget?

(1) Examine all semi-annual call reports, audit independent annual certified financial statements, and further exams as needed.

(2) Varies from bank to bank.

(3) One part time - use outside independent firm experienced in commercial bank director audits which is available when needed.

(4) No fixed budget.

C. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

Yes - receive them upon request.

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

Yes

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

Work closely with Banking Division, State of Colorado, on problem banks. Corporation has no direct statutory authority other than termination of insurance, except as set forth in Attachment 3.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

Yes

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?

Policy is to pay immediately.

3. A. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

No

B. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

Yes, subject to approval of State Bank Commissioner.

C. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

Yes, dependent upon circumstances.

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980 to date: SEE ATTACHMENT 4.

A. The name, location, and size of the institution;

B. The total dollar cost of the insolvency to your fund;

C. The dollar amount of insured deposits in the institution at time of closing;

D. The dollar amount of uninsured deposits in the institution;

E. The percentage recovery to date to depositors on uninsured deposits;

F. The gross dollar amount of outstanding unpaid depositor claims; and

G. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983 and 1984.

	1981	1982	1983	1984
Total Assets as of June 30	5,539,017	7,300,026	6,167,364	9,300,751

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

See Attachment 5.

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

No

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

As of February 28, 1985, 10.71%.

5. Please provide a copy of your latest annual report.

(Enclosed)

(d) and 11-22-116 and, in addition, the status of the bank as a member of the guaranty corporation may be terminated pursuant to the provisions of section 11-22-519.

11-22-518. Action by guaranty corporation as to embarrassed or impaired members. (1) When the guaranty corporation determines that a member is or may become temporarily embarrassed or that its capital, surplus, and undivided profits may be or may become impaired or when a member is in the process of liquidation, the guaranty corporation, through its board of directors, may take such action as it deems necessary, in its discretion, after receiving the advice and approval from the commissioner in order to minimize the risk of loss to the guaranty fund, to facilitate the sale of any assets of such member to another institution, to facilitate the assumption of any liabilities of such member by another institution, or to otherwise protect the interests of the depositors or the public. Such action may include but shall not be limited to:

(a) Contributing, investing, or lending to the member bank, on a secured or unsecured basis, under terms specified by the guaranty corporation;

(b) Purchasing any assets or the stock of the member bank;

(c) Participating in or directing the management of the member bank; and

(d) Guaranteeing any institution which purchases the assets of such member or which assumes the liabilities of such member against loss.

(2) There shall be no liability on the part of the guaranty corporation or its members, directors, officers, employees, or agents or the commissioner or his authorized agents for any recommendations made or actions taken pursuant to the provisions of this section.

11-22-519. Termination as a member bank. (1) Whenever the guaranty corporation finds that a member bank or its directors, officers, agents, or employees have engaged in or are engaging in unsafe or unsound business practices in conducting the business of such bank or have violated an applicable law, rule, regulation, or order, or any condition imposed in writing by the commissioner, the guaranty corporation shall serve the commissioner with a statement with respect to such practices or violations for the purpose of securing the correction thereof and the guaranty corporation shall also serve a copy of such statement on the bank. Unless such correction is made within one hundred twenty days from the date the statement was served on the member bank, the guaranty corporation may serve the bank and the commissioner

ATTACHMENT 1

50-923 O—85——24

with written notice of its intention to terminate the status of the bank as a member bank. If the guaranty corporation determines that the guaranty risk of the guaranty corporation is unduly jeopardized, it may fix a shorter period for the correction to be made, but not less than twenty days. Within thirty days of service of the notice of intent to terminate, the commissioner shall fix a time and place for a hearing on such termination. Unless the bank appears at the hearing through a duly authorized representative, its membership in the guaranty corporation shall be automatically terminated and the commissioner shall make findings to such effect. If the bank appears at the hearing through a duly authorized representative, and the commissioner determines that any unsafe or unsound business practice or any condition or violation specified in the statement has been established and has not been corrected, the guaranty corporation may order the membership of the bank in the guaranty corporation to be terminated but no sooner than ten days following the commissioner's finding. After the termination of the member status of any bank under the provisions of this subsection (1), the guaranteed savings obligations of each depositor in the bank on the date of termination, less all subsequent withdrawals, shall continue to be guaranteed for a period of two years, or with regard to time deposits, until six months following the maturity date thereof. During such period, unless the bank is in liquidation, the bank shall continue to pay assessments to the guaranty corporation and shall otherwise comply with the provisions of this article applicable to a member bank. No additions to any savings obligations and no new savings obligations in such bank made following the date of termination shall be guaranteed by the guaranty corporation. The bank whose status as a member bank in the guaranty corporation has been terminated shall give notice of such termination to its depositors in such form as the commissioner may require.

(2) In the event a member bank stops accepting savings obligations or is no longer required to be a member of the guaranty corporation pursuant to this article, such member bank shall continue to pay all assessments and shall comply with all other provisions of this article until such member bank has no savings obligations which are guaranteed by the guaranty corporation. Status of a bank as a member of the guaranty corporation and the guaranty of its savings obligations by the guaranty corporation shall terminate as of the effective date of the insurance of such savings obligations by the federal deposit insurance corporation.

(3) In the event the membership of a bank in the guaranty corporation is terminated pursuant to the provisions of this section or for any other reason, such bank shall not be entitled to a refund of its initial membership assessment or to a refund of any other assessment required under this article.

(2) The guaranty corporation shall not be liable or held accountable for any misrepresentation by its members concerning guaranty of savings obligations.

11-22-517. List of banks having outstanding savings obligations - audit report. (1) In order to permit the guaranty corporation to fulfill its obligations under this article, the commissioner shall furnish it with a list of all banks which have outstanding savings obligations and one copy of each report on each such bank filed with him as required by section 11-22-109 (9).

(2) Within ninety days after the close of the fiscal year, each member, at its own expense, shall furnish the guaranty corporation with a certified audit performed by an independent certified public accountant in accordance with generally accepted auditing standards. Any bank which fails to comply with the provisions of this subsection (2) shall be liable to the guaranty corporation in the amount of two hundred dollars per day for each day the submission of the audit is delayed.

(3) The guaranty corporation, at any time and without notice, may appoint an independent qualified person, an audit committee, or a specialized employee to perform an audit or other investigation of a member, including a member in the process of liquidation. The results of the audit or investigation shall be contained in a report which shall include such information regarding the financial condition and operating procedures of the member as the guaranty corporation shall reasonably require. Upon being notified by the guaranty corporation that a report is to be prepared, the member or the commissioner, if he has taken possession of the bank, shall allow immediate access to all records, examination reports, and such other information as the investigator or the guaranty corporation may request. Any report prepared shall be given only to the board of directors of the guaranty corporation and to the commissioner. The cost and expenses of such audit or investigation shall be paid by the guaranty corporation.

(4) Upon request of the guaranty corporation, each member shall provide the guaranty corporation with copies of all reports or special reports made to the commissioner, including examination reports and responses to examinations.

(5) The audits and reports and other information required by subsections (2), (3), and (4) of this section shall not be made public except as otherwise authorized by law.

(6) Failure of any officer or director of a member to comply with any of the provisions of this section constitutes an unsound business practice under section 11-22-115, and he shall be subject to the provisions of sections 11-22-109 (5)

ATTACHMENT 2

(d) and 11-22-116 and, in addition, the status of the bank as a member of the guaranty corporation may be terminated pursuant to the provisions of section 11-22-519.

11-22-518. Action by guaranty corporation as to embarrassed or impaired members. (1) When the guaranty corporation determines that a member is or may become temporarily embarrassed or that its capital, surplus, and undivided profits may be or may become impaired or when a member is in the process of liquidation, the guaranty corporation, through its board of directors, may take such action as it deems necessary, in its discretion, after receiving the advice and approval from the commissioner in order to minimize the risk of loss to the guaranty fund, to facilitate the sale of any assets of such member to another institution, to facilitate the assumption of any liabilities of such member by another institution, or to otherwise protect the interests of the depositors or the public. Such action may include but shall not be limited to:

(a) Contributing, investing, or lending to the member bank, on a secured or unsecured basis, under terms specified by the guaranty corporation;

(b) Purchasing any assets or the stock of the member bank;

(c) Participating in or directing the management of the member bank; and

(d) Guaranteeing any institution which purchases the assets of such member or which assumes the liabilities of such member against loss.

(2) There shall be no liability on the part of the guaranty corporation or its members, directors, officers, employees, or agents or the commissioner or his authorized agents for any recommendations made or actions taken pursuant to the provisions of this section.

11-22-519. Termination as a member bank. (1) Whenever the guaranty corporation finds that a member bank or its directors, officers, agents, or employees have engaged in or are engaging in unsafe or unsound business practices in conducting the business of such bank or have violated an applicable law, rule, regulation, or order, or any condition imposed in writing by the commissioner, the guaranty corporation shall serve the commissioner with a statement with respect to such practices or violations for the purpose of securing the correction thereof and the guaranty corporation shall also serve a copy of such statement on the bank. Unless such correction is made within one hundred twenty days from the date the statement was served on the member bank, the guaranty corporation may serve the bank and the commissioner

(d) and 11-22-116 and, in addition, the status of the bank as a member of the guaranty corporation may be terminated pursuant to the provisions of section 11-22-519.

11-22-518. Action by guaranty corporation as to embarrassed or impaired members. (1) When the guaranty corporation determines that a member is or may become temporarily embarrassed or that its capital, surplus, and undivided profits may be or may become impaired or when a member is in the process of liquidation, the guaranty corporation, through its board of directors, may take such action as it deems necessary, in its discretion, after receiving the advice and approval from the commissioner in order to minimize the risk of loss to the guaranty fund, to facilitate the sale of any assets of such member to another institution, to facilitate the assumption of any liabilities of such member by another institution, or to otherwise protect the interests of the depositors or the public. Such action may include but shall not be limited to:

(a) Contributing, investing, or lending to the member bank, on a secured or unsecured basis, under terms specified by the guaranty corporation;

(b) Purchasing any assets or the stock of the member bank;

(c) Participating in or directing the management of the member bank; and

(d) Guaranteeing any institution which purchases the assets of such member or which assumes the liabilities of such member against loss.

(2) There shall be no liability on the part of the guaranty corporation or its members, directors, officers, employees, or agents or the commissioner or his authorized agents for any recommendations made or actions taken pursuant to the provisions of this section.

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Attachment 4

Delta Industrial Bank

a. Delta Industrial Bank
Delta, Colorado
Total deposits: $1,532,000

b. cost of the insolvency: -0-, full recovery

c. protected deposits at time of closing: $1,361,000

d. unprotected deposits: $183,000

e. percentage recovery on unprotected deposits: unknown at this time, claims outstanding against bank assets.

f. outstanding unpaid depositor claims: $183,000

g. length of time between closing and completion of payouts on protected deposits: three days.

First Savings Industrial Bank

a. First Savings Industrial Bank
Pueblo, Colorado
Total deposits: $3,610,000

b. cost of the insolvency: $-0-, full recovery

c. protected deposits at time of closing: $2,838,000 (adjusted for offsets)

d. unprotected deposits: $674,141 (adjusted for offsets)

e. percentage recovery on unprotected deposits: 0% to date, estimated recovery 60%, claims outstanding against bank assets.

f. outstanding unpaid depositor claims: $674,141

g. length of time between closing and completion of payouts on protected deposits: Payments began 20 days after closing, 2.4 million in undisputed claims paid within 30 days, remaining accounts paid in next 60 days.

Gunnison Industrial Bank

a. Gunnison Industrial Bank
Gunnison, Colorado
Total deposits: $2,933,000

b. cost of the insolvency: unknown at this time.

c. protected deposits at time of closing: $2,789,000 (adjusted for offsets)

d. unprotected deposits: $84,000 (adjusted for offsets)

e. percentage recovery on unprotected deposits: unknown at this time, claims outstanding against bank assets.

f. outstanding unpaid depositor claims: $84,000

g. length of time between closing and completion of payouts on protected deposits: three days.

COLORADO NATIONAL BANK
OF DENVER

COLORADO NATIONAL BANK-DENVER
CUSTODIAN FOR
INDUSTRIAL BANK SVGS GUARANTY

ACCOUNT NUMBER 501501700

ACCOUNT

ESTIMATED MARKET VALUE AS OF 02/28/85

INDUSTRIAL BANK SAVINGS
GUARANTY CORP OF COLORADO
BOX 5637, T.A.
DENVER, CO 80217

ATTACHMENT 5

COLORADO NATIONAL BANK
OF DENVER

COLORADO NATIONAL BANK-DENVER
CUSTODIAN FOR
INDUSTRIAL BANK SVGS GUARANTY

ACCOUNT NO. 501501700
PAGE 2

* * * P O R T F O L I O S U M M A R Y * * *

CLASS OF ASSET	INVESTMENT COST	MARKET VALUE	% ACCT	ESTIMATED ANNUAL INCOME	% YIELD MARKET
CASH	0.00	0.00	0.0		
CASH EQUIVALENTS	396,597.20	396,597.20	5.1	36,828.71	9.3
TIME DEPOSITS	1,269,213.39	1,269,213.39	16.3	109,673.42	8.6
U.S. GOVT. OBLIGATIONS	5,710,928.83	5,801,624.20	74.7	650,906.25	11.2
U.S. GOVT. AGENCIES	294,993.75	296,982.25	3.8	33,843.75	11.4
TOTAL ACCOUNT	7,671,733.17	7,764,417.04	100.0	831,252.13	10.7

COLORADO NATIONAL BANK
OF DENVER

* * * S C H E D U L E O F A S S E T S * * *

SHARES FACE	DESCRIPTION	INVESTMENT COST / AVG UNIT COST	MARKET VALUE UNIT PRICE	% ACCT	INC RATE	EST ANNUAL INCOME / % YIELD MKT
	CASH	0	0	0.00		
ASH EQUIVALENTS						
80,000	US TREASURY BILLS DUE 3-21-85	72,222 90.27	72,222	0.9	0.00	8,069 11.17
335,000	US TREASURY BILLS DUE 3-28-85	324,375 96.82	324,375	4.2	0.00	28,760 8.87
OTAL CASH EQUIVALENTS		396,597	396,597	5.1		36,829 9.29
IME DEPOSITS						
696,000	COLORADO NATIONAL BANK CERT DEP #524268 DTD 12-11-84 9.00% DUE 3-11-85 N/O INDUSTRIAL BANK SVGS GTY CORP OF COLO	696,000 100.00	696,000 100.00	9.0	9.00	62,640 9.00
214,666.900	COLORADO NATIONAL BANK CERT DEP #524341 DTD 2-6-85 8.35% DUE 4-8-85 N/O INDUSTRIAL SAVINGS GUARANTY CORP OF COLO	214,667 100.00	214,667 100.00	2.8	8.35	17,925 8.35
172,652.680	COLORADO NATIONAL BANK CERT DEP #524346 DTD 2-11-85 8.30% DUE 3-13-85 N/O INDUSTRIAL BANK GUARANTY CORP OF COLORADO	172,653 100.00	172,653 100.00	2.2	8.30	14,330 8.30

FIAC
Financial Institutions Assurance Corporation

Donald R. Beason
President

March 22, 1985

The Honorable Doug Barnard, Jr.
United States House of Representatives
Washington, D.C. 20515

Dear Mr. Barnard:

Thank you for the opportunity to respond to your questionnaire concerning private deposit insurance. We welcome hearings by the Commerce, Consumer, and Monetary Affairs Subcommittee concerning this matter and stand ready to provide any information or take any other action to assist the Subcommittee. We particularly appreciate the scope of these hearings and their objectives.

Financial Institutions Assurance Corporation has long supported the strengthening of the private deposit insurance system and reform of the federal deposit insurance system. We have met numerous times with members of Congress and the Administration officials on these matters.

As the Subcommittee's recent hearings on deposit insurance have shown, safety and soundness concerns extend far beyond Ohio. These concerns are reflected in the financial institutions regulatory system on both the state and federal levels. A thoughtful and reasoned response which addresses these concerns in a comprehensive manner is needed. Any abrupt and sweeping reaction to Ohio will only increase the concerns raised by the foreign loan exposure of major money center banks, nationalization of Continental Illinois, recent farm bank failures, and the financial condition of the FSLIC and its insured institutions.

The Subcommittee, in stating the scope of its hearings, has recognized that private deposit insurance is only one of the issues involved in the Ohio situation. There is a delicate balance of costs and benefits which must be weighed when addressing this issue. The private deposit insurance system has provided many benefits to consumers and has pioneered reforms which have been adopted or are under consideration by federal deposit insurers. This system has maintained the dynamic competitive interplay between the state and federal system which is a crucial ingredient in the financial institutions industry's ability to respond to marketplace demands.

Our corporation is committed to preserving the benefits of the dual system but not at the expense of eroding confidence in the United States banking system. We have fought within the private deposit insurance industry to establish national standards and a

222 S. Wilmington Street P.O. Drawer 2688 Raleigh, NC 27602 919-828-8578 800-222-3422 (U.S.) 800-662-7151 (N.C.)

FIAC

certification body for deposit insurers. We have attempted to forge closer links between the industry and state and federal regulators. We believe initiatives such as these can maintain public confidence and stability in the banking system while preserving the benefits of the dual system.

Once again, we appreciate the opportunity to work with the Subcommittee. We have enclosed our response to your questionnaire. If we can be of further assistance, please do not hesitate to call upon us.

Sincerely,

Donald R. Beason

Donald R. Beason

NAME OF DEPOSIT INSURANCE FUND

FINANCIAL INSTITUTIONS ASSURANCE CORPORATION

I. **General Information**

1. **Type(s) of Financial Institution(s) whose deposits you insure:**

Savings and Loans
Credit Unions
Industrial Thrift and Loans

2. **In which state(s) do you insure:**

North Carolina
Minnesota
West Virginia
Indiana

3. A. **Cost of initial membership in your fund, if any:**

$2,000 underwriting fee; capital deposit equal to 1.25% of outstanding savings accounts.

B. **Annual Premium**

A risk related premium of up to 1/12 of 1% of savings and/or an additional 3/4 of 1% deposit may be imposed on individual institutions.

C. **Continuing equity contribution or membership deposit:**

Semi-annual adjustment of 1.25% deposit.

4. **Maximum coverage per account or per depositor:**

$100,000 per account (subject to rights and capacities similar to federal insurers (IRA's, SEP and KEOGH accounts are insured to $250,000).

5. **Do you insure brokered deposits:**

Yes, but in limited amounts. No FIAC institution actively solicits brokered deposits.

6. **Number of insured institutions, by type: (As of December 31, 1984)**

	Savings & Loans	Credit Unions	Thrift & Loans
A. **Under $100 million:**	27	23	8
B. **$100 million to $500 million:**	7	1	1
C. **$500 million to $1 billion:**	0	1	0
D. **Over $1 billion:**	0	0	0

7. **Aggregate amount of deposits insured, by type of institution:**

Savings and Loans	$2,071,789,000
Credit Unions	$1,092,946,000
Industrial Thrift and Loans	$ 382,495,000

8. **Your fund's total usable assets:**

$79,488,000

9. **Ratio of usable insurance fund assets to deposits insured:**

2.24%

II. **Background:**

1. **Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority:**

   FIAC is a private agency established pursuant to a 1967 act of the General Assembly. Complete text of relevant statute is attached. (Exhibit 1)

2. **Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.**

   North Carolina Department of Commerce
   430 North Salisbury Street
   Raleigh, North Carolina 27602
   (919) 733-3525

3. **If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,**

   a. **access to the treasuries of the state(s) in which you operate; and/or**

      No.

   b. **authority to assess other insured institutions enough to cover the losses?**

      FIAC may assess all institutions an additional 3/4 of 1% to cover such losses, pursuant to Sections 1 and 2 of Article IV of FIAC's Standards and Procedures. (Exhibit 2 - Standards and Procedures)

4. **Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?**

   A minimum ratio of 1% must be maintained.

5. **Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?**

   Yes. FIAC has a $75 million contractual line of credit with Wachovia Bank and Trust Company and First National Bank of Chicago. In addition, all FIAC insured institutions are required to maintain independent lines of credit in amounts deemed necessary by FIAC's Board. (See Section 12 of Article III of FIAC's Standards and Procedures.)

6. **Do you reinsure your risks with any other insurance carriers? Please provide details.**

Yes. FIAC maintains a $25 million reinsurance policy with AEtna Casualty and Surety Company and a $2 million policy with Svenska Kredit. Copies of these agreements are enclosed. (Exhibit 3)

7. **Regarding your board of directors:**

a. **How is your board of directors selected?**

The Nominating Committee of the Board (composed of public members) presents a slate of candidates, which is voted on by the membership.

b. **What rules govern the size and composition of the board?**

State law requires that a majority of the nine member board must not have an affiliation with any insured institution (Chapter 54B-237).

c. **Who are the present members of your board? (Please provide names and principal affiliations.)**

Walter W. Baucom, Chairman
Treasurer, Blue Cross Blue Shield of North Carolina

Mrs. L. Y. Ballentine
Executive Vice President (Retired)
North Carolina Automobile Dealers Association

Victor W. Barfield
Senior Vice President and Chief Operating Officer
Financial Institutions Assurance Corporation

Donald R. Beason
President and Chief Executive Officer
Financial Institutions Assurance Corporation

J. D. Clawson
President, Granite Savings and Loan Association

Sam A. Harris
Financial Consultant

F. Kenneth Iverson
President, Nucor Corporation

Dr. J. Finley Lee
Professor of Insurance and Risk Management Specialist

Henry Wyche
Director
United Carolina Bancshares

III. **Supervision of insured institutions:**

1. **Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?**

   Yes. Minimum net worth and liquidity levels are imposed. FIAC's Board of Directors is empowered to set levels at such amounts they deem adequate, in accordance with Section 11 and 12 of Article III of the Standards and Procedures. A minimum net worth requirement of 5% of total deposits or the state requirement, if higher, is required.

2. **Please respond separately for each state in which you insure deposits:**

   a. **Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?**

      Yes. A copy of the insurance contract is enclosed, affirming each member's commitment to adhere to the provisions of FIAC's Standards and Procedures. Article VI, Section 2 of these Standards and Procedures governs termination of membership. (Exhibit 4)

   b. **Under what set of conditions or circumstances would you be authorized to discontinue insurance?**

      If, in the opinion of FIAC, a member is deemed to be operating in an unsafe or unsound manner, notice of termination can be given in accordance with Section 4 of Article III of the Standards and Procedures.

   c. **Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.**

      None

3. **Please respond separately for each state in which you insured deposits:**

   a. **Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.**

      Yes. Under its enabling statutes (N.C.G.S. 54B-24(b)(8)), Standards and Procedures (Section 2 and 3 of Article III) and agreements with state regulators in all states in which it operates, FIAC may examine or

cause the examination of all books, records, loans and other transactions.

b. **How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?**

FIAC performs a detailed monthly analysis of each institution it insures and performs examinations as needed. FIAC employs a staff of 20 people, all of whom are directly or indirectly related to this risk management function. FIAC's annual expense budget is $3.8 million. Sample copies of regular monthly reports are enclosed. (Exhibit 5)

In addition to the reports generated by FIAC's Financial Analysis System, FIAC conducts diagnostic reviews, similar in nature to an operational audit. An example of one such diagnostic review is enclosed. (Exhibit 6)

c. **Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?**

Yes, under Section 2 of Article III of FIAC's Standards and Procedures. Examination reports are received on a regular basis.

4. **Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants.**

Yes.

5. **If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?**

FIAC has the right to make any special investigation it deems necessary, require changes in investment or operating practices and policies or remove the officers or directors of a member institution. Such rights are set forth in Section 4 of Article III of the Standards and Procedures.

IV. **Payment of Losses:**

1. **Do you act as receiver/liquidator for failed institutions you insure?**

   Yes. We are empowered (N.C.G.S. 54B-244(a)(3)) to act as receiver/liquidator but have never needed to exercise such power.

2. **If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?**

   They have immediate access to funds. Our plans call for an institution to be open during liquidation for purposes of savings withdrawals and taking of loan payments.

3. a. **If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?**

      No. FIAC may also arrange mergers or sales, provide a capital infusion or take control of the institution and continue operations.

   b. **Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?**

      Yes.

   c. **Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?**

      Yes. FIAC's policy is not to close an insolvent institution but to provide sufficient liquidity and competent management to effect an orderly transition.

4. **Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date:**

   a. **The name, location, and size of the institution;**

   b. **The total dollar cost of the insolvency to your fund;**

   c. **The dollar amount of insured deposits in the institution at time of closing;**

   d. **The dollar amount of uninsured deposits in the institution;**

   e. **The percentage recovery to date to depositors on uninsured deposits;**

   f. **The gross dollar amount of outstanding unpaid depositor claims; and**

   g. **The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.**

      None of the above.

V. **Insurance Fund Reserves:**

1. **How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.**

December 31, 1981	$42,051,000
December 31, 1982	$40,562,000
December 31, 1983	$70,399,000
December 31, 1984	$79,488,000

2. **What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?**

U.S. Treasury and Agency Securities	$30,305,215
Bank Certificates of Deposit	5,008,238
Corporate Bonds	1,499,333
Commercial Paper	2,000,000
Term Federal Funds	1,000,000
sub total	$39,812,786
Cash and overnight investments	9,482,512
Total liquid assets	$49,295,298

A complete listing of the portfolio (including market values) is attached. (Exhibit 7)

3. **Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?**

No.

4. **In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?**

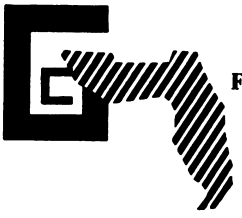
1981	8.98%
1982	10.29%
1983	10.66%
1984	10.95%

5. **Please provide a copy of your latest annual report.**

Copy enclosed. (Exhibit 8)

FINANCIAL INSTITUTIONS ASSURANCE CORPORATION

INDEX TO EXHIBITS



FLORIDA CREDIT UNION GUARANTY CORPORATION
Suite 108, 8000 South Orange Avenue, Orlando, Florida 32809
Telephone: 305/859-3528

March 28, 1985

The Honorable Doug Barnard, Jr., Chairman
Commerce, Consumer and Monetary Affairs Subcommittee
of the Committee on Government Operations
House of Representatives
Rayburn House Office Building, Room B-377
Washington, D.C. 20515

There is enclosed, Congressman Barnard, . . .

. . . the replies to the questions contained in the questionaire attached to your letter of March 20, 1985, directed to the President of this Corporation, Mr. Donald F. Wills (please note the correct spelling of his name).

If additional information is necessary, or if any of the responses are in need of clarification, please contact me.

Very truly yours,

Richard Filip
Executive Vice President

RF/sml

attachment

cc: Directors, FCUGC
M.W. Wells, Jr.

1

* See Attached Response Sheet

NAME OF DEPOSIT INSURANCE FUND FLORIDA CREDIT UNION GUARANTY CORPORATION, INC.

I. General Information:

1. Type(s) of Financial Institution(s) whose deposits you insure:
Credit unions chartered by the state of Florida

2. In which state(s) do you insure:
Florida

3. A. Cost of initial membership in your fund, if any: 1/2 of 1% of guaranteed shares and deposits.

B. Annual assessments: 1/20th of 1% of guaranteed shares and deposits.

C. Continuing equity contribution or membership deposit: 1/2 of 1% of annual growth of guaranteed shares and deposits.

4. Maximum coverage per account or per depositor: See attached Response Sheet, page 1

5. Do you insure brokered deposits:
Not applicable as credit unions may only accept shares and deposits of members.

6. Number of insured institutions, by type:

A. Under $1 million: 74

B. $1 million to $5 million: 62

C. $5 million to $50 million: 33

D. Over $50 million: 3* *the largest being $ 99,031,475

7. Aggregate amount of deposits insured, by type of institution: $ 813,325,275.00 (as of 12/31/84)

8. Your fund's total useable assets: $ 6,197,535.00 (as of 2/28/85)

9. Ratio of usable insurance fund assets to deposits insured: 76 ¢ per $ 100 of shares guaranteed (as of 2/28/85)

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

The Florida Credit Union Guaranty Corporation, Inc. is a private corporation fully funded by its member credit unions. The Corporation was created by an act of legislature in 1974. A copy of Chapter 657 Part I and Part II is attached.

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

The Florida Department of Banking and Finance, at least annually, examines the books and records of the Florida Credit Union Guaranty Corporation, Inc. The Department of Banking and Finance also reviews the operations of the Corporation as the Department deems necessary.

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or

Chapter 657.258 Florida Statutes (3)(j) reads: "No state funds of any kind shall be allocated or paid to the corporation."

b. authority to assess other insured institutions enough to cover the losses?

See attached Response Sheet, page 1

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

No

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

See attached Response Sheet, page 1

6. **Do you reinsure your risks with any other insurance carriers? Please provide details.**

Reserve funds are considered adequate to cover any losses which may occur. Reinsurance would not assist in responding to liquidity problems of member credit unions.

7. **Regarding your board of directors:**

a. **How is your board of directors selected?**

At each annual meeting, directors are elected by representatives of the member credit unions.

b. **What rules govern the size and composition of the board?**

See attached Response Sheet, page 1

c. **Who are the present members of your board? (Please provide names and principal affiliations.)**

Donald F. Wills, President
Broward Schools Credit Union, Fort Lauderdale, FL 33310

Robert H. Osterland, Vice President
St. Petersburg Municipal Employees Credit Union, St. Petersburg, FL 33705

Walter W. Runge, Secretary
Space Coast Credit Union, Melbourne, FL 32901

Thomas E. Davis, Director
Florida Food Industry Credit Union, Miami, FL 33169

John W. Wallace, Director
Educational Community Credit Union, Jacksonville, FL 32202

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

See attached Response Sheet, page 2

2. Please respond separately for each state in which you insure deposits:

a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

Chapter 657.257 Florida Statutes (4)(c), specifically empowers the Corporation with the right of cancellation of guaranty certificate.

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

See attached Response Sheet, page 2

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

See attached Response Sheet, page 2

3. Please respond separately for each state in which you insure deposits:

a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

See attached Response Sheet, page 3

b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?

See attached Response Sheet, page 3

c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

See attached Response Sheet, page 3

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

See attached Response Sheet, page 3-4

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

See attached Response Sheet, page 4

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?
Chapter 657.260 Florida Statutes (1) The department shall:
(c) Designate and appoint the corporation as liquidating agent for any member credit union.

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process? The primary purpose of the Florida Credit Union Guaranty Corporation, Inc., as stated in the Statutes, reads, in part, "... and to avoid excessive delay in payment of such shares and deposits." The Corporation continues the operation of the credit union as an "on going" business so that members are not denied access to their funds.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?
No. To the contrary, a purchase of assets and an assumption of liabilities is a most valuable tool used by the Florida Credit Union Guaranty Corporation, Inc., and has been highly successful in that the use of such an instrument minimizes losses.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

Refer to response to question 3a immediately above

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

Yes. The ability to continue operating the member credit union imparts a degree of confidence in the membership and also encourages the members to continue payments on the obligations they may have to the credit union.

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date:

a. The name, location, and size of the institution;
See Exhibit 1
b. The total dollar cost of the insolvency to your fund;
See Exhibit 1
c. The dollar amount of insured deposits in the institution at time of closing;
See Exhibit 1
d. The dollar amount of uninsured deposits in the institution;
None
e. The percentage recovery to date to depositors on uninsured deposits;
Not applicable
f. The gross dollar amount of outstanding unpaid depositor claims; and
None
g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

Immediate payment upon member demand

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

1981	$ 3,063,506
1982	3,465,984
1983	4,314,873
1984	5,283,205

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

See attached Response Sheet, page 4

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

Chapter 657.258 Florida Statutes (2) The corporation may:
(j) "Invest its funds in ... and in such other investments, other than investments in credit unions which are members of the corporation ... "

Assets may be loaned or advanced with security by pledge of assets to a member credit union to assist with liquidity problems or to enable immediate withdrawal from share and deposit accounts by members.

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

See attached Response Sheet, page 4

5. Please provide a copy of your latest annual report.

A copy of the Audited Financial Statements and Other Financial Information of the Florida Credit Union Guaranty Corporation, Inc., as of December 31, 1984, as prepared by Ernst and Whinney, Certified Public Accountants, is enclosed.

FLORIDA CREDIT UNION GUARANTY CORPORATION, INC.
SUPPLEMENT TO QUESTIONAIRE OF COMMERCE, CONSUMER
AND MONETARY AFFAIRS SUBCOMMITTE OF THE
COMMITTEE ON GOVERNMENT OPERATIONS

RESPONSE SHEET

- 1 -

* In reviewing the request for information, we note that there are several inferences to financial institution, insure, and the like. Therefore, the responses to your questions are in the context that financial institution means member credit union, insure means guarantee, deposit insurance means Guaranty Corporation, and insurance means guarantee.

Page 1, Part I, General Information

4. $ 100,000 per member or such greater amount as may be approved by the Board of Directors of the Florida Credit Union Guaranty Corporation, Inc. Separate coverage is also afforded to the plan for retirement benefit which qualifies for special treatment under section 401, 403(b), 408 or 457 of the Internal Revenue Code.

Page 2, Part II, Background

3b. Chapter 657.258 (3)(d) Florida Statutes, reads, in part, ". . . the corporation, in the event of potential impairment of the corporation's capital assets, may levy and collect from the member credit unions uniform special assessments in amounts to be determined by the board of directors, subject to approval by the department. . . . such determination shall be submitted in writing to the department, and the special assessment shall be approved, modified, or disapproved, within 60 days . . . "

The Guaranty Corporation has had occasion to impose only one such special assessment. This occurred at the end of its first year of operation and was the result of a loss sustained on a credit union which was insolvent at the time of the effective date of the Guaranty Corporation as a result of transactions predating the organization.

5. A line of credit is in effect with the National Credit Union Central Liquidity Facility, for an aggregate not to exceed 80 % of the Corporation's market value of investments. (It appears that this question is seeking information regarding liquidity. With that in mind, the following is offered.) The member credit unions have available the ability to approach the National Credit Union Central Liquidity Facility (CLF) and borrow up to 50 % of its assets. This availability of funds should be more than adequate to provide sufficient liquidity.

Page 3, Part II, Background

7b. In order to be eligible to be elected or to serve or continue to serve on the board of directors, a person must reside in the state of Florida, and must have served for at least two (2) years as an officer or in a managerial position of an eligible member credit union, and, during the term of office, such person must continue to serve as an officer or in a managerial position of an eligible member credit union and reside in the state of Florida.

Page 4, Part III, Supervision of insured institutions

1. The only "requirements" that are imposed would include that the credit union maintain solvency and maintain reserves in accordance with statutory requirements based on delinquency analysis.

   Regular analyses are made to determine pertinent ratios which are then used as a tool for evaluation of safety and soundness on a comparative basis with other credit unions and for early warning and detection of danger signals. Such analyses include ratio of total reserves to aged delinquencies, ratio of aged delinquencies to loans, ratio of expenses to income and maturity dates of investments.

   The results of these analyses would not constitute "requirements" but are measures to obtain early alert as to the safety and soundness of the credit union and are designed to prevent the likelihood of insolvency.

2b. Discontinuance or cancellation of the Guaranty Certificate would be a drastic action imposed only as a last resort after all efforts to salvage the credit union or to arrange for a purchase and assumption had been unsuccessful. Such action would be taken only where the official family of the credit union was completely uncooperative in other efforts. Factors to be taken into account would include:

   (a) insolvency;

   (b) unsafe or unsound practices, including excessive concentration of loans and investments and long-term or fixed rate, excessive expense ratio, excessive or increasing delinquency factors, and inadequacy of reserves;

   (c) refusal of the credit union to respond to or correct deficiencies noted in an examination report or recommendations from the Guaranty Corporation.

2c. There has not been a specific need for the directors of the Florida Credit Union Guaranty Corporation, Inc. to cancel a Certificate of Guaranty. The usual procedure is for the credit union to enter voluntary or involuntary liquidation, or to seek a merger. From January, 1980, to December, 1984, 29 credit unions liquidated and 23 credit unions merged.

   The liquidations and mergers have required liquidity assistance from the Guaranty Corporation in the total amount of $ 3,577,589; actual losses resulting from advances during the five-year period were a total of $ 116,091.

Page 5, Part III, Supervision of insured institutions

3a. Chapter 657.258 Florida Statutes (2) The corporation may:

(q) Have access to and make audit or examination of all records and information concerning the affairs of a member credit union.

The agreement with the member credit union (copy attached) Paragraph 2d, to permit the Corporation to have access to all records, reports and information concerning the business affairs of the credit union and any examination made by or for the credit union, the Department of Banking and Finance or any other governmental or regulatory authority.

3b. Actually examination of the records of the credit unions are handled by personnel of the Department of Banking. In addition to the regular examinations, the Department conducts special examinations upon request of the Guaranty Corporation. All reports of examination are carefully reviewed for follow up of noted deficiencies and comments. In addition, staff personnel, being 5 in number, are available for special examination of specific areas or problems. Regular semi-annual financial statements are reviewed and analyzed to determine compliance with or deviation from standard ratios for evaluation. Periodic visits are made with each member credit union, with priority being given to those "On the Watch List" or where problems or deficiencies have been detected.

3c. The Department of Banking, which is the financial institution supervisory authority in Florida, routinely provides a copy of each examination report when issued as provided in Section 657.260, Florida Statutes. Preliminary information, before issuance of the examination report, is provided by the Department when a particular problem area of a significant or serious nature is detected by the examiner. This is provided at an early date so that timely remedial action can be taken by the Guaranty Corporation. The Department also has a statutory duty to advise the Guaranty Corporation of any insolvency of a member credit union.

4. No. Chapter 657.026 Florida Statutes charges the Supervisory Committee of a member credit union to "make or cause to be made a comprehensive annual audit of the credit union in accordance with the rules of the department, and also to make or cause to be made such supplementary audits or examinations as it deems necessary or as requested by the board of directors or the department."

Chapter 3C-30.10 of the Rules of the Department of Banking and Finance, read, in part, "The supervisory committee shall make or cause to be made a comprehensive annual audit of the credit union, and shall submit, within 30 days after its completion a detailed report of the results to the board of directors, the Department, and the Corporation. . . . This audit shall be performed by a certified public accountant engaged by the supervisory committee for said purpose, or in the alternative, the supervisory

committee shall complete or cause to be completed the Minimum Audit Procedures Report on Form DBF-C-63." That rule also provides that "The Department shall complete its review of the audit report and notify the credit union and the Florida Credit Union Guaranty Corporation of its acceptance of the report or specific areas of inadequate compliance with minimum audit requirements."

There are at least 36 member credit unions that have their books and records audited and the financial statements certified by CPAs.

5. Upon discovery or detection of any problem area or deficiency, appropriate contact and follow up, by personal visits, telephone and correspondence, are made for inquiry, clarification and remedial action. If the credit union management fails to satisfactorily respond to and resolve the problem areas, then direct involvement of the board of directors and supervisory committee of the credit union is required.

If the credit union fails to correct the deficiency by taking appropriate remedial actions or persists in operating in an unsafe and unsound manner, and if the credit union is insolvent, the corporation may assume control of the credit union and manage its operations for a period of up to 6 months. Within that period, a determination is made as to whether to turn the credit union back over to management by the members or to proceed with liquidation. During the period of assumption of control, the Guaranty Corporation acts as the board of directors, credit committee and supervisory committee of the credit union.

Page 7, Part V, Insurance Fund Reserves

2. Composition and Market Value, by type of Insurance Fund assets

Prudential Bache Investment Other	$ 286,320.00	
Bank CDs	700,000.00	(limited to $ 100,000 in any one bank)
Credit Union CDs	200,000.00	(limited to $ 100,000 in any one credit union)
Treasury Bills	808,291.00	
Treasury Notes	1,249,504.00	
FNMA	799,815.00	
Advances to Credit Unions	1,894,687.00	
Mortgages Receivable	171,912.00	
TOTAL	$ 6,110,529.00	

4. Average Yield from Interest, Dividends, etc.

1984	9.83 %
1983	10.35 %
1982	12.61 %
1981	12.08 %

50-923 O—85——25

EXHIBIT 1
Reply to Part IV, Payment of Losses
Question 4a, 4b, 4c

FLORIDA CREDIT UNION GUARANTY CORPORATION, INC.
JANUARY, 1980 - DECEMBER, 1984

NAME	LOCATION	ASSETS	ACTUAL COSTS	TOTAL SHARES
Bay County Employees	Panama City, FL	$ 373,720	$ 16,835	$ 300,000
Central Florida State Emp.	Orlando, FL	139,070	9,292	117,607
Dept. of Natural Resources	Tallahassee, FL	810,726	21,150	695,544
Florida Physicians	Sanford, FL	17,704	44	19,378
Lake City & Columbia County	Lake City, FL	103,738	5,563	110,705
Musicians	Miami, FL	132,776	2,738	71,620
Sacred Heart Hospital Emp.	Pensacola	294,924	25,674	15,645
Stromberg-Carlson	Sanford, FL	201,919	29,146	134,914
Ernie Burt Memorial	Tampa, FL	475,750	5,649	423,591

Audited Financial Statements
and Other Financial Information

Florida Credit Union Guaranty Corporation, Inc.

December 31, 1984

Ernst & Whinney

Audited Financial Statements
and Other Financial Information

FLORIDA CREDIT UNION GUARANTY CORPORATION, INC.

December 31, 1984

Audited Financial Statements

BOARD OF DIRECTORS AND EXECUTIVE VICE PRESIDENT

FLORIDA CREDIT UNION GUARANTY CORPORATION, INC.

BOARD OF DIRECTORS

Donald F. Wills, President

Robert H. Osterland, Vice President

Walter W. Runge, Secretary

John W. Wallace

Thomas E. Davis

EXECUTIVE VICE PRESIDENT

Richard Filip

Ernst & Whinney Certified Public Accountants

332 North Magnolia Avenue
P.O. Box 3426
Orlando, Florida 32802

305/841-2050

Board of Directors
Florida Credit Union
Guaranty Corporation, Inc.
Orlando, Florida

We have examined the balance sheets of Florida Credit Union Guaranty Corporation, Inc. as of December 31, 1984 and 1983, and the related statements of revenues and expenses, members' equity and reserves and changes in financial position for the years then ended. 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.

In our opinion, the financial statements referred to above present fairly the financial position of Florida Credit Union Guaranty Corporation, Inc. as of December 31, 1984 and 1983, and its revenues and expenses and changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Ernst & Whinney

Orlando, Florida
January 4, 1985

BALANCE SHEETS

FLORIDA CREDIT UNION GUARANTY CORPORATION, INC.

	December 31 1984	1983
ASSETS		
CURRENT ASSETS		
Cash and certificates of deposit	$ 619,847	$ 631,514
United States government and agency securities--at amortized cost, maturing within one year (market value--$2,518,920 for 1984 and $1,668,099 for 1983)	2,494,271	1,624,200
Advances to credit unions (less allowances for uncollectible advances of $35,283 in 1984 and $-0- in 1983)--Note B	1,735,343	93,341
Bond claim receivable		166,000
Accrued interest receivable	50,492	60,342
Mortgage loan receivable--amount due within one year--Note C	5,767	5,141
Prepaid expenses and other current assets	10,246	14,036
TOTAL CURRENT ASSETS	4,915,966	2,594,574
PROPERTY AND EQUIPMENT--at cost, less allowance for depreciation--Note D	57,133	76,140
OTHER ASSETS		
Mortgage loan receivable, less amount due within one year--Note C	167,073	123,082
United States government and agency securities--at amortized cost, long-term (market value--$202,170 for 1984 and $1,606,117 for 1983)	200,166	1,597,216
	367,239	1,720,298
	$5,340,338	$4,391,012
LIABILITIES AND MEMBERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 7,948	$ 5,449
Accrued expenses and other current liabilities	2,331	3,267
TOTAL CURRENT LIABILITIES	10,279	8,716
DEFERRED SUPPLEMENTAL RETIREMENT BENEFITS--Note I	19,233	16,455
MEMBERS' EQUITY AND RESERVES		
Equity membership fees--Note A	3,727,159	3,154,432
Statutory loss reserve--Note A	372,258	
Reserve for losses and liquidation expense--Note A	1,211,409	1,211,409
	5,310,826	4,365,841
	$5,340,338	$4,391,012

See notes to financial statements.

STATEMENTS OF REVENUES AND EXPENSES

FLORIDA CREDIT UNION GUARANTY CORPORATION, INC.

	Year Ended December 31 1984	1983
Revenues:		
Member assessments--Note A		$296,431
Interest income	$475,894	381,573
Fee income		54,690
Other		19,894
	475,894	752,588
Expenses:		
Administrative and general	361,587	288,442
Provision for losses on advances to credit unions	126,701	7,334
	488,288	295,776
REVENUES (LESS THAN) IN EXCESS OF EXPENSES--NOTE G	$(12,394)	$456,812

See notes to financial statements.

STATEMENTS OF MEMBERS' EQUITY AND RESERVES

FLORIDA CREDIT UNION GUARANTY CORPORATION, INC.

	Equity Membership Fees	Statutory Loss Reserve	Reserve for Losses and Liquidation Expense	Total
Balance at January 1, 1983	$2,760,766		$ 754,597	$3,515,363
Membership fees (net of $54,690 transferred to income for liquidated credit unions).	393,666			393,666
Excess of revenues over expenses			456,812	456,812
Balance at December 31, 1983	3,154,432		1,211,409	4,365,841
Membership fees	602,440			602,440
Annual statutory assessments paid by member credit unions		$354,939		354,939
Membership fees of liquidated credit unions transferred to statutory loss reserve	(29,713)	29,713		
Excess of expenses over revenues		(12,394)		(12,394)
	$3,727,159	$372,258	$1,211,409	$5,310,826

See notes to financial statements.

STATEMENTS OF CHANGES IN FINANCIAL POSITION

FLORIDA CREDIT UNION GUARANTY CORPORATION, INC.

	Year Ended December 31 1984	1983
SOURCES OF WORKING CAPITAL		
Revenues (less than) in excess of expenses	$ (12,394)	$ 456,812
Charges to expense not requiring working capital--depreciation of property and equipment	20,042	19,605
TOTAL FROM OPERATIONS	7,648	476,417
Membership fees	602,440	393,666
Statutory assessments paid by member credit unions	354,939	
Disposal of property and equipment		11,510
Increase in liability for supplemental retirement benefits	2,778	5,116
Transfer of long-term investments maturing currently	1,497,050	
Transfer of mortgage loan receivable to amount due within one year	5,767	5,141
	2,470,622	891,850
APPLICATIONS OF WORKING CAPITAL		
Purchase of long-term investments in United States government and agency securities	100,000	1,297,216
Additions to property and equipment	1,035	38,808
Additions to mortgage loan receivable	49,758	
	150,793	1,336,024
INCREASE (DECREASE) IN WORKING CAPITAL	$2,319,829	$ (444,174)
CHANGES IN COMPONENTS OF WORKING CAPITAL		
Increase (decrease) in current assets:		
Cash and certificates of deposit	$ (11,667)	$ 122,275
United States government and agency securities	870,071	(485,800)
Advances to credit unions	1,642,002	(70,367)
Bond claim receivable	(166,000)	
Other	(13,014)	(9,299)
	2,321,392	(443,191)
Increase (decrease) in current liabilities:		
Accounts payable	2,499	980
Other	(936)	3
	1,563	983
INCREASE (DECREASE) IN WORKING CAPITAL	$2,319,829	$ (444,174)

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

FLORIDA CREDIT UNION GUARANTY CORPORATION, INC.

December 31, 1984

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General: The Florida Credit Union Guaranty Corporation, Inc. was incorporated in 1974 under applicable laws of the State of Florida. The corporation was created for the purpose of providing protection of individuals' share and deposit accounts in member credit unions through detection and prevention of credit union insolvencies or liquidations. The standard guarantee amount per individual is $100,000. Upon application, an increased guarantee amount may be approved by the Board of Directors. Eight credit unions have been approved for increased guarantees of varying amounts up to $300,000. The upper limit of guaranty is set based on the Board of Directors discretion.

Equity Membership Fees: Member credit unions pay an initial equity membership fee at the rate of .5% of its guaranteed shares and deposits as of the date of application for membership. Thereafter, each member credit union must pay a growth membership fee in an amount equal to .5% of the annual increase in its guaranteed shares and deposits determined as of December 31, of each year. These fees are recognized as members' equity capital contributions under the requirements of section 657 Florida Statutes and will be refunded to the member credit union when it withdraws from membership in the Corporation if certain conditions are met.

Member Assessments, Statutory Loss Reserve and Reserve for Losses and Liquidation Expense: Annual assessments are charged to member credit unions in an amount to be determined by the Board, not to exceed .05% of the member credit union's guaranteed shares and deposits as determined as of December 31 of the preceding year. Such assessments are recorded as revenue in 1983. In 1984, section 657.258 Florida Statutes became law and required member assessments and nonrefundable fees of liquidated and withdrawing member credit unions to be credited to the Statutory Loss Reserve. The statute requires the excess of expenses over revenues to be charged against the Statutory Loss Reserve under certain conditions. The Statutory Loss Reserve will be refunded to the member credit unions if certain conditions are met. Reserve for Losses and Liquidation Expense represents the accumulation of the Corporation's excess of revenues over expenses from incorporation through December 31, 1983. The Reserve for Losses and Liquidation Expense plus the Statutory Loss Reserve represents the total amount appropriated for possible losses and liquidation expenses incurred on behalf of member credit unions.

Provision for Losses: Provision for estimated losses on advances to credit unions is recorded as expense when management believes such advances will not be collected in the ordinary course of operations.

Investments: The Corporation generally invests in United States government and agency obligations. It is management's intention to hold these investments until maturity.

NOTES TO FINANCIAL STATEMENTS--Continued

FLORIDA CREDIT UNION GUARANTY CORPORATION, INC.

NOTE B--ADVANCES TO CREDIT UNIONS

In connection with its guarantee of individual share and deposit accounts in member credit unions, the Corporation, from time to time, advances funds to credit unions experiencing financial difficulties. Advances are repaid at such times as the troubled credit union's financial condition is restored or, in the case of liquidation or merger of a troubled credit union, as collections or liquidations are made on that credit union's assets. Any advance which is not considered by management to be collectible is written off in the year such determination is made.

NOTE C--MORTGAGE LOAN RECEIVABLE

The Corporation is mortgagee on two notes secured by real property. One mortgage bears interest at the rate of 8.5% and has scheduled contractual repayments through October 1997. The other mortgage bears interest at 13.25% and has scheduled contractual repayments through April 2013.

NOTE D--PROPERTY AND EQUIPMENT

Depreciation has been computed using the straight-line method. The estimated useful lives of property and equipment range from three to ten years. Property and equipment are summarized as follows:

	1984		1983	
	Cost	Allowance for Depreciation	Cost	Allowance for Depreciation
Furniture and equipment	$ 82,350	$38,823	$ 80,440	$27,677
Automobiles	26,607	13,001	27,482	4,105
	$108,957	$51,824	$107,922	$31,782
Carrying Amount		$57,133		$76,140

NOTE E--LINES OF CREDIT

At December 31, 1984 the Corporation had available the following lines of credit:

A line of credit with a commercial bank for 85% of the Corporation's investments, generally U.S. Government and Agency securities, at the bank's prime rate of interest collateralized by an assignment of the investments. The maximum amount of the line at December 31, 1984 was approximately $2,780,000.

NOTES TO FINANCIAL STATEMENTS--Continued

FLORIDA CREDIT UNION GUARANTY CORPORATION, INC.

NOTE E--LINES OF CREDIT--Continued

A line of credit with the Central Liquidity Facility (CLF) of the National Credit Union Administration for up to 50% of a liquidating credit union's total shares and deposits, with a maximum aggregate line not to exceed 80% of the Corporation's market value of investments available to be used as collateral, whichever is less. The interest rate would be based on CLF's prevailing rate at the time of disbursement. The maximum amount of the line at December 31, 1984 was $2,600,000.

At December 31, 1984 the Corporation had no outstanding borrowings under either of these lines of credit.

NOTE F--CONTINGENCIES

The Corporation has entered into agreements with various credit unions for the repurchase of loans which were sold to those credit unions, if the loans subsequently become delinquent. At December 31, 1984, the total of loans subject to repurchase agreements approximates $80,000. If any loans are repurchased, the Corporation will acquire the rights of collection on the loans. No provision has been made in the accompanying financial statements for any loss which may result if the Corporation fails to collect the loans in full.

In 1984 the Corporation found one of the member credit unions experiencing liquidity problems. Pursuant to directions of the Department of Banking and Finance the Corporation assumed control of the credit union and has advanced $1,650,000 as of December 31, 1984. No specific allowance for advance loss has been established. It is management's opinion that the amount of any future loss incurred will not materially affect the financial condition of the Corporation.

During 1983, the Corporation developed a method whereby a member credit union could avoid undesirable mergers or liquidations and/or an insolvent credit union would be given sufficient time to become a self-supporting institution. This method, called a guaranty agreement, can be used when a member credit union is, or may become, insolvent as defined by Florida Statutes. The agreement requires the Corporation to pay to the credit union the amount of the guaranty account upon liquidation of the credit union. As of December 31, 1984, the Corporation had no guaranty agreements outstanding.

NOTES TO FINANCIAL STATEMENTS--Continued

FLORIDA CREDIT UNION GUARANTY CORPORATION, INC.

NOTE G--INCOME TAXES

The Corporation was exempt from federal income taxes by the Internal Revenue Service (IRS) under Section 501(c)(6) of the Internal Revenue Code prior to January 1, 1984. Under a revenue ruling issued by the IRS, the exempt status of all state share guaranty/insurance corporations expired December 31, 1983. The Corporation, beginning January 1, 1984, is a corporate entity taxable under regulations of the IRS. The Corporation had no taxable income for 1984.

Investment tax credit, which is not material, is accounted for using the flow-through method.

NOTE H--RELATED PARTY TRANSACTIONS

All of the directors of the Corporation are associated with credit unions which are members of the Corporation. All membership and assessments fees paid by these credit unions are calculated on the same basis as those for other member credit unions.

NOTE I--RETIREMENT PLAN AND DEFERRED SUPPLEMENTAL RETIREMENT BENEFITS

The Corporation has a defined contribution retirement plan covering substantially all employees. The Corporation makes annual contributions to the plan equal to 5% of each participant's compensation, not to exceed amounts specified in applicable Internal Revenue Service regulations.

The Corporation has also agreed to establish a liability for deferred supplemental retirement benefits for the executive Vice President equal to 10% of regular annual compensation, plus an additional amount based on the average rate of earnings on the Corporation's investments. The liability is not funded.

Total expense for the defined contribution retirement plan was $5,280 in 1984 and $4,080 in 1983. Total expense for the deferred supplemental retirement benefit was $5,825 in 1984 and $5,116 in 1983.

1

NAME OF DEPOSIT INSURANCE FUND: Georgia Credit Union Deposit Insurance Corporation

I. General Information:

1.	Type(s) of Financial Institution(s) whose deposits you insure:	Credit unions and savings and loan associations
2.	In which state(s) do you insure:	Georgia
3. A.	Cost of initial membership in your fund, if any:	1% of the first $1 Million of deposits & dividends payable, plus ½% of the next $4 Million, plus ¼% of all deposits & dividends payable in excess of $5 M.
B.	Annual premium:	1/12% of total deposits and dividends payable
C.	Continuing equity contribution or membership deposit:	Yes. Must be maintained at level shown un "A" through annual assessments. Refunds made for declines.
4.	Maximum coverage per account or per depositor:	$100,000 per account. $100,000 per depositor for interests in all individual accounts. $100,000 per depositor for all interests in joint accounts.
5.	Do you insure brokered deposits:	Yes

6. Number of insured institutions, by type:	Credit Unions	Savings & Loans
A. Under $100 million:	126	8
B. $100 million to $500 million:	3	
C. $500 million to $1 billion:		
D. Over $1 billion:		

7.	Aggregate amount of deposits insured, by type of institution:	$800 Million in credit unions $100 Million in savings & loans
8.	Your fund's total useable assets:	$7.6 Million
9.	Ratio of usable insurance fund assets to deposits insured:	.84%

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

A private corporation set up under an Enabling Act of the 1974 Georgia General Assembly (copy attached)

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

Georgia Department of Banking & Finance

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or

No

b. authority to assess other insured institutions enough to cover the losses?

Up to 1% of deposits insured

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

No

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

Approximately $5.4 Million with the CLF and $1 Million with the National Bank of Georgia, the latter soon to be increased to approximately $10 Million

6. Do you reinsure your risks with any other insurance carriers? Please provide details.

No

7. Regarding your board of directors:

a. How is your board of directors selected? Elected by the membership for staggered 3-year terms. All directors must be directors and officers of insured financial institutions.

b. What rules govern the size and composition of the board?

The above Board composition and the number of seats - currently set at seven - are spelled out in our bylaws, a copy of which is attached.

c. Who are the present members of your board? (Please provide names and principal affiliations.)

Eloise A. Woods, Chairman
Georgia Telco Credit Union

George E. Williams, Vice Chairman
Delta Employees' Credit Union

Vercie T. Cason, Secretary
Valdosta Onized Credit Union

J. Norman Smith, Treasurer
Rich's Employees' Credit Union

Moses M. Spence, Director
Atlanta Postal Credit Union

Frank Groce, Director
Federal Employees' Credit Union (Macon)

Janice E. Miller, Director
Sea Island Employees' Credit Union

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

We have adopted the Georgia Department of Banking's safety and soundness policies:

6% capital/asset ratio; 15% minimum liquidity; reserve/risk asset ratio of 7½%; reserve transfer level of 7½% of gross income. In addition, we have our own share dollar minimum value of $1.05.

2. Please respond separately for each state in which you insure deposits:

a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

By statute

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

Non-payment of fees. Careless or unsound practices or mismanagement.

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

None

3. Please respond separately for each state in which you insure deposits:

   a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

   Yes. Both the power to examine and the power to request the Georgia Department of Banking to conduct a special examination.

   b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget? We do not examine but rather rely on the examinations performed by the Georgia Department of Banking as set out in 3-C below:

   We have a computerized EWS in place that makes use of 5 years of detailed, accurate information on our financial institutions. Results are shared with the Department of Banking for their independent verification.

   c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis? We have statutory right to copies of the examination reports produced yearly on each insured financial institution by the Georgia Department of Banking. This report, and the examination process that produces it, are considered excellent models throughout the country.

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

   Yes. Annually. Many use internal auditors in liew of outside auditors. We have access to copies of all reports.

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

   Powers are wide-ranging. With or without the concurrence of the Department of Banking, we may order corrective action, remove boards or management, initiate and supervise conservatorships, institute liquidations, and arrange mergers. We have the right to serve as liquidation agent and the Department of Banking so appoints us.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

Yes

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process? Pay-off is immediate - subject only to verification of account balances, a process that can take as long as two weeks.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

No. Rehabilitation, merger, and purchase and assumption routes are all three open to us.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

Yes

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

Yes

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date: Please see attached schedule and comments below:

a. The name, location, and size of the institution;

b. The total dollar cost of the insolvency to your fund;

c. The dollar amount of insured deposits in the institution at time of closing;

d. The dollar amount of uninsured deposits in the institution;
All accounts were insured

e. The percentage recovery to date to depositors on uninsured deposits;

f. The gross dollar amount of outstanding unpaid depositor claims; and
Depositors received 100% pay-off

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

No longer than 2 weeks. Most accomplished within 48 hours.

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

12/31/81 - $2.3 Million
12/31/82 - $3.8 Million
12/31/83 - $4.8 Million
12/31/84 - $6.1 Million
1/31/85 - $7.6 Million

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

As of 1/31/85:		Total
	U. S. Treasury Bills	$ 613,071
	Federally insured deposits in banks, S&L's and CU's	5,357,561
	*GNMA	30,681
	*Patriot II Ship Financing Bond	100,000
	Miscellaneous	100
		$6,101,413

* Purchased with a resell agreement as part of a package of assistance to a member credit Union.

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

No

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

1981 - 13.3%
1982 - 12.3%
1983 - 9.4%
1984 - 10.0%

5. Please provide a copy of your latest annual report.

Audit by Ernst & Whinney as of 12/31/84 currently being completed. A copy of our unaudited financial statement for 12/31/84 is enclosed, as is our Annual Report for 1983.

IV. Payment of Losses: 4

GEORGIA CREDIT UNION DEPOSIT INSURANCE CORPORATION

(State Share Insurance Corporation)

CLAIMS PAID, RECOVERIES, AND LOSSES SINCE INCEPTION

Credit Union Name	CU Deposits/ Amt. Uninsured	Date Merged/ Liquidated	Reason For Merger/Liquidation	$ Gross Sums Expended	Date (Yr.) Expended	$ Amount Recovered	Date (Yr) Recovered	Add'l. Recovery Anticipated
SAV Employees' Credit Union Atlanta, Georgia	$170,000 / -0-	9/20/76	sponsor went out of business	$139,158.00	1976	$136,783.00	'77-92,693.00 '78-30,090.00 '79- 8,000.00 '80- 6,000.00	- 0 -
Augusta Plant, TRW United Greenfield Divisions, ECU Augusta, Georgia	$ 65,000 / -0-	9/13/78	small cu suffered massive embezzlement over short period of time	$ 74,737.00	1978	$ 73,382.00	'79-16,037.00 '80-57,345.00	- 0 -
TEXACOTE Credit Union Dalton, Georgia	$ 28,000 / -0-	3/05/80	layoffs in textile industry	$ 28,769.00	1980	$ 28,769.00	1980	- 0 -
WeaReRel Credit Union Columbus, Georgia	$100,000 / -0-	3/19/80	reorganization of sponsor	$ 13,250.00	1980	$ 2,312.00	'81- 1,004.00 '82- 801.00 '83- 507.00	$1,000.00
DDI Employees' Credit Union Dalton, Georgia	$ 14,000 / -0-	7/29/80	sponsor went out of business	$ 7,616.00	1980	$ 7,616.00	1982	- 0 -
Marion Manufacturing Credit Union Atlanta, Georgia	$ 13,784 / -0-	5/15/81	small cu - largest borrower files bankruptcy	$ 19,799.00	1981	$ 12,500.00	1983	$ 585.06
Presbyterian Center Credit Union Atlanta, Georgia	$134,320 / -0-	3/03/83	sponsor reorganization/layoffs	$ 10,071.55	1983	$ 165.48	1983	$2,071.00
TOTALS	$525,104 / -0-			$293,400.55		$261,527.48		$3,656.06

* * * U N A U D I T E D * * *

GEORGIA CREDIT UNION DEPOSIT INSURANCE CORPORATION

COMPARATIVE BALANCE SHEET

DECEMBER 31, 1984 AND DECEMBER 31, 1983

	December 31, 1984	December 31, 1983
ASSETS:		
Cash	$ 14,599.33	$ 8,772.60
Investments	6,084,792.29	4,276,713.49
Accrued Investment Income	10,023.45	51,948.92
Liquidation Receivables	6,896.93	6,943.17
Membership Fee Receivable	36,440.85	482,262.75
Prepaid Expenses & Miscellaneous	7,912.00	13,277.50
Fixed Assets	20,668.18	12,568.25
TOTAL ASSETS	$6,181,333.03	$4,852,486.68
LIABILITIES, RESERVES & CAPITALIZATION:		
LIABILITIES:		
Accounts Payable	$ 3,833.06	$ 125,248.64
Accrued Payroll Taxes	2,207.98	2,891.12
TOTAL LIABILITIES	$ 6,041.04	$ 128,139.76
RESERVES & CAPITALIZATION:		
Membership Fee Equity	$2,737,885.41	$2,110,559.28
Reserve Fund	3,437,406.58	2,613,787.64
TOTAL RESERVES & CAPITALIZATION	$6,175,291.99	$4,724,346.92
TOTAL LIABILITIES, RESERVES & CAPITALIZATION	$6,181,333.03	$4,852,486.68

* * * U N A U D I T E D * * *

GEORGIA CREDIT UNION DEPOSIT INSURANCE CORPORATION

COMPARATIVE STATEMENT OF INCOME & EXPENSE

	December 31, 1984	January Thru December, 1984	January Thru December, 1983
Premium Income	$51,912.24	$426,180.59	$334,316.78
Investment Income	45,456.51	553,467.70	361,092.12
Liquidation Income	.00	.00	.00
Other Income	.00	110.00	80.00
TOTAL INCOME	$97,368.75	$979,758.29	$695,488.90
Less: Total Operating Expenses	15,360.65	156,139.44	133,017.00
NET INCOME	$82,008.10	$823,618.85	$562,471.90
Ratio of Total Expense to Total Income	15.8%	15.9%	19.1%

* * * UNAUDITED * * *

GEORGIA CREDIT UNION DEPOSIT INSURANCE CORPORATION

SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 1984

Corporate Money Market/Savings Accounts:

Anchor Savings Bank		$ 101,689.29
First Georgia		326,746.72
Fulton Federal Savings & Loan		2,866.13
Georgia Federal Savings & Loan		385,196.04
National Bank of Georgia		1,126,486.62
C & S National Bank		276,560.11
Trust Company Bank		937,793.28
First National Bank of Atlanta		940,390.26
Georgia Central Credit Union (Overnight Account)		48,000.00
Georgia Central Credit Union:	Daily/Monthly Share Account	4,599.84
	Permanent Capital Base Account	180,000.00
GNMA Certificate No. 5140		30,738.78
Patriot II Ship Financing Bond No. Ser. B		100,000.00
International Share & Deposit Guaranty Association, Inc.		100.00
U. S. Treasury Bills		608,625.22

* * * CERTIFICATES * * *

C & S National Bank	7.950%, due 03/28/85	$ 265,000.00	$ 265,000.00
Fulton Federal Savings & Loan	10.200%, due 05/04/85	$ 100,000.00	$ 100,000.00
Bank South	8.250%, due 03/27/85	$ 200,000.00	$ 200,000.00
Georgia Central Credit Union	8.100%, due 03/27/85	$ 100,000.00	
	8.100%, due 03/28/85	100,000.00	$ 200,000.00
Georgia Federal Savings & Loan	10.700%, due 02/23/85	$ 100,000.00	$ 100,000.00
Trust Company Bank	10.250%, due 02/19/85	$ 150,000.00	$ 150,000.00
	TOTAL CERTIFICATES	$1,015,000.00	
	TOTAL INVESTMENTS		$6,084,792.29

1983 ANNUAL REPORT

GEORGIA CREDIT UNION DEPOSIT INSURANCE CORPORATION

2990 Brandywine Road, Suite 220
Atlanta, Georgia 30341

CONTENTS / ANNUAL MEETING

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ANNUAL MEETING

April 12, 1984
5:00 P.M.
McIntosh Room
Heritage House Best Western Hotel
Albany, Georgia

ANNUAL MEETING AGENDA

1. Opening-Determination of Quorum
2. Adoption of Agenda
3. Approval of 1983 Minutes
4. Reports to the Membership
5. Old Business
6. New Business
7. Elections of Directors
8. Adjournment

DIRECTORS / STAFF

DIRECTORS

	TERM EXPIRES
Eloise A. Woods, Chairman Georgia Telco Credit Union, Atlanta	1985
George E. Williams, Vice Chairman Delta Employees' Credit Union, Atlanta	1985
Vercie T. Cason, Secretary Valdosta Onized Credit Union, Valdosta	1984
J. Norman Smith, Treasurer Rich's Employees' Credit Union, Atlanta	1986
Moses M. Spence, Director Atlanta Postal Credit Union, Atlanta	1986
Frank L. Groce, Director Federal Employees' Credit Union, Macon	1984

STAFF

John E. Martin, President
Assistant Treasurer/Board

E. Diane Rolin, Executive Administrative Assistant
Assistant Secretary/Board

Martha H. Tarrant, Administrative Assistant

LEGAL COUNSEL

Richard P. Kessler, Jr., Partner, Macey & Sikes, Atlanta, Ga.

AUDITORS

Ernst & Whinney, Atlanta, Ga.

FROM THE BOARD OF DIRECTORS . . . .

As in the past eight years, we are pleased to inform you that the Georgia Credit Union Deposit Insurance Corporation, for the ninth consecutive time since it began business, has completed a year of progress and growth in the vital task it performs for its member financial institutions.

Some of the highlights of 1983 are:

INCREASED assets over $1 million

PAID premium rebates of more than $123,000

RETAINED earnings of almost $563,000

PROVIDED deposit insurance protection to a total of 133 financial institutions, whose potential membership is more than one million Georgians.

These 1983 achievements were especially gratifying to us who serve on your Board of Directors for two reasons: first, they occurred in a year that has been a time of profound change in the financial institutions industry; and, secondly, our 1983 record, when added to the exceptional growth of the previous eight years, positions the Corporation to wind up its first decade at the end of 1984 with a record of accomplishment and service to its members that few, if any, of the other deposit insurers, private or federal, can match.

We are convinced that since the beginning of the GCUDIC, our insured financial institutions have been better able to adapt to the rapidly changing requirements of the market place because they have had the strength of the Corporation behind them. It is the pledge of this Board that the Georgia Credit Union Deposit Insurance Corporation will continue to play this role in future years.

Eloise A. Woods, Chairman

FROM THE PRESIDENT . . . .

During 1983, management and staff of the Georgia Credit Union Deposit Insurance Corporation continued to devote much time and energy to tasks we have engaged in since the early days of the Corporation. Three of these tasks - monitoring our insured financial institutions, assisting those with problems or questions, and serving as merger/liquidation agent - together with numerous special projects and managing the International Share & Deposit Guaranty Association, kept everyone busy throughout the year.

As to the monitoring - our most important activity - we reported to you last year on the purchase of a micro computer. The software we customized for this machine during 1983 allowed us to store call report data on all of our financial institutions. Our Early Warning System proved its value on more than one occasion to both the Corporation and the Department of Banking by accurately red-flagging serious problems. We anticipate making additional refinements in these programs and plan to share these findings on a regular basis with the credit unions and savings and loan associations the Corporation insures. Analysis of insured financial institutions at year-end 1983 reveals an average solvency ratio up considerably over the previous year-end's solid figure, while during the same time period, the average capital-to-asset ratio, which has declined drastically in many parts of the country, rose .3% to a remarkable 11.1%.

The year saw one voluntary liquidation, two mergers, and two purchase and assumptions. Although the five credit unions involved totalled approximately $1.7 million in assets, less than $11,000 in Corporate funds were expended in all of these operations combined. The GCUDIC has no further liability in any of the five, and there is a strong possibility we will recover some of the funds expended. Since inception, the GCUDIC has paid seven claims amounting in the aggregate to $293,000. The Corporation has recovered 89% of this money, and anticipates additional recovery. This is an enviable record of achievement, and the GCUDIC's cumulative loss ratio - 1.2% of all dollars of annual premiums collected since we began business - is by far the best in the deposit insurance industry, private or federal.

Throughout 1983, management and staff of the Corporation have frequently turned to outside groups and individuals for assistance of one sort or another. Corporate Counsel Richard P. Kessler and auditors from the firm of Ernst & Whinney have given valuable advise. The Corporation has worked closely with the Georgia Credit Union Affiliates. The continuing cooperation between the GCUDIC and the Department of Banking remains the key external relationship in insuring that our programs meet the needs of our member financial institutions. The record of Commissioner E. D. Dunn and Deputy Commissioners Robert M. Moler and Charles W. Burge, especially their ability to deal with troubled or failed institutions, is unmatched in the country.

Our greatest debt in 1983 as in previous years, however, remains to the financial institutions we insure. Enthusiastic member support and the high quality of member operations make our work possible.

John E. Martin, President

MEMBER FINANCIAL INSTITUTIONS

NAME	LOCATION	MEMBER GDIC
A D CO Employees' Credit Union	Atlanta	1976
AGH Employees' Credit Union	Athens	1975
AMILSCO Credit Union	Atlanta	1977
AMOCO Fabrics Company Credit Association	Bainbridge	1975
ARMCO Credit Union	Atlanta	1977
Albany Federal Employees' Credit Union	Albany	1975
Amarlite Employees' Credit Union	Atlanta	1980
Associated Grocers Credit Union, Inc.	College Park	1977
Athens Division Credit Union	Athens	1975
Atlanta City Employees' Credit Union	Atlanta	1975
The Atlanta Coca Cola Bottling Company Employees' CU	Atlanta	1976
Atlanta Cooperative Credit Association	Atlanta	1975
Atlanta Postal Credit Union	Atlanta	1975
Atlanta Railway Postal Clerks Credit Union	Atlanta	1975
Atlanta Teachers Credit Union	Atlanta	1982
Attapulgus Employees' Credit Union	Attapulgus	1981
W. C. Bradley Employees' Credit Association	Columbus	1975
C.C.B.E. Employees' Credit Union	Jonesboro	1977
Calhoun Gordon County Educators' Credit Union	Calhoun	1978
Callaway Gardens Credit Association	Pine Mountain	1977
Central Ogeechee River Educators (CORE) Credit Union	Statesboro	1975
Champion Employees' Credit Association	Monroe	1977
Christian Churches Credit Union	Warner Robins	1980
Chevron Southern Credit Union	Atlanta	1976
City Employees' Credit Union	Macon	1978
C-Mar Credit Union	Marietta	1975
Cobb County Savings & Loan Association	Marietta	1981
Columbus Coca Cola Employees' Credit Union	Columbus	1978
Columbus Health & Hospital Credit Union	Columbus	1978
Columbus Regional Hospital Credit Union	Columbus	1975
Concrete Credit Union	Macon	1980
Crown Crafts, Inc. Employees' Credit Union	Calhoun	1976
Cumberland Credit Association	Chatsworth	1981
Dairy-Pak Athens Credit Union	Athens	1978
Davis Employees' Credit Association	Thomasville	1978
Day Company, Inc. Employees' Credit Union	Cuthbert	1981
Decatur Employees' Credit Union	Decatur	1979
Decatur Postal Employees' Credit Union	Decatur	1975
Decatur Teachers Credit Union	Decatur	1977
Delta Employees Credit Union	Atlanta	1975
Dixisteel Credit Union	Tallapoosa	1975
Doctors Hospital Employees Credit Union	Tucker	1975
East Point Municipal Employees' Credit Union	East Point	1975
Educator's Credit Union	Athens	1975
Employees' Credit Union, c/o NEW SIPCO, INC.	Moultrie	1977
Employees' Credit Union, Swift and Company	Atlanta	1976
Engelhard Employees' Credit Union	McIntyre	1980
Ethicon Credit Union	Cornelia	1979

NAME	LOCATION	MEMBER GDIC
Family Lines Credit Union of Savannah	Savannah	1975
Federal Employees Credit Union	Macon	1975
First Columbia Savings & Loan Association	Augusta	1983
Flowers Employees' Credit League	Thomasville	1975
Floyd County Postal Employees' Credit Union	Rome	1978
Ft. McPherson Credit Union	Ft. McPherson	1977
Freeport Kaolin Employees' Credit Union	Gordon	1979
GPA Credit Union	Savannah	1983
GPC Credit Association	Atlanta	1975
GTA Credit Union	Atlanta	1975
Gas Light Employees' Credit Union	Columbus	1977
Gaylord Employees' Credit Union	Doraville	1975
Genuine Parts Credit Union	Norcross	1977
Georgia DOT Credit Union	Atlanta	1975
Georgia Department of Public Safety Credit Union	Atlanta	1975
Georgia E.S.A. Credit Union	Atlanta	1976
Georgia Kaolin Employees' Credit Union	Dry Branch	1975
Georgia State Department of Education Credit Union	Atlanta	1975
Georgia Telco Credit Union	Atlanta	1975
Georgia-Tennessee Mining & Chemical Employees' CU	Wrens	1977
HCH Employees' Credit Union	Gainesville	1975
Hapeville Employees' Credit Union	Hapeville	1979
Harris Employees' Credit Union	Cordele	1975
Health Center Credit Union	Augusta	1976
Health Employees Chatham County Credit Union	Savannah	1975
Hospital Authority Employees' Credit Union	Atlanta	1975
IBEW Local 613 Credit Union	Atlanta	1980
Journal-Constitution Employees' Credit Union	Atlanta	1975
Keenan Credit Union	Albany	1977
Kennestone Regional Credit Union	Marietta	1981
Kraft Employees' Credit Union	Decatur	1977
Laundrers & Cleaners Credit Union	Griffin	1979
Macon Firemen's Credit Union	Macon	1977
Macon Water Works Credit Union	Macon	1978
Mead Packaging Employees' Credit Union	Atlanta	1975
Moultrie Container Employees' Credit Union	Moultrie	1983
Mountain Savings & Loan Association	Doraville	1983
Munford Employees' Credit Union	Atlanta	1978
Mutual Savings Credit Union	Atlanta	1977
N.G.E.M.C. Credit Union	Dalton	1975
Nashville Mills Employees' Credit Association	Nashville	1981
North Georgia Credit Union	Toccoa	1982
North Georgia Savings & Loan Association, Inc.	Canton	1979
Orbit Savings & Credit Association	Nalen	1977
Oxford Employees Credit Union	Vidalia	1977
P.H.P. Credit Association	Fitzgerald	1976
Patchogue Plymouth Employees' Credit Association	Hazelhurst	1975
Phoebe Putney Employees' Credit Union	Albany	1977
Piedmont Hospital Credit Union	Atlanta	1978
Reliance Credit Union	Atlanta	1978
Richmond County Health Department Employees' CU	Augusta	1977
Rich's Employees' Credit Union	Atlanta	1975

NAME	LOCATION	MEMBER GDIC
Rock-Tenn Company Employees' Credit Union	Norcross	1977
Rockdale Savings & Loan Association	Conyers	1981
Roper LaFayette Employees' Credit Union	LaFayette	1979
Ruralist Employees' Credit Union	Atlanta	1978
S.M.C.R.C. Credit Union	Atlanta	1978
Savannah Electric and Power Employees' Credit Union	Savannah	1975
Savannah Federal Credit Union	Savannah	1976
Savannah J-Mers Credit Union	Savannah	1977
Savannah Postal Credit Union	Savannah	1976
Savannah Regional Hospital Credit Union	Savannah	1983
Sea Island Employees' Credit Union	Sea Island	1980
Sewell Employees' Credit Union	Atlanta	1975
Sexton Atlanta Employees' Credit Union	Forest Park	1975
South Georgia Area Public Employees' Credit Union	Valdosta	1982
Southern Freight Bureau Employees' Credit Union	Atlanta	1976
Southern States Employees' Credit Union	Savannah	1975
Statco Credit Union	Cornelia	1975
Stratton Industries Credit Association	Cartersville	1981
Stuckey's Employees' Association Credit Union	Eastman	1978
Sumter County Teachers Credit Union	Americus	1976
Swift Credit Union	Columbus	1975
Tappan Employees' Credit Union	Delton	1980
The Thrift Credit Union	Atlanta	1975
Tom's Credit Union	Columbus	1982
USSAC Credit Union	Atlanta	1977
United Family Employees' Credit Union	Atlanta	1975
Valdosta Onized Credit Union	Valdosta	1975
White Columns Credit Union	Atlanta	1975
Whitfield County Postal Employees' Credit Union	Delton	1975
Williams Bros., Employees' Savings & Credit Association	Atlanta	1978
Woodco Credit Union	Decatur	1977
Workmen's Circle Credit Union	Savannah	1978
Wright Manufacturing Employees' Credit Union	Toccoa	1975

****

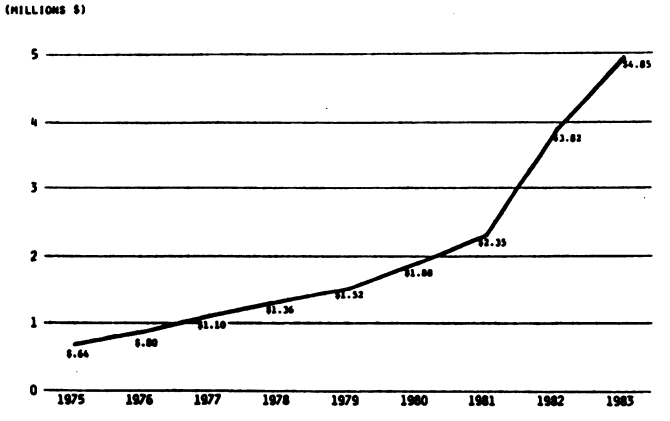
ASSETS OF MEMBER FINANCIAL INSTITUTIONS

December 31, 1983	December 31, 1982
$787,774,036	$586,797,086

SHARES AND DEPOSITS INSURED

December 31, 1983	December 31, 1982
$741,038,885	$547,977,719

GROWTH OF GCUDIC ASSETS, 1975 — 1983



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HISTORICAL HIGHLIGHTS

1961 - Massachusetts Credit Union Share Insurance Corporation - the oldest currently functioning deposit insurance program for credit unions - is incorporated. By the end of the 1960's, other state programs are established in North Carolina and Rhode Island.

1970 - The National Credit Union Share Insurance Fund is created. Begins insuring shares in both federal credit unions and state charters that apply and are approved in 1971.

1974 - In February, the Georgia General Assembly passes legislation paving the way for the creation of the GCUDIC.

The GCUDIC is chartered on August 28th. Incorporators are: Frank L. Groce, Federal Employees' Credit Union (Macon); Henry C. Oxford, Atlanta Postal Credit Union; and Eloise A. Woods, Georgia Telco Credit Union.

On November 14th, the Organizational Meeting of the GCUDIC is held. John I. Beck, Jr., Managing Director of Georgia Credit Union League, agrees to serve as part-time employee of GCUDIC. Twenty-nine credit unions apply for and are approved for coverage by December 31, 1974.

1975 - On January 1st, the GCUDIC begins to insure accounts. Per account coverage is set at $40,000.

The first Annual Meeting of the GCUDIC is held in Macon on April 12th.

On April 25th, the GCUDIC hires its first full-time employee - John E. Martin.

1976 - On September 20th, the GCUDIC began its first successful liquidation - SAV Employees' Credit Union.

1977 - The GCUDIC insures its 100th credit union - Champion Employees' Credit Union - on September 22nd.

1978 - The GCUDIC hires E. Diane Primm Rolin as Administrative Assistant on June 12th.

1979 - On April 20th, the GCUDIC insured its first savings and loan association - North Georgia Savings & Loan Association.

1980 - In April, Moses C. Davis, a GCUDIC founder and its first Treasurer, retires from the Board of Directors.

In April the GCUDIC raises its per account coverage to $100,000.

1982 - The GCUDIC Board approves separate coverage for IRA's.

On October 18th, the GCUDIC hires Martha Tarrant as Administrative Assistant.

On December 31st, assets of GCUDIC - insured financial institutions - exceed $500,000,000.

1983 - On June 28th, the GCUDIC is approved for a written line-of-credit from the National Credit Union Administration's Central Liquidity Fund.

Ernst & Whinney

1800 Peachtree Center South Tower
225 Peachtree Street, N.E.
Atlanta, Georgia 30303

404/658-9400

Board of Directors
Georgia Credit Union Deposit Insurance Corporation
Atlanta, Georgia

We have examined the balance sheets of Georgia Credit Union Deposit Insurance Corporation as of December 31, 1983 and 1982 and the related statements of revenues and expenses and reserve fund and changes in financial position for the years then ended. 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.

In our opinion, the financial statements referred to above present fairly the financial position of Georgia Credit Union Deposit Insurance Corporation as of December 31, 1983 and December 31, 1982, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Ernst & Whinney

Atlanta, Georgia
March 8, 1984

BALANCE SHEETS

GEORGIA CREDIT UNION DEPOSIT INSURANCE CORPORATION

	December 31 1983	1982
ASSETS		
Cash	$ 8,773	$ 46,163
Investments--Note B	4,276,713	3,025,721
Accrued interest	51,949	56,544
Receivable from International Share and Deposit Guaranty Association	2,206	918
Liquidation and merger receivables--Note D	6,943	21,418
Membership fees receivable--Note C	482,263	650,278
Prepaid expenses and miscellaneous	11,072	8,481
Furniture and equipment--at cost, less accumulated depreciation	12,568	9,865
TOTAL ASSETS	$4,852,487	$3,819,388
LIABILITIES AND RESERVE FUND		
Accrued expenses and payroll withholdings	$ 128,140	$ 3,824
Membership fees--Note C	2,110,559	1,764,248
Reserve fund	2,613,788	2,051,316
TOTAL LIABILITIES AND RESERVE FUND	$4,852,487	$3,819,388

See notes to financial statements.

STATEMENTS OF REVENUES AND EXPENSES AND RESERVE FUND

GEORGIA CREDIT UNION DEPOSIT INSURANCE CORPORATION

	December 31 1983	1982
Revenues:		
Premiums	$ 457,725	$ 360,308
Less premium rebates	123,408	98,385
NET PREMIUMS	334,317	261,923
Investment income	361,092	337,443
Other	80	1,459
	695,489	600,825
Expenses:		
Reinsurance	-0-	13,125
Salaries, payroll taxes and employee benefits	71,037	55,724
Professional fees	11,386	7,121
Travel and meetings	9,734	8,068
Rent	9,991	9,251
Depreciation and amortization	3,229	1,799
General and administrative	18,156	13,211
	123,533	108,299
EXCESS OF REVENUES OVER EXPENSES	571,956	492,526
(Losses) recoveries on liquidations and mergers	(9,484)	527
EXCESS OF REVENUES OVER EXPENSES AND LIQUIDATIONS	562,472	493,053
Reserve fund at beginning of year	2,051,316	1,558,263
RESERVE FUND AT END OF YEAR	$2,613,788	$2,051,316

See notes to financial statements.

STATEMENTS OF CHANGES IN FINANCIAL POSITION

GEORGIA CREDIT UNION DEPOSIT INSURANCE CORPORATION

	December 31 1983	1982
FUNDS PROVIDED		
From operations:		
Excess of revenues over expenses and liquidations	$ 562,472	$493,053
Add charge not affecting funds in the current period - depreciation	3,229	1,799
TOTAL FROM OPERATIONS	565,701	494,852
Decrease in receivable from International Share and Deposit Guaranty Association	-0-	9,576
Decrease in liquidation receivables	14,475	6,187
Membership fees	514,326	336,130
Decrease in prepaid expenses and miscellaneous	-0-	9,197
Decrease in accrued interest	4,595	-0-
Increase in accrued expenses and payroll withholdings	124,316	-0-
TOTAL FUNDS PROVIDED	1,223,413	855,942
FUNDS APPLIED		
Decrease in accrued expenses and payroll withholdings	-0-	4,974
Increase in investments	1,250,992	841,548
Increase in accrued interest	-0-	11,849
Increase in receivable from International Share and Deposit Guaranty Association	1,288	-0-
Increase in prepaid expenses and miscellaneous	2,591	-0-
Net additions to furniture and equipment	5,932	6,464
TOTAL FUNDS APPLIED	1,260,803	864,835
NET (DECREASE) IN CASH	(37,390)	(8,893)
Cash at beginning of year	46,163	55,056
CASH AT END OF YEAR	$ 8,773	$ 46,163

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

GEORGIA CREDIT UNION DEPOSIT INSURANCE CORPORATION

December 31, 1983

NOTE A--ACCOUNTING POLICIES

General: The Georgia Credit Union Deposit Insurance Corporation (Corporation) was incorporated under the laws of the State of Georgia as a non-profit corporation to aid and assist member financial institutions facing liquidation, and to provide insurance against losses by individual depositors and shareholders of members. The Corporation consults with the State of Georgia Department of Banking and Finance on a continuing basis regarding the monitoring and liquidation of members, and the Corporation serves as Deputy Receiver to the Department in such liquidations.

Investments: Investments, consisting principally of certificates of deposit and other interest bearing deposits, are generally held to maturity. Investments are stated at cost, which approximates market value, adjusted for known losses.

Depreciation: Depreciation of furniture and equipment is computed on the straight-line basis over five years, the estimated useful life of the assets.

Membership fees: Membership fees are assessed based upon the total shares, deposits and accrued interest and dividends of each member financial institution. The fees are revised each year based upon changes in each members shares, deposits and accruals. Upon termination of membership the fees are subject to refund.

Premiums and Premium Rebates: Annual premiums are charged to members based upon each member's shares and deposits. Premium rebates in 1983 were calculated as 27% of premiums. In 1982, premium rebates were calculated as 10% of paid-in membership fees.

Since its inception, the Corporation has reserved the annual excess of revenues over expenditures for possible losses (reserve fund). In 1982, the reinsurance carrier discontinued offering the reinsurance program.

Management is of the opinion that the results of current assistance activities with members, and member liquidations in process, will not have a material adverse effect on the financial condition at December 31, 1983.

NOTES TO FINANCIAL STATEMENTS--Continued

GEORGIA CREDIT UNION DEPOSIT INSURANCE CORPORATION

NOTE B--INVESTMENTS

The cost (which approximates market) of investment securities at year-end are as follows:

	1983	1982
Certificates of deposit	$2,070,000	$1,560,000
U. S. Treasury bills and note	1,371,892	1,078,151
Other interest bearing deposits	701,950	253,061
Securities purchased under agreements to resell	132,871	134,509
TOTAL	$4,276,713	$3,025,721

Investments mature $3,793,843 in 1984, $350,000 in 1985 and $132,870 thereafter.

NOTE C--MEMBERSHIP FEES

In 1982, the Board of Directors revised membership fees, resulting in increased fees to members. The increased fees, recognized in 1982, are due in three annual installments through 1984. Approximately $477,000 of membership fees receivable at December 31, 1983, represent the third of these annual installments. The remainder of the membership fees receivable, $5,263 represents installments due in 1985 from members insured in 1983.

NOTE D--LIQUIDATIONS AND MERGERS

In connection with liquidations of member\financial institutions, the Corporation may reimburse the member's depositors and shareholders for insured amounts, incur certain liquidation expenses and earn administrative fees as defined by law. Liquidation receivables represent such expenditures which are owing to the Corporation as of year end. Losses on liquidations represent expenditures which, based upon management's estimation, will not be collected by the Corporation.

NOTES TO FINANCIAL STATEMENTS—Continued

GEORGIA CREDIT UNION DEPOSIT INSURANCE CORPORATION

NOTE E—LINE OF CREDIT

The Corporation has availiable two lines of credit totalling approximately $4,400,000 as of December 31, 1983.

One of these, a bank line, is in the amount of $1,000,000. Any borrowing under this line would bear interest at the prime rate. A non-refundable commitment fee of $5,000 was paid to the bank. No amount was drawn against the line at December 31, 1983.

The Corporation's other line of credit in the amount of approximately $3,400,000 as of December 31, 1983, is through the National Credit Union Administration's Central Liquidity Facility. To assist in a liquidation, the Corporation may borrow up to 50% of the liquidating credit union's total shares/deposits, with a maximum aggregate commitment not to exceed 80% of the fair market value of the Corporation's investments. Any amounts borrowed under this line would bear interest at the lender's prevailing rate, and all borrowings would be collateralized by the Corporation's investment portfolio. No amount was drawn against the line at December 31, 1983.

NOTE F—RELATED PARTY TRANSACTIONS

All of the Corporation's directors are associated with member financial institutions, as specified in the Corporation's by-laws. All membership fees and premiums paid by their credit unions are at the same rates as those of other insured credit unions.

The President of the Corporation is also President of the International Share and Deposit Guaranty Association, an affiliation of share insurance organizations. The Corporation paid normal membership fees to the International Association of $3,211 in 1983 and $3,158 in 1982. The Corporation charged the International Association $23,775 in 1983 and $14,993 in 1982 for services provided by its employees. These charges have been reported as a reduction in salaries and employee benefits. Receivables from the International Association represent amounts due the Corporation for expenditures made by the Corporation on behalf of the International Association. The Board of Directors of the Corporation has voted to terminate the management agreement with the International Share and Deposit Guaranty Association effective no later than July 1, 1984.

NOTES TO FINANCIAL STATEMENTS--Continued

GEORGIA CREDIT UNION DEPOSIT INSURANCE CORPORATION

NOTE G--EMPLOYEE RETIREMENT PLAN

The Corporation has a noncontributory defined benefit plan covering employees with six months service. The effective date of the plan was January 1, 1982. Pension expense representing premiums for purchased annuity contracts was $5,753 in 1983 and $4,944 in 1982.

NOTE H--FEDERAL INCOME TAXES

In 1983 and in prior years the Corporation was awardad a tax-exempt status by the Internal Revenue Service under Code Section 501(c)(6). However, in a November 7, 1983 Revenue Ruling by the Internal Revenue Service, the Service took the position that credit union share and deposit insurance companies are not tax-exempt entities. As a result of this revenue ruling the Internal Revenue Service may assess tax to the company beginning in 1984.

INDUSTRIAL LOAN THRIFT GUARANTY CORPORATION OF IOWA
228 Insurance Exchange Building • Des Moines, Iowa 50309 • 515/288-5585

March 29, 1985

The Honorable Doug Barnard, Jr.
Chairman
Commerce, Consumer and Monetary Affairs
Subcommittee of the Committee on Government Operations
House of Representatives
Congress of the United States
Rayburn House Office Building
Room B-377
Washington, D.C. 20515

Dear Congressman Barnard:

In response to your March 20, 1985 letter to Mr. John D. Wolfe, I have enclosed herewith, on behalf of the Industrial Loan Thrift Guaranty Corporation of Iowa, a completed copy of the questionnaire which accompanied your letter.

The Guaranty Corporation guarantees, up to $10,000 per account, the thrift certificates issued by its 14 member companies. Thrift certificates do not technically constitute "deposits" under state law, although generally they are functionally equivalent to deposits; under state law, member companies are permitted to issue thrift certificates that are redeemable upon demand. However, none of the member companies offer checking or NOW accounts.

The latest readily available information on the member companies' outstanding thrift certificates is as of December 31, 1983; December 31, 1984 data should be available within the next several weeks.

In your letter, you indicated that the subcommittee will be examining the issue of whether there is a need to strengthen the current system of state and private deposit insurance. One thing that the Guaranty Corporation and the Auditor of the State of Iowa (and probably similar organizations and regulators in other states) would find extremely helpful would be the elimination of the ability of industrial loan companies and similar financial organizations that have such state or private deposit insurance to file a bankruptcy petition under Chapter 11 of the United States Bankruptcy Code. The Guaranty Corporation strongly urges that this matter be considered in conjunction with the issues identified in your letter. Enclosed herewith are copies of letters previously sent to Senator Charles E. Grassley and to Congressman Cooper Evans from the Office of the Auditor of State, State of Iowa, which further discusses this matter.

If you have any questions about the enclosures or need any further information, please contact me at the following address or phone number. Steve R. Wagner, Norwest Financial, Inc., 207 Ninth Street, Des Moines, Iowa 50307, (515) 243/2131.

Sincerely,

Steve R. Wagner

fk

Enc.

1

NAME OF DEPOSIT INSURANCE FUND Industrial Loan Thrift Guaranty Corporation of Iow (hereinafter called the "Guaranty Corporation")

I. General Information:

1. Type(s) of Financial Institution(s) whose deposits you insure: Iowa industrial loan companies licensed under Iowa Code Chapter 536A [a copy of Iowa Code Chapter 536A is attached hereto as Exhibit A.]

2. In which state(s) do you insure: Iowa (only)

3. A. Cost of initial membership in your fund, if any: See page 1A attached hereto.

B. Annual premium: 1/4 of 1% of thrift certificates outstanding at December 31 See Iowa Code Section 536B.8(2).

C. Continuing equity contribution or membership deposit: Additional payments must be made to the Guaranty Corpora tion as thrift certificates outstanding increase, until a maximum of $10,000 has been paid. See the response to item 3.A. on page 1A attached hereto.

4. Maximum coverage per account or per depositor: $10,000 per account per person, except that additional coverage can be obtained through joint accounts, etc. See Iowa Code Section 536B.7. Also, see the brochure attached hereto as Exhibit C.

5. Do you insure brokered deposits: Brokered thrift certificates would be afforded the guarantee protection, although to the best of the Guaranty Corporation's knowledge, none of the member companies are having their thrift certificates brokered.

6. Number of insured institutions, by type:

A. Under $100 million: 14

B. $100 million to $500 million: -0-

C. $500 million to $1 billion: -0-

D. Over $1 billion: -0-

7. Aggregate amount of deposits insured, by type of institution: Under $100 million: Approximately $212.5 million at December 31, 1983*

8. Your fund's total useable assets: At January 31, 1985, approximately $360,000.

9. Ratio of usable insurance fund assets to deposits insured: .00169 to 1*

*The amount of thrift certificates actually guaranteed by the Guaranty Corporation is unknown since information as to thrift accounts in excess of $10,000 is not available. Total outstanding thrift certificates of all member companies at December 31, 1983 was $212.5 million.

Response to Item 3A:

An initial membership assessment is to be paid by each company at the time it becomes a member of the Guaranty Corporation in accordance with the following schedule:

Outstanding Thrift Certificates	Initial Membership Assessment
$250,000 or less	$2,500
$1,000,000 or less, but more than $250,000	$5,000
More than $1,000,000	$10,000

When the amount of a member company's issued and outstanding thrift certificates increases from $250,000 or less to more than $250,000 (but less than $1 million), the member company is required to pay an additional $2,500, and when such outstanding thrift certificates increase to more than $1 million, an additional $5,000 is required to be paid. See Iowa Code Section 536B.5. [A copy of Iowa Code Chapter 536B is attached hereto as Exhibit B].

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

The Guaranty Corporation is a non-profit corporation organized under the Iowa Nonprofit Corporation Act; the Guaranty Corporation was required to be organized, and is governed by, Iowa Code Chapter 536B, a copy of which is attached hereto as Exhibit B.

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

Auditor of State, State of Iowa

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or.

No

b. authority to assess other insured institutions enough to cover the losses?

Member companies may be assessed an amount equal to two times their last annual assessments. These are advance assessments and are credited against subsequent annual assessments. See Iowa Code Section 536B.8(3).

4. Are you subject to state limitations as to the rati of insurance fund assets to total deposits insured?

No

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

No

6. Do you reinsure your risks with any other insurance carriers? Please provide details.

No

7. Regarding your board of directors:

a. How is your board of directors selected? Pursuant to the Guaranty Corporation's by-laws, the Board of Directors are elected for three year terms by the member companies (although vacancies occuring on the board can be filled by the remaining directors). The terms of the directors are staggered. Each director must be an officer or a director of a member company.

b. What rules govern the size and composition of the board?

The Guaranty Corporation's by-laws provide for seven directors to constitute the board.

c. Who are the present members of your board? (Please provide names and principal affiliations.)

Name	Principal Affiliation
Richard J. Brinkman	Norwest Financial, Inc.
Wayne O. Frazer	Frazer Finance Company
Bertrand E. King	Heights Finance Corporation
Lloyd Pottratz	Lloyd's Plan, Inc.
Glenn R. Sanders	Household Finance Corporation
John D. Wolfe	MorAmerica Financial Corporation
Phil C. Yoder	Midwest Agricultural Investments, Inc

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

Iowa Code Chapter 536A and Iowa Code Chapter 536b impose minimum capital requirements on member companies, limit the amount of thrift certificates that may be outstanding relative to subordinated debt plus stockholders equity, and limit the amount of subordinated debt that may be issued relative to stockholders equity. See Iowa Code Sections 536A.8, 536A.22 and 536B.24.

2. Please respond separately for each state in which you insure deposits:

a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

No specific authority for this exists. It is the opinion of the Guaranty Corporation that a member company's membership may be terminated, but this has not been attempted.

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

Unknown.

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

None.

3. Please respond separately for each state in which you insure deposits:

   a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

Under Iowa Code Section 536B.22(3), the Guaranty Corporation can hire an independent certified public accountant to make such an examination. Otherwise, only the Auditor of State can make such an examination. On occasion, certain member companies have discussed their business affairs and provided financial records and other information to Guaranty Corporation representatives at the Guaranty Corporation's request.

   b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?

Each branch office of each member company is examined by the Auditor of State at least annually, as a general matter. To date, the Guaranty Corporation has not exercised its authority to hire a certified public accountant to make an examination of a member company.

   c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

No.

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

Yes.

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

The Guaranty Corporation can make recommendations to the Auditor of State as to the actions it believes should be taken. Otherwise, the Guaranty Corporation must deal directly with the member company and request that the member company take the desired action. In addition, the Guaranty Corporation is authorized by regulation to lend money to, or purchase equity securities issued by a member company in order to prevent or minimize losses to the Guaranty Corporation. (To date, this authority has not been exercised).

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

No. Under Iowa Code Section 5368.16, it is contemplated that the Auditor of State be appointed as the receiver/liquidator for a failed member company.

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process? Under Iowa Code Chapter 5368, it is contemplated that investors generally await a liquidation process, although in the case of the three member companies which were or are being liquidated, guaranteed amounts were paid prior to the completion of the liquidation process.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

Generally, yes.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

There is no statutory authority for this, but the Guaranty Corporation takes the position that it could assist in or otherwise facilitate such a transaction.

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

The Auditor of State could do this, but the Guaranty Corporation itself could not (unless the insolvent member company consented to a capital infusion by the Guaranty Corporation and permitted the Guaranty Corporation representatives to assist in the member company's operations).

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date:

a. The name, location, and size of the institution;

b. The total dollar cost of the insolvency to your fund;

c. The dollar amount of insured deposits in the institution at time of closing;

d. The dollar amount of uninsured deposits in the institution;

e. The percentage recovery to date to depositors on uninsured deposits;

f. The gross dollar amount of outstanding unpaid depositor claims; and

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

See page 6A attached hereto.

[First Security Acceptance Corporation]

a. First Security Acceptance Corporation
3512 Ingersoll Avenue
Des Moines, Iowa 50312

Total assets at the end of the fiscal year preceding the bankruptcy date were approximately $1.6 million.

b. Approximately $413,000; it is expected that the Guaranty Corporation may ultimately recover approximately $200,000 from the bankruptcy estate upon completion of the bankruptcy proceedings.

c. Approximately $413,000.

d. Approximately $193,000 (excluding subordinated debt)

e. None.

f. Approximately $193,000 (excluding subordinated debt)

g. Approximately 15 months.

[American Securities & Loan, Inc.
and its wholly owned subsidiary, Kinney Finance Company, Inc.]

a. American Securities & Loan, Inc.
Council Bluffs, Iowa

Kinney Finance Company, Inc.
Boone, Iowa

Thrift certificates issued by these two companies totalled approximately $8.2 million; total consolidated liabilities of these two companies approximated $11.2 million.

b. It is estimated that the total dollar cost to the Guaranty Corporation of the insolvency of American Securities & Loan and Kinney Finance together will approach $3 million, less any recoveries the Guaranty Corporation may eventually obtain from directors, officers or accountants for these companies.

c. American Securities & Loan: approximately $4,502,000
Kinney Finance: approximately $995,000

d. American Securities & Loan: approximately $2,391,000 (excluding subordinated debt)
Kinney Finance: approximately $326,000 (excluding subordinated debt)

e. None.

f. Approximately $5.7 million, combined (excluding subordinated debt)

g. The pay outs to holders of thrift certificates issued by American Securities & Loan and Kinney Finance have not yet been completed. These companies were closed by the Auditor of State in August, 1984, and in November, the Guaranty Corporation, following its receipt of the maximum amount of advance assessments from its member companies, began paying to thrift certificate holders 50% of the guaranteed amounts. The balance of the guaranteed amounts, which is expected to be derived from the liquidation proceeds, will be paid in two or more installments (as funds become available to the receiverships for these two companies) commencing within the next two or three months.

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

December 31, 1984 - $360,000 (estimated)
December 31, 1983 - $1,303,062
December 31, 1982 - $700,755
December 31, 1981 - $575,029

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

100% in Treasury Securities or other U.S. Government Securities (or their equivalent) or repurchase agreements for the same.

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

No.

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

No such computations have been made; however, funds historically have been invested in bank certificates of deposit or U.S. Government securities with maturities of one year or less, or in short-term government securities mutual funds.

5. Please provide a copy of your latest annual report.

A copy of the latest annual report (December 31, 1983) is attached hereto as Exhibit D.

Maryland Savings-Share Insurance Corporation

Charles C. Hogg, II
PRESIDENT

April 1, 1985

The Honorable Doug Barnard, Jr.
Chairman, Commerce, Consumer and
Monetary Affairs Subcommittee
Rayburn House Office Building, Room B-377
Washington, D.C. 20515

Dear Mr. Chairman,

Enclosed is the completed questionnaire you requested in connection with congressional hearings to be conducted on the Ohio deposit insurance problem.

I have been requested to testify at these hearings and can respond to any questions you or members of your staff or of the subcommittee have.

Sincerely,

Charles C. Hogg, II
President

CCH/lsk

Enclosure

NAME OF DEPOSIT INSURANCE FUND Maryland Savings-Share Insurance Corporation (MSSIC

I. General Information:

All financial data for both MSSIC and industry is as of December 31, 1984

1. Type(s) of Financial Institution(s) whose deposits you insure:
State chartered savings and loan associations

2. In which state(s) do you insure:
Members must have principal offices in Maryland. There are two branches in Delaware.

3. A. Cost of initial membership in your fund, if any: 0.4% of initial savings for new members, due for each of first five years
B. Annual premium: opportunity cost on 2% Capital Deposit
C. Continuing equity contribution or membership deposit:
2% Capital Deposit adjusted June 30 and December 31

4. Maximum coverage per account or per depositor:
$100,000 per account

5. Do you insure brokered deposits:
Yes, but members are limited in levels accepted

6. Number of insured institutions, by type:
A. Under $100 million: 83
B. $100 million to $500 million: 11
C. $500 million to $1 billion: 6
D. Over $1 billion: 1

7. Aggregate amount of deposits insured, by type of institution:
$7,212,447,328

8. Your fund's total useable assets:
Total Assets $204,818,857, Reserves $166,756,118

9. Ratio of usable insurance fund assets to deposits insured: $\frac{\text{Reserves}}{\text{Savings}} = \frac{\$166,756,118}{7,212,447,328} = 2.31\%$

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

"There is a Maryland Savings-Share Insurance Corporation, established as a nonprofit, nonstock corporation, the members of which are associations that are accepted for membership under this title." Section 10-102, Title 10, Financial Institution Article, Annotated Code of Maryland.

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

Director, Division of Savings and Loan Associations has approval authority over By-Laws, Rules and Regulations. See Section 10-111, Title 10, FI.

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or
No. See Section 10-116, Title 10, FI

b. authority to assess other insured institutions enough to cover the losses?
Yes. See attached Sections 3-304 and 3-305 of Rules and Regulations

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?
No

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

Yes. Loan Agreement dated May 1, 1983 with First Amendment dated April 30, 1984, requires banks to lend up to $60,000,000 under terms and conditions of Loan Agreement. Participating banks are:

The First National Bank of Chicato	$25,000,000
The Riggs National Bank of Washington, D.C.	13,000,000
Mellon Bank, N.A.	10,000,000
Union Trust Company of Maryland	7,000,000
Equitable Bank, National Association	5,000,000
	$60,000,000

6. Do you reinsure your risks with any other insurance carriers? Please provide details.

No.

7. Regarding your board of directors:

a. How is your board of directors selected?

Three (3) members appointed by Governor
Eight (8) members elected from the membership

b. What rules govern the size and composition of the board?

Section 10-109, Title 10, FI. (attached)

c. Who are the present members of your board? (Please provide names and principal affiliations.)

Name	Principal Affiliation

BOARD OF DIRECTORS

George W.H. Pierson (Chairman)
President
Parkville Savings and Loan
Association
7802 Harford Road
Baltimore, Maryland 21234

Jerome F. Dolivka (Vice Chairman)
Executive Vice President
Fairmount Savings and Loan
Association
8201 Philadelphia Road
Baltimore, Maryland 21237

Frances F. Anderson (Treasurer)
Clark and Anderson (CPA's)
900 Crain Highway, S.W.
Glen Burnie, Maryland 21061

Michael J. Dietz (Secretary)
Executive Vice President
Baltimore County Savings and Loan
Association
4208 Ebenezer Road
Baltimore, Maryland 21236
(Mail - P.O. Box 397, Perry Hall, Md. 21128)

Leonard Bass
Vice President
Business Men's Building
Association
916 Munsey Building
Baltimore, Maryland 21202

Joseph P. Carroll
Executive Vice President
Automobile Trade Association
of Maryland
100 Cathedral Street, Suite 9
Annapolis, Maryland 21401

Mr. John C. Donohue, Sr. (Retired)
Donohue Agencies
7402 York Road
Towson, Maryland 21204

Henry R. Elsnic
President
Madison and Bradvord Savings and
Loan Association
6721 Harford Road
Baltimore, Maryland 21234

Mr. John D. Faulkner, Jr.
961 Stable Court
Davidsonville, Maryland 21035

Mr. James D. Laudeman, Jr. (Attorney
Callahan, Calwell and Laudeman
210 East Redwood Street
Baltimore, Maryland 21202

Terry L. Neifeld
Secretary
Cowenton Savings and Loan
Association
5423 Ebenezer Road
White Marsh, Maryland 21162

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose? Yes
Monthly submission of complete financial report, over $3 million.
Liquidity - as defined, 6% of savings - R&R Section 3-210
Net Worth - as defined, 4.66% of savings - R&R Section 3-211
Delinquencies - as defined 4.0% of loans - R&R Section 3-212
Mortgage loan concentration - R&R Section 3-217
Borrowing - 15% from all sources - Policy Statement No. 2.

2. Please respond separately for each state in which you insure deposits:

a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?
Yes, If the institution (1(violates the laws of the State, (2) is conducting unsafe or unsound practices, (3) is in violation of By-Laws, Rules or Regulations or (4) has insurance terminated by FSLIC. See Subtitle VI, Rules and Regulations.

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

See III.2.a. and Subtitle VI, Rules and Regulations

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

None

3. Please respond separately for each state in which you insure deposits:

a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

Yes. See Section 3-208, Rules and Regulations

b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?

Reviews of operations include both annual reviews and spot reviews, which may be limited to loans, securities, expenses, or other areas of interest. Eight members of twelve member staff devote primary time to review of member operations. Examination or review is major responsibility of staff and budget is not separate.

c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis? Yes. Staff attends Exit Interviews. We receive copy of Examination and Institution's Response to Comments. See Section 3-208, Rules and REgulations.

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

Yes, if above $5,000,000 in assets. Small institutions audited internally. See Section 3-203, Rules and Regulations.

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

1. Appoint Director to Board of institution (Section 3-204)
2. Issue Cease and Desist Orders (Section 3-222)
3. Remove officers and Driectors (Section 3-222)
4. Require Operating Agreement (Section 3-211)
5. Require merger, sale or capital infusion.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

Yes. "The Federal Savings and Loan Insurance Corporation or the Maryland Savings-Share Insurance Corporation has absolute right to be appointed conservator or receiver of a savings and loan association insured by it." Section 9-709, Title 9, FI.

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?

Intent and policy is to provide funds immediately, but liquidation process is provided in Subtitle VII of By-Laws.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

No. See III .5. Also, By-Laws allow transfer of accounts.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

Through Operating Agreements.

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

Yes

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date: None

a. The name, location, and size of the institution;

b. The total dollar cost of the insolvency to your fund;

c. The dollar amount of insured deposits in the institution at time of closing;

d. The dollar amount of uninsured deposits in the institution;

e. The percentage recovery to date to depositors on uninsured deposits;

f. The gross dollar amount of outstanding unpaid depositor claims; and

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

	Capital Deposits	Retained Earnings	Insurance Reserve	Total
1981	$ 49,073,200	$ 6,537,191	$1,250,000	$ 56,860,391
1982	70,175,786	8,596,545	2,250,000	81,022,331
1983	106,619,400	11,858,672	3,200,000	121,678,072
1984	144,260,100	17,496,018	5,000,000	166,756,118

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

See Footnotes B and C to attached Report on Examinations of Financial Statements and Additional Information, Touche Ross & Co., as of December 31, 1984.

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

See Footnotes E,F and G to audit above.

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

11.11% in 1984
10.88% in 1983
14.84% in 1982
12.14% in 1981

5. Please provide a copy of your latest annual report.

See 2 and 3 above. Annual Report is not yet published.

Maryland Credit Union Insurance Corporation
THE S.J. DOMENICK CREDIT UNION BUILDING
8501 LaSalle Road, Baltimore, Maryland 21204 (301) 321-6641

March 25, 1985

Congressman Doug Barnard, Jr. Chairman
Commerce, Consumer, and Monetary Affairs
Subcommittee of the Committee on
Government Operations.
Rayburn House Office Building, Room B-377
Washington, D. C. 20515

Dear Congressman Barnard,

Your letter of March 20th, attached was received by me on Friday, March 22, 1985 in which we have complied in submitting the required data of your questionnaire.

If I can be of further service to you in this matter, please call on me.

Sincerely yours,

CHARLES L. BENTON
Chairman

CLB/sjd

Encls: a/s

NAME OF DEPOSIT INSURANCE FUND: MARYLAND CREDIT UNION INSURANCE CORPORATION

I. General Information: Incorporated in 1975 (Annotated Code of Maryland Financial Institutions Article Section 7, 101-ET SEQ. The corporation was established for the purpose of promoting the elasticity and flexibility of the resources of credit unions through a central fund and to insure credit union accounts of affiliated member credit unions

1. Type(s) of Financial Institution(s) whose deposits you insure:
MARYLAND STATE CHARTERED CREDIT UNIONS

2. In which state(s) do you insure:
MARYLAND ONLY

3. A. Cost of initial membership in your fund, if any:

B. Annual premium:

(C.) Continuing equity contribution or membership deposit: of 1% fee on shares and deposits which is adjusted annually for the netchange in the total amount of such shares/deposits.

4. Maximum coverage per account or per depositor:
$250,000

5. Do you insure brokered deposits:
No. Only members accounts

6. Number of insured institutions, by type:

A. Under $100 million: --Twenty-three (23)

B. $100 million to $500 million: -- Two (2)

C. $500 million to $1 billion:

D. Over $1 billion:

7. Aggregate amount of deposits insured, by type of institution:
$547.9 Million (as of 12-31-84)

8. Your fund's total useable assets: $6,802,886

9. Ratio of usable insurance fund assets to deposits insured: 1.24%

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

PRIVATE AGENCY, CREATED BY STATE LAW AS PER ITEM I, page I, COPY OF STATUTORY AUTHORITY ATTACHED.

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

MARYLAND STATE BANKING DEPARTMENT

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or

NO.

b. authority to assess other insured institutions enough to cover the losses?

CAN BE ESTABLISHED FROM TIME TO TIME BY THE CORPORATION WITH APPROVAL OF THE SUPERVISORY AUTHORITY TO INSURE AND GUARANTEE THE SHARES AND DEPOSITS OF MEMBER CREDIT UNION.

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

NO.

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

YES. FIVE ($5) MILLION WITH THE NATIONAL CREDIT UNION ADMINISTRATIONS' CENTRAL LIQUIDITY FACILITY, WASHINGTON, D.C.

CORPORATION ALSO HAS THE POWERS TO BORROW MONEY AND OTHERWISE INCUR INDEBTNESS FOR ANY OF ITS PURPOSES, TO ISSUE BONDS, DEBENTURES OR OTHER EVIDENCES OF INDEBTNESS, WHETHER SECURE OR UNSECURED AND TO SECURE BY MORTGAGE, PLEDGE DEED OF TRUST OR OTHER LIENS ON ITS PROPERTY, RIGHTS AND PRIVILEGES OF EVERY KIND AND NATURE OR ANY PART THEREOF.

6. Do you reinsure your risks with any other insurance carriers? Please provide details. NO.

7. Regarding your board of directors:

a. How is your board of directors selected?

EIGHT (8) ARE ELECTED BY THE INSURED MEMBER CREDIT UNIONS
THREE (3) ARE APPOINTED BY THE GOVERNOR

b. What rules govern the size and composition of the board?

STATE REGULATION (ARTICLE 23-453 attached) ELEVEN (11)MEMBERS

c. Who are the present members of your board? (Please provide names and principal affiliations.)

(See roster attached)

1985-86

BOARD OF DIRECTORS
MARYLAND CREDIT UNION INSURANCE CORPORATION

Telephone: 321-6641

Name	Term Expires	Home Phone	Business Address	Business Phone	Position
Charles L. Benton 3915 Calverton Drive Hyattsville, Md. 20782	1988	(301) 277-2449	Dept. of Finance 452 City Hall Baltimore, Md. 21202	396-3100	Director of Finance City of Baltimore
James R. Brown, III 5 Running Fox Road Glen Arm, Md. 21057	1986	661-6057	Brown & Brown Chartered 8501 La Salle Road Towson, Md. 21204	296-2000	Attorney-at-Law
Frank F. Cossentino 26 Hickory Meadow Rd. Cockeysville, Md. 21030	* Appointed 1984 Expires 1988	252-3428	Cossentino Bros., Inc. 6717 Quad Avenue Baltimore, Md. 21237	325-2001-2	President Cossentino Bros., Inc.
Dorothy George (Mrs.) 201 Suter Road Baltimore, Md. 21228	* Appointed 1984 Expires 1988	788-6833	Uptan House for Homless Women 848 Edmondson Avenue Baltimore, Maryland 21201	539-6321	Director
Kenneth M. Jones 1902 Dumont Court Timonium, Md. 21093	1987	252-3571			
Thomas J. Martin 125 Mount Harmony Rd. Owings, Md. 20736	* Appointed 1984 Expires 1988	(301) 257-9688	Capital Associates, Inc. 1022 Upshur Street, N.E. Washington, D. C. 20017	(202) 526-5850	President
George P. Reichenberg 5805 Loch Raven Blvd. Baltimore, Md. 21239	1988	323-9140	State Employees CU 8503 La Salle Road Towson, Md. 21204	821-1980	President/CEO
John T. Roycroft *** 3106 Tyndale Avenue Baltimore, Md. 21214	1986	254-1930	State Employees CU 8503 La Salle Road Baltimore, Md. 21204	821-1980	Vice-President

* Governors' appointees

OVER

The Board of Directors has established criteria to judge the insurance risk of member credit unions. These are the standards for performance:

III. Supervision of insured institutions:

1. **Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?**

a. Delinquent loans to toal loans should not exceed 10%.
b. Estimated loss on delinquent loans should not exceed 30% of the reserve for loss.
c. Reserve for loss to total loans should not be below 3%.
d. Reserve for loss to total deposits should not be below 3%.
e. Total capital including reserves to total loans minus shares should not be below 5%.
f. Reserve for loss plus equity to total loans should not be below 75%.

2. **Please respond separately for each state in which you insure deposits:**

a. **Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?**

YES, Article 23-Sec.454(Page 49-attached)"If the directors of the corporation acertain evidence of carelessness, unsound practices or mismanagement of any member credit union which appears to adversely affect the solvency or liquidity of the credit union or threaten undue loss, the corporation directors may order that corrective action be taken or after due notice with approval of the supervisory authority revoke the credit unions'membership in the Corporation.

b. **Under what set of conditions or circumstances would you be authorized to discontinue insurance?** Mismanagment, the failure of the credit union board of directors to meet the safety guidelines after consultation & monitoring within a designated period of time. Non-compliance to adverse conditions that would jeporadize the safety and soundness of the credit union. This would include where credit committee or loan officers or both are not following sound practices., Where the general ledger is more than 60 days in arrears or where illegal loans or disbursements were deliberately made when not in compliance. When expense ratios exceed 60% of Income or when delinquent loans exceed the standards.

c. **Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.**

NONE

3. Please respond separately for each state in which you insure deposits:

a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

YES, Article 23, Section 455, "The Corporation may require independent audits and investigations of any member credit union in order to learn of the financial condition of the credit union as it relates to insurance of shares and deposit accounts.

b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?

For those that may be under the standards, monthly, and annually on others through reporting data. The procedure is to meet - with the board of directors and management staff to review the adverse conditions and recommend and assist them to necessary resolution. The Corporation has an experienced auditor available when required and the Presidents spends 40 to 50% of his time in consultation and personal visits. The total budget for this service is $28,325.

c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

YES, Usually received within one week after completion of the examination.

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

NO. The Credit Union Law, Fin.Inst. Article 12, Title 6, Sec. 6-302 (B) "Audits, requires the Supervisory Committee to audit the affairs of the credit union twice annually-- **

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance? Article 23-Sec. 452., par.9:"Upon written direction of the Supervisory Authority, assume control of the property and business of the credit union and operate the credit union in accordance with any recommendations that the Supervisory Authority may offer." Par. 10-"To assist in the merger, stabilization, consolidation or liquidation of credit unions.

4.(continued)--and make a full report to the credit union board of directors and for the period ending December 31st report at the annual meeting of the membership. Currently 14 of the larger credit unions have independent CPA Audits annually.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

YES

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?

As soon as books and records are brought into balance and accounts verified.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

NO. The credit unions are made whole and merged with another local credit union.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

YES

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner? YES

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date: (SEE ATTACHED---)

a. The name, location, and size of the institution;

b. The total dollar cost of the insolvency to your fund;

c. The dollar amount of insured deposits in the institution at time of closing;

d. The dollar amount of uninsured deposits in the institution;

e. The percentage recovery to date to depositors on uninsured deposits;

f. The gross dollar amount of outstanding unpaid depositor claims; and

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

DATA TO ITEM 4 - PAGE 6.

INSOLVENT CREDIT UNIONS COVERED BY THE INSURANCE FUND FROM JANUARY 1, 1980 to DATE:

1. A.B.C. CREDIT UNION(Allied Builders & Contractors) Moved to D.C.
   444 N. Capitol St. N.W. Suite 409
   Washington, D. C. 20001
   Size of institution: $443,289 Date: June 21, 1981
   At closing $305,000 December 18, 1981

2. Southern Md. Hospital Center Employees Credit Union
   Clinton, Maryland 20735

   Size of institution:$183,000 At time of Closing: $130,210
   (November 1, 1984) (February 25, 1985)

TOTAL DOLLAR COST TO THE INSURANCE FUND:

#1. $78,200 #2. $297.39 plus $10,040 operational expenses for a total of$10,337.39.

Item D- THERE WERE NO UNINSURED DEPOSITS

Item E- Not applicable

Item F- None

Item G- The length of time between closing of the insitutions and completion of all pay out or transfers of insurance deposits:

Credit Union No. 1 (ABC CU) 180 Days

Credit Union No. 2 (So. Md. Hospital CU) 120 days.

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

1981- $3,266,666
1982- $3,980,789
1983- $5,380,805
1984- $6,802,886

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)? Total:$6.917,935

Baltimore Gas & Electric	$ 200,000
State & Local Investments (C.Ds)	$1,435,776
U. S. Treasury Securities	$4,405,000
F.N.M.A.s	$ 400,000
Federal Land Bank Bonds	$ 250,000
A.T. & T.	$ 100,000
GNMA's	$ 127,177

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

Yes. In 1981 -$130,000 loan to a member credit union at 10% repaid in one year.

In 1984 -$ 24,550 loan to a merging credit union at 12%, repaid in 90 days.

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

1981 - 12.20%
1982 - 11.33%
1983 - 10.87%
1984 - 10.60%

5. Please provide a copy of your latest annual report.

A T T A C H E D

The CO-OPERATIVE CENTRAL BANK
225 FRANKLIN STREET · BOSTON · MASSACHUSETTS 02110
(617) 542-3093

JAMES L. BURNS, JR.
EXECUTIVE VICE PRESIDENT
AND TREASURER

March 27, 1985

The Honorable Doug Barnard, Jr.
Committee on Government Operations
Rayburn House Office Building
Room B-377
Washington, D. C. 20515

Dear Representative Barnard:

Enclosed you will find the completed questionnaire with all the pertinent information relative to The Co-operative Central Bank as deposit insurer of the co-operative bank industry in the Commonwealth of Massachusetts.

Sincerely,

James L. Burns, Jr.
Executive Vice President

JLB:t
Enclosures

1

NAME OF DEPOSIT INSURANCE FUND The Co-operative Central Bank

I. General Information:

1. Type(s) of Financial Institution(s) whose deposits you insure: Co-operative Banks

2. In which state(s) do you insure: Massachusetts

3. A. Cost of initial membership in your fund, if any: 1934 - ½ of 1% of deposits

   B. Annual premium: 1/27th of 1% of deposits - may be raised to 1/12th of 1%.

   C. Continuing equity contribution or membership deposit: $7.50 per $1,000 of total assets

4. Maximum coverage per account or per depositor: Insured in full

5. Do you insure brokered deposits: N/A - none in system

6. Number of insured institutions, by type:

   A. Under $100 million: 88

   B. $100 million to $500 million: 12

   C. $500 million to $1 billion: None

   D. Over $1 billion: None

7. Aggregate amount of deposits insured, by type of institution: $4,783,000,000

8. Your fund's total useable assets: $170,000,000

   $124,000,000 Share Insurance Fund
   46,000,000 Reserve Fund
   $170,000,000 Combined

9. Ratio of usable insurance fund assets to deposits insured: 3.55

   2.59 SIF
   .96 RF
   3.55

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

   Private -- creation of state law - subject to continuing state regulation - see Massachusetts Statutes appendix to Chapter 170: Acts of 1932, Chapter 45, as amended; Acts of 1934, Chapter 73, as amended.

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

   Commissioner of Banks
   Commonwealth of Massachusetts

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

   a. access to the treasuries of the state(s) in which you operate; and/or

      No (see attachment)

   b. authority to assess other insured institutions enough to cover the losses?

      Special assessment made in 1943 through legislative process - legislative process would be available, if needed.

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

   Yes - Share Insurance Fund ratio of 3%.
   See Appendix to Chapter 170 (Acts of 1934, Chapter 73, as amended), Section 1.

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established? $63,000,000

	RF	SIF	Total
Bank of Boston	$10,000,000	$10,000,000	$20,000,000
Bank of New England	4,000,000	4,000,000	8,000,000
State St. Bank & Trust Co.	5,000,000	5,000,000	10,000,000
Bank of New York	5,000,000	5,000,000	10,000,000
National Cooperative Bank	15,000,000	---	15,000,000
	$39,000,000	$24,000,000	$63,000,000

6. Do you reinsure your risks with any other insurance carriers? Please provide details.

No

7. Regarding your board of directors:

a. How is your board of directors selected?

Election at annual meeting of members.
Note: Board size will be increased to 19 by the addition of four public interest directors in October, 1985.

b. What rules govern the size and composition of the board?

See Massachusetts Statutes: Appendix to Chapter 170, Acts of 1932, Chapter 45, as amended; and Corporate By-Laws.

c. Who are the present members of your board? (Please provide names and principal affiliations.)

BOARD OF DIRECTORS

	City	Term Expires
David E. Bradbury, *Chairman of the Board* The Co-operative Bank of Concord	Concord	1987
Robert E. Coderre, *President* Savers Co-operative Bank	Southbridge	1985
John T. Day, *Chairman of the Board* Mt. Washington Co-operative Bank	Boston	1986
Robert F. Day, *President* Needham Co-operative Bank	Needham	1985
Edward E. Fuller, *President* George Peabody Co-operative Bank	Peabody	1986
Charles P. Hooker, *President* Pittsfield Co-operative Bank	Pittsfield	1987
William C. MacLeod, *President* Mayflower Co-operative Bank	Middleboro	1985
Francis M. Metterville, *President* Fidelity Co-operative Bank	Fitchburg	1985
Walter A. Murphy, *President* Falmouth Co-operative Bank	Falmouth	1987
Charles G. Peterson, *President* Braintree Co-operative Bank	Braintree	1985
Leslie D. Stark, *President* Reading Co-operative Bank	Reading	1986
Robert W. Stevens, *President* Auburndale Co-operative Bank	Auburndale	1987
Robert S. Stoller, *President* Coolidge Corner Co-operative Bank	Brookline	1987
Randall B. Tatro, *President* Norwood Co-operative Bank	Norwood	1986
Raymond F. Wheeler, *President* Weir Co-operative Bank	Taunton	1986

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

Yes. See Chapter 170 of Massachusetts Statutes, Sections 21, 22 and 23. Additional guidelines on capital ratios by Commissioner of Banks for Commonwea of Massachusetts have been in use for several years.

2. Please respond separately for each state in which you insure deposits:

a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

Yes, in instances when institution has merged into another financia institution with other deposit insurance coverage (see Chapter 170, Sections 26A and 26B) and when charter conversion to federally insu institution (see Chapter 170, Section 28).

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

See above - only when federal charter or other state (Mass.) insurance obtained.

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

2 - Federal charter obtained through conversion under Chapter 170, Section 28.

3 - erger into Massachusetts savings bank (insured by Mutual Savings Central Fund) under Chapter 170, Section 26A.

Note: These five were market arrangements and not supervisory actions.

3. Please respond separately for each state in which you insure deposits:

a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

Yes.
Section 1A of Chapter 170 - Appendix

b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?

Examinations are conducted by the Commissioner of Banks of the Commonwealth of Massachusetts, field audit staff of 85 examiners; and audits by independent public accountants, annually. Additional examination or audit by or on behalf of insurance fund performed on those occasions when a potential problem may be suspected at an insured bank. Examination expense would be an extraordinary expense. Audit and appraisal has been utilized when needed.

c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

Yes.
Yes.

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

Yes.

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

Chapter 170 - Appendix, Acts of 1934, Chapter 73, Section 1A: examination and audit; asset appraisals; make recommendations to correct practices or policies.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

Yes.

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?

No Massachusetts co-operative bank has ever been closed due to insolvency - immediate funds would be available if necessary.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

No. Loan, asset restructure, merger, purchase and sale of non-liquid assets, etc. are additional remedies.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

Yes.

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

Yes.

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date: None

a. The name, location, and size of the institution; N/A

b. The total dollar cost of the insolvency to your fund; N/A

c. The dollar amount of insured deposits in the institution at time of closing; N/A

d. The dollar amount of uninsured deposits in the institution; N/A

e. The percentage recovery to date to depositors on uninsured deposits; N/A

f. The gross dollar amount of outstanding unpaid depositor claims; and N/A

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits. N/A

Note: See attachment regarding financial assistance rendered in the period.

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

	RF	SIF	Total
8/31/81	$44,063,000	$ 98,282,000	$142,345,000
8/31/82	45,747,000	103,579,000	149,326,000
8/31/83	45,976,000	108,557,000	154,533,000
8/31/84	45,025,000	117,461,000	162,486,000

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

	RF	SIF	Total
Cash	$ 261,000	$ 159,000	$ 420,000
U.S. Governments	2,005,000	2,311,000	4,316,000
U.S. Federal Agencies	50,917,000	97,464,000	148,381,000
*Repurchase Agreements	7,380,000	6,835,000	14,215,000
Certificates of Deposit	150,000	150,000	300,000
GNMA - Securities Acquired		11,232,000	11,232,000

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

	RF	SIF	Total
Loans to Members	$1,200,000	$2,799,000	$3,999,000

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

	RF	SIF
1981	10.56%	9.70%
1982	10.73	11.05
1983	10.92	11.33
1984	10.95	11.34

5. Please provide a copy of your latest annual report.

Copy enclosed herewith.

*With commercial banks - delivery of collateral required.

ATTACHMENT

II. Background

3a. Situation would be extremely remote and next to impossible due to the system of checks and balances in Massachusetts, to include: (a) annual audits by independent public accountants, (b) regular recurring examination by the State Banking Department, (c) monthly financial reporting to the deposit insurer, (d) loan and investment limitations as provided by Massachusetts Statutes, and (e) early detection and expedient remedial action by the deposit insurer or State Banking Department.

Additional liquidity backup is furnished by:

(a) Member banks and deposit insurer maintain various lines of credit with commercial banks in Massachusetts, New York and Washington, D.C.
(b) Forty-two member banks are also members of the Federal Home Loan Bank system and have borrowing access to the FHLB.
(c) Member banks and deposit insurer would also have access to the discount window of the Federal Reserve Bank of Boston, if needed.

IV. Payment of Losses

4. It should, however, be noted that since 1980 The Co-operative Central Bank has furnished financial assistance to insured members to facilitate mergers, or to assist in asset restructure. None of these cases involved insolvency but were cases of early detection and prompt remedial action to maintain banking system safety and soundness.

(a) Permanent capital of $1,950,000 was disbursed to two institutions.
(b) Interest bearing loans of $3,529,670 were advanced to three institutions. Current outstanding balance of $899,670 exists.
(c) Capital certificates of $16,724,000 were issued to four institutions. $13,819,700 remains outstanding presently.
(d) Securities of $10,065,000 were acquired from one institution at book value. $8,731,700 remains outstanding subject to resale on 4/21/87.

THE CO-OPERATIVE CENTRAL BANK

Boston, Massachusetts

B Y - L A W S

Including Amendments
through October 25, 1983

I N D E X

ARTICLE I

NAME, LOCATION AND SEAL

This Corporation is and shall be known as THE CO-OPERATIVE CENTRAL BANK. Its principal office shall be situated in Boston, Massachusetts, at such location as from time to time shall be determined by the Board of Directors. The Corporation shall have an official seal bearing its name, the year of organization and such other device or inscription as the Board of Directors may determine.

ARTICLE II

PURPOSES

The purposes of the Corporation shall be to give effect to and administer for the benefit of Massachusetts Co-operative Banks, the laws governing The Co-operative Central Bank and the Reserve Fund and the Share Insurance Fund thereof, more particularly Chapter 45 of the Acts of 1932 and Chapter 73 of the Acts of 1934, as heretofore or hereafter amended.

ARTICLE III

MEETINGS OF THE CORPORATION

Section 1. Annual Meetings. The Annual Meeting of the Corporation shall be held within the Commonwealth within ninety days following the close of its fiscal year and shall be called by the Clerk to be held at such time and place as shall be designated by the Directors. Notice of such meeting shall be mailed to each member bank at its principal place of business at least thirty days before the date of the meeting.

Section 2. Special Meetings. Special meetings of the Corporation may be called and held as provided by law and by this Section.

(a) Call by Twenty Banks. The Clerk shall call a Special Meeting of the Corporation if requested in writing so to do by twenty or more member banks. Such request shall be in the form and substance prescribed by applicable provisions of law and shall be delivered to the Clerk at least forty-five days before the date of the meeting. The call for such meeting shall state the time, place and purpose or purposes thereof and shall be mailed to each member bank at its principal place of business at least thirty days before the date of the meeting.

(b) Call by Directors. The Clerk shall call a Special Meeting of the Corporation at the request of not less than a majority of the Directors. The call for any Special Meeting under this provision shall state the time, place and purpose or purposes thereof and shall be mailed to each member bank at its principal place of business at least ten days before the date of the meeting.

Section 3. Delegates. Except as otherwise provided by applicable law, at all meetings of the Corporation each member bank, by a delegate authorized by its Board of Directors, shall have one vote, provided that such delegate shall not vote on behalf of more than one member bank. The appointment of such delegate shall be certified by the Clerk of the member bank which the delegate represents and he shall vote in person and not by proxy.

Section 4. Quorum. A quorum at meetings of the Corporation shall consist of delegates from twenty-five percent of the banks which are member banks on the date of the meeting, but a lesser number may adjourn from time to time.

ARTICLE IV

BOARD OF DIRECTORS

Section 1. Composition and Election. The Board of Directors shall consist of such number as from time to time shall be prescribed by applicable provisions of law, subject to the limitations on the number of Directors who may, at the same time, be Directors or Officers of member banks which are members of the Federal Savings and Loan Insurance Corporation, and subject to such other limitations as may be prescribed by law. The election of Directors and the filling of vacancies on the Board of Directors shall be governed by provisions of law applicable thereto. Directors may serve for an unlimited number of terms, except that no person shall serve more than two full terms consecutively, for terms commencing on or after December 31, 1974.

A Director whose bank ceases to be a member of the Corporation shall cease to be an Officer or Director and his office(s) shall be deemed vacant as of the date his bank ceases to be a member. Said disqualification shall not apply to a Director whose bank ceases to be a member of the Corporation by virtue of its consolidation or merger with another co-operative bank. For purposes of these By-Laws, a member bank shall mean a co-operative bank organized and chartered pursuant to chapter one hundred and seventy of the General Laws.

Section 2. Meetings. Regular Meetings of the Board of Directors shall be held at least once each month, except that the Board may, by vote, omit not more than two of such Regular Meetings in any one calendar year. Special Meetings shall be called by the Clerk upon request of the President or upon the written request of at least five Directors. The time and place and the manner and extent of notice of Regular and Special Meetings of the Board of Directors shall be determined by the Board. The Board of Directors shall cause to be kept a record of all of its meetings and of all action taken thereat.

Section 3. Powers and Duties. Subject to applicable provisions of law from time to time in force and effect, the Board of Directors shall have full power and authority (a) to govern the business and affairs of The Co-operative Central Bank and the Reserve Fund and Share Insurance Fund thereof, and to take or cause to be taken all action determined by said Board at any time or from time to time to be necessary or advisable to give effect to the purposes of The Co-operative Central Bank and the Reserve Fund and the Share Insurance Fund thereof, and the provisions of law applicable thereto; (b) to supervise the acts of officers and employees of the Corporation and to approve their compensation; (c) to receive such fees for attendance at meetings of the Board of Directors or committees thereof as the Board from time to time may determine; and (d) to fill vacancies in any office or committee and to designate a person to act in place of any absent or disabled officer or committee member until the next legally prescribed election or until his successor is appointed. All books, papers and other documents, of every kind, owned by the Corporation or to which it may be legally entitled, and wherever located, shall be open for inspection to the Board of Directors at all times. Any or all powers, duties and responsibilities conferred upon the Board of Directors may be exercised by vote of a majority of its members in attendance at any meeting of such Board at which a quorum is present, except in cases where under applicable provisions of law, action by two-thirds or other percentage of the Directors is required.

Section 4. Executive Committee

(a) Composition. At the first meeting of the Board of Directors after the Annual Meeting of the Corporation, said Board shall elect from its own members an Executive Committee of five who shall serve until their successors are elected and qualified. In addition to said five members, the President and the Treasurer of the Corporation shall be members ex officio of the Executive Committee.

(b) Powers. The Executive Committee shall investigate and report to the Board of Directors on all applications for financial assistance from the Share Insurance Fund; and on such other matters as said Committee from time to time may deem to be in the interests of the Corporation or of the Board of Directors. The Executive Committee may authorize or approve the purchase, sale or exchange of investments of the Reserve Fund and of the Share Insurance Fund; except that by vote of the Board of Directors a Bond Committee, in lieu of the Executive Committee, may exercise such authority or give such approvals. The Executive Committee shall have such further powers and duties as the Board of Directors from time to time may prescribe; and between regular meetings of the Board of Directors the Executive Committee (and any Bond Committee to the extent above provided) may act for the Corporation in matters not expressly requiring action by the Board of Directors under any provision of law. At all times the Executive Committee and all other Committees shall be subject to the control of the Board of Directors.

Section 5. Nominating Committee. In or before May of each year, the Board of Directors shall elect a Nominating Committee of not less than three and not more than seven persons, each of whom shall be a Director or Officer of a member bank. Said Committee shall nominate not more than two nominees for each office of Director to be filled at the next Annual Meeting. The report of said Committee and the list of nominees selected thereby shall be delivered to the Clerk of the Corporation not later than July fifteenth of such year. The Clerk shall cause a copy of such report and list to be mailed, postage prepaid, to each member bank at least forty-five days before said Annual Meeting. Nothing in this Section shall preclude the nomination at the Annual Meeting of any other persons for such office of Director.

Section 5(a). Other Committees. The Board of Directors may elect from among its own members such other committees as the Board may determine, which shall in each case consist of not less than two (2) Directors, and which shall have such powers and duties as shall from time to time be prescribed by the Board. All actions by any committee established under this Section shall be reported to the Board of Directors at the meeting succeeding such action and shall be subject to revision, alteration and approval by the Board of Directors.

Section 6. Indemnification of Directors, Officers, Employees and Other Agents

(a) Directors and Officers. Each Director and Officer of the Corporation, including those who had so served but are no longer such, shall be indemnified by the Corporation against all charges which may be reasonably incurred or paid by him in connection with any claim, actual or threatened action, suit or proceeding (civil, criminal or other, including appeals) in which he may be involved by

reason of his being or having been such Director or Officer, made or brought against him by reason of any act or omission, or alleged act or omission (including all such antedating the adopting of this By-Law) by him in any or each such capacity, and also against all charges which may be reasonably incurred or paid by him (other than to the Corporation for its account) in reasonable settlement of any such claim, action, suit or proceeding.

The determination whether a settlement is or was reasonable shall be made by a majority of a quorum of the Board of Directors comprised of those Directors who are not involved in the claim, action, suit or proceeding, and if there be no such quorum, then by one or more disinterested persons to whom the question may be referred by the Board of Directors.

Such indemnification may include payment by the Corporation in advance of expenses incurred in defending a civil or criminal action or proceeding upon receipt of an undertaking by the person indemnified to repay such payment in advance if he shall be adjudicated to be not entitled to indemnification.

(b) Employees and Other Agents. The Board of Directors may, by general vote or by vote pertaining to a specific employee or agent or class thereof, authorize indemnification of the Corporation's employees and agents, other than those Officers, Directors and persons referred to in paragraph (a) above, to whatever extent they may determine, which may be in the same manner and to the same extent provided in paragraph (a) above.

(c) Definition of "Charges". As used in this Section (6) the term "charges" shall include all liabilities and expenses, and without limitation, judgment awards, settlement awards, awards by other tribunals or bodies, attorneys' fees, costs, fines and penalties.

(d) Limit upon Indemnification. Indemnification under this Section (6) whether under paragraph (a) or paragraph (b) shall not be made, and no person shall be entitled to indemnification, in any case where such claim, action, suit or proceeding shall proceed to final adjudication and it shall be finally adjudged, nor shall any settlement be determined reasonable if it is found that such Director, Officer, person, employee or agent has not acted in good faith in the reasonable belief that his action was in the best interests of the Corporation. Neither a judgment of conviction nor the entry of any plea in a criminal case shall of itself be deemed an adjudication that such Director, Officer, employee or agent was not acting in good faith, if he acted for a purpose which he reasonably believed to be in the best interests of the Corporation, and had no reasonable cause to believe that his conduct was unlawful.

(e) Insurance. The Board of Directors may, by general vote or by vote pertaining to a specific Director, Officer, employee, agent or class thereof, including those who had so served but are no longer such, authorize the purchase and maintenance of insurance on behalf of the designated Director, Officer, employee, agent or class thereof, in such amounts and on such terms as the Board of Directors deems advisable, against any liability incurred by any person by reason of his serving or having served in any such capacity, or arising out of his status as such, whether or not the Corporation would have the power to indemnify him against such liability pursuant to this Section (6).

(f) Other Remedies. The rights of indemnification and/or insurance herein provided for shall be severable, shall not be exclusive of other rights to which any Director, Officer, employee or agent may now or hereafter be entitled, shall continue as to a person who has ceased to be such Director, Officer, employee or agent, and shall inure to the benefit of the heirs, executors and administrators of such a person.

ARTICLE V

OFFICERS

Section 1. Composition and Election. The officers of the Corporation shall consist of the officers prescribed by law and such other officers, including such number of Assistant Treasurers, as the Board of Directors from time to time may deem necessary. Such officers shall be elected by the Board of Directors at its first meeting after the Annual Meeting and they shall continue in office until their successors are duly elected and qualified. The President and a Vice President, other than the Executive Vice President, shall be elected from the Board of Directors. Other officers may, but need not be, members of the Board of Directors. The Clerk of the Corporation shall be Clerk of the Board of Directors. The Directors may fill any vacancies in said offices until the next Annual Meeting or until their successors are appointed and qualified.

Section 2. President. The President shall preside at all meetings of the Board of Directors and of the Corporation, at which he is present. He shall have and may exercise any or all of the powers and duties which from time to time may be prescribed or conferred upon him by law or by the Board of Directors, and such other powers and authority as may be necessary or incidental to the proper discharge of the duties and responsibilities of President. He shall hold or control custody of all surety bonds covering officers and employees of the Corporation.

Section 3. Vice Presidents. In the event of the absence or disability of the President, the Vice President elected from the Board of Directors shall perform all of the duties and may exercise any or all of the powers of the President, subject to the control of the Board of Directors. The Executive Vice President shall be the executive officer of the Corporation unless and until some other officer is so designated by the Board of Directors. The Vice Presidents, respectively, shall have such other powers and duties as the Board of Directors from time to time may confer or prescribe. With the approval of the Board of Directors the Executive Vice President may, at the same time, serve as Treasurer of the Corporation.

Section 4. Treasurer. The Treasurer shall have the following powers and duties and such other powers and duties as from time to time may be conferred or specified by law or by the Board of Directors:

(a) He shall keep safely or cause to be held or deposited for safekeeping, all of the money, securities and other property belonging to or held by the Corporation; and he shall disburse or otherwise dispose of the same subject to the supervision and direction of the Board of Directors or of the Executive Committee thereof.

(b) He shall give bond to the Corporation for the faithful performance of his duties in such amount and with such surety or sureties as the Board of Directors and the Commissioner of Banks from time to time may prescribe or approve; and he shall file an attested copy of such bond with said Commissioner, together with a certificate of the custodian thereof that the original bond is in such custodian's possession or under his control.

(c) He shall keep or cause to be kept true and proper books of account showing all moneys, securities, and other property received by him and all disbursements made by him, together with vouchers for such disbursements. He shall have custody of the seal and of all books and papers of the Corporation not otherwise provided for by law or by these By-Laws or by vote of the Board of Directors.

(d) He shall prepare such financial and other reports, returns and statements of condition as from time to time may be required of the Treasurer of this Corporation by law or by the Board of Directors or by the Executive Committee thereof, or by the Commissioner of Banks.

Assistant Treasurers. An Assistant Treasurer may perform all the duties of the Treasurer.

Section 5. Clerk. The Clerk shall keep the records of all meetings of the Corporation and of the Board of Directors. He shall call and give notice of meetings of the Corporation and of the Board of Directors when and in the manner required by law or by these By-Laws, or by order of the President or Board of Directors not inconsistent therewith. The Clerk shall perform such other duties as from time to time may be required by law or by these By-Laws or by the Board of Directors.

ARTICLE VI

FINANCIAL ASSISTANCE TO MEMBER BANKS

Loans made and financial assistance granted to member banks from the Reserve Fund or the Share Insurance Fund, or both, of this Corporation, shall be made or granted and administered in accordance with applicable provisions of law; and the appropriate officers or Executive Committee of the Corporation, with the authority of the Board of Directors, are respectively authorized and empowered to do any and all things necessary or advisable to negotiate, make, grant, approve or consummate any such loan or financial assistance, and any matters relating thereto or arising therefrom, subject to such approvals and legal requirements as may be applicable in each instance.

ARTICLE VII

EXCESS INSURANCE

The portions of accounts of shareholders of member banks which become members of the Federal Savings and Loan Insurance Corporation, in excess of the amounts from time to time insured by that Corporation, shall continue to be insured by the Share Insurance Fund of The Co-operative Central Bank, subject to its rights of subrogation and to receive assessments as provided by law and subject to other applicable provisions of law governing the Share Insurance Fund.

ARTICLE VIII

EXECUTION OF INSTRUMENTS

Section 1. Checks, Etc. Notes, checks, drafts and bills of exchange shall be executed in the manner prescribed by the Board of Directors and by the officer or officers who may be designated for such purpose by the Board of Directors.

Section 2. Other Instruments. The President, Vice Presidents, Treasurer and Assistant Treasurers, or any of them, are authorized and empowered severally to execute, acknowledge, seal if necessary, and deliver, in the name and on behalf of The Co-operative Central Bank or of the Reserve Fund or Share Insurance Fund thereof whenever authorized by the Board of Directors by general or specific vote, all agreements, deeds and conveyances of real estate, all assignments, extensions, releases, partial releases or discharges of mortgages, and all assignments and transfers of bonds and other securities, and to release or assign the interest of The Co-operative Central Bank or of the Reserve Fund or Share Insurance Fund thereof, in any policy of insurance held in connection with any of the foregoing.

ARTICLE IX

AMENDMENTS

These By-Laws may be amended by vote of two-thirds of the delegates of the member banks present and voting at any regular or special meeting of the Corporation, and any such amendments shall not become effective until they shall have been approved by the Commissioner of Banks. Copies of all proposed amendments to the By-Laws shall be submitted to the member banks and to the Directors of this Corporation at least thirty days before the date of the meeting at which action is proposed to be taken thereon.

Mutual Savings Central Fund, Inc.
ONE LINSCOTT ROAD
WOBURN, MASSACHUSETTS 01801
617-938-1984

March 28, 1985

Honorable Doug Barnard, Jr., Chairman
Subcommittee on Commerce, Consumer, and
Monetary Affairs
U.S. House of Representatives
Rayburn Building, Room B-377
Washington, DC 20515

Dear Chairman Barnard:

Enclosed is the completed questionaire you sent by letter dated March 20, 1985. If we can provide any additional information, please do not hesitate to contact me or Mark Medvin of my staff.

Sincerely,

Leonard Lapidus
Executive Vice President

MSM/bc
Enclosure

NAME OF DEPOSIT INSURANCE FUND Mutual Savings Central Fund, Inc.
Note: Answers too long for the space provided are carried over to page 8.

I. General Information: The MSCF insures the full amount of deposits in insured institutions. Members have the option of joining the FDIC, in which case the FDIC insures the first $100,000 per account and the MSCF insures any excess not covered by FDIC. 49 of our 145 members have FDIC insurance.

1. Type(s) of Financial Institution(s) whose deposits you insure: State-chartered savings banks

2. In which state(s) do you insure: Massachusetts

3. A. Cost of initial membership in your fund, if any: One quarter of one percent of deposits.

   B. Annual premium: Maximum is one-sixteenth of one percent of deposits. Current is 1/24 of one percent of deposits.

   C. Continuing equity contribution or membership deposit: None other than initial membership contribution. Board can call up to a total of one percent of deposits.

4. Maximum coverage per account or per depositor: No maximum. Deposits insured in full.

5. Do you insure brokered deposits: Yes

6. Number of insured institutions, by type: (Total deposits as of 2/28/85; Savings banks)

   A. Under $100 million: 61

   B. $100 million to $500 million: 77

   C. $500 million to $1 billion: 6

   D. Over $1 billion: 1

7. Aggregate amount of deposits insured, by type of institution: Approximately $12.3 billion (all savings banks; 1/31/85)

8. Your fund's total useable assets: $398 million (1/31/85)

9. Ratio of usable insurance fund assets to deposits insured: 3.23 percent (1/31/85)

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

The Central Fund is a private corporation created by a special act of the state legislature. It was established in 1932 as a liquidity facility, and the Deposit Insurance Fund was added in 1934. (Statute attached as EXHIBIT I)

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

Massachusetts Banking Division

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or

No

b. authority to assess other insured institutions enough to cover the losses?

Authority to assess insured institutions up to a maximum of one percent of deposits (this represents a call on approximately $240 million.)

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

No

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

Established bank lines of credit total $40 million. (State Street Bank and Trust Company, Bank of Boston, Bank of New England, Shawmut Bank of Boston, Barclays Bank). We have an additional $40 million in non-contractual lines with Salomon Brothers Inc. and William E. Pollock Government Securities, Inc.

6. Do you reinsure your risks with any other insurance carriers? Please provide details.

No

7. Regarding your board of directors:

a. How is your board of directors selected?

By vote of member banks.

b. What rules govern the size and composition of the board?

Board has 25 members. By law, 21 are bankers and four are outside directors. Banks are divided into seven districts, and each district elects three bank directors. The four outside directors are elected at-large and cannot be affiliated with any financial institution. In all elections each bank has one vote for each $10 million of deposits.

c. Who are the present members of your board? (Please provide names and principal affiliations.)

Bank Directors:

1. Francis J. Shea, Union Warren Savings Bank
2. Robert G. Lee, First American Bank for Savings
3. Harlan R. Pinkham, Hyde Park Savings Bank
4. Thomas J. Kelly, Somerset Savings Bank
5. Robert B. Nickerson, Winchester Savings Bank
6. Janet M. Pavliska, Bank Five for Savings
7. John P. Fitzpatrick, First Essex Savings Bank
8. Charles W. Morse, Newburyport Five Cents Savings Bank
9. John H. Pramberg, Institution for Savings in Newburyport
10. Ralph C. Jackson, Canton Institution for Savings
11. John D. Lund, Dedham Institution for Savings
12. Richard M. Berrio, Provincetown Savings Bank
13. John J. Jackson, Spencer Savings Bank
14. Stanley G. Quackenbush, Worcester County Institution for Savings
15. Emil G. Schirner, Whitinsville Savings Bank
16. Malcolm R. George, Ludlow Savings Bank
17. Donald A. Williams, Westfield Savings Bank
18. Victor E. Quillard, Hampden Savings Bank
19. George P. Adams, Great Barrington Savings Bank
20. Roy C. Ekengren, Easthampton Saving Bank
21. Duane A. Nyman, Orange Savings Bank

Outside Directors:

1. James S. Duesenberry - Harvard University
2. John H. Fitzpatrick - Owner of Red Lion Inn, Blantyre Castle, and Country Curtains; Former State Senator
3. Gerard L. Pellegrini - Pellegrini & Seeley, P.C.; WNEC School of Law
4. Eileen Schell - Former Secretary of Consumers Affairs (Massachusetts State Government); owner of Copyprint franchise

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

The Central Fund has no supervisory authority. All such requirements are imposed by the Massachusetts Banking Division.

2. Please respond separately for each state in which you insure deposits:

a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

No. All state-chartered savings banks must be members of the Fund, and there is no provision in the law for administrative discontinuance of insurance. However, if a member converts to a federal charter, or merges with a non-savings bank where the non-savings bank is the surviving institution, insurance would be cancelled automatically.

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

None, other than conversion to federal charter or disappearance of the institution in a merger.

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

Four banks have had their insurance discontinued as a result of conversion to federal charter.

3. Please respond separately for each state in which you insure deposits:

a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

Not on a continuing basis. The Fund has authority to "review the financial condition" of members from time to time to the extent the Commissioner approves. Also, the Fund can request that the Commissioner cause a special examination and audit to be made by a CPA. These authorities are specified by statute (see Section 1A of the Deposit Insurance Fund statute).

b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?

The Central Fund has no regular examination authority. Regular supervisory examinations are performed by the Massachusetts Banking Division.

c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

The Commissioner is directed by law (Section 1A of the Deposit Insurance Fund statute) to furnish the Central Fund with a copy of each member bank's examination report. These are received on a regular basis. In addition, the

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants? (to p. 9)

Yes

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance? The Central Fund has the authority to make recommendations to the bank to correct unsafe or unsound practices, and if the recommendations are not followed, the Fund is directed to notify the Commissioner. If the Commissioner determines that the bank is in an unsafe or unsound condition to transact its business, he can so certify and either take possession and control of the bank (FDIC banks) or turn the possession and control of the bank over to the Central Fund (non-FDIC banks). (Section 1A of the Deposit Insurance Fund statute). In addition, the Central Fund has broad authority to provide assistance to members in order to reduce the risk or avoid a threatened loss to the Central Fund, or to facilitate a merger, consolidation, or a purchase and assumption.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

Yes, but only for those institutions that are not also members of the FDIC.

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?

We have never liquidated a bank and would never, under normal circumstances, do so. Rather we would seek to merge the bank or sell it. Nevertheless, in the event of a liquidation, even though our statute sets a maximum payout period of three years (Section 6), we would pay all depositors immediately.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

When a bank is certified to the Central Fund, the Fund can operate the bank until it is rehabilitated or a merger partner can be found. In either instance, the Fund can provide assistance.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

Yes. This would normally be a joint effort on the part of the Banking Division and the Fund and, in any event, would require the Commissioner's approval. The Fund has explicit authority to provide assistance to facilitate a purchase and assumption.

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

Yes. When a bank is certified to the Central Fund, the Fund can continue to operate the bank until it is either rehabilitated or a merger partner can be found. In either case, the Fund can also provide assistance to the bank.

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date: None.

a. The name, location, and size of the institution;

b. The total dollar cost of the insolvency to your fund;

c. The dollar amount of insured deposits in the institution at time of closing;

d. The dollar amount of uninsured deposits in the institution;

e. The percentage recovery to date to depositors on uninsured deposits;

f. The gross dollar amount of outstanding unpaid depositor claims; and

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

Year Ending October 31	
1981	$291,000,000
1982	$323,000,000
1983	$360,000,000
1984	$403,000,000

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

See EXHIBIT II (data as of October 31, 1984). The Fund invests only in US Government and agency obligations, bankers acceptances and CDs in commercial banks operating in Massachusetts, and repurchase agreements secured by US Government or agency collateral (possession delivered to the Central Fund).

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

No

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

Year ending October 31	Yield Before Gains/Losses	Year After Gains/Losses
1981	10.32	11.62
1982	10.93	9.93
1983	9.96	10.44
1984	10.34	10.46

5. Please provide a copy of your latest annual report.

(FY 1983) EXHIBIT III
(FY 1984) Not yet available; Audited Financials are EXHIBIT IV

Page 5-3C. Central Fund receives a variety of reports from member banks that are used to maintain surveillance. These include (a) Monthly Deposit Analysis and Balance Sheet Report, (b) Quarterly Delinquency Report, (c) Semiannual Liquidity Report, and (d) Quarterly and Year-end Call Report. These reports are provided pursuant to regulations adopted by the Central Fund with the Commissioner's approval.

1

RECEIVED 4/2/85 Boston, MA

NAME OF DEPOSIT INSURANCE FUND Massachusetts Credit Union Share Insurance Corporation

I. General Information:

1. Type(s) of Financial Institution(s) whose deposits you insure:
State-chartered credit unions in Massachusetts

2. In which state(s) do you insure:
Massachusetts

3. A. Cost of initial membership in your fund, if any: 1% of insured shares and deposits

B. Annual premium: 1/12 of 1% of insured shares and deposits

C. Continuing equity contribution or membership deposit:
1/4 of 1% of growth through 6/30/85; none thereafter

4. Maximum coverage per account or per depositor:
CU under $4MM: $75M single/$100M joint; CU over $4MM: $150M single/$200M joint
Plus individual retirement accounts (no limit) and club accounts ($4M max.)

5. Do you insure brokered deposits:
We insure all legal deposits up to legal limits.

6. Number of insured institutions, by type:

A. Under $100 million: 220

B. $100 million to $500 million: 4 (largest = $170MM)

C. $500 million to $1 billion:

D. Over $1 billion:

7. Aggregate amount of deposits insured, by type of institution: $2,750,000,000.

8. Your fund's total useable assets: $40,000,000.

9. Ratio of usable insurance fund assets to deposits insured: 1.45%

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

Created by Massachusetts General Laws, Chapter 294 of the Acts of 1961, as amended, as a quasi-public corporation.

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

Massachusetts Department of Banking

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or

No

b. authority to assess other insured institutions enough to cover the losses?

Yes, within specified limits

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

Assets of the Corporation must be maintained at at least 1.25% of insured shares and deposits.

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

Central Liquidity Facility, NCUA	$5,000,000.*	secured
Century Bank & Trust Co.	2,000,000.	unsecured

*increaseable up to 80% of the market value of the Corporation's assets.

6. **Do you reinsure your risks with any other insurance carriers? Please provide details.**

No.

7. **Regarding your board of directors:**

a. **How is your board of directors selected?**

By election at annual meeting. One vote per insured member CU.

b. **What rules govern the size and composition of the board?**

Massachusetts General Laws

c. **Who are the present members of your board? (Please provide names and principal affiliations.)**

Joseph J. Altman, CPA	Brown, Altman & Co.	Partner
Robert C. Arsenault	Mitre Employees CU	President
Robert W. Carlson	Sharon Credit Union	President
Marvin L. Cashman	Metropolitan CU	Chmn & Treasurer
Herbert J. Collins	Harvard Univ. Emp. CU	Manager
Marilyn M. Dumais	Buxton Employees CU	Treasurer
Joseph V. Forti	Rockland Credit Union	President
B. George Frizzell	GTE Employees CU	Treasurer
Kent B. Goodchild	Springfield Muni. ECU	Manager
Lloyd P. McDonald	Financial Benefits, Inc.	President
Robert R. Montgomery, Jr.	Telephone Workers' CU	Member
Robert J. O'Regan	White, Inker, Aronson	Attorney
Harold N. Orent	Progressive Concumers CU	President
Barbara M.W. Silva	Citizens Credit Union	President
Gregory A. Smith	Cobblestone Corporation	President
Stewart A. Steele	Quincy Municipal CU	Treasurer
John J. Svagzdys	Brockton Credit Union	Asst. Treasurer

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

No.

2. Please respond separately for each state in which you insure deposits:

a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

Yes.

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

Non-payment of assessments, or unsound practices, after a hearing, with the approval of the Commissioner of Banks.

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

None (with the exception of merged or liquidated members)

3. Please respond separately for each state in which you insure deposits:

a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

No. Such legislation is pending.

b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget? n/a

c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

Yes - annually in all cases.

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

Only members having over $5 million in assets.

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

Seek permission for intervention from the Commissioner of Banks.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

Yes.

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?

Within days.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

No.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

Yes.

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

Yes.

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date:

This information to follow at later date.

a. The name, location, and size of the institution;

b. The total dollar cost of the insolvency to your fund;

c. The dollar amount of insured deposits in the institution at time of closing;

d. The dollar amount of uninsured deposits in the institution;

e. The percentage recovery to date to depositors on uninsured deposits;

f. The gross dollar amount of outstanding unpaid depositor claims; and

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

1981:	$ 20,870,000
1982:	24,626,000
1983:	27,920,000
1984:	35,224,000

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

US Govt & Agency Bonds	$ 28,491,873	book	28,362,432	market
Corporate Bonds	3,697,247	"	3,541,953	"
Stock	2,245,679	"	2,469,863	"
Invested Cash	3,268,060	"	3,268,060	"
Acquired Notes	750,000	" (net)	750,000	"

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

No.

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

Approximately 10.5% - 11.5% for all years

5. Please provide a copy of your latest annual report.

NDGC

National Deposit Guaranty Corporation
555 Metro Place North, Dublin, Ohio 43017 (614) 764-1900

March 26, 1985

MR. DOUG BARNARD, JR., Chairman
Ninety-Ninth Congress
Congress of the United States
House of Representatives
Commerce, Consumer, and Monetary Affairs
Subcommittee of the
Committee on Government Operations
Rayburn House Office Building, Rm. B-377
Washington, DC 20515

Dear Chairman Barnard:

Enclosed you will find our response to your letter of March 20, 1985. Also we have enclosed a copy of our "Operations Manual" which will provide additional background on our activity. Please note a number of the reports in the manual, particularly composite member financial data, have not been updated for the period ending 1984. You will be provided with those reports as soon as they are available.

We obviously have a sincere interest in the activities of your committee and accordingly would appreciate a schedule of all public hearings concerning this matter. In addition, I am available to appear as a witness on this subject.

Thank you for your cooperation in this matter. If you have any further questions or need additional information, please contact me at your convenience.

Sincerely,

SAMUEL J. RIZZO
President

SJR/csb

Enclosure

NAME OF DEPOSIT INSURANCE FUND: National Deposit Guaranty Corporation

I. General Information:

Many of the questions herein do not allow adequate space for response, therefore, we have reformatted your questions and incorporated by reference our "Operations Manual" which provides additional data.

1. **Type(s) of Financial Institution(s) whose deposits you insure:**

   Credit Unions

2. **In which state(s) do you insure:**

   Arizona, California, Idaho, Illinois, Indiana, Iowa, Louisiana, Minnesota, Missouri, Nevada, New Hampshire, New Jersey, Ohio, Oklahoma, Pennsylvania and West Virginia.

3. **A. Cost of initial membership in your fund, if any:**

   A deposit equal to one percent (1%) of member savings.

   B. Annual premium:

   Allowable to 1/12 of one percent (1%).

   C. Continuing equity contribution or membership deposit:

   1) Adjustment of one percent (1%) deposit annually.

   2) Special assessment authority by necessity.

4. **Maximum coverage per account or per depositor:**

   100%

5. **Do you insure brokered deposits:**

   No.

6. **Number of insured insitutions, by type:**

A.	**Under $100 million:**	435
B.	**$100 million to $500 million:**	6
C.	**$500 million to $1 billion:**	1
D.	**Over $1 billion:**	0

7. **Aggregate amount of deposits insured, by type of institution:**

   $3.15 billion - Credit unions

8. **Your fund's total useable assets:**

   $33.6 million plus $12 million (reinsurance policy)

9. **Ratio of useable insurance fund assets to deposits insured:**

   $1.51 per $100 of insured deposits with reinsurance.

II. Background:

1. **Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.**

   The National Deposit Guaranty Corporation is a private agency created by Chapter 1761 of the Ohio Revised Code. The act has yet to be amended to reflect the corporate name change in 1981 and still refers to the corporation as the American Credit Union Guaranty Association. (See Operations Manual Section "Regulations")

2. **Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.**

State	Regulatory Agency
Arizona	Walter C. Madsen State Banking Department
California	Jack A. Carlson Department of Corporations
Idaho	Tom D. McEldowney Department of Finance
Illinois	Victor Pambianco Department of Financial Institutions
Indiana	Richard Wiles Department of Financial Institutions
Iowa	Betty Minor Credit Union Department
Louisiana	Henry N. Harris Office of Financial Institutions
Minnesota	Terry R. Meyer Division of Financial Institutions
Missouri	Doyle R. Brown, Jr. Division of Credit Unions
Nevada	L. Scott Walshaw Financial Institution Divison
New Hampshire	Arlan S. Macknight Banking Department
New Jersey	Joseph P. Lanigan Banking Department
Ohio	Robert A. Sorin Department of Commerce
Oklahoma	R.Y. Empie State Banking Department
Pennsylvania	Fred George Banking Department
West Virginia	Thomas J. Hansberry Department of Banking

3. **If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,**

   a. **access to the treasuries of the state(s) in which you operate; and/or,**

      No, the corporation cannot access the treasuries of states in which we operate, however, the corporation has purchased reinsurance to protect against catastrophic loss, and has arranged substantial lines of credit.

   b. **authority to assess other insured institutions enough to cover the losses?**

      Yes, the corporation has the authority to make special assessments of its members to cover losses.

4. **Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?**

   Yes, governing statutes set the minimum ratio of insurance fund assets to insured deposits at one percent (1%).

5. **Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution(s) have these credit lines been established?**

   Yes, we have lines of credit with two Ohio banks. We have a $100 million credit facility with Bank One of Columbus and a $5 million line of credit with the Central National Bank of Cleveland. All borrowings under the above lines must be collateralized with government securities at 80% of fair market value.

6. **Do you reinsure your risks with any other insurance carriers? Please provide details.**

   Yes, we have a $12 million dollar reinsurance contract. Policy requires a $2 million deductable with $4 million coverage per occurance.

7. Regarding your board of directors:

a. How is your board of directors selected?

The board of directors is elected by our member credit unions.

b. What rules govern the size and composition of the board?

Section 1761.15 of the Ohio Revised Code (See Operations Manual - Section "Regulations")

c. Who are the present members of your board? (Please provide names and principal affiliations.)

William A. Herring, Chairman
President of the Cincinnati Central Credit Union
Cincinnati, Ohio

Gene Artemenko, Vice Chairman
President/Treasurer - United Air Lines Employees Credit Union
Chicago, Illinois

Samuel J. Rizzo
President of the National Deposit Guaranty Corporation
Dublin, Ohio

Jose Alonzo
President of the West Virginia Credit Union League
Parkersburg, West Virginia

William Brown
Partner - Law firm of Crabbe, Brown, Jones, Potts and Schmidt
Columbus, Ohio

Paul W. Brown
Partner in the law firm of Thompson, Hine & Flory
Columbus, Ohio

Lesley McElrath
Treasurer/Manager of Cleveland Postal Employees Credit Union
Cleveland, Ohio

Peter L. Pointer
Vice-President of Lowe & Associates
Columbus, Ohio

William A. Strickland
Treasurer and Manager of the Number Five Credit Union
Akron, Ohio

III. Supervision of insured institutions:

1. **Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?**

   Yes, underwriting and solvency conditions are required per contract and governing statute; in addition, the credit unions are required to meet their domicile state requirements concerning financial operations. Monthly, each member credit union is required to submit financial statements inclusive of delinquent loan analysis and investment schedules to the corporation to facilitate the monitoring of their financial position.

2. **Please respond separately for each state in which you insure deposits:**

   a. **Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit fund?**

      Yes, the corporation has the authority by contract and statute to terminate insurance of any member institution.

   b. **Under what set of conditions or circumstances would you be authorized to discontinue insurance?**

      Chapter 1761.28 - (See Operations Manual - Section "Regulations")

   c. **Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.**

      None

3. **Please respond separately for each state in which you insure deposits:**

   a. **Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.**

   Yes, the corporation may by contract and statutory authority examine any financial record of its member institutions.

   b. **How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have? What is your examination operating budget?**

   For each state we do business in, our examination policies and procedures are:

   1. Monthly, each member credit unions submits its financial statement which is analyzed by computer.

   2. Annually, each credit union is examined by its state regulatory agency.

   3. On-site examinations conducted when certain indicators are triggered by the computer analysis and state examinations.

   The corporation has a staff of four examiners with a total operating budget of $263,500 for the current year.

   c. **Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?**

   Yes, we have the right of access to the examination reports of the supervisory authority in each state we do business.

   Yes, we receive each member credit union's examination report annually from each state.

4. **Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?**

   No.

5. **If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?**

See Operations Manual - Section "Operations".

IV. Payment of Losses:

1. **Do you act as receiver/liquidator for failed institutions you insure?**

Yes, we will act as receiver/liquidator of any failed institution that we insure.

2. **If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they wait a liquidation process?**

In normal cases, depositors receive their funds within ten (10) days.

3. a. **If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?**

No, in addition to liquidation, we may merge the credit union with another financial institution.

b. **Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?**

Yes

c. **Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?**

Yes

4. **Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date:**

a. **The name, location, and size of the institution;**

See Operations Manual - Section "Reports"

b. **The total dollar cost of the insolvency to your fund;**

See Operations Manual - Section "Reports"

c. **The dollar amount of insured deposits in the institution at time of closing;**

See Operations Manual - Section "Reports"

d. **The dollar amount of uninsured deposits in the institution;**

All deposits were fully insured in each institution.

e. **The percentage recovery to date to depositors on uninsured deposits;**

All depositors have received 100% of their funds.

f. **The gross dollar amount of outstanding unpaid depositor claims; and**

None.

g. **The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.**

All payouts occurred within ten (10) days of closing of the institution with the exception of the Credit Union OH - 1121 which due to missing funds and lack of ledgers, journals, and account cards, required extensive recontruction of those records.

V. Insurance Fund Reserves:

1. **How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.**

   1981 - $ 8,577,785
   1982 - $12,612,461
   1983 - $25,120,505 Plus $10,000,000 (Reinsurance Policy)
   1984 - $33,581,703 Plus $12,000,000 (Reinsurance Policy)

2. **What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank corporate bonds, mutual fund investments, state/local securities)?**

   See Operations Manual - Section "Reports".

3. **Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?**

   No.

4. **In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?**

   1981 - 9.84%
   1982 - 12.19%
   1983 - 10.52%
   1984 - 11.10%

5. **Please provide a copy of your latest annual report.**

   See Operations Manual - Section "Reports".

LOSS HISTORY

CERTIFICATE NO.	STATE	ASSET SIZE	YEAR	SHARES	NET LOSS (GAIN) TO THE FUND
OH - 786	Ohio	105,000	1980	96,000	60,738.61
OH - 535	Ohio	400,000	1980	271,000	79,436.51
OH - 1187	Ohio	13,000	1981	11,000	905.32
OH - 1121	Ohio	35,000	1981	32,000	21,212.38
OH - 127	Ohio	5,000,000	1981	4,700,000	154,294.37
OH - 1277	Ohio	4,500	1981	4,200	354.54
OH - 754	Ohio	68,000	1982	57,000	17,292.85
OH - 1268	Ohio	155,000	1982	150,000	2,064.00
OH - 902	Ohio	45,000	1982	35,000	(190.00)
OH - 304	Ohio	105,000	1982	98,000	17,336.23
OH - 825	Ohio	100,000	1982	93,000	9,410.34
OH - 518	Ohio	30,000	1982	24,000	2,758.04
OH - 821	Ohio	50,000	1982	47,000	2,069.22
OH - 703	Ohio	190,000	1982	170,000	8,520.16
OH - 1049	Ohio	1,900,000	1982	1,850,000	152,863.35
OH - 1097	Ohio	135,000	1982	120,000	11,495.00
WV - 2017	W.Va.	62,000	1982	61,000	10,740.63
OH - 134	Ohio	3,800,000	1983	3,350,000	376,415.56
OH - 1323	Ohio	175,000	1983	144,000	(5,081.98)
OH - 1148	Ohio	70,000	1983	65,000	24,316.81
OH - 1337	Ohio	4,000,000	1983	3,900,000	11,525.58
OH - 755	Ohio	125,000	1983	115,000	78,344.89
OH - 558	Ohio	80,000	1983	75,000	11,877.86
OH - 782	Ohio	160,000	1983	127,000	8,334.62
OH - 1007	Ohio	110,000	1983	105,000	45,759.22
IL - 4727	Illinois	180,000	1984	150,000	131,557.63
IL - 4371	Illinois	500,000	1984	475,000	21,531.88
IL - 4121	Illinois	100,000	1984	90,000	440.28
TOTALS		$17,697,500		$16,415,200	$1,256,323.90

NAME OF DEPOSIT INSURANCE FUND: OHIO DEPOSIT GUARANTEE FUND (the "ODGF")

I. General Information

1. Type(s) of Financial Institution(s) whose deposits you insure: Ohio chartered savings and loan associations.

2. In which state(s) do you insure: Ohio only.

3. A. Cost of initial membership in your fund, if any: 2% of withdrawable savings, rounded to the nearest $100, adjusted semi-annually as of June 30 and December 31 of each year, plus pro rata share of accumulated earnings at date of acceptance into fund membership.

B. Annual premium: None.

C. Continuing equity contribution or membership deposit: 2% of withdrawal savings, rounded to the nearest $100, adjusted semi-annually as of June 30 and December 31 of each year.

4. Maximum coverage per account or per depositor: 100%

5. Do you insure brokered deposits: Yes, but members are controlled by the OGDF Rules and Regulations as to amounts they can take in brokered deposits (See Item II(k) the ODGF Rules and Regulations (the "Rules").

6. Number of insured institutions, by type:

A.	Under $100 million:	61
B.	$100 million to $500 million:	7
C.	$500 million to $1 billion:	1
D.	Over $1 billion:	1 (Home State)

	December 31, 1984	
	Assets	Deposits
A.	$1,833,006,000	$1,699,704,000
B.	$1,175,396,000	$1,119,130,000
C.	$ 914,551,000	$ 823,675,000
D.	$1,440,608,000	$ 668,005,000

7. Aggregate amounts of deposits insured, by type of institution: $4,310,514,000 at December 31, 1984.

8. Your fund's total usable assets: $126,912,430 at December 31, 1984 (market value)

9. Ratio of usable insurance fund assets to deposits insured: 2.94% at December 31, 1984

II. Background:

1. Are you a governmental or private agency and are you a creation of state law? Please provide a text or description of your basic statutory authority.

   The ODGF is a non profit, private mutual corporation created pursuant to Ohio Revised Code Section 1151.80-92, as repealed by Amended Substitute Ohio Senate Bill 119.

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

   Ohio Division of Savings and Loans.

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute:

a. Access to the treasuries of the state(s) in which you operate; and/or

No

b. Authority to assess other insured institutions enough to cover the losses?

Not by statute; however, Article V of the ODGF Constitution and Item III(A) of the ODGF Rules provides a method for an assessment.

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

No

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

The ODGF has a $1,000,000 line of credit at the Bank for Savings & Loan Associations, Chicago, Illinois

6. Do you reinsure your risks with any other insurance carriers? Please provide details.

$2,000,000 Insurance Company of North America. $25,000,000 retention rider

7. Regarding your board of directors:

a. How is your board of directors selected:

Selected by Nominating Committee and/or representatives or members at ODGF Annual Meeting. See Article VIII of the Constitution.

b. What rules govern the size and composition of the board?

See Article VIII of the ODGF Constitution.

c. Who are the present members of your board? (Please provide names and principal affiliations.)

Name	Affiliation
Charles A. Brigham, Jr.	President and Director, Federated Savings Bank, Lockland, Ohio
John A. Dreyer	Director, Baltimore Savings and Loan Company, Cincinnati, Ohio
Richard D. Hoffman	Chairman of the Board, The City Loan & Savings Company, Lima, Ohio
Vernon W. McDaniel	Assistant Treasurer and Director, Anderson Ferry Building and Loan Company, Cincinnati, Ohio
John R. Perkins	President and Director, The Metropolitan Savings Bank, Youngstown, Ohio
Eleanor J. Remke	President and Director, Madison Saving Bank, Cincinnati, Ohio
Joseph D. Rusnak	President and Director, Mentor Savings Bank, Mentor, Ohio
David J. Schiebel	Chairman of the Board, Home State Savings Bank, Cincinnati, Ohio
Harold R. Swope	President and Director, Independent Savings Association, Euclid, Ohio
Charles F. Tilbury, Sr.	Executive Vice-President and Director, The Clermont Savings Association, New Richmond, Ohio
Jack R. Wingate	Executive Vice-President and Director, Heritage Savings Bank, Cincinnati, Ohio

Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and

soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

Yes. See Item II of the ODGF Rules.

2. Please respond separately for each state in which you insured deposits: Ohio only

   a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

      Yes--See:

      (1) Article IX, Section 6(a) of the ODGF Constitution;

      (2) Item IV(A) of the ODGF Rules provides for at least two months of continued insurance;

      (3) Item VI of the ODGF Rules requires Notice of Termination to be given to depositors.

   b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

      By resolution of the Board of Trustees for due cause. See Article IX, Section 6(a) of the ODGF Constitution.

   c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

      None.

3. Please respond separately for each state in which you insure deposits: Ohio only

   a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

      Yes. See Item VI(F) of the ODGF Rules. Also see Article IX, Section 6(b) of the ODGF

Constitution and Item VI(C) of the ODGF Rules concerning additional directors.

b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have? What is your examination operating budget?

Member institutions are examined as deemed necessary by the Department of Supervision of the ODGF. Policies and procedures vary with the type of information desired. The Department of Supervision consists of three persons capable of examining and auditing with an unlimited budget.

c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

Yes, the ODGF receives copies of all examination reports of its member institutions as prepared by the Division of Savings and Loan Associations, State of Ohio.

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

No.

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

The ODGF has no direct authority to correct problems; however, the ODGF closely supervises problems through the Department of Supervison which works with the member institution to resolve its problems. If the problem cannot be resolved by the Department of Supervision, the ODGF works with the Division of Savings and Loans, State of Ohio, to seek to effect a merger with another financially viable institution. The Advisory Committee of the ODGF can make recommendations to

the Board of Trustees with respect thereto.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

   No. By agreement with member institutions, the ODGF has replaced management and directors in the past with ODGF employees and Trustees, corrected problems and then effected a merger with a financially viable association. The ODGF has never been a receiver/liquidator.

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?

   The ODGF has never experienced a closing of a financial institution due to insolvency.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

      No. See Ohio Revise Code §1151.87(H). Pursuant to the ODGF Rules and general authority, the ODGF can attempt to effect mergers or provide other assistance.

   b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

      No, not without the complete, full knowledge and approval of the Superintendent of the Division of Savings and Loan Associations, State of Ohio, and the ODGF member institutions.

   c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

      Yes, but the OGDF needs the approval of the member institution and the Superintendent to provide assistance.

4. Please provide a listing showing, for each insolvency covered by your fund from January 1,

1980, to date:

The only situation to date is Home State Savings Bank, Cincinnati, Ohio, which is now in the hands of a state appointed conservator.

Insured Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year date for 1981, 1982, 1983, and 1984.

Fiscal Year Ended June 30

1981	$50,182,978	1982	$59,269,202
1983	$88,354,862	1984	$108,413,800

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury Securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

At March 23, 1985

U.S. Government Securities	$33,848,375
U.S. Government Agency Bonds	39,472,914
U.S. Government Treasury Bills	2,243,760
Cash and Federal Funds	2,968,157
Bank Certificate of Deposits	450,000

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

ODGF deposits are made in member institutions only in the event of an assisted transaction. At present, $6,955,311 is on deposit in a savings account at City Loan & Savings Co. pursuant to a contractual agreement arising out of an acquisition of Central Savings Association, Blue Ash, Ohio.

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

Fiscal Year Ended June 30

1981	9.98%
1982	11.36%
1983	11.30%
1984	11.32%

5. Please provide a copy of your latest annual report.

PENNSYLVANIA DEPOSIT INSURANCE CORPORATION

March 27, 1985

The Hon. Doug Barnard, Jr., Chairman
Congress of the United States,
House Representatives,
Commerce, Cunsumer, and Monetary Affairs
SubCommittee on Government Operations
Rayburn House Office Building, Room B-377
Washington, D. C. 20515

Dear Mr. Barnard:

I enclose the completed questionnaire you recently sent to me and I trust I have furnished all the information requested. It was most unfortunate that I was out of town visiting my son who lives in upper New Jersey when your mail apparently arrived in Harrisburg. In order to hasten my reply to your request, I have resorted to sending a copy of Senate Bill No 1456 of the General Assembly of Pennsylvania which established the Pennsylvania Deposit Insurance Corporation. in lieu of my personal written comments. I trust that this procedure will more quickly provide the necessary data requested.

Respectfully,

Paul F. Gastrock

Enc.

Paul F. Gastrock, Chairman
PENNSYLVANIA DEPOSIT INSURANCE CORPORATION
3208 Meadow Lane
Harrisburg, Pennsylvania 17109

1

NAME OF DEPOSIT INSURANCE FUND Pennsylvania Deposit Ins Corp.

I. General Information:

1. Type(s) of Financial Institution(s) whose deposits you insure: Private Banks

2. In which state(s) do you insure: Pennsylvania,

3. A. Cost of initial membership in your fund, if any: $500.00

   B. Annual premium: 1/6 of 1% of total average deposits. Deposits secured by pledge of Bank assets is not subject to the annual premium.

   C. Continuing equity contribution or membership deposit: None

4. Maximum coverage per account or per depositor: $100,000.00

5. Do you insure brokered deposits: YES

6. Number of insured institutions, by type:

   A. Under $100 million: Four

   B. $100 million to $500 million: — 0 —

   C. $500 million to $1 billion: — 0 —

   D. Over $1 billion: — 0 —

7. Aggregate amount of deposits insured, by type of institution: $119,654,000.00 as of 9-30-84 the latest data available

8. Your fund's total useable assets: $780,694.00 as of 12-31-84
   $743,205,12 " " 9-30-84

9. Ratio of usable insurance fund assets to deposits insured: 9-30-84 .621 % 119,654/743

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

See Copy of Senate Bill No. 1456 attached

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

Pennsylvania Department of Banking

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or

Yes. see pages 7 + 8 of Senate Bill No. 1456

b. authority to assess other insured institutions enough to cover the losses?

no

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

No

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

No

6. Do you reinsure your risks with any other insurance carriers? Please provide details.

No

7. Regarding your board of directors:

a. How is your board of directors selected?

See Senate Bill No. 1456, Page 3

b. What rules govern the size and composition of the board?

See Senate Bill No 1456, Page 3

c. Who are the present members of your board? (Please provide names and principal affiliations.)

(1) Paul H. Gastrock, Chairman, + Director
no affiliations

(2) W. Thomas Tither, Jr. Director
Managing General Partner
Knoblauch Private Bank
209 Lancaster Ave.
PO Box 8121
Reading, Pa 19603

(3) Paul J. Lawrence - Director
Executive Deputy Treasurer - Financial Operations
Room 129 Finance Bldg
Harrisburg, Pa 17126

(1) appointed & Reappointed by the Governor of the Com. of Pa
(2) " by a majority vote of the members which are private banks
(3) " by the State Treasurer of Pennsylvania

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

No. Supervision of insured institutions is the responsibility of the Penna. Dept. of Banking

2. Please respond separately for each state in which you insure deposits:

a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

Yes but only by reason of an insured member bank's failure to pay when due, all or any part of an assessment made upon such member

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

See answer to (a) above

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

None

3. Please respond separately for each state in which you insure deposits:

a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

No

b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?

FDIC has no examination privilege. Examinations & procedures are made by the Dept. of Banking, Penna.

c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

FDIC does not have a right of access to examination reports, however officials of the Pa Banking Dept will make available to the FDIC reports of examinations. FDIC does not receive copies of Exam. Reports

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

Yes

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

None

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

no

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?

Immediately

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

The Pa. Dept. of Banking determines what procedures will be followed.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

no

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

no

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date:

none

a. The name, location, and size of the institution;

b. The total dollar cost of the insolvency to your fund;

c. The dollar amount of insured deposits in the institution at time of closing;

d. The dollar amount of uninsured deposits in the institution;

e. The percentage recovery to date to depositors on uninsured deposits;

f. The gross dollar amount of outstanding unpaid depositor claims; and

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

1981 – $17,658.00
1982 – 306,803.00
1983 – 570,904.00
1984 – 780,694.00

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

This information is detailed in the enclosed Auditors Report

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

no

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

1981 – 15.3%
1982 – 17.1%
1983 – 10.7%
1984 – 10.5%

5. Please provide a copy of your latest annual report.

The required annual report is a fiscal letter to the Secretary of Banking together with a copy of the Auditors Report. A copy of the letter to the Secretary is not available however much of the data is reflected in the Auditors Report.

NAME OF DEPOSIT INSURANCE FUND Pennsylvania Savings Association Insurance Corporation

I. General Information:

1. Type(s) of Financial Institution(s) whose deposits you insure: Savings & loan associations

2. In which state(s) do you insure: Pennsylvania

3. A. Cost of initial membership in your fund, if any: Non-refundable filing fee - $1,250.00

   B. Annual premium: None

   C. Continuing equity contribution or membership deposit: Two (2) per cent of savings membership deposit

4. Maximum coverage per account or per depositor: $100,000 per account

5. Do you insure brokered deposits: Yes, however our institutions do not use brokered deposits

6. Number of insured institutions, by type:

   A. Under $100 million: Sixty-eight (68)

   B. $100 million to $500 million: None

   C. $500 million to $1 billion: None

   D. Over $1 billion: None

7. Aggregate amount of deposits insured, by type of institution: $208,502,800 (Jan. 31, 1985)

8. Your fund's total useable assets: $5,120,000 (Jan. 31, 1985)

9. Ratio of usable insurance fund assets to deposits insured: 2.46% (Jan. 31, 1985)

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

We are a private agency created by State law (P.L. 17, No. 5 - April 6, 1979) as a nonstock, nonprofit corporation, the purpose of which is "to promote the elasticity and flexibility of the resources of member associations, to provide for the liquidity of such associations through a central reserve fund and to insure the savings accounts in such associations."

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc. By statute, the Secretary of Banking "may make such examinations and inspections of the corporation and require the corporation to furnish him with such reports and records or copies thereof as the Secretary of Banking may consider necessary or appropriate in the public interest or to effectuate the purposes of this act." In addition the Secretary of Banking must approve any amendment to the bylaws, rules and regulations (attached sheet)

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or

No.

b. authority to assess other insured institutions enough to cover the losses? The Corporation can make mandatory the purchase of debentures, notes or other evidence of indebtedness, in an amount not to exceed two (2) percent of a member's total assets. We also can increase the 2% membership deposit but only upon the affirmative vote of 75 percent of all members entitled to vote at a meeting called for that purpose. The Board is, however, presently considering (attached sheet)

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured? Act 5-1979 provides that the "fund shall consist of capital contributions by each member in an amount equal to not less than 2% of the total savings on deposit with each member."

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

No.

II. Background:

2. (cont'd.)

of the Corporation prior to final adoption. We are also required to make an annual report of our financial condition and activities to the Secretary of Banking after the close of our fiscal year.

3. (cont'd.)

b. language to remove the need for approval of the membership to increase the assessment.

6. Do you reinsure your risks with any other insurance carriers? Please provide details. No.

7. Regarding your board of directors:

a. How is your board of directors selected? We have an eleven (11) member Board of Directors - eight (8) are elected by the membership from the representatives of insured associations and three (3) are appointed by the Governor of Pennsylvania upon the advice of the Secretary of Banking.

b. What rules govern the size and composition of the board? Section 4 of Act 5-1979 and Article II, Section 2 of the Bylaws require that eight of the directors be selected from among the insured institutions and three be appointed by the Governor to comprise the required board membership of eleven.

c. Who are the present members of your board? (Please provide names and principal affiliations.)

Edward J. Bartosiewicz - Metropolitan Savings & Loan Assn., Secretary-Treasurer

Walter A. Benfield - Bally Building & Loan Assn., President

Herbert J. Blair - Tioga-Franklin Savings Assn., Secretary

Shirley C. Chiesa - Carnegie Savings, Building & Loan Assn., President

J. Richard Eshleman - public director appointed by the Governor

John J. Kelly, Jr. - public director appointed by the Governor

Anthony V. Miscavige, Jr., - Sobieski Building & Loan Assn., Secretary

Edward B. Servov - public director appointed by the Governor

Gregory L. Walker - Huntingdon Savings & Loan Assn., EVP

Fred J. Wiest - Union Savings & Loan Assn., Solicitor

John M. Zdanowicz - Windthorst Warsaw Savings Assn., Secretary

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

All institutions must abide by the provisions of the Savings Association Code of Pennsylvania, as per reserve and capital requirements, as well as lending limits, borrowing limits and investment authority. Our associations must maintain at least 8% reserves and 10% total net worth, loans to one borrower are limited to 10% of total savings, associations are permitted to borrow only up to 50% of total savings and we require associations to maintain at least 7% liquidity at all times.

2. Please respond separately for each state in which you insure deposits:

a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund? Yes - Our rules and regulations provide for termination of insurance and expulsion from membership in the Corporation.

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance? We may expel an association and terminate its insurance if:

(1) The member is violating any provisions of the laws of the Commonwealth.
(2) The member is conducting unsafe or unsound practices in the conduct of business.
(3) The member is in violation of any of the bylaws, rules and regulations of the Corporation.

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

None.

3. Please respond separately for each state in which you insure deposits:

   a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

Yes - The rules and regulations provide that an association must "provide and permit examination of any and all books, papers and records of the member as may be requested by the Board of Directors of the Corporation."

   b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget? We presently employ no examiners or auditors. The Department of Banking provides us with a complete copy of the examination which they conduct once a year at each of our institutions. We also receive monthly financial data from each of our insured members as well as a copy of the annual audit report as conducted by an independent accountant. With regard to any special examinations we might request, we can employ an outside auditor for that purpose or request that the Department of Banking conduct a special examination.

   c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis? Yes we have a right of access to the examination reports and we do receive them on a regular basis. In addition, we are a part of any subsequent correspondence or action in regard to the examination.

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

Yes - at least annually at the close of their fiscal year.

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance? We have the authority to issue cease-and-desist orders and temporary cease-and-desist orders which are effective immediately upon service upon the institution. If such orders are violated we have the authority to appoint a "Supervisor in Charge" of the institution. We also have authority to remove from participation in the conduct of business of the association any officer, director or employee who has violated the law, rules and regulations or cease-and-desist order. We are authorized to enter into written agreements with members for the purpose of averting an event of default - this can include lending money, purchasing assets, endorsing or acting as surety on obligations of the member. In conjunction with the Department of Banking we can also arrange mergers, require infusion of capital or require other underwriting.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure? No. The Secretary of Banking would declare an association "in default" and become receiver. After depositors are paid off, the Secretary would turn over the assets of the failed institution to the Corporation for liquidation.

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process? Depositors would receive their funds immediately upon determination of the net insurable loss.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

No.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution? Yes - we would work with the Department of Banking to arrange such a takeover.

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner? Yes - as long as an institution has not been declared "in default" and closed we can keep it operating while we work with the Department to find a merger partner.

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date:

a. The name, location, and size of the institution;

b. The total dollar cost of the insolvency to your fund;

c. The dollar amount of insured deposits in the institution at time of closing;

d. The dollar amount of uninsured deposits in the institution;

e. The percentage recovery to date to depositors on uninsured deposits;

f. The gross dollar amount of outstanding unpaid depositor claims; and

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

No insolvencies covered, to date.

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

1981 - $2,094,634
1982 - $2,386,713
1983 - $2,792,376
1984 - $4,612,357

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

As of February 28, 1985:

Bank Deposits - $2,596,531
U. S. Treasury Securities - $2,275,852
U. S. Agency Bonds - $125,000
Money Market Fund - $26,573

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

No

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

1981 - 13.71%
1982 - 14.30%
1983 - 13.23%
1984 - 12.20%

5. Please provide a copy of your latest annual report.

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE INSPECTOR OF COOPERATIVES OF PUERTO RICO
SAN JUAN, PUERTO RICO

G. P. O. BOX 4108
SAN JUAN, PUERTO RICO 00936

VICK CENTER BUILDING
867 MUÑOZ RIVERA AVE.
RIO PIEDRAS, PUERTO RICO 00927

March 29, 1985

Mr. Doug Barnard, Jr.
Chairman
Commerce, Consumer, and
Monetary Affairs of the
Committee on Government
Operations
Congress of the United States
House of Representatives
Rayburn House Office Building
Room B-377
Washington, DC 20515

Dear Mr. Barnard, Jr:

Enclosed please find the response to the questionnaire sent with your communication dated March 20, 1985, regarding the polices and operations in our Agency.

Please do not hesitate to contact us, if further information is necessary.

Sincerely yours,

Adalberto Ortiz-Prado
Subinspector of Cooperatives
of Puerto Rico

AOP/bpi

Enclosures

1

NAME OF DEPOSIT INSURANCE FUND Program of Share and Deposit Insurance Fund of the Savings and Credit Corporation

I. General Information:

1. Type(s) of Financial Institution(s) whose deposits you insure: Credit Unions

2. In which state(s) do you insure: Rhode Island

3. A. Cost of initial membership in your fund, if any: A. 1% of shares and deposits.

   B. Annual premium: B. 1/10 of 1% of shares and deposits

   C. Continuing equity contribution or membership deposit: C. 1/2

4. Maximum coverage per account or per depositor: $40,000 per person

5. Do you insure brokered deposits: No.

6. Number of insured institutions, by type:

   A. Under $100 million: A. 22

   B. $100 million to $500 million: B. —

   C. $500 million to $1 billion: C. —

   D. Over $1 billion: D. —

7. Aggregate amount of deposits insured, by type of institution: $ 149,000,000.00

8. Your fund's total useable assets: $6,554,721.00

9. Ratio of usable insurance fund assets to deposits insured: 9%

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

A Governmental agency. See EXHIBIT No. 1

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

Office of the Inspector of Corporations of P. R.
and The Comptroller of Puerto Rico

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or

yes, we have access to the treasuries of the states to operate.

b. authority to assess other insured institutions enough to cover the losses?

yes we have such authority

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

No.

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

No.

6. Do you reinsure your risks with any other insurance carriers? Please provide details.

Yes

7. Regarding your board of directors:

a. How is your board of directors selected?

By General Meeting of Credit Union Delegates and by designation of Gov't. See EXHIBIT 4

b. What rules govern the size and composition of the board?

See Article 18 of Law Act No. 39 of June 6, 1960
See EXHIBIT 4

c. Who are the present members of your board? (Please provide names and principal affiliations.)

1. Inspector of Cooperatives of P.R. - VACANT
2. Mr Juan Agosto - Treasury Department
3. Mr Cesar Estrada - Cooperative Development Administration
4. Mr Juan Garcia - Commissioner of Insurance of Puerto Rico
5. Mr Victor Zayas Chandler - Credit Union Representative
6. Mr Antauro Suarez - " " "
7. Mr Luis Llorens - " " "
8. Mr José A Magnani - " " "
9. Mr Juan Perez " " "

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

Yes. We impose reserve for capital, Reserve for bad loans. Also we impose operating internal Control, adequate bonds and insurance

2. Please respond separately for each state in which you insure deposits:

a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

Yes we have that authority by statute

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

We discontinue insurance of the Credit Union doesn't pay the assoc.' premium.

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

None

3. Please respond separately for each state in which you insure deposits:

a. Do you have <u>authority</u> to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

We do have that authority by statutory
See Exhibit No. 4

b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?

We on yearly basis we have twenty nine
The audit are performed by the Office of the
Inspector of Cooperatives in accordance with
Act No. 1 See Exhibit No. 2

c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

We have them. We receive the examination
report on a regular basis

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

Not necessarily

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

Through the Office of Inspector of Cooperatives
by the Council of Act 341 approved on
April 19, 1956 as amended

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

N/C

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?

Immediately or as soon as possible

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

Not necessarily. There may be a few of those in practice of merger

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

N/C

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

U/2 S.

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date:

a. The name, location, and size of the institution;

b. The total dollar cost of the insolvency to your fund;

c. The dollar amount of insured deposits in the institution at time of closing;

d. The dollar amount of uninsured deposits in the institution;

e. The percentage recovery to date to depositors on uninsured deposits;

f. The gross dollar amount of outstanding unpaid depositor claims; and

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

See Exhibit No. 2

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

$1,100,000.00 at 1985

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

Bank deposits

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

No.

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

9 per cent

5. Please provide a copy of your latest annual report.

See Exhibit No. 3

RISDIC
RHODE ISLAND SHARE AND DEPOSIT INDEMNITY CORP.

March 28, 1985

Mr. Peter S. Barash
Subcommittee Staff Director
Commerce, Consumer, and Monetary Affairs
Subcommittee
Committee on Government Operations
House of Representatives
Rayburn House Office Building
Room B-377
Washington, DC 02515

Dear Mr. Barash:

In accordance with Congressman Barnard's request received by this office on March 27, 1985, I am forwarding to you information regarding the policies and operations of our Corporation.

If any additional information is required, please feel free to contact this office.

Very truly yours,

RHODE ISLAND SHARE AND DEPOSIT INDEMNITY CORPORATION

Peter A. Nevola
President

PAN:mn

Enclosures

1220 PONTIAC AVENUE, SUITE 101, CRANSTON, R.I. 02920 (401) 943-1060

NAME OF DEPOSIT INSURANCE FUND RHODE ISLAND SHARE AND DEPOSIT INDEMNITY CORPORATION (RISDIC)

I. General Information:

1. Type(s) of Financial Institution(s) whose deposits you insure:
   Credit Unions - 50 / Total Members
   Loan & Investment Companies - 12 / as of
   Commercial Bank (Presently with no deposits) - 1 \ 2/28/85 =
   Industrial Thrift (State of MINN) - 1 \ 64

2. In which state(s) do you insure:
   Rhode Island
   Minnesota (One Thrift Institution)

3. A. Cost of initial membership in your fund, if any:
   a) Capital investment: 1% insured deposits (minimun of $5,000)
   b) Premium: 1/12% of insured deposits (minimum of $1,000)

   B. Annual premium: 1/12 of 1% annual assessment in semi-annual installments. May be reduced by the Board of Directors to no less than the lessor of 1/50 of 1% or $100.

   C. Continuing equity contribution or membership deposit: Maintain 1% of insured deposits on a semi-annual basis, plus an additional annual contribution of 1/24 of 1%. until the member's total contribution equals and is maintained at 2% of its insured deposits.

4. Maximum coverage per account or per depositor: $100,000 per depositor aggregate accounts; $250,000 state, municipal and IRA depositor aggregate accounts in this category.

5. Do you insure brokered deposits: NO

6. Number of insured institutions, by type:

   A. Under $100 million: Credit unions: Forty-nine (49) Loan & Investment Companies: Ten (10)

   B. $100 million to $500 million: Credit Unions: One (1) Loan & Investment Companies: Three (3) Commercial Bank: One (1)

   C. $500 million to $1 billion: NONE

   D. Over $1 billion: NONE

7. Aggregate amount of deposits insured, by type of institution: AS OF 2/28/85

Credit Unions	:	$639,188,961
Loan & Investment Companies	:	904,916,562
Industrial Thrift (1)	:	40,036,382
Commercial Bank Member	:	-0-
	Total:	$1,584,141,905

8. Your fund's total useable assets: $24,271,173 AS OF 2/28/85

9. Ratio of usable insurance fund assets to deposits insured: 1.53 %

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

A private corporation created by an act of the state legislature (Copy of Charter enclosed)

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

1) State of R.i. Department of Business Regulation and Banking Division (Executive Branch).
2) Auditor General of the State of Rhode Island (Legislative Branch)

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or

NO

b. authority to assess other insured institutions enough to cover the losses?

YES

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured? our bylaws, which must receive approval of the State of R.I. Director of the Dept. of Business Regulation, require that the fund be maintained at 1% of insured deposits. Further, our bylaws require that the corporation reassess its members to replenish the fund to 1% should it ever fall below the requirement.

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

Fleet National Bank - $10,000,000 line of credit;
R.I. Corporate Central Credit Union - $5,000,000 line of credit.
We are in the final stages of completing the negotiation of $10,500,000 line of credit, $500,000 of which would be an unsecured portion available, with R.I. Hospital Trust National Bank.

6. Do you reinsure your risks with any other insurance carriers? Please provide details.

Not at present. However, we are seeking sources to provide the corporation with reinsurance.

7. Regarding your board of directors:

a. How is your board of directors selected?

Five directors representing member institutions are elected for three year terms, totalling 15 member represented directors. Three non-member directors are elected annually. Total directors number 18.

b. What rules govern the size and composition of the board?

Bylaws of the corporation.

c. Who are the present members of your board? (Please provide names and principal affiliations.)

Please see enclosed Annual Report.

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

Yes, please see enclosed bylaws and rules and regulations which include reserve, capital, investment of deposits and other safety and soundness requirements to meet and maintain eligibility standards. We use the CAMEL uniform rating system for monitoring our member institutions.

2. Please respond separately for each state in which you insure deposits:

a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

Rhode Island: YES

Minnesota: YES

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

1. Violation of state statutes or regulations.
2. Violation of this corporation's bylaws or rules and regulations.
3. If the financial condition of a member institution according to our CAMEL rating system is determined that it poses a present or future exposure to the fund. In the case of a projected future exposure, a "show cause" hearing is provided to the member institution.

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

NONE: Member institutions representing present and/or future exposure to this fund have been acquired by other healthy financial institutions.

3. Please respond separately for each state in which you insure deposits:

   a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority. YES:
   Rules and Regulations. Also, the state of Rhode Island Director of Business Regulation (Bank Commissioner) has the statutory authority to accept this corporation's examination report in lieu of conducting his own examination.

   b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?
   1. All members examined at least annually.
   2. Examinations include compliance with state statutes and rules and regulations, analysis of capital adequacy, asset quality and mix, management capabilities, earnings and liquidity, adequacy of security devices and internal controls.
   3. Twelve (12) examiners.
   4. Budget: $300,000.

   c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?
   Yes to both questions. Additionally, sharing both examination reports and monitoring is statutorily provided.

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?
   All institutions with assets equal to or over $10,000,000 are statutorily required to have an audit by an independent certified public accounting firm. Nevertheless, all institutions with assets over $1,000,000 provide for an outside accounting firm's audit.

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?
   Our Charter provides for this corporation, with our regulator's approval, to operate a member institution when required in the public interest. Our Charter also provides that during such operation of a member, this corporation, with the state regulator's approval, may merge or have acquired said member with another member or non-member financial institution.

   NOTE: No required pecking order for mergers and/or acquisitions of a member institution being operated by this corporation.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

YES

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?

Depositors would receive their funds immediately upon the determination of the insured amount of his aggregate deposits.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

NO, last resort.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

YES. And, have so done in the past.

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

YES

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date: No pay outs of any member institution has been made by this corporation since its inception (see below) --

a. The name, location, and size of the institution;

b. The total dollar cost of the insolvency to your fund;

c. The dollar amount of insured deposits in the institution at time of closing;

d. The dollar amount of uninsured deposits in the institution;

e. The percentage recovery to date to depositors on uninsured deposits;

f. The gross dollar amount of outstanding unpaid depositor claims; and

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

However, since January 1, 1981, this corporation has provided a combination of direct funding and guarantees to member institutions that have acquired insolvent other member institutions totalling $367,658 over the four-year period. There are no expenditures or guarantees for the present and last fiscal year.

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

Please see enclosed financial statements.

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

Please see enclosed financial statements.

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

We have the ability to invest in a member institution subordinate to its insured deposits.

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

FISCAL
1981: 11.8%
1982: 12.2%
1983: 9.5%
1984: 9.4%

Annual investment income divided by year end investments balance.

5. Please provide a copy of your latest annual report.

Enclosed

STATE CREDIT UNION SHARE INSURANCE CORPORATION

INSURED

March 28, 1985

The Honorable Doug Barnard, Jr.
c/o Peter S. Barash
House of Representatives
Commerce Consumer & Monetary Affairs Sub-committee
of the Committee on Government Operations
Rayburn House Office Building, Room B-377
Washington, D. C. 20515

Dear Mr. Barnard:

Please find enclosed a copy of my response to your survey and cover letter dated March 20, 1985. I have responded to each question in the survey and attached requested and supporting documents for the information and review of your sub-committee. I will welcome your further inquiries concerning the position and operations of this institution.

Sincerely,

Tom Gaines, III

Thomas F. Gaines, III
President

Enclosure

P.O. BOX 21429 / CHATTANOOGA, TENNESSEE 37421 / 615-899-2350

State Credit Union
Share Insurance Corporation

March 28, 1985

NAME OF DEPOSIT INSURANCE FUND:

State Credit Union Share Insurance Corporation (herein SCUSIC)

1. General Information:

Created by a special act of the Tennessee legislature in 1974 as a non-profit membership public corporation; aid and assist any member credit union which is in liquidation or incurs financial difficulty. Reference: Tennessee Code Annotated 45-4-1101 (Appendix A)

1. Type(s) of Financial Institution(s) whose deposits you insure:

Credit Unions only

2. In which state(s) do you insure:

Tennessee, Missouri, Kansas, Iowa & Indiana

3. A. Cost of initial membership in your fund, if any:

One percent of insured accounts as an investment.

B. Annual premium:

Currently 1/12 of one percent (not to exceed 1/10 of one percent of insured accounts).

C. Continuing equity contribution or membership deposit:

Maintain one percent equity to risk - initial and continuing equity requirements may be adjusted (amendment attached to Appendix A)

4. Maximum coverage per account or per depositor:

$100,000 per account as defined in Contract of Insurance (Appendix B, Article XVI)

5. Do you insure brokered deposits:

If defined as non-member or member accounts, yes; if defined as non-member promissory note or credit instrument, no.

1 cont'd

6. Number of insured institutions, by type:

   A. Under $100 million: 422 (over 50 percent of total members have assets of less than $500,000)

   B. $100 million to $500 million: 2

   C. $500 million to $1 billion: 0

   D. Over $1 billion: 0

7. Aggregate amount of deposits insured, by type of institution:

   Approximately $1,244,000,000 as of December 31, 1984

8. Your fund's total usable assets:

   $16,811,000 as of December 31, 1984 ($17,321,000 as of February 28, 1985)

9. Ratio of usable insurance fund assets to deposits insured:

   Approximately 1.35 percent as of December 31, 1984

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

SCUSIC was created by the legislature as a non-profit membership public corporation in 1974; 45-4-1101(a) Tennessee Code Annotated, also reference Section 45-4-114 Tennessee Code Annotated (Appendix A)

2. Provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

Tennessee - Department of Financial Institutions; Missouri - Division of Credit Unions; Kansas - State Department of Credit Unions; Indiana - Division of Credit Unions; Iowa - Credit Union Department

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate;

No

b. authority to assess other insured institutions enough to cover the losses?

Yes, with the approval of the Commissioner of Financial Institutions, State of Tennessee

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

Yes, capital contributions to be refunded to each member credit union when unencumbered funds of the corporation exceed two percent of the aggregate total of all shares, accounts and certificates of member credit unions by an amount equal to the aggregate capital contribution of all members; essentially, this represents a ceiling of three percent of aggregate risk insured on the corporation.
Reference: 45-4-1108 (b) (Appendix A)

5. Do you have lines of credit already established by contract on which you can draw at will?

Yes

5. Cont'd

What is the aggregate dollar limit of established lines of credit?

Aggregate dollar limits currently $29 million

With what institution or institutions have these credit lines been established?

$15 million - First American National Bank, Nashville, TN;
$14 million - National Cooperative Bank, Washington, D.C.

6. Do you reinsure your risks with any other insurance carriers? Please provide details.

No

7. Regarding your board of directors:

a. How is your board of directors selected?

States with 50 or more members may elect a state director from among that group (one member - one vote); all other directors elected at-large by total membership, again, one member - one vote, all terms three years. Currently, nine directors-at-large and three state directors (Tennessee, Kansas and Missouri).

b. What rules govern the size and composition of the board?

See Tennessee Code Annotated 45-4-1101 (Appendix A);
Article VIII, Board of Directors, Bylaws (Appendix B)

c. Who are the present members of your board? (Please provide names and principal affiliations)

(See following 2 pages)

3 cont'd

Board of Directors, 1984 - 1985
State Credit Union Share Insurance Corporation

Frank S. "Jerry" Arnold, B.S., C.P.A.; Chairman of the Board, SCUSIC
Manager/Treasurer, Eastman Credit Union
Board of Directors, Volunteer Corporate Credit Union; Current Chapter President

Lee E. Duckett, B.A.; Treasurer, SCUSIC
Loan Manager, Bowaters Credit Union

James E. Eakes, (volunteer)
Nashville Electric Service Credit Union

Betty G. Hobbs
President, Tennessee Teachers Credit Union
Chairman of the Board, Tennessee Credit Union League
Board of Directors, Credit Union National Association
1984 Credit Union Executive of the Year, Credit Union Executive Society

E. Ray Hudgens, B.A., M.A.
Manager, Educators Credit Union
Former Member, Board of Directors, Tennessee Credit Union League
Former Member, Board of Directors, Credit Union National Association

Lawrence W. Hurst, 1st Vice Chairman, SCUSIC
Manager, Knoxville Post Office Credit Union
Former Treasurer, Board of Directors, Tennessee Credit Union League

William L. Jenkins (volunteer)
Rohm & Haas Credit Union
Member and former Chairman, Board of Directors, Tennessee Credit Union League

Felix L. Murphy, State Director, Tennessee
Tennessee Telco Credit Union
Chairman of the Board, Volunteer Corporate Credit Union

Al L. Poertner, 2nd Vice Chairman, SCUSIC, State Director, Missouri
President, Arsenal Credit Union
Former member, Board of Directors, Credit Union National Association
Former member, Board of Directors, Missouri Credit Union League
CUES and Defense Council of Credit Unions

E. Odell Smith, B.S., M.A.
President, Old Hickory Credit Union
Board of Directors, Credit Union National Association
Board of Directors, CUNA Mutual Insurance Society
Former Chairman, Board of Directors, Tennessee Credit Union Leaues

Wayne E. VandeVere, B.A., M.B.A., PhD., C.P.A.; Secretary, SCUSIC (volunteer)
Collegedale Credit Union

NOTE: The position of Kansas State Director is currently vacant. An election is now in progress, to be completed by April 25, 1985.

3 cont'd

Management Biographies
State Credit Union Share Insurance Corporation

Thomas F. Gaines, III, President: Mr. Gaines graduated from Southwestern at Memphis, Tennessee, with a B.A. (major in Business Administration); and Memphis State University, with an M.B.A (concentrations in finance and economics). Prior to SCUSIC, Mr. Gaines was employed at Union Planters National Bank in Memphis (large bank holding company). Responsibilities included the investment division (trading, retail, and portfolio strategy); business development (managed bank-wide program to increase product usage per customer and profile potential product usage); and personnel (managed the recruiting and development of future corporate officers). Mr. Gaines completed the Graduate School of Banking of the Mid-South, sponsored by the American Institute of Banking.

Phillip G. Hise, Vice President, Finance Division: Mr. Hise is the past president of a federally chartered credit union. He is a C.P.A., and was recently awarded professional recognition by successfully completing the examinations required for the Certified Credit Union Executive (C.C.U.E.) designation. He is a member of the following professional organizations: American Institute of Certified Public Accountants, National Association of Accountants, Tennessee Society of Certified Public Accounts. He currently is a member of the AICPA committee which is developing audit standards for the CPA audit of credit unions. Mr. Hise is a Navy veteran and graduate of the University of Tennessee in Chattanooga, Tennessee, with a B.S. (major in accounting). His work experience includes four years in public accounting, two and one-half years in the health care industry, and assistant comptroller of a $750,000,000 bank. He developed the Standard Accounting Manual for state chartered credit unions, endorsed and recommended by the National Association of State Credit Union Supervisors.

James H. Roberts, Vice President, Operations Division: Mr. Roberts was a captain in the U.S. Air Force, and his duties included the management of numerous types of communications equipment. He received the Air Force Commendation Medal and was on the Officer's Club Board of Governors. He received his B.A. from Southwestern in Memphis, Tennessee, with a major in economics. At Southwestern, he lettered in both baseball and football, and was a Southwestern Leadership Scholar. Prior to joining SCUSIC, Jim spent several years as an account executive with E. F. Hutton & Company. He is a graduate of the Southeast Regional Credit Union School.

Duane L. Thorpe, Vice President, Marketing Division: Mr. Thorpe has a B.S. in business administration, with a minor in economics from Southeast Missouri State College, Cape Giradeau, Missouri. He is a graduate of the School of Banking of the South, Louisiana State University, Baton Rouge, Louisiana. Mr. Thorpe has over twenty-six years of banking and credit union experience, having served as chief executive officer of a bank and as manager of a credit union.

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so what basic requirements do you impose?

Yes, the corporation has established underwriting standards for admission to membership in the classification and quality of operations, including probability of failure of current members (underwriting standards, Appendix C). These standards were developed with the aid of an actuarial consulting firm, based on comparative financial data of credit unions that failed or required financial assistance to survive and those that did not over a five-year period. This material is received every other year to insure current period applicability.

2. Please respond separately for each state in which you insure deposits:

a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

Yes - all states

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

As defined under Section 45-4-1112, Tennessee Code Annotated, Sections (b), (c) and (d). Essentially, if a member credit union is determined to be operating in an unsafe or unsound manner with correctible operating circumstances, policies and administrative procedures, workout plans and corrective action is required and communicated to the respective state regulator, board of directors and management of the credit union. If acceptable corrective measures are not taken, the corporation will put the credit union on notice and move to discontinue insurance. Because of mandatory insurance laws in states of operation, and the concern and cooperation of state regulators, SCUSIC has never had to implement procedures cancelling insurance. Recognition of personal liability and the cooperation of state regulators has been sufficient for the establishment of acceptable workout and corrective procedures.

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

None

3. Please respond separately for each state in which you insure deposits:

a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure?

Yes, all states.

Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

By Contract of Insurance, Article VI of SCUSIC Bylaws (Appendix B), credit unions agree to abide by relevant sections of Tennessee Code Annotated and comply with the bylaws of the corporation. 45-4-112, T.C.A., sets out the rights of the corporation to require independent audits and investigations of any member credit union to determine its financial condition as it relates to share insurance. Such audits will be at the corporation's expense. Article IX, Examination of Credit Unions, provides parallel audit authority. (Appendicies A & B)

b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?

As standard operating procedure, SCUSIC does not directly examine the books and records of insured institutions. The corporation analyzes each member's financial statement quarterly for ratio and trend analysis in comparison with our underwriting standards (Appendix C). Additionally, the corporation reviews each member's annual regulatory examination as independent confirmation of the balances on statements furnished by members. The corporation has no examiner or auditors on staff. However, the vice president of our Finance Division is a C.P.A. with experience in public accounting as well as the audit department of a commercial bank. To the extent that our financial analysis or discussions with examiners indicate the existence of a problem or need for further investigation, it is the responsibility of the Finance Division to investigate and outline a required audit or further investigative procedures. Such investigations/audits are contracted with outside firms subject to the engagement requirements of SCUSIC's Finance Division.

c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

SCUSIC has the right to review the regulatory examination reports of the supervisor of state chartered credit unions in each state of operation, and we regularly receive copies of such reports.

5 cont'd

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

No; the majority of insured credit unions are extremely small; they utilize cash basis accounting and could not receive an unqualified C.P.A. audit. The larger institutions generally have an outside, independent audit.

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

The corporation has no specific authority other than insurance termination to force the correction of problem situations. Much of SCUSIC's success in the area of problem correction has been based on the cooperative relationships with state regulators and the recognition of the common interest in a credit union problem. Court enforced cease and desist orders are in the realm of regulatory authority. The deposit insurer makes a business judgement; the reasonable authority for the insurer is the adjustment of price to reflect levels of acceptable risk and refusal to participate in unacceptable risks. Such decisions will include subjective judgements, including management competency, against the requirement to protect the fund from unacceptable risk and losses. Once the risk has been accepted (credit union insured), the pressure shifts to correcting threatening situations. The credit union can comply or go to another insurer. The check and balance against abuses and arbitrary judgements are mutual ownership and competition. These also provide the sensitivity to improve the service and product for insured credit unions. This will be lost without alternatives to NCUA, a non-accountable insurer/regulator.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

Yes

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?

As a matter of operating consideration, all members receive access to their deposits as soon as their claims and balances can be verified. The only circumstances where liquidation has been completed in order to make balances available relates to uninsured depositors and balances.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits you only alternative?

No

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

Yes

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

Yes

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date:

a. The name, location, and size of the institution;
b. The total dollar cost of the insolvency to your fund;
c. The dollar amount of insured deposits in the institution at time of closing;
d. The dollar amount of uninsured deposits in the institution;
e. The percentage recovery to date to depositors on uninsured deposits;
f. The gross dollar amount of outstanding unpaid depositor claims; and
g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

4. Cont'd

The attached report (Appendix D-1) lists the name, location and financial references for each merged or liquidated member credit union from November, 1975, through December, 1984. Additionally, I have attached a listing of all credit union insolvencies (Appendix D-2) that resulted in some form of terminal activity (merger or liquidation) since January 1, 1980. Some discussion is required to properly disclose the time frame for payouts. Under a merger situation, insured depositors have access to their funds immediately upon completion of the merger. Indemnities against loss and cash payments are made from SCUSIC to the surviving credit union. Under circumstances of a liquidation and/or a merger where books and records are not in good order, the only delay in making funds available to insured depositors is associated with restructuring the records to verify claims and balances. Uninsured depositors in a liquidation are not protected by SCUSIC. They share pro rata in the results of the liquidation. There have been instances where credit union members have been without access to their fund, but these were not the result of insurance activities. It has been a common practice among state regulators historically (some currently) to freeze the activity of a credit union while books and records are updated or certain financial conditions investigated. There have been instances where state regulators have frozen the availability of funds to members prior to delivering control of the credit union to SCUSIC. However, this is generally recognized as a regressive practice, and because of improved evaluation and monitoring techniques, such action is rarely taken today. It was a regulatory approach stemming from the era of non-mandatory insurance to prevent further losses.

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

All of the corporation's equity, paid-in membership fees, and retained earnings is available as an insurance reserve. Audited financial statements for fiscal years ending December 31, 1981, 1982, and 1983 are attached under Appendix E. Unaudited 1984 statements are also attached. Audited statements will be furnished as soon as received from Ernst & Whinney.

2. What is the present composition and market value, by type of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

Appendix F is a copy of the corporation's portfolio and distribution analysis as of February 28, 1985.

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure?

No

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

The average weighted yield of SCUSIC's investment portfolio as of December 31, of each of the requested years is listed below:

1981 - 12.08 %
1982 - 11.69 %
1983 - 10.30 %
1984 - 9.96 %

The average weighted yield of SCUSIC's portfolio was reduced from 1984 because of a shift to lower gross yielding tax exempt munucipal bonds. This was necessitated after loss of tax exemption by IRS ruling in 1983.

5. Please provide a copy of your latest annual report.

Appendix G (1984 unaudited statements provided in Appendix E)

TEXAS SHARE GUARANTY
CREDIT UNION

400 East Anderson Lane Suite 205
PO Box 14584
Austin, TX 78761-4584
(512) 836-1667

March 28, 1985

The Honorable Doug Barnard, Jr.
Chairman, Commerce, Consumer and Monetary
Affairs Subcommittee
U. S. House of Representatives
Rayburn House Office Building, Room B-377
Washington, DC 20515

Dear Congressman Barnard:

As requested, enclosed is the completed questionnaire (with attachments) that was received March 25th.

If clarification is needed in any area, please let me know.

Sincerely,

Billy F. Spivey
President

BFS/tab

Enclosures

NAME OF DEPOSIT INSURANCE FUND Texas Share Guaranty Credit Union

I. General Information:

1. Type(s) of Financial Institution(s) whose deposits you insure:
Credit Unions

2. In which state(s) do you insure:
Texas

3. A. Cost of initial membership in your fund, if any: 1% of member credit unions' shares and deposits
B. Annual premium: up to 1/10th of 1% of shares and deposits
C. Continuing equity contribution or membership deposit: Pays such amounts annually as are required to maintain the investment deposit at 1% of shares & deposits.

4. Maximum coverage per account or per depositor:
$100,000.00

5. Do you insure brokered deposits:
No

6. Number of insured institutions, by type:
A. Under $100 million: 364
B. $100 million to $500 million: 2
C. $500 million to $1 billion: None
D. Over $1 billion: None

7. Aggregate amount of deposits insured, by type of institution:
February 1985 1.99 Billion

8. Your fund's total useable assets:
February 1985 25 Million

9. Ratio of usable insurance fund assets to deposits insured:
1.26%

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

Private agency authorized by Section 11.10(e) of the Texas Credit Union Act. (Excerpt of C. U. Act, and special rules regulating Texas Share Guaranty Credit Union are enclosed)
Exhibit "A"

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

Credit Union Department, State of Texas

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or

No

b. authority to assess other insured institutions enough to cover the losses?

Up to additional 1% of credit unions' shares and deposits

(At present, estimate amount - $20 Million)

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

No Upper Limits

Minimum Limits - 1% of shares and deposits

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

3M - Southwest Corporate (oral approval received for 20M - agreements being executed)

Line of credit currently being discussed with Central Liquidity Facility (CLF)

Discussions to increase or establish lines of credit were in progress prior to Ohio situation.

6. **Do you reinsure your risks with any other insurance carriers? Please provide details.**

No. Efforts have been and are currently being made to secure re-insurance.

7. **Regarding your board of directors:**

a. **How is your board of directors selected?**

By authorized representatives of member credit unions voting at an annual meeting.

b. **What rules govern the size and composition of the board?**

Credit Union Department rules and Texas Share Guaranty Credit Union bylaws.

c. **Who are the present members of your board? (Please provide names and principal affiliations.)**

Robert Hayes, President, Public Service Employees Credit Union, Amarillo, Texas

Ed Hale, President, Dallas Teachers Credit Union, Dallas, Texas

Ruby Weinholt, President, St. Joseph's Credit Union, San Antonio, Texas

Odell Dancak, President, Texas DPS Credit Union Austin, Texas

Merle Young, President, THD-DPS Credit Union Beaumont, Texas

Jerry Deering, President, Educational Employees Credit Union, Fort Worth, Texas

Don Rutter, President, Ethyl Employees Credit Union Pasadena, Texas

Gene Wenzel, President, Educators Credit Union Waco, Texas

Pat Hayes, President, Atlantic Richfield Credit Union Pasadena, Texas

John P. Parsons, Director Ex-officio, Commissioner, Texas Credit Union Department, Austin, Texas

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

No, TSGCU can make reports and recommendations to the Commissioner, Credit Union Department, State of Texas, upon any matter which is relevant to the solvency, liquidation, rehabilitations or conservation of any member credit union. In addition, may make recommendation to the Commissioner for the detection and prevention of member credit union insolvencie or which are calculated to enhance the financial soundness of member credit unions. (Exh. No. 8)

2. Please respond separately for each state in which you insure deposits:

a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

Yes

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

1. Engaged in unsafe or unsound practices
2. Is in unsafe or unsound condition to continue operations.
3. Is violating or has violated an applicable law, rule, order, written, condition imposed by the Commissioner, or any written agreement entered into with TSGCU.

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

None

3. Please respond separately for each state in which you insure deposits:

   a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

   Upon request by TSGCU, the Commissioner, Credit Union Department, State of Texas, can authorize TSGCU to conduct an examination or audit of any member credit union. We are furnished copies of the state's examination reports, and we are included in exit conferences at the conclusion of examinations of problem credit unions.

   b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?

   TSGCU does not conduct examinations, but we have full access to reports of those conducted by the Texas Credit Union Department. The Department chartered and supervises and examines TSGCU, hence, is vitally interested, not only in our operations, but in our ability to effectively insure the shares and deposits of the 366 state chartered credit unions we insure. Hence, there is a free flow of information and the closest of cooperation between the Department and Texas Share Guaranty Credit Union.

   c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

   Yes

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

   Either by (1) supervisory committee, or (2) outside auditor.

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

   TSGCU is not a regulatory agency. If corrective action is deemed necessary by TSGCU, the Commissioner, Credit Union Department, is requested to impose whatever sanctions or restrictions necessary to correct the condition.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

Yes

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?

Immediately upon verification of deposit.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

No

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

Yes

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

Yes

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date:

a. The name, location, and size of the institution;

b. The total dollar cost of the insolvency to your fund;

c. The dollar amount of insured deposits in the institution at time of closing;

d. The dollar amount of uninsured deposits in the institution;

e. The percentage recovery to date to depositors on uninsured deposits;

f. The gross dollar amount of outstanding unpaid depositor claims; and

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

List Attached (Exhibit "C")

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

	Reserves	1% Member Dep.	Total of Fund
1981	$1,571,383	$14,306,360	$15,877,743
1982	1,552,378	14,435,578	15,987,956
1983	2,725,000	15,562,678	18,287,678
1984	4,744,166	18,095,441	22,839,607

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

Please refer to page 11 of Annual Report (Exhibit "D")

(Current) Feb. 1985 Government and Federal Agency Obligations:

FMHA Bonds	$ 142,167.71	Treas N & B's	$15,198,036.95
FHLMC Bonds	1,146,322.53	Cert. of Dep.	1,700,000.00*
GNMA Bonds	1,865,555.96	SW Corp. Central	
SBA Loans	1,423,200.77	Fed. Cr. Un.	1,374,941.86

* Limited to insured amount

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

No

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

1981 - 13.3%
1982 - 12.5%
1983 - 9.91%
1984 - 10.57%

5. Please provide a copy of your latest annual report.

Enclosed (Exhibit "D")

1

NAME OF DEPOSIT GUARANTY FUND Industrial Loan Guaranty Corporation

I. General Information:

1.	Type(s) of Financial Institution(s) whose deposits you insure:	Utah Industrial Loan Corporations
2.	In which state(s) do you insure:	State of Utah only
3.	A. Cost of initial membership in your fund, if any:	$75,000 for a new member
	B. Annual premium:	
	C. Continuing equity contribution or membership deposit:	.0025 times total thrift deposits as of December 31 each year. When the fund reaches a certain size the level of annual assessment will decrease. (see Exhibit 1)
4.	Maximum coverage per account or per depositor:	$15,000 per account
5.	Do you insure brokered deposits:	No
6.	Number of insured institutions, by type:	
	A. Under $100 million:	26 - all
	B. $100 million to $500 million:	None
	C. $500 million to $1 billion:	None
	D. Over $1 billion:	None
7.	Aggregate amount of deposits insured, by type of institution:	441,000,000
8.	Your fund's total useable assets:	3,500,000
9.	Ratio of usable insurance fund assets to deposits insured:	1/111 or .9%

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

Private agency established by state law.
"The purpose for which the corporation is organized is to guarantee full payment of account obligations of members up to fifteen thousand dollars for each account." Utah Code Annotated 7-8a-1 et. seq. (1953, as amended).

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

State of Utah Department of Financial Institutions

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or

No

b. authority to assess other insured institutions enough to cover the losses?

Commissioner of the Department of Financial Institutions has authority to assess members up to 2 years in advance of yearly assessment.

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

See attachment - Exhibit 1

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

No

6. Do you reinsure your risks with any other insurance carriers? Please provide details.

No

7. Regarding your board of directors:

a. How is your board of directors selected?

By vote of the membership

b. What rules govern the size and composition of the board?

By-Laws and Articles of Incorporation

c. Who are the present members of your board? (Please provide names and principal affiliations.)

Richard A. Christenson	Capitol Company
Robert B. Beckstead	Copper State Thrift & Loan
Ed G. Throndsen	Valley Thrift & Loan
W. Harold Dobson	The Lockhart Co.
Richard M. Robinson	Commerce Financial
Stanley A. Anderson	Basin Loans
Mirvin D. Borthick	Moore Financial
Ed M. Jamison	First Security Financial
Paul A. Miller	H.F.C. Thrift, Inc.
Carl A. Hulbert	Attorney at Law
John C. Jarman	Utah Financial Thrift
Fred S. Kohlruss	CrediThrift
Charles E. Johnson	CPA, Main Hurdman
Richard D. Paul	Foothill Thrift
Irene Jorgensen	Assistant Secretary, Industrial Loan Guaranty Corp.

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

Capitalization and reserves are established by state law.

Certified audits are required and the State Department of Financial Institutions regulates the companies and examines them.

2. Please respond separately for each state in which you insure deposits:

a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

Yes, after proper notification.

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

If the guaranty corporation finds that a member institution or its directors, officers, agents, or employees have engaged in or are engaging in unsafe or unsound business practices in conducting the business of such institution or have violated an applicable law, rule, regulation, or order, or any condition imposed in writing by the commissioner, the guaranty corporation shall serve the commissioner with a statement with respect to such practices or violations for the purpose of securing their correction.

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

None

3. Please respond separately for each state in which you insure deposits:

a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

Yes - by state law

See attachment - Exhibit 2

b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?

The Department of Financial Institutions examines member institutions on a regular basis. Quarterly call reports are also required. ILGC has a special audit performed only if warranted. Yearly audits are regularly required. ILGC retains an auditing firm to analyze the quarterly call reports. Concerns are brought to our attention and appropriate action taken, in conjunction with the State regulator.

c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

Yes to first question.
No to second question. However, if problems are suspected, we work closely with the Dept. of Finan. Inst. and it provides us with the reports.

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

Yes - audits are due 90 days after close of each member's fiscal year.

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

ILGC works closely with the Department of Financial Institutions. That Department has substantial authority, management may be removed, etc..

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

The Commissioner of the Department of Financial Institutions is the statutory receiver, but he may appoint the Industrial Guaranty Corporation as liquidator.

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process? The Department of Financial Institutions takes possession of the institution, determines the amount of assets versus liability and then makes a demand upon the guaranty corporation for the amount in excess of assets. Thus the depositors don't get their money immediately but they don't have to wait until the completion of a liquidation to begin receiving their funds.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative? No - Only one institution has been liquidated and that occurred in 1977. Since then the law has been strengthened to prevent a reoccurrence of the problems unique to that company. Because of its problems we were unable to arrange a merger or find a buyer. Since that time we have assisted with 7 mergers or sales in order to prevent companies from having to be liquidated

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

Yes, we work with the Department of Financial Institutions

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?
Final authority rests with the Department of Financial Institutions. We have assisted the Commissioner when this action was necessary.

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date:

a. The name, location, and size of the institution;

b. The total dollar cost of the insolvency to your fund;

c. The dollar amount of insured deposits in the institution at time of closing;

d. The dollar amount of uninsured deposits in the institution;

e. The percentage recovery to date to depositors on uninsured deposits;

f. The gross dollar amount of outstanding unpaid depositor claims; and

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

See attachemnt - Exhibit 3

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

Aug. 31, 1981	$1,814,535.09
June 30, 1982	2,965,752.50
June 30, 1983	1,857,358.40
June 30, 1984	2,884,013.10

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

TCD
Money Market Account
U.S. Treasury Bills

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

Yes. As part of a rehabilitation $1,817,670. is on deposit at First Security Financial until December 17, 1985. $287,210 is on deposit at Commerce Financial until April 1, 1987 as part of another rehabilitation.

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

1981 - 14.26
1982 - 12.37
1983 - 9.65
1984 - 10.37 except for Commerce funds 9% - First Security Financial Funds 5%

5. Please provide a copy of your latest annual report.

UTAH CREDIT UNION GUARANTY CORP.

March 27, 1985

Mr. Doug Barnard Jr.,
Commerce, Consumer, and Monetary Affairs
Subcommittee of the
Committee on Government Operations

Dear Representative Barnard,

Thank you for the opportunity to respond to your questionaire. After reviewing our answers and the additional information I have provided you I trust you will find credit unions and their respective Deposit Guaranty Corporations to be at least somewhat more stable than other depository institutions and their Deposit Guaranty Corporations.

Please remember that nearly 92% of our depositors money has been loaned back to our members and is not subject to investment losses of the magnitude of Home Savings of Ohio. Even during the depression few credit unions failed.

Please compare the following to other depository institutions.

The reserves and surplus of our member credit unions are equal to 7.88% of their total deposits. This is reserves and surplus after allowance for losses has been made.

Net charged off loans for the year of 1984 and provision for loan losses were less than 3/10 of 1% of total outstanding loans. The addition to reserves and surplus for the same period were in excess of 1.4%

Total investments in depository institutions, treasury securities, corporate bonds, mutual funds and other securities are just over 14% of member deposits, and the majority of these investments are covered by Federal Deposit Insurance.

We're sincerely interested in providing safety for our members depositors, and therefore welcome your sincere interest.

Sincerely,

Don B. Duncan
President

DBD/lw
Enclosures

...GEORGIA, CHAIRMAN

NINETY-NINTH CONGRESS

Congress of the United States

House of Representatives

COMMERCE, CONSUMER, AND MONETARY AFFAIRS
SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS

RAYBURN HOUSE OFFICE BUILDING, ROOM B-377
WASHINGTON, DC 20515

March 20, 1985

Mr. Donald B. Duncan
Utah Credit Union Guaranty
P. O. Box 26008
Salt Lake City, Utah 84126

Dear Mr. Duncan:

On April 3, 1985, the Commerce, Consumer, and Monetary Affairs Subcommittee will begin congressional hearings into the Ohio deposit insurance problem and the adequacy of the federal response. Specifically, the subcommittee will be examining the impact of the Home State Savings collapse on the Ohio Deposit Guaranty Fund and on the other state-insured thrifts; the adequacy of the response to the crisis by the Federal Home Loan Bank Board and the Federal Reserve System; the condition of other state/private deposit insurance systems; and, whether there is a need to strengthen the current system of state/private deposit insurance.

In preparation for these hearings, the subcommittee requires certain information regarding the policies and operations of your agency. We would greatly appreciate your responses to the attached questionnaire by March 29, 1985. I apologize for the relatively short timeframe of the request. If there are any questions, please call the subcommittee staff director, Peter S. Barash.

In the interests of time, your handwritten responses directly on the questionnaire form will be entirely satisfactory.

Sincerely,

Doug Barnard, Jr.

Doug Barnard, Jr.
Chairman

Enclosures

DB:psb:b

NAME OF DEPOSIT INSURANCE FUND [illegible]

OUR NAME WAS UTAH CREDIT UNION GUARANTY CORP.

I. General Information:

1. Type(s) of Financial Institution(s) whose deposits you insure: CREDIT UNIONS

2. In which state(s) do you insure: UTAH

3. A. Cost of initial membership in your fund, if any: ½ OF 1% OF TOTAL ASSETS

B. Annual premium: BASED ON BUDGET PROJECTIONS NORMALLY ½ of 1% OF TOTAL SHARES AND DEPOSITS. WE HAD RISK RATE FORMULA.

C. Continuing equity contribution or membership deposit: MUST MAINTAIN ½ of 1% - ADJUSTED ANNUALLY CAN REQUIRE ADDITIONAL ½ of 1% DEPOSIT - ONCE IN ANY YEAR

4. Maximum coverage per account or per depositor: UNLIMITED For REGULAR members. (Corporate accounts limited to $100,000 for Act)
TOTAL OF ANY ACCOUNT IN EXCESS OF $100,000 AT TIME OF $ AMOUNT CALLED

5. Do you insure brokered deposits: NO

6. Number of insured institutions, by type:

A. Under $100 million: 163

B. $100 million to $500 million: NONE

C. $500 million to $1 billion: NONE

D. Over $1 billion: NONE

7. Aggregate amount of deposits insured, by type of institution: CREDIT UNIONS Corporate CUs $4,100,000 Regular CUs $31,492,997 $ 35,592,997

8. Your fund's total useable assets: $ 3,293,334.

9. Ratio of usable insurance fund assets to deposits insured: [illegible] = .10
[illegible] .09
IF WE CALLED IN THE [illegible] 1.35

II. **Background:**

1. **Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.**
Private Agency.
Not created by STATE LAW.
Organized under Corporations Laws of UTAH.

2. **Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.**
STATE OF UTAH, Department of Financial Institutions
Now in the process of Registering with the Insurance Department.

3. **If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,**

   a. **access to the treasuries of the state(s) in which you operate; and/or**
   No. We're working on it.

   b. **authority to assess other insured institutions enough to cover the losses?**
   We Hope! Can assess members and require higher or additional Premiums.

4. **Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?** No.

5. **Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?**
Corporate Credit Union $2,000,000
Preparing to Establish with C.L.F.

6. **Do you reinsure your risks with any other insurance carriers? Please provide details.** NO,

NO AFFORDABLE, VIABLE PROGRAM IS AVAILABLE.
THOSE THAT WE'VE BEEN AWARE OF HAVE DEDUCTIBLES THAT EXCEED OUR NET WORTH!

7. **Regarding your board of directors:**

a. **How is your board of directors selected?**
10 Elected by the membership - ONE APPOINTED

b. **What rules govern the size and composition of the board?**
OUR BY LAWS EXHIBIT A

c. **Who are the present members of your board? (Please provide names and principal affiliations.)**

COLLEEN MILLARD - VICE PRESIDENT DAVIS SCHOOLS C.U.
RICHARD BEACKEN - PRESIDENT CARBON C.U.
N. KEITH CARROLL - PRESIDENT L.D.S. EMPLOYEES C.U.
MONA DE LA BERA - PRESIDENT ELITECH C.U.
LELAND ERICKSON - VICE PRESIDENT SOUTH UNION C.U.
MARY DAMRON - RETIRED WAS PRESIDENT UTAH CENTRAL C.U.
STEVEN LETHLEAN PRESIDENT SLC FIREMAN'S C.U.
CARL M. STOTT - PRESIDENT GRANITE DISTRICT C.U.
GUENEVERE NIELSEN RETIRED - WAS PRESIDENT IRON MTN C.U.
LARRY BLUNT PRESIDENT BACKWOOD RAILWAY CLERKS C.U.
CHARLES SULLIVAN PRESIDENT UTAH CREDIT UNION LEAGUE
FRED S. RICO CHAIRMAN OF THE BOARD UTAH CREDIT UNION LEAGUE.

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?
WE EVALUATE THE STRENGTH OF MEMBERS AND RECOMMEND ACTION WHENEVER SHARE VALUE DECLINES. WE ALSO MONITOR PROFITABILITY AND RECOMMEND ACTION WHEN ADVISABLE. STATE LAW REQUIRES ALLOWANCE FOR LOAN LOSSES. SEE OUR CONSOLIDATED REPORT IT MEASURES CHANGES IN FINANCIAL STRENGTH AND PROFITABILITY

2. Please respond separately for each state in which you insure deposits:
ALL FOR UTAH ONLY
a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?
YES.

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance? WHENEVER IT SHALL APPEAR THAT A MEMBER CREDIT UNION HAS CONDUCTED ITS BUSINESS IN AN UNSAFE OR UNSOUND MANNER OR HAS KNOWINGLY OR NEGLIGENTLY PERMITTED ANY OF ITS OFFICERS OR AGENTS TO VIOLATE ANY PROVISION OF ANY LAW OR REGULATION TO WHICH THE CREDIT UNION IS SUBJECT INSURANCE CAN BE CANCELLED.

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.
SEE EXHIBIT "B"

3. Please respond separately for each state in which you insure deposits:

a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

YES. By Agreement EXHIBIT [illegible]

b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?

Only when we believe there's a problem
We normally only look at specific areas of concern
We have two auditors. Both have other responsibilities as well

c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

YES. We receive mini Reports on all and full Reports on problem credit unions. We can receive full Reports on any or all.

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

No.

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

We can force removal of officers committee members and employees of the credit union.
We have a collective agency to deal [illegible]

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?
YES.

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process? Normal payouts are within 7 days. [illegible]
Liquidations are purchase and Assumptions are within

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?
NO. We use Mergers - Normal Mergers - Purchase And Assumptions.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution? YES

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner? YES.

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date: See EXHIBIT "B"

a. The name, location, and size of the institution;
See Col 1. 2. 4.

b. The total dollar cost of the insolvency to your fund;
See Col 9.

c. The dollar amount of insured deposits in the institution at time of closing;
92% of Col 4

d. The dollar amount of uninsured deposits in the institution;
NONE All deposits [illegible]

e. The percentage recovery to date to depositors on uninsured deposits;
N/A

f. The gross dollar amount of outstanding unpaid depositor claims; and
NONE

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.
IN NO CASE [illegible]

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

1981
1982
1983 942,853
1984 831,793

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

Bank Deposits 1,606,859
Loans purchased from members 513,727 [illegible]
SF 298,834 Net is 214,933
Corporate CU 1,210,[illegible]

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

YES, THE CORPORATE CENTRAL CREDIT UNIONS
Presently we HAVE 1,210,259 IN THESE. HAVE been moving more to OTHER Investments lately

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

1981 ~~16.10%~~ 15.08%
1982 13.45%
1983 8.93%
1984 10.10%

5. Please provide a copy of your latest annual report.

VIRGINIA CREDIT UNION SHARE INSURANCE CORP.

1207 Fenwick Drive
P. O. Box 11469
Lynchburg, Virginia 24506
Phone (804) 237-0206

March 26, 1985

The Honorable Doug Barnard, Jr., Chairman
Commerce, Consumer and Monetary Affairs
Subcommittee of the Committee on Government Operations
House of Representatives
Rayburn House Office Building, Room B-377
Washington, D.C. 20515

Dear Mr. Barnard:

We are very pleased to find that the Commerce, Consumer and Monetary Affairs Subcommittee will conduct hearings which will determine a "need to strengthen the current system of state/private deposit insurance."

The Virginia Credit Union Share Insurance Corporation was created in 1974 by an act of the Virginia Legislature in order to provide state chartered credit unions in Virginia with an opportunity to maintain a truly dual chartering system for their financial institutions. Our members (insured credit unions) voluntarily joined the Virginia Credit Union Share Insurance Corporation in order to mutually provide for the security of their members' savings (shares). As of December 31, 1984 we insured the members interests in 111 state chartered credit unions in Virginia (aggregate insured deposits of $280,390,603 representing the savings of 220,045 members).

The Virginia Credit Union Share Insurance Corporation is not an insurance company engaged in the business of selling insurance, but rather a member owned entity enabled by the Virginia Legislature to provide assurance of deposits to its participating credit unions through their funding - at no cost to either the federal or state governments.

In addition to insurance of shares (deposits) we are also charged with the responsibilities of:

- Advancing funds to aid member credit unions to operate and meet liquidity requirements.

- To assist in the merger, consolidation and liquidation of credit unions.

and,

- Upon direction of the State Corporation Commission, to assume control of the business and property of member credit unions and to operate such credit unions to the point of resolution of its problem.

In an effort to maximize our ability to perform these functions, we have strived throughout out existance to develop a strong capital structure. I would suggest that the recent Internal Revenue Ruling (83-166), which provides for taxation of state share insurance programs, is certainly contrary to the objective of strengthening the current system of state share insurance programs.

I hope that the information will be of assistance to your committee in performance of its charges. If we may be of further assistance, please feel free to contact us.

Very truly yours,

Giles E. Wood
Executive Vice-President

GEW:ssc

Enclosures

NAME OF DEPOSIT INSURANCE FUND Virginia Credit Union Share Insurance Corporation

I. General Information:

1. Type(s) of Financial Institution(s) whose deposits you insure:
State Chartered Credit Unions

2. In which state(s) do you insure:
Virginia Only

3. A. Cost of initial membership in your fund, if any: Proscribed by Virginia Code 1% of Credit Union's Shares Outstanding
B. Annual premium: Proscribed by Virginia Code Annual Assessment - 1/12 of 1% of outstanding shares
C. Continuing equity contribution or membership deposit: Maintain 1% of outstanding shares proscribed by Virginia Code

4. Maximum coverage per account or per depositor:
$100,000 per Depositor(s)

5. Do you insure brokered deposits:
No

6. Number of insured institutions, by type:

A. Under $100 million: 111

B. $100 million to $500 million: 0

C. $500 million to $1 billion: 0

D. Over $1 billion: 0

7. Aggregate amount of deposits insured, by type of institution:
$280,390,603

8. Your fund's total useable assets:
$4,718,092

9. Ratio of usable insurance fund assets to deposits insured:
1.68% not including 1985 billing for assessments (1.96% when included)

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

Nonstock, nonprofit corporation created by Chapter 4.1 (Virginia Credit Union Share Insurance Act) of the Code of Virginia (copy attached) to assist member credit unions experiencing difficulties and to provide insurance for the shares of members of member credit unions. See also Code 6.1-226.8.

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

State Corporation Commission, Bureau of Financial Institutions (see Code 6.1-226.10)

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or

No

b. authority to assess other insured institutions enough to cover the losses?

Yes, special assessments are provided for (Code §6.1-226.7(2)

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

No

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

Yes, Bank of Virginia	$750,000
Central Liquidity Facility (NCUA)	$3,600,000
Aggregate Amount	$4,350,000

6. **Do you reinsure your risks with any other insurance carriers? Please provide details.**

Maintained reinsurance coverage with AETNA Casualty and Surety Corporation in the amount of $2,000,000 until May, 1982 at which time the carrier discontinued all coverages. Have been actively seeking coverage since that time.

7. **Regarding your board of directors:**

a. **How is your board of directors selected?**

Elected from member credit unions.

b. **What rules govern the size and composition of the board?**

By-Laws (Article VII, Section 1) - "Seven members..." Code §6.1-226.4(2) "...not less than five."

c. **Who are the present members of your board? (Please provide names and principal affiliations.)**

Kenneth E. Lantz, President - D. I. R. Credit Union
Dorothy J. Hall, Vice-President - State Employees Credit Union
Thomas J. Hall - Martinsville DuPont Employees Credit Union
James P. Kirsch - Portsmouth Post Office Credit Union
Raymond Barbour - Fort Monroe Credit Union
Artwell L. Pierce - Navy Yard Credit Union
Kenneth Ballentine - PFD Firefighters Credit Union

III. Supervision of insured institutions:

1. **Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?**

Yes, based upon insured credit union's operating ratios, i.e., capital/asset, delinquency/loans, income/expense, delinquency/capital. Operational, reserving and dividend paying restrictions may be imposed.

2. **Please respond separately for each state in which you insure deposits:**

a. **Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?**

Virginia - Yes (Code §6.1-226.11)

b. **Under what set of conditions or circumstances would you be authorized to discontinue insurance?**

Evidence of unsound practices, mismanagement and carelessness which would affect solvency or liquidity of the credit union or threaten loss to the Corporation.

c. **Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.**

None

3. Please respond separately for each state in which you insure deposits:

a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

Yes, Virginia Code 6.1-226.11 - The Corporation may require audits and investigations of member credit unions.

b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?

Insured credit unions are examined at least twice in every three-year period by the Bureau of Financial Institutions.

c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

Yes, copies of all examinations are forwarded to the Corporation.

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

No

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

The Corporation may require additional audits and examinations of the credit union and assume control of the property and business of the insured credit union and operate the credit union under the direction of the Bureau of Financial Institutions.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

Yes

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?

Shareholders are paid as rapidly as possible. To date most disbursements to members have been made in less than 30 days.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

No, assumption of control of the property and business of the credit union and continue operation is an option.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

Yes, the Corporation has the authority to receive control of an insolvent credit union and convey title to the assets and liabilities of that credit union to another credit union.

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

Yes, see 3.a.

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date:

a. The name, location, and size of the institution;

b. The total dollar cost of the insolvency to your fund;

c. The dollar amount of insured deposits in the institution at time of closing;

d. The dollar amount of uninsured deposits in the institution;

e. The percentage recovery to date to depositors on uninsured deposits;

f. The gross dollar amount of outstanding unpaid depositor claims; and

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

1981	$2,520,704
1982	$2,636,939
1983	$3,800,445
1984	$4,718,000

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

Bank C/D's (balances $100,000)	$800,000
S & L C/D's (balances $100,000)	$3,600,000
U. S. Central CU C/D	$50,000
U. S. Treasury Note	$99,965
Bank Checking	$19,663
Bank Demand Deposit	$84,533
U. S. Central credit union demand deposit	$58,129

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

No

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

1981	13.93%
1982	12.67%
1983	12.52%
1984	10.63%

5. Please provide a copy of your latest annual report.

Enclosed

VIRGINIA CREDIT UNION SHARE INSURANCE CORPORATION

SUMMARY OF LIQUIDATIONS AND MERGERS

JANUARY, 1980 - DECEMBER, 1984

	Credit Union	Location	$ Asset Size	$ Cost to Fund (Gain)	$ of Insured Deposits	$ of Uninsured Deposits	% Recovery of Uninsured Deposits	Outstanding Unpaid Claims	Date Institution Closed	Deposits Paid
+	Gilco	Norfolk, Va.	30,100	(1,080)	23,871	0	NA	0	05/80	05/80
+	CRT	Hampton, Va.	23,100	(5,235)	19,910	0	NA	0	04/80	04/80
+	Eastern State	Williamsburg, Va.	104,200	(7,628)	90,245	0	NA	0	01/82	02/82
+	Red Carpet	Lynchburg, Va.	53,000	(23,047)	27,047	0	NA	0	04/82	04/82
+*	LAM	Hampton, Va.	117,900	4,541	108,000	0	NA	0	12/83	12/83
+	Central Telco	Martinsville, Va.	6,500	(1,441)	4,626	0	NA	0	04/83	04/83
#*	Fredericksburg Area	Fredericksburg, Va.	335,400	23,105	299,700	0	NA	0	12/83	12/83
#	Whittaker (Est.)	Newport News, Va.	164,000	68,000	36,000	0	NA	0	Institution Not Closed	

* Indicates Merger
\# Indicates Insolvency
\+ Indicates Voluntary Liquidation or Merger

Virginia Credit Union Share Insurance Corporation Annual Report 1983

President's Report

May, 1984

The Virginia Credit Union Share Insurance Corporation will mark the Tenth Anniversary of its creation on July 25, 1984. The Corporation was created to provide insurance of the shares of members of state chartered participating credit unions in Virginia. The Corporation is also structured to provide aid and assistance to member credit unions experiencing difficulties and provide for the orderly liquidation of member credit unions when requested.

During 1983 the Corporation assisted in mergers involving four (4) insured credit unions and the voluntary liquidations of three (3) others. These current activities bring the total number of credit unions liquidated since organization to twelve (12) with a total share value expended to insured members in excess of $600,000.

The Corporation currently provides financial guarantees to two (2) credit unions which have allowed them to continue to operate through a temporary period of insolvency. These guarantees are structured so that the individual credit unions make regular monthly allocations in order to reduce the amount guaranteed.

During 1983 our insured credit unions generally experienced both growth in shares and membership. As of year-end 1983 a total of $242,454,594 in shares was insured, an increase of 21.2% over year-end 1982. This represented the savings of 211,874 members. Accompanying this increase in insured shares, the assets of the Corporation increased 24.9% to $3,838,798 as of year-end. This provided a ratio of funds available to shares insured of $1.57 per $100 - this compares favorably with a national average of $1.28 per $100 for other similar state share insurance programs.

In November 1983, the Internal Revenue Service reversed a previously issued ruling which had provided for an income tax exempt status for all state share insurance programs. At present, efforts are being made cooperatively with the other state share insurance programs through the International Share and Deposit Guaranty Association to have the income tax exempt status of the Corporation restored. In the event this is not successful, the Corporation will have a tax liability for 1984. We are presently working with our Certified Public Accountant to minimize a tax liability if imposed.

The Board of Directors would like to express its appreciation for the cooperation it has received from the Bureau of Financial Institutions and the Virginia Credit Union League throughout the year.

Respectfully submitted,

Kenneth E. Lantz

Kenneth E. Lantz
President

Balance Sheet

December 31, 1983 and 1982

ASSETS	1983	1982
CURRENT ASSETS		
Cash and Short Term Investments	$ 416,094	$ 134,126
Prepaid expenses	1,199	809
Interest receivable	49,102	59,877
Travel advance	32	89
TOTAL CURRENT ASSETS	$ 466,427	$ 194,901
OTHER ASSETS		
Certificates of deposit	$3,250,556	$2,650,000
Treasury notes, at cost (Market value $93,875 for 1983)	99,656	199,656
Loans receivable, less allowance for losses ($187,775 in 1982 and $167,998 in 1983)	12,725	24,607
TOTAL OTHER ASSETS	$3,362,939	$ 2,874,263
PROPERTY AND EQUIPMENT		
Furniture and fixtures	$ 2,335	$ 2,335
Automobile	9,177	6,884
Office equipment	7,417	7,417
TOTAL	$ 18,929	$ 16,636
Less accumulated depreciation	9,497	9,443
NET PROPERTY AND EQUIPMENT	$ 9,432	$ 7,139
	$3,838,799	$ 3,076,357

LIABILITIES AND FUND BALANCE		
CURRENT LIABILITIES		
Accounts Payable	19,633	$ 11,279
ALLOWANCE FOR LIQUIDATION LOSSES AND DEFERRED CREDITS	$ 10,766	$ 9,698
COMMITMENTS AND CONTINGENCIES		
FUND BALANCE		
Membership fees	$2,010,929	$ 1,662,533
Accumulated income:		
Segregated by management for guaranty agreement	$ 10,985	$ 28,511
Other	$1,786,485	$ 1,364,336
TOTAL	$1,797,470	$ 1,392,847
TOTAL FUND BALANCE	$3,808,399	$ 3,055,380
	$3,838,798	$ 3,076,357

Extracted from audited statements

Statement of Income

For the Years Ended December 31, 1983 and 1982

	1983	1982
REVENUE		
Annual assessments	$ 166,656	$ 136,733
Investment interest income	339,384	359,129
Other income	9,387	23,086
TOTAL REVENUE	$ 515,466	$ 518,948
EXPENSES		
Administrative	$ 78,505	$ 79,869
Automobile operations	1,150	1,240
Depreciation	4,778	4,444
Examination reports	765	815
Group insurance	2,621	2,288
Insurance, general	2,143	1,488
Meetings	3,079	1,558
Miscellaneous	3,022	1,068
National dues	1,981	1,981
Professional fees	6,387	3,949
Provision for losses on liquidations in process, net of (gains)	(11,429)	2,649
Reinsurance premium	—	10,200
Rent and occupancy costs	4,115	2,777
Retirement plan	3,148	4,138
Stationery and supplies	2,513	3,007
Taxes	164	182
Telephone	2,164	2,386
Travel	5,599	4,980
TOTAL EXPENSES	$ 110,633	$ 129,019
NET INCOME	$ 404,633	$ 389,929

Extracted from audited statements

Member Credit Unions

December 31, 1983	TOTAL SHARES	TOTAL ASSETS	NUMBER MEMBERS
Abex Employees	162,668	175,216	304
A. B. & W. Transit Employees	3,333,602	3,759,674	1,621
Alexandria Postal	834,957	941,789	668
Allied Employees	199,870	227,766	202
AMS	1,139,618	1,197,755	1,178
Arlington County Employees	7,004,790	8,110,616	3,897
Arlington Hospital Employees	222,141	257,227	604
B & B	83,926	89,742	253
B&W Petersburg Employees	2,613,494	3,466,666	1,679
Bayville Farms	37,259	48,621	75
Belt Line Employees	716,807	919,493	476
Blue Cross Blue Shield Employees	1,299,579	1,396,917	1,569
Campbell County Employees	140,554	159,593	579
C.C.C. Martinsville Employees	286,485	328,713	114
Chesapeake City Employees	648,267	722,448	1,058
Chesapeake Public Schools Employees	1,713,708	1,883,201	1,732
Chessie-Newport News	2,570,036	2,916,057	2,052
City of Alexandria Employees	3,967,931	4,714,389	3,807
Contelco	2,933,222	3,168,172	2,166
C&O Employees	7,221,559	7,757,046	3,991
Craddock-Terry	208,503	380,944	1,100
Danville Postal	667,684	824,654	468
D.I.R.	1,643,108	1,934,896	1,296
Disston Employees	120,320	130,500	296
Dupont Fibers Employees	27,906,032	30,906,949	8,270
Economy	135,297	153,954	439
E.T.C. Virginia	68,222	84,226	176
Fairfax County Employees	9,185,137	10,970,679	6,382
Fairfax Hospital Association Employees	1,681,609	1,892,869	2,322
Farm Fresh Employees	668,669	743,258	2,009
Fluvanna County School Employees	28,468	31,006	136
Fort Monroe	8,397,313	9,726,567	4,677
Frederick	121,880	138,573	476
Fredericksburg Area	301,990	317,867	1228
G&L Employees	24,005	27,066	60
Gwaltney Employees	735,612	837	1,262
Hanover County Employees	362,305	393,127	792
Hampton City Employees	587,589	649,533	1,220
Hampton Roads Educators	4,090,677	4,696,105	3,894
Hercules Covington	218,438	257,974	308
Heritage Employees	19,614	19,388	180
H.L.D. Employees	79,923	87,305	299
Howmet Hampton Employees	299,129	360,440	472
I.C.I. Employees	214,461	243,425	405
Kennedy's Piggly Wiggly	45,407	72,504	139
Klann Employees	37,900	45,781	68
L.G.-M.L. Employees	246,627	269,915	808
Loudoun	265,263	285,830	709
Lynchburg Appalachian Employees	181,513	204,424	176
Lynchburg Postal	1,552,662	1,722,221	971
Martinsville Dupont Employees	22,622,765	26,162,051	6,796
Martinsville Postal	117,373	145,795	98
Martha Jefferson Hospital	252,417	315,420	579
M.H.M.H.C. Employees	164,576	196,337	618
Montgomery County Employees	92,105	113,508	363
National Homes Employees	60,791	70,918	120
Nabisco Employees	471,460	536,093	609
Navy Yard	13,819,374	15,350,382	16,656

	TOTAL SHARES	TOTAL ASSETS	NUMBER MEMBERS
Nansemond	1,332,956	1,638,914	2,061
Naval Hospital	2,122,260	2,518,251	2,680
N.C.S.E.	142,684	184,890	330
N.C.H.	169,717	235,318	481
Newport News Educators'	6,347,188	7,298,777	4,610
Newport News Municipal Employees	3,950,981	4,243,989	2,820
Newport News Post Office	1,057,368	1,205,806	875
Norfolk, Va. Postal	2,242,395	2,545,330	1,500
Norfolk Southern Employees	1,001,603	1,268,603	1,040
Peninsula Newspapers	1,114,957	1,287,401	1,345
Petersburg Federal Reformatory	455,013	562,230	430
PFD Firefighters	876,104	1,097,853	712
Piedmont Educational Employees	969,605	1,123,996	1,845
Portsmouth Police	393,673	520,162	308
Portsmouth Post Office	873,404	1,024,934	798
Proctor & Gamble Employees	126,815	147,765	118
P.W.C. Employees	468,782	500,119	1,350
P.W.H. Employees	237,166	257,003	382
R&B Employees	90,295	99,133	93
Reco Employees	302,620	348,111	270
Richmond Fire Department	1,123,201	1,283,949	711
Richmond Memorial Hospital Employees	1,076,206	1,181,366	1,515
Richmond Police	643,170	743,047	722
Richmond Postal	11,361,877	13,283,455	3,788
Roanoke Blue Cross & Blue Shield	85,086	94,717	293
Rosso & Mastracco Employees	210,672	246,248	755
S&S Machinery	169,393	196,639	455
Salem E.B.A.	765,902	846,313	860
S.C.L. Employees	171,296	200,956	246
Seaboard System Employees	210,733	310,250	438
Southern States Employees	1,939,598	2,339,737	2,156
S.M.H. Employees	532,776	597,161	949
Smithfield Packing Employees	643,760	1,382,283	951
S.N.B.F. Employees	123,530	141,961	196
Shenandoah County	69,757	73,323	158
State Employees	37,155,081	39,947,944	44,250
Staunton Employees	84,390	96,943	320
Strother Drug Co. Employees	78,634	107,284	139
T.M.C. Employees	458,190	507,436	550
Thalhimer's	1,128,806	1,548,566	2,099
Texaco Employees	524,627	623,404	461
Tidewater Telephone Employees	5,242,941	6,503,742	3,473
University	148,295	170,955	510
U.S.E.	408,859	452,818	493
Valley	50,328	54,056	160
V.B.H. Employees	154,581	186,897	390
Vepco	4,948,546	5,226,463	7,251
Virginia Gas	881,539	1,044,269	540
Virginia League Central	7,041,138	8,027,485	12,546
Virginia State School	50,918	55,498	113
Waynesboro G.E. Employees	1,660,428	1,764,038	1,501
Wayn-Tex Employees	119,222	175,381	416
W.C.H. Employees	356,179	377,115	522
WECCU	2,663,033	3,016,207	1,860
W.P.S.E.	342,379	394,409	430
Whittaker Memorial Hospital	106,487	159,825	254
TOTALS	242,454,594	275,747,871	211,874

NAME OF DEPOSIT INSURANCE FUND Washington Credit Union Share Guaranty Association

I. General Information:

1. Type(s) of Financial Institution(s) whose deposits you insure:
Credit Unions

2. In which state(s) do you insure:
Washington

3. A. Cost of initial membership in your fund, if any: $25.00

B. Annual premium: -0-

C. Continuing equity contribution or membership deposit: Fund reserves are adjusted annually to .5 of 1%. Association Board has authority to require additional transfer of .5 of 1% annually.

4. Maximum coverage per account or per depositor:
$100,000 except retirement accounts $250,000.

5. Do you insure brokered deposits:
N/A as deposits are derived from the field of membership and would not be brokered. Borrowed funds are an indirect liability and are provided for

6. Number of insured institutions, prior to distribution of shares. by type:

A. Under $100 million: 136 credit union

B. $100 million to $500 million: 1 credit union

C. $500 million to $1 billion:

D. Over $1 billion:

7. Aggregate amount of deposits insured, by type of institution:
$1,082,000,000*

8. Your fund's total useable assets:
$10,679,627*

9. Ratio of usable insurance fund assets to deposits insured:
.987%*

*2/28/85 reporting info.

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

Private agency created by law.

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

Division of Savings & Loan Association

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or

No.

b. authority to assess other insured institutions enough to cover the losses?

Method of operation permits deferring some liability into future years thus permiting additional assessments in subsequent years.

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

Yes. Funding provisions require the adjustment at the beginning of each calendar year to .5 of 1% with the option of the Board to require an additional .5 of 1% in any calendar year.

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

$350,000.
Bank
Corporate Credit Union

6. **Do you reinsure your risks with any other insurance carriers? Please provide details.**

No.

7. **Regarding your board of directors:**

a. **How is your board of directors selected?**

Election by member credit unions at annual meeting for three year term.

b. **What rules govern the size and composition of the board?**

The state act and bylaws must be 5 or less and be an officer or a director of a member credit union.

c. **Who are the present members of your board? (Please provide names and principal affiliations.)**

Clare Chapman, Chairman
Spokane Teachers Credit Union, Manager

Earl Weatherman, Vice Chairman
Yakima City & County Employees Credit Union , Manager

Ray Lundeen, Secretary
Washington School Employees Credit Union, Adm. Manager

Diana Vogel, Treasurer
Seattle Credit Union Center, Manager

Doug Piete, Director
Snohomish County Teachers Credit Union, President

III. Supervision of insured institutions:

1. **Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?**

We require a minimum solvency level of 1.02 share value. This is derived by adjusting assets to reflect sound assets and ratioing to shares.

2. **Please respond separately for each state in which you insure deposits:**

a. **Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?**

Yes.

b. **Under what set of conditions or circumstances would you be authorized to discontinue insurance?**

Insolvency-failure to comply with procedure required by the Association, improper or unsafe practices.

c. **Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.**

One-failure to improve financial condition.

3. Please respond separately for each state in which you insure deposits:

a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

Agreement-membership application and agreement (enclosed)

b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?

We have not established an examination policy. We rely on the Supervisor agency examinations. There are no examiners on staff and there is no examination budget.

c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

Yes, they are available. No, we do not receive these on a scheduled basis.

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants? No.

They are required to have books and records reviewed semi-annually by the supervisory committee.

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

We require additional information when deemed necessary and require corrective action be implemented, however, cessation of coverage is the only authority we maintain to force action.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

No.

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?

We have used the merger/assumption of assets and liabilities procedure so there has been no delay regarding distribution of deposits.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

No.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

Yes, in conjunction with the state regulating agency.

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

Yes, in conjunction with the state regulatory agency.

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date:

a. The name, location, and size of the institution;
Schedule A

b. The total dollar cost of the insolvency to your fund;
$459,155.

c. The dollar amount of insured deposits in the institution at time of closing;
$4,196,308.

d. The dollar amount of uninsured deposits in the institution;
-0-

e. The percentage recovery to date to depositors on uninsured deposits;
N/A

f. The gross dollar amount of outstanding unpaid depositor claims; and
-0-

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.
None

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

1981	$874,383
1982	$777,494
1983	$3,273,073
1984	$4,404,762
2/28/85	$10,679,627

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

Reserves held by CU members	$10,818,379
Savings certificates	270,000
Daily Deposit	12,750
Cash	1,758
TOTAL	$11,102,887

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

$82,750.

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

1981	8.02
1982	11.57
1983	9.25
1984	9.15

5. Please provide a copy of your latest annual report.

1984 annual report included.

Enclosures:

Schedule A - Insolvent Credit Unions Liquidated Since 1/01/80

Credit Union Share Guaranty Association Act of 1975

Membership Application & Agreement

1984 Annual Report

Schedule A

INSOLVENT CREDIT UNIONS LIQUIDATED SINCE 1/01/80

Year	Name	Location	Assets
1980	IBEW #46	Seattle	$249,099
1981	ELDEC	Seattle	247,568
	Harbor Community	Aberdeen	381,763
	Sheet Metal Wkrs. #150	Tacoma	74,165
	Valley Teamsters	Yakima	897,462
	Wenatchee Medical Wkrs.	Wenatchee	382,919
1982	Centerville Community	Centralia	994,136
	Motor Coach	Tacoma	759,457
	Realty	Tacoma	429,211
	Waspen	Walla Walla	152,024
1983	Stevenson	Stevenson	152,570
	TOTAL		$4,720,374

MEMBERSHIP APPLICATION AND AGREEMENT

WASHINGTON CREDIT UNION SHARE GUARANTY ASSOCIATION

DATE:_____

TO: WCUSGA
BOX WCUL
BELLEVUE, WASHINGTON 98009

THE: _____ CREDIT UNION

Mailing Address:_____

City: _____ , Washington_____
(Zip Code)

hereby applies for membership in the Washington Credit Union Share Guaranty Association, as provided in RCW 31 . 12A, and, in consideration of the certification of membership, hereby agrees:

1. To comply with all applicable rules and regulations as outlined in RCW 31 . 12, bulletins (relating to Credit Unions) issued by the Supervisor, Division of S&Ls, and the bylaws of the Washington Credit Union Share Guaranty Association.

2. To pay the application fee, as required by the bylaws of the Association, and such additional operating assessments as may be levied by its Board of Directors.

3. To permit the Association to have access to all records and information concerning the affairs of the Credit Union, and to furnish such information pertinent thereto, as may be required.

Signed _____
President, Board of Directors

Signed _____
Secretary, Board of Directors

Approved:_____ Date:_____
Supervisor, Division of S&L Associations

Ratified:_____ Date:_____
Chairman of Board, WCUSGA

washington credit union share guaranty assn.

P.O. BOX WCUL • Bellevue, Washington 98009 • (206) 881-2382 • 1-800-562-1012

1984 ANNUAL REPORT

The year 1984 was a year of improvement for the Washington Credit Union Share Guaranty Association. There were no additions to the guarantee list and due to satisfactions of guarantees and loans purchased as the result of guarantees, the liability was reduced from $820,761.00 to $467,397.00.

The reduction of $353,364 during 1984 were loans purchased per guarantees of $101,519, satisfaction of guarantees for less than the guarantee amount, $107,916 and renegotiated guarantees for a lesser amount than at the beginning of the year for $143,929.

The total liability outstanding at the end of 1984 in relation to the total funds available was 9.69%, the total guarantee losses for 1984 was 2.01% of the WCUSGA collected funds plus the Contingency Reserve held by members.

The merging of credit unions continues with a net change of 13 credit unions during the year with one member credit union merging with a non member. None of the mergers required guarantees. Four federal credit unions merged with member credit unions. One new charter was granted during 1984 and and membership was approved for this credit union.

Three credit unions were on the alert list during 1984 for additional monitoring and two have improved. The third credit union was issued a cancellation of coverage order effective March 12, 1985.

The attention directed to the FDIC as the result of the problems with Continental Illinois Bank and the additional developments regarding the failure of the Nebraska Depository Institutions Guaranty Corporation has created some adverse publicity regarding share and deposit guarantying/insuring corporations and, as a result, several credit union members have contacted the office to obtain specific information regarding operation and funds available to provide protection for their accounts. When given the average losses for guarantees since organization, and told of the procedure utilized in liquidating a credit union and the funds that are available for this purpose, they seem satisfied.

The most significant factor is the average losses paid since organization and over the last four years, which is approximately $135,000 per year in each instance.

Because of this situation and the capitalization of the NCUSIF at 1.3% of insured balances, the Board of WCUSGA voted to request an additional .5% be transferred to the WCUSGA Contingency Reserve effective January 2, 1985. This increases the fund to $10,823,278. Guaranteed shares at the end of 1984 were $1,082,327,852.

There have been some inquiries and one pending application of changing to WCUSGA from federally insured credit unions.

The loss of tax exempt status has not been fully resolved. The Association presently has an interpretation from a tax attorney that excludes it from the ruling.

The current Board of Directors are Clare Chapman, Manager of Spokane Teachers Credit Union; Earl Weatherman, Manager of Yakima City & County Employees Credit Union; Ray Lundeen, Manager of Washington School Employees Credit Union, Secretary; Diana Vogel, Manager of Seattle Credit Union Center, Treasurer; and Doug Piete, Manager of Snohomish County Teachers Credit Union. Ray was elected at the annual meeting to the position vacated by Stu Shogreen who chose not to run after six years on the Board. Doug was appointed by the Board to fill the vacancy of Rosie Shultz who resigned in November after serving seven years.

I would like to take this opportunity to express my thanks for the efforts of the Board and Staff this past year and my sincere appreciation for the many years of service devoted to the Association by Rosie and Stu.

The year 1985 looks very promising. The remainder of the current guarantees will expire and it is anticipated the guarantee payments will be $90,000 or less and, at the present time, there is only one credit union that appears to require a guarantee for 1985.

With the conclusion of the current guarantees and with the Contingency Reserve at the one percent level and with the continued stabilizing of the economy, the Association is approaching 1985 most optimistically.

Respectfully submitted,

Clare Chapman

Clare Chapman, Chairman
For the Board of Directors

Washington Credit Union Share Guaranty Association

Balance Sheet

December 31, 1984

Assets	
Cash	$ (262.08)
Certificates & Deposits in WCCCU	174,378.12
Certificates in Savings & Loan Association	100,000.00
Furniture & Equipment (at cost less $2,563.85 accumulated depreciation)	7,306.07
Assessments Receivable	34,960.54
Asset in Liquidation	19,142.93
Funds Held in Trust by Member Credit Unions	4,541,533.14
Total	4,877,058.72
Liabilities	
Accounts Payable	4,240.68
Deferred Income on Recoveries	504.32
Liquidated Credit Union Assessments	562.35
Committed Guarantees	472,296.28
Liabilities for Funds Held	4,069,235.94
Fund Balance	330,219.15
Total	$4,877,058.72

Washington Credit Union Share Guaranty Association

Statement of Revenue, Guarantees Disbursed,
Operating Expenses and Changes in Fund Balance

For Year Ended December 31, 1984

Revenue:		
Interest	$	17,627.35
Interest Loan Recovery		510.22
Fees		25.00
Assessments		200,136.12
Marketing Supplies		1,617.04
Revenue		219,915.73
Guarantees Disbursed		101,519.41
Less Recoveries on Loans		23,182.64
Net Guarantees Disbursed		78,336.77
Operating Expenses		
Salaries		54,252.32
Rent		2,133.48
Telephone		1,049.41
Office Supplies		1,738.23
Travel & Meetings		4,601.13
Board Expense		4,046.76
Bond & Insurance		730.00
Audit Expense		2,500.00
Association Dues		5,162.60
Depreciation		1,722.71
Printing		321.75
Legal Expense		1,500.00
Misc.		845.89
Operating Expenses		80,604.28
Total Net Guarantees Disbursed and Operating Expenses		158,942.05
Excess Disbursements		60,974.68
Prior Period Adjustment		1,804.47
Prior Fund Balance, January 1, 1984		267,440.00
Fund Balance, December 31, 1984	$	330,219.15

Chapter 31.12A
CREDIT UNION SHARE GUARANTY ASSOCIATION ACT OF 1975

Sections

31.12A.005 Purpose. The purpose of this chapter is to provide funds arising from assessments upon member credit unions chartered by the state of Washington (1) to guarantee payment, to the extent herein provided, to credit union shareholders of the amount of loss to their share and deposit accounts in a liquidating member credit union, and (2) to provide other services to promote the stability of state-chartered credit unions. In the judgment of the legislature, the foregoing purposes not being capable of accomplishment by a corporation created under general laws, the creation of the nonprofit association hereinafter in this chapter described is deemed essential for the protection of the general welfare.

31.12A.010 Definitions. As used in this chapter, unless the context otherwise requires, the terms defined in this section shall have the meanings indicated.

(1) "Assessment" means the amount levied by the association against its members in order to carry out its stated purposes.

(2) "Association" means the credit union share guaranty association created in RCW 31.12A.020.

(3) "Board" means board of directors of the guaranty association.

(4) "Contracted guarantees" means those liabilities specifically agreed to by the association for providing assistance to member credit unions or for indemnifying any other entity against loss because of its participation in the absorption or liquidation of a distressed member credit union.

(5) "Credit union" means a credit union organized and authorized under laws contained in chapter 31.12 RCW, as now or hereafter amended.

(6) "Initial member" means a member qualified by the supervisor within sixty days after September 1, 1975, but not yet ratified by the board.

(7) "Member" means a member of the guaranty association, ratified by the board.

(8) "Share account" of a credit union shareholder includes the share and/or deposit accounts and the share and/or deposit certificates of which the shareholder is owner of record with the credit union.

(9) "Shareholder" includes both members and nonmembers of a credit union, who have either shares and/or deposits in the credit union, including deposits of deferred compensation as referred to in RCW 31.12.305.

(10) "Supervisor" means the state supervisor of the division of savings and loan associations, or his successor in the event of a departmental restructuring.

(11) "Transfer" means entering on the credit union's books of account a decrease to one account and a corresponding increase to another account.

31.12A.020 Guaranty association created. There is hereby created a nonprofit unincorporated legal entity to be known as the Washington credit union share guaranty association, which shall be comprised of state-chartered credit unions in the state of Washington and governed by a board of directors as in RCW 31.12A.060 provided. (1975 1st ex.s. c 80 § 4.)

31.12A.030 Powers of the association. The association shall have power:

(1) To use a seal, to contract, to sue and be sued;

(2) To make bylaws for conduct of its affairs, not inconsistent with the provisions of this chapter;

(3) To lend and to borrow money, and require and give security;

(4) To receive, collect, and enforce by legal proceedings, if necessary, payment of all assessments for which any member may be liable under this chapter, and payment of any other debt or obligation due the association;

(5) To invest and reinvest its funds in investments permitted for credit unions in RCW 31.12.260, as now or hereafter amended, provided such investments do not exceed a maximum maturity of one year;

(6) To acquire, hold, convey, dispose of and otherwise engage in transcations involving or affecting real and personal property of all kinds;

(7) To assess each member an amount not exceeding that permitted in RCW 31.12A.050 for liquidations to cover the expense of operation of the association, as established in the bylaws, and for such other proper purposes of the association;

(8) To enter into contracts of insurance or reinsurance, insuring in whole or in part its contractual guaranties to its member credit unions and other insurance or bonding contracts necessary or advisable in the conduct of its business; and

(9) To carry out the applicable provisions of this chapter.

31.12A.040 Membership--Association operative date. (1) Every credit union meeting the following qualifications is eligible for membership in the association:

(a) Must be in business as a duly authorized credit union.

(b) Must be operating in compliance with applicable laws and the rules and regulations of the supervisor.

(c) Must not be in the process of liquidation, either voluntary or involuntary.

(2) Prior to the operative date stated in subsection (3) of this section, application for membership shall be made by the credit union in writing to the association on forms designed and furnished by the association, and filed with the secretary. An application fee, as fixed in the bylaws payable to the order of the association, shall accompany each such application. If the application is found to be:

(a) Complete, and the applicant qualified for membership: The association shall issue and deliver to the applicant a certificate of membership in appropriate form.

(2) Sums specified in subsection (1) of this section may be offset from the statutory transfer requirement to the guaranty fund and shall be retained in the credit union share guaranty contingency reserve as an integral part of its guaranty fund until such time and if necessary to be drawn for the purposes set forth in this chapter.

(3) Members' share guaranty association contingency reserve funds shall be invested in investments as permitted in the bylaws of the association.

(4) The board, in concurrence with the supervisor, may also suspend or diminish the transfer in any given period after reaching a normal operating sufficiency as provided in the bylaws.

(5) Membership in this association may be terminated upon approval by a majority of the credit union members responding to such a proposal and subject further to acceptance by the national credit union administration of continued share insurance coverage under the national credit union administration share insurance program. Notice of such intentions shall be in writing to the association's board of directors at least twelve months prior to such contemplated action: PROVIDED, That in the event that the credit union board has voted to recommend to the membership liquidation, conversion from state to federal credit union charter, or merger with or conversion to a credit union organized under the laws of another state, the liquidating, converting, or merging member will notify the association in writing within seven days after the credit union board has taken such action. Share guarantee coverage through the association will terminate with the effective date of the new charter or completion of the liquidation or merger as determined by the supervisor.

(6) Except for a credit union merging with a member credit union, any credit union terminating membership in the association shall be assessed its pro rata share of the difference, if any, between the association's current liability for contracted guarantees and the amount from previous assessments currently held for contracted guarantees by the association. Such difference shall be determined by the supervisor at the time the membership is terminated. If the amount of the assessment exceeds the amount of the actual obligation when finalized, the excess shall be refunded in the same proportion as paid.

31.12A.060 Management. (1) The affairs and operations of the association shall be managed and conducted by a board of directors and officers.

(2) The board shall consist of not more than five directors, as provided by the bylaws. Directors shall be elected by members for terms, as fixed by the bylaws, of not more than three years. The board shall have power to fill vacancies occurring during the interim between annual meetings and until an election is held at the next annual meeting, to fill that portion of the unexpired term.

(3) The officers shall be elected by the board, and shall be a chairman of the board, a vice chairman, a secretary and a treasurer. The offices of secretary and treasurer may be held by the same person. The officers shall have the usual and customary powers and responsibilities of the respective offices, as fixed by the bylaws.

(4) The directors shall be compensated only to the extent of actual out-of-pocket travel and meeting expenses as provided in the bylaws.

31.12A.070 First meeting of members and board of directors. (1) Within thirty days after the operative date of this chapter, the supervisor shall call a first meeting of the initial members of the association for the purpose of electing directors and shall give written notice of the time and place of such meeting. The meeting shall be held within sixty days after such operative date, at a place in this state selected

(b) Incomplete: The association shall require the applicant to refile said application in its entirety within thirty days.

(c) Not qualified: The association shall notify said applicant within thirty days of filing: PROVIDED, That said applicant will be allowed to meet qualification standards under conditions as provided in the bylaws of the association.

(3) The initial membership of the association shall be comprised of all those credit unions qualified under subsection (1) of this section by the supervisor within sixty days after September 1, 1975, with final ratification by the initial board of directors subject to full compliance of all qualifications for membership within one hundred twenty days after September 1, 1975.

(4) Membership in either this association or the federal share insurance program under the national credit union administration shall be mandatory.

31.12A.050 Funding--Liquidity--Investments--Termination. (1) Funding of the association shall be by transfers to a share guaranty association contingency reserve as follows:

(a) Credit unions approved by the supervisor and ratified by the board for membership subsequent to those initial members shall establish a share guaranty association contingency reserve by transferring from their guaranty fund an amount equal to one-half of one percent of the total guaranteeable outstanding share and deposit balances as of the date of membership. When one member credit union is merged into another member credit union, the continuing credit union shall include in its share guaranty contingency reserve the share guaranty contingency reserve of the merged credit union. A nonmember credit union merging with a member credit union must transfer into the share guaranty contingency reserve of the continuing credit union an amount equal to one-half of one percent of the total guaranteeable outstanding share and deposit balances of the nonmember credit union as of the effective date of the merger, as determined by the supervisor.

(b) On the first business day of each year, member credit unions shall make a transfer of an amount sufficient to adjust the contingency reserve to a level of one-half of one percent of the guaranteeable outstanding share and deposit balances as of December 31st of the previous year. If the member's guaranteeable outstanding share and deposit balances decrease from the previous year, any excess which may then appear in the contingency reserve may be transferred to the guaranty fund.

(c) The board may require one additional transfer during the calendar year of an amount not to exceed one-half of one percent of the guaranteeable outstanding share and deposit balances as of December 31st of the previous year. Credit unions which have merged during the year and credit unions which have joined during the year will be subject to the one additional transfer, even if that required transfer occurred before ratification of the joining member or the merger of the two credit unions. The transfer will be based on the guaranteeable share and deposit balances of those credit unions as of the following dates:

(i) For new members, the balances as of the date of membership;

(ii) For members that merge, the sum of the balances as of December 31st of the previous year;

(iii) For a nonmember merging with a member, the sum of the member's balances as of December 31st of the previous year, and of the nonmember's balances as of the effective date of the merger.

by the supervisor and of convenience to members. The supervisor shall preside at the meeting.

(2) The initial board of directors shall meet within thirty days after the first meeting of members, to elect officers, consider bylaws, and transact such other business relating to the association as may properly come before it. (1975 1st ex.s. c 80 § 9.)

31.12A.080 Bylaws. (1) The first bylaws of the association shall be as adopted by its initial board, and the board shall so adopt bylaws within three months after the association has become operative. All bylaws, and amendments thereof, shall be promptly filed with, and are subject to the approval of, the supervisor, and shall be approved if found by the supervisor to be reasonable, and fair and equitable to the association and its members. Among the customary, useful, and desirable provisions the bylaws shall provide:

(a) For the date and place of holding the annual meeting of members.

(b) Procedure for holding of special meetings.

(c) For voting privilege.

(d) For quorum requirements.

(e) For qualifications of directors, for procedures for nomination, election and removal of directors; and number, term and compensation of directors.

(f) For the bonding of any individual who may be expected to handle funds for the association.

(g) Qualifications for membership.

(h) Duties of officers.

(i) Application fees and assessment fees.

(j) Fines, if any.

(k) Coverage loss limits.

(l) Powers and duties of the board.

(m) Types of investments, liquidity, and normal operating sufficiency.

(n) Such other regulations as may be deemed necessary.

(2) After adoption of initial bylaws by the board, the bylaws shall be subject to amendments only by vote of the members. The secretary-treasurer of the association shall promptly file all bylaws and amendments with the supervisor. No bylaws or amendments thereto, except the adoption of initial bylaws, shall be effective until approved by the supervisor as hereinabove in this section provided. (1975 1st ex.s. c 80 § 10.)

31.12A.090 Liquidation of members--Assessment. (1) In the event a member of the association is placed in liquidation, either voluntary or involuntary, the supervisor or his representative shall determine as soon as is reasonably possible the probable assessment, if any, resulting therefrom to its shareholders. If an assessment seems to be indicated, the supervisor or his representative shall promptly inform the association in writing of the probable amount of such assessment. In determining the probable assessment for the liquidating member, charges, if any, for services of the supervisor or his representative, or his staff, as well as accrued but unpaid interest or dividends on share accounts, shall not be deemed liabilities of the liquidating credit union; and, with the consent of the association, all illiquid holdings (furniture, fixtures and other personal property) of the liquidating member, at the fair recoverable value thereof, as determined by the supervisor or his representative, may be excluded as assets. In determining the assessment as to a particular share account, the supervisor or his representative shall first deduct the amount of any accrued and currently payable obligation of the shareholder to the liquidating credit union.

(2) Within thirty days after receipt by the association of the foregoing information, the board shall notify the remaining members of the association of the aggregate amount required to make good the probable net loss to share accounts, subject to the following conditions:

(a) The amount of loss to be made good to any shareholder shall not be less than provided by the national credit union administration share insurance program, with authority vested in the association to increase the coverage.

(b) To the amount of the assessment as otherwise determined pursuant to this section, the board may add such amount as it may deem to be reasonably necessary to cover its clerical, mailing and other expense connected with the assessment and distribution of the proceeds thereof to shareholders of the liquidating credit union, not to exceed actual costs of such mailing and clerical services.

(c) The amount of the assessment shall be prorated among the assessed members against their share guaranty contingency reserve: PROVIDED, That members shall not be liable for any amount of assessment exceeding their share guaranty contingency reserve or for any assessment exceeding those permitted in RCW 31.12A.050 as now or hereafter amended.

(d) That a plan for an orderly and expeditious liquidation be presented to the board of directors for their consideration and approval. In cases where a central or other eligible credit union is authorized to act as liquidator or liquidating agent, the association would provide an indemnity against loss to such authorized credit union.

(3) In case of liquidation the board shall cause written notice to each member only if a potential assessment is indicated and the probable amount of such contingency as it relates to a percentage of their total share guaranty contingency reserve. The actual assessment shall be paid by members upon completion of liquidation or sooner, as determined by the board of directors. In all cases the total reserve structure of a liquidating credit union, including its share guaranty contingency reserve, shall be utilized in concluding the liquidation.

31.12A.100 Payment to shareholders--Subrogation. (1) Upon collection in full of the amount assessed against members as provided for in RCW 31.12A.090, or other provision satisfactory to the board, the association shall conclude the liquidation subject to acceptance by the supervisor.

(2) If illiquid holdings of the liquidating member have not been included as assets in determining net loss to share accounts, as provided for in RCW 31.12A.090(1), the association shall be subrogated to all rights of shareholders with respect to such holdings and to the extent of the value thereof so excluded and reflected in the assessment of association members; and the officers of the liquidating member or other persons having authority with respect thereto shall execute such conveyances, assignments, or other documents as may be requested by the association to facilitate recovery by the association in due course of the amount of its interest in such assets or so much thereof as may in fact be recoverable. The association shall have the right to bring and maintain suit or other action in its own name for the enforcement of any right of the insolvent member or its shareholders with respect to any such asset. (1975 1st ex.s. c 80 § 12.)

31.12A.110 Disposition of amounts recovered. Amounts recovered by the association pursuant to its right of subrogation as provided in RCW 31.12A.100(2) shall be refunded pro rata to those members who paid assessments out of which right of subrogation arose. (1975 1st ex.s. c 80 § 13.)

31.12A.120 Reports--Recommendations--Examination. (1) Within sixty days after expiration of each calendar year, the association shall render a report in writing of its financial affairs and transactions for the year, and of its

financial condition at year-end. The association shall furnish a copy of the report to each member and to the supervisor.

(2) The financial affairs of the association shall be subject to examination by the supervisor at such intervals as he may deem advisable in relation to the extent of the association's activities. The cost of the examination shall be borne by the association. In lieu of his own examination, the supervisor may accept the report of any competent accountant, satisfactory to the supervisor. (1975 1st ex.s. c 80 § 14.)

31.12A.130 Taxation. The association shall be exempt from all taxes and fees now or hereafter imposed by the state of Washington or any county, municipality, or local authority or subdivision; except that any real property owned by the association shall be subject to taxation to the same extent according to its value as other real property is taxed. (1975 1st ex.s. c 80 § 15.)

31.12A.140 Immunity. There shall be no separate and individual liability on the part of and no cause of action of any nature shall arise against any member insurer, agents or employees of the association, the board of directors, or the supervisor or his representatives, for any action taken by them in the performance of their powers and duties under this chapter. (1975 1st ex.s. c 80 § 16.)

31.12A.900 Short title. This chapter shall be known and may be cited as the Washington credit union share guaranty association act. (1975 1st ex.s. c 80 § 17.)

31.12A.910 Construction--1975 1st ex.s. c 80. This chapter shall be liberally construed to effect the purpose stated in RCW 31.12A.005, which shall constitute an aid and guide to interpretation. (1975 1st ex.s. c 80 § 18.)

31.12A.920 Section headings not part of law. Section headings in this act do not constitute any part of the law. (1975 1st ex.s. c 80 § 19.)

31.12A.930 Effective date--1975 1st ex.s. c 80. This act shall become effective on September 1, 1975. (1975 1st ex.s. c 80 § 21.)

31.12A.940 Severability--1975 1st ex.s. c 80. If any clause, sentence, paragraph, section or part of this act shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair or invalidate the remainder thereof but shall be confined in its operation to the clause, sentence, paragraph, section or part thereof directly involved in the controversy in which such judgment has been rendered. (1975 1st ex.s. c 80 § 20.)

NOTE TO CREDIT UNIONS: The following are new sections added by the 1983 legislative session. We have made them available so you would have the new language as soon as possible. When code numbers (RCWs) have been assigned, we will send the new section, with proper cites, to you. The amendments referred to in Sec. 3 following have been incorporated into 31.12A.050.

Sec. 3. During calendar year 1983, the 1983 amendments to RCW 31.12A.050 shall be applied according to the following transition rules:

(1) If, on the effective date of this 1983 act, the share guaranty contingency reserve does not meet the level of one-half of one percent of the member's guaranteeable outstanding share and deposit balances as of December 31, 1982, the credit union shall be required to adjust its share guaranty contingency reserve to that level within thirty days of the effective date of this 1983 act. However, if any assessments were made in 1983 prior to the effective date of this 1983 act, the required one-half of one percent level shall be reduced by the amount of any such assessments.

(2) Credit unions that become members or that merge on or after the effective date of this act and before January 1, 1984, shall be subject to the provisions of RCW 31.12A.050(1)(a) as amended by this 1983 act.

(3) During the remainder of the calendar year following the effective date of this 1983 act, one additional transfer as provided for in RCW 31.12A.050(1)(c) will be permitted.

(4) This section shall expire on January 1, 1984.

Sec. 4. This act is necessary for the immediate preservation of the public peace, health, and safety, the support of the state government and its existing public institutions, and shall take effect immediately.

WCUSIC
WISCONSIN CREDIT UNION
SAVINGS INSURANCE CORP.

5011 Monona Drive
Madison, Wisconsin 53716

Donald J. Schaefer,
Executive Vice-President

March 26, 1985

Honorable Doug Barnard, Jr.
House of Representatives
Rayburn House Office Building, Room B-377
Washington, DC 20515

SUBJECT: DEPOSIT INSURANCE QUESTIONNAIRE

Dear Congressman Barnard:

In reply to your recent inquiry, we are enclosing the completed questionnaire along with the requested data. We hope this will be of assistance to you and your Committee as you begin your Congressional hearings.

I was most interested in your remarks regarding the possible need to strengthen the current system of state/private deposit insurance. We feel we are healthy and strong - the one thing we could surely use, however, is the borrowing power from the U.S. Treasury, as afforded the 3 Federal programs.

We would be most happy to work with you and your Committee in these efforts.

Sincerely,

Donald J. Schaefer
Executive Vice-President

DJS:lc

enclosures

NAME OF DEPOSIT INSURANCE FUND WISCONSIN CREDIT UNION SAVINGS INSURANCE CORPORATION

I. General Information:

1. Type(s) of Financial Institution(s) whose deposits you insure:
Credit Unions Only.

2. In which state(s) do you insure: Wisconsin

3. A. Cost of initial membership in your fund, if any: 1/2 of 1% of Outstanding Savings.

B. Annual premium: 1/12 of 1% of Outstanding Savings.

C. Continuing equity contribution or membership deposit: None

4. Maximum coverage per account or per depositor: $100,000 per account.

5. Do you insure brokered deposits: No

6. Number of insured institutions, by type:

A. Under $100 million: 559

B. $100 million to $500 million: 3

C. $500 million to $1 billion:

D. Over $1 billion:

7. Aggregate amount of deposits insured, by type of institution: $2,480,000,000 - Credit Unions

8. Your fund's total useable assets: $27,000,000.00

9. Ratio of usable insurance fund assets to deposits insured: 1.12%

II. Background:

1. Are you a governmental or private agency and are you a creation of State law? Please provide a text or description of your basic statutory authority.

Private - created by Chapter 186.35 Wisconsin Statutes.

2. Please provide name of the state agency(ies), if any, with supervisory authority over your books, records, operations, etc.

Commissioner of Credit Unions, State of Wisconsin.

3. If a situation arises where your insurance funds are inadequate to cover deposit losses, do you have, by statute,

a. access to the treasuries of the state(s) in which you operate; and/or

No.

b. authority to assess other insured institutions enough to cover the losses?

Yes.

4. Are you subject to state limitations as to the ratio of insurance fund assets to total deposits insured?

No.

5. Do you have lines of credit already established by contract on which you can draw at will? What is the aggregate dollar limit of established lines of credit? With what institution or institutions have these credit lines been established?

$20,000,000 with Central Liquidity Facility (CLF).

1,000,000 with depository bank.

6. **Do you reinsure your risks with any other insurance carriers? Please provide details.**

No.

7. **Regarding your board of directors:**

a. **How is your board of directors selected?**

By regions of the State - elected by credit unions.

b. **What rules govern the size and composition of the board?**

See attached Bylaw excerpt.

c. **Who are the present members of your board? (Please provide names and principal affiliations.)**

Mr. O.L. Johnson, Chairman of the Board
(Cooperative Credit Union - Racine)

Mr. Ernest Berryman, Vice-Chairman
(Port Credit Union - Port Edwards)

Mrs. Carole Elbe, Secretary
(Theda Clark Credit Union - Neenah)

Mrs. Suzanne Barrett, Trustee
(Eaton Employees Credit Union-Milwaukee)

Mr. David Bitter, Trustee
(Gasco Community Credit Union - West Allis)

Dr. W. Donald Knight, Trustee
(University of Wisconsin Credit Union - Madison)

Donald J. Schaefer, Executive Vice-President
Wisconsin Credit Union Savings Insurance Corporation

III. Supervision of insured institutions:

1. Do you impose on the institutions whose deposits you insure, reserve, capital or other safety and soundness requirements designed to prevent the likelihood of insolvency? If so, what basic requirements do you impose?

Set by statutes and State Department rules.

2. Please respond separately for each state in which you insure deposits:

a. Do you have authority, either by statute or contract, to discontinue a financial institution's membership in your deposit insurance fund?

No (Mandatory law).

b. Under what set of conditions or circumstances would you be authorized to discontinue insurance?

N/A

c. Since January 1, 1980, set forth the number of institutions whose insurance you have discontinued and the reasons for such discontinuance.

N/A

3. Please respond separately for each state in which you insure deposits:

a. Do you have authority to examine the books, records, loans and other financial transactions of the institutions you insure? Is any such authority statutory or by agreement? Please describe and/or provide a copy of your authority.

Statutory, (See attached Chapter 186.35).

b. How frequently do you examine the institutions whose deposits you insure? Please describe your examination policies and procedures. How many examiners/auditors do you have. What is your examination operating budget?

Have access to all Department Examinations. Currently have follow-up staff of four.

c. Whether or not you have independent examination powers, do you have a right of access to the examination reports of the relevant financial institution supervisory authority in your state? If so, do you receive their examination reports on a regular basis?

Yes.

4. Are the institutions you insure required to have their books audited and their financial statements certified by independent outside accountants?

May have.

5. If a financial problem is discovered or otherwise becomes apparent in a member financial institution, what authority do you have, short of insurance termination, to force correction of the problem and thereby forestall the necessity for claims against the deposit insurance?

See attached statute.

Can recommend merger or liquidation.

IV. Payment of Losses:

1. Do you act as receiver/liquidator for failed institutions you insure?

Yes.

2. If a financial institution whose deposits you insure is closed due to insolvency, do depositors receive their funds immediately or must they await a liquidation process?

Immediately.

3. a. If an institution whose deposits you insure becomes insolvent, is liquidation and a payout of insured deposits your only alternative?

No.

b. Do you have authority to arrange a purchase-and-assumption takeover (purchase of assets and assumption of deposit liabilities) of a closed institution by another sound institution?

Yes.

c. Do you have authority to keep an insolvent institution open and operating while seeking a merger partner?

Yes.

4. Please provide a listing showing, for each insolvency covered by your fund from January 1, 1980, to date:

a. The name, location, and size of the institution;

b. The total dollar cost of the insolvency to your fund;

c. The dollar amount of insured deposits in the institution at time of closing;

d. The dollar amount of uninsured deposits in the institution;

e. The percentage recovery to date to depositors on uninsured deposits;

f. The gross dollar amount of outstanding unpaid depositor claims; and

g. The length of time between the closing of the institution and the completion of all payouts or transfers of insured deposits.

(See attached list of historical data on liquidations/mergers.)

V. Insurance Fund Reserves:

1. How much is your total usable insurance reserve? Provide calendar or fiscal year data for 1981, 1982, 1983, and 1984.

2. What is the present composition and market value, by type, of your insurance fund assets (for example: U.S. Treasury securities, bank deposits, corporate bonds, mutual fund investments, state/local securities)?

See attached.

3. Do you invest any insurance fund assets in deposits, notes, debentures, or other obligations of the institutions you insure? How much?

No

4. In each of the past four calendar or fiscal years, what has been the average yield from interest, dividends, etc., on your investment portfolio?

10 to 11.5%

5. Please provide a copy of your latest annual report.

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LAWS OF WISCONSIN

RELATING TO

CREDIT UNIONS

1984

Prepared under the direction of the
Office of the Commissioner of Credit Unions

MADISON, WISCONSIN

sidered a normal operating expense of the central credit union's operation and rates of such dividends and terms of payment may be established and guaranteed in advance by action of the central credit union's board of directors.

History: 1971 c. 193; 1979 c. 282; 1981 c. 5.

186.33 Other powers. Credit unions may engage in the business and functions provided for in s. 218.05 and ch. 217 for their members upon receiving a certificate of authority from the commissioner. The certificate of authority shall be issued by the commissioner upon application of a credit union whenever the commissioner finds that the credit union has adequate clerical facilities and has provided for the keeping of adequate accounts and for the segregation of funds used in carrying on the business of issuing their own credit union money orders. The applicants shall meet the same requirements as other applicants under ch. 217, but no investigation fee may be charged of credit union applicants. The commissioner may revoke a certificate of authority following a hearing held upon 10 days' notice to the credit union for any reason which would have justified the rejection of an application or on the ground that the continued operation of the business threatens the solvency of the credit union.

History: 1971 c. 193 s. 42 (1); 1971 c. 307; 1977 c. 152.

186.35 Wisconsin credit union savings insurance corporation. (1) ORGANIZATION. The Wisconsin credit union savings insurance corporation, a nonprofit corporation, hereinafter referred to as the "corporation", shall be organized within one year after February 14, 1970, by the duly authorized representatives of not less than 9 credit unions chartered and existing under this chapter. The articles of incorporation shall require the approval of the commissioner, and shall be filed with the commissioner and the register of deeds of the county in which the principal office of the corporation is located. Amendments to the articles, adopted by a vote of two-thirds of the member credit unions present at an annual meeting or a special meeting called for that purpose, shall be filed with the commissioner upon payment of a fee of $5 and if approved by the commissioner shall become effective upon being recorded in the office of the register of deeds in the same manner as the original articles. This corporation shall be under the exclusive supervision of the commissioner.

(2) PURPOSES. The general purposes of the corporation shall be to:

(a) Aid and assist any member credit union which develops financial difficulties such as insolvency, nonliquidity or liquidation, in order that the savings of each member of a member credit union shall be protected or guaranteed. The corporation shall protect or guarantee each account in a member credit union to the extent the funds in the account do not exceed the greater of $100,000 or the amount of deposit protection or guaranty provided for the benefit of a depositor in any other financial institution authorized to do business in this state.

(b) Cooperate with its member credit unions and the office of the commissioner for the purpose of improving the general welfare of credit unions in this state.

(3) POWERS. If any of the powers in this section conflicts with any other provision of this chapter, this section controls. The corporation may:

(a) Make contracts.

(b) Sue and be sued.

(c) Adopt, use and display a corporate seal.

(d) Advance funds to aid member credit unions to operate and to meet liquidity requirements.

(e) Assist in the orderly liquidation of credit unions.

(f) Receive money or property from its member credit unions, or any corporation, association or person.

(g) Invest its funds in bonds, notes or securities of the federal government or its agencies, and such other investments as are deemed prudent by the trustees but these other investments shall not exceed 50% of the outstanding capital of the corporation.

(h) Borrow money from any source, upon such terms and conditions as the trustees determine, for the purpose of this section.

(i) Purchase in its own name, hold and convey real and personal property.

(j) Receive by assignment or purchase, from its member credit unions, any notes, mortgages, real estate, securities and other assets owned by those member credit unions.

(k) Sell, assign, mortgage, encumber or transfer any notes, mortgages, real estate, securities and other assets.

(m) Adopt and amend bylaws, rules and regulations for carrying out the purposes of this section.

(4) USE OF NAME. This corporation shall have the sole right to the use of the name "Wisconsin Credit Union Savings Insurance Corporation".

(5) MEMBERSHIP. (a) All credit unions and central credit unions operating and existing under this chapter except national corporate central credit unions shall become members of the corporation. Credit unions organized under federal charter, whose principal office is located

in this state, may become members upon application and approval of the trustees.

(b) The corporation shall bill and collect from all members a membership fee of $5 or 0.5% of the share capital of each member, whichever is greater. When paid, the membership fee shall be a charge to the member's regular reserve or may be established as a prepaid asset, to be charged against its regular reserve over a period of 5 years.

(c) The membership fee shall be refunded when the unencumbered funds of the corporation reach 2% of the aggregate total share capital of the members, as determined by the annual report of the office of the commissioner. These refunds shall be paid to current members of the corporation on the date the refund is authorized by the trustees of the corporation. The refund shall be credited to the member's regular reserve.

(d) A regular annual assessment, not to exceed 0.1% of the member's savings capital, including public funds deposited in the credit union, shall be levied by the trustees against each member. In the event of potential impairment of the corporation's capital funds, special assessments may be levied by the trustees with the approval of the commissioner. The member's savings capital as of December 31 shall be the basis for calculating the assessment due the ensuing year. The trustees shall determine the date the annual assessment is due and payable. Each annual assessment, and any special assessment, when paid by the member, shall be a charge to its regular reserve. The guaranty on these credit union savings in a central credit union shall extend to the full amount of the savings balances and is not limited by the maximum protection afforded a member under sub. (2) (a). The guaranty on public funds is not limited by sub. (2) (a). Nothing in this paragraph authorizes levying of assessments against national corporate central credit unions.

(e) A member's membership fee to the corporation shall be considered part of its regular reserve for the purpose of determining its compliance with ss. 186.11 (2) (b) and 186.17.

(f) The trustees may reduce or waive the annual assessment when the total funds in this corporation equal an amount which is mutually agreed upon by the trustees and the commissioner.

(g) If this corporation is liquidated, the assets of the corporation remaining after payment of all of the corporation's outstanding liabilities shall be distributed among the credit unions which are members of the corporation on the date the liquidation is authorized. Liquidation payments to each eligible credit union shall be a fraction of the remaining assets, the numerator of which is the sum of the membership fee, all annual assessments and any special assessments paid by the credit union to the corporation, and the denominator of which is the sum of all membership fees, annual assessments and special assessments paid by all credit unions eligible for liquidation payments.

(6) TRUSTEES. The corporation's business shall be conducted by not less than 7 trustees elected by the members in accordance with the bylaws.

(7) SUPERVISION OF CORPORATION. The corporation shall be subject to supervision and an annual examination by the office of the commissioner. The cost of each examination shall be paid by the corporation.

(8) EXAMINATIONS OF CREDIT UNIONS. The office of the commissioner shall promptly forward to the corporation copies of examination reports of all members. The cost of these copies shall be paid by the corporation. If the trustees of the corporation ascertain evidence of carelessness, unsound practices or mismanagement of any member or if the trustees determine that the activities of any member may jeopardize any of the corporation's assets, the trustees or their designees may require the member to disclose its operational policies and procedures, and may recommend appropriate corrective measures to the member. If the trustees determine that the carelessness, unsound practices or mismanagement is not promptly corrected or that the threat to the corporation's assets has not been removed, the trustees may make appropriate recommendations to the commissioner, including the recommendation that the member be liquidated or consolidated.

(9) BYLAWS. The incorporators shall subscribe and submit to the commissioner, for approval, the bylaws and any amendments thereto under which the corporation shall operate. These bylaws may be amended at any regular or special meeting of the trustees or any annual or special meeting of the corporation.

History: 1971 c. 136; 1971 c. 193 ss. 40, 42 (1), (2), (4), (5); 1971 c. 307 ss. 83, 119; 1975 c. 14, 15, 16, 199; 1979 c. 34, 282; 1981 c. 5, 156; 1981 c. 390 s. 252; 1981 c. 391; 1983 a. 368; 1983 a. 369 ss. 20, 21, 25; 1983 a. 538.

The Wisconsin credit union share insurance corporation does not have authority unilaterally to regulate the credit union industry of this state. 64 Atty. Gen. 7.

186.36 Sale of insurance in credit unions. Any agent who is an officer or employe of a credit union may pay the whole or any part of his commissions from the sale of credit life insurance or credit accident and sickness insurance to the credit union.

History: 1973 c. 243.

186.37 Immunity of commissioner. The commissioner of credit unions shall not be subject to

BYLAWS
OF THE
WISCONSIN CREDIT UNION SAVINGS INSURANCE CORPORATION
MONONA, WISCONSIN

ARTICLE I

NAME -- PRINCIPAL OFFICE -- PURPOSE

Section 1. Name. The name of this Corporation shall be the Wisconsin Credit Union Savings Insurance Corporation (hereinafter referred to as the "Corporation").

Section 2. Principal Office. The principal offices of the Corporation shall be located in Dane County, Wisconsin.

Section 3. Purpose. The purposes of this Corporation shall be:

(a) To aid and assist any member credit union which develops financial difficulties such as insolvency, nonliquidity or liquidation, in order that the savings of any member of a member credit union shall be protected or guaranteed. The corporation shall protect or guarantee each account in a member credit union to the extent the funds in the account do not exceed the greater of $100,000 or the amount of deposit protection or guaranty provided for the benefit of a depositor in any other financial institution authorized to do business in this state.

(b) To cooperate with its member credit unions and the Commissioner of Credit Unions for the purpose of improving the general welfare of credit unions in this state.

ARTICLE II

MEMBERSHIP

Section 1. Membership Rights. The rights of members of this Corporation shall be determined and exercised in accordance with applicable law, the articles of incorporation and bylaws of this Corporation and valid resolutions of the Board of Trustees of the Corporation (hereinafter referred to as the "Board").

Section 2. Membership Eligibility. (a) Every credit union operating and existing under Chapter 186 of the Wisconsin Statutes shall become a member of the Corporation.

(b) Any credit union organized under federal charter whose principal office is located in Wisconsin may become a member upon approval by the Board.

(c) A credit union's membership in the Corporation commences upon organization of the credit union, payment of the membership fee calculated in accordance with Section 186.35 (5)(b) of the Wisconsin Statutes, and approval of the Board, if any is required under Paragraph (b) of this Section.

ARTICLE III

MEETINGS OF MEMBERS -- VOTING

Section 1. Voting. At all meetings of member credit unions, each member shall designate a delegate who shall have one (1) vote. Each delegate shall cast his or her own vote. At the request of the Secretary, each member credit union shall certify the name of its delegate to the Credentials Committee.

Section 2. Annual Meetings. The credit union shall hold an annual meeting of the members at such time and place as the Board shall designate. The Board shall determine annually the date, time and place of the annual meeting of the membership and the Secretary shall give each member credit union at least thirty (30) days prior written notice.

Section 3. Special Meetings. Special meetings of the members may be called at any time by the Board. Special meetings shall be called by the Secretary upon the written request of seventy-five (75) members. Each member credit union shall be given at least fifteen (15) days prior written notice of each special meeting. The notice shall state the purposes of the meeting. No action may be taken at any special meeting, except actions with respect to the purposes specified in the notice of the meeting.

Section 4. Quorum. Delegates from fifty (50) member credit unions eligible to vote at meetings of the members shall constitute a quorum at any annual or special meeting. If a quorum is not present on the date specified in the notice of meeting, the meeting shall be adjourned for at least one (1) week and a second notice shall be mailed to each member. The notice shall specify the date, time, place and purpose of the adjourned meeting. Notwithstanding the remaining provisions of this section, the number of delegates present at the place and time specified in the notice of the adjourned meeting shall constitute a quorum for the transaction of all business compatible with the purpose of the meeting.

Section 5. Actions by Members. (a) Except as provided in Paragraph (b) of this section, the members may decide by vote of a majority of the members present any question of interest to the Corporation.

(b) No item of new business involving any of the following actions may be brought before any annual or special meeting of members unless the items have been submitted to the Corporation's Secretary at least sixty (60) days prior to the date of the annual or special meeting:

1. Amendment of these Bylaws.

2. Establishment of one or more committees.

3. Expenditure of significant amounts of corporate funds or use of significant amount of time by the employees, officers or Trustees of the Corporation.

4. Establishment of new operating procedures or organizational structure.

(c) Unless greater notice is required under Paragraph (b) of this section, at least thirty (30) days prior to the date of the annual meeting, the Secretary of the Corporation shall send all member credit unions and the Commissioner of Credit Unions a copy of the proposed agenda, a copy of any proposed amendments to the bylaws, a copy of the current financial report of the Corporation, and copies of all other reports where the subject matter contained therein might of necessity require board action of the member credit unions. Unless otherwise specifically provided in these Bylaws, all notices to member credit unions shall be mailed to the member at the member's address as shown on the Corporation's records.

(d) The order of business at meetings of the members shall be based on an agenda submitted to the members and the Commissioner of Credit Unions prior to the date of the meeting. It shall be the duty of the presiding officer to submit the agenda to the delegates for their approval or alteration immediately after the meeting is called to order.

ARTICLE IV

BOARD OF TRUSTEES

Section 1. Qualifications of Trustees. (a) Each elected Trustee shall:

1. Have been a member of a Wisconsin credit union for at least five years; and

2. Have an aggregate of at least five (5) years' experience in the actual operation of a Wisconsin credit union in one or more of the following capacities: officer, director or employee.

(b) Members of the Credit Union Review Board, members of the Board of Directors and employees of the Wisconsin Credit Union League, members of the Board of Directors and employees of CUNA International or any of its affiliates, employees of the Office of the Commissioner of Credit Unions, and employees of the Wisconsin Credit Union Savings Insurance Corporation other than the Executive Vice-President shall not be eligible for election or appointment as a Trustee.

Section 2. Number and Terms of Trustees. (a) The Board shall consist of seven (7) Trustees. One (1) Trustee shall be elected as a representative of the credit unions located in each of the six (6) examination regions as defined by the Commissioner of Credit Unions on May 18, 1984. The Executive Vice-President of the Corporation shall be the seventh Trustee during his or her tenure as Executive Vice-President.

(b) The terms of office for elected Trustees shall be three (3) years in length and shall be staggered so that one-third shall expire each year.

Section 3. Nomination of Trustee Candidates. (a) At least sixty (60) days prior to the date for the election of one or more Trustees, each candidate for election as a Trustee shall submit a written nomination application on a standardized form provided by the Corporation to the nominating committee selected by the Board. Each application shall then be reviewed by the nominating committee which shall certify or refuse to certify each candidate. The names of those candidates certified by the nominating committee shall be announced to the member credit unions at least thirty (30) days prior to each election of Trustees.

(b) A candidate for election as a Trustee shall be certified if he or she:

1. Is a member and either an officer, director or employee of a member credit union;

a. whose loan delinquency percentage is less than six percent (6%) for loans which have been contractually delinquent at least six (6) months;

b. whose ratio of expenses, excluding the cost of acquisition of funds, to income is less than fifty percent (50%); and

c. whose principal office is located in one of the examination regions defined by the Commissioner of Credit Unions on May 18, 1984, which is represented by a Trustee whose term will expire at or prior to the annual meeting at which the election is to be held.

2. Is at least 18 years of age.

3. Is not serving as a director of a bank, saving and loan or investment brokerage firm,

4. Is willing to submit to an Oath of Office and comply with Chapter 186 of the Wisconsin Statutes, and

5. Is qualified to serve as Trustee under Section 1 of this Article.

(c) Trustees shall be elected to represent the credit unions of a specific examination region from among the candidates certified by the nominating committee for that region. If a candidate for election as a Trustee is an officer, director or employee of two (2) or more member credit unions, the candidate shall designate in his or her written application which one of the member credit unions will be used to determine the candidate's eligibility for election as a Trustee. If elected, the candidate shall be bound by the designation during his or her three-year term.

Section 4. Election of Trustees. (a) At each annual meeting, the delegates shall elect by a plurality vote one Trustee to fill each vacancy on the Board, including any unexpired term occupied by a Trustee appointed by the Board under Section 6 of this Article. Each newly-elected Trustee shall take office immediately following the adjournment of the annual meeting, and shall hold office until the annual meeting of the members held in the calendar year in which the Trustee's term expires and until his or her successor has been elected and qualified; or until the Trustee's death or resignation; or until the Trustee has been removed from office as provided in Section 5 of this Article, whichever is sooner. A Trustee may resign at any time by filing his or her resignation with the Secretary.

Section 5. Removal from Office. (a) The Board by majority vote may remove any Trustee who violates applicable law, the Articles of Incorporation of this Corporation or these Bylaws, or for any other good and sufficient cause. No person may be removed under this section until the person has been informed in writing of the reasons for the person's proposed removal and until the person has been given the opportunity to appear before the Board to rebut the allegations made against the person.

(b) A Trustee's office shall be declared vacant when the Trustee ceases to be a member and either an officer, director, or employee of a member credit union. If a Trustee ceases to be an officer, director or employee of a member credit union during his or her term as Trustee, he or she may complete the unexpired term.

(c) If a credit union designated in a Trustee's application for certification or any other member credit union which the Trustee serves as an officer, director or employee fails at any time to meet the qualifications under Section (3)(b) 1. a. or b. of this Article, the Trustee's term shall be declared vacant.

(d) If a Trustee fails to attend three (3) consecutive, regular meetings without cause satisfactory to the Board, the Trustee's office may be declared vacated by the Board.

Section 6. Vacancies. The Board shall by a vote of the plurality of the Trustees then holding office appoint a person who meets the requirements of Sections (1) and (3)(b) of this Article to fill the vacancy. Trustees appointed under this section shall serve only until the next annual meeting of the Corporation. A successor of a Trustee appointed under this section shall be elected at the first annual meeting held after the date of the appointment. The successor elected by the members shall be elected to serve for the balance

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of the unexpired term. A Trustee appointed under this section to fill a vacancy may be elected by the members to serve for the balance of the unexpired term.

Section 7. Meetings; Quorum. (a) An organizational meeting of the Board shall be held within fifteen (15) days after each annual meeting of the members, and thereafter the Board shall meet at least quarterly. At all meetings of the Board, four (4) Trustees shall constitute a quorum. Except as otherwise provided in these Bylaws, all matters presented to the Board shall be decided by a majority of the Directors present.

(b) Except as otherwise provided in these Bylaws, regular meetings of the Board shall be held at the time and place fixed by resolution of the Board. Notice of all meetings shall be given to Trustees by the Secretary in such manner as the Board from time to time by resolution prescribes. A Trustee's attendance at any meeting of the Board constitutes his or her waiver of notice of that meeting unless the Trustee attends and objects at the meeting to the transaction of business because proper notice was not given. Otherwise, no waiver of notice of any meeting is valid unless made in writing.

(c) Special meetings of the Board may be called by the Chairman, or by any four (4) Trustees upon at least three (3) days prior written or other actual notice to all Directors. The Board may hold special meetings by telephone conference call. A telephone conference of which all Directors have received actual notice at least twenty-four (24) hours prior to the time the telephone conference is actually held shall be deemed to have satisfied the notice requirements of this section.

Section 8. Powers and Duties of the Board of Trustees. The Board shall be responsible for the management of the affairs of the Corporation and these Bylaws. Subject to limitations established in applicable law and these Bylaws, the Board shall have all of the powers necessary or convenient to carry out the purposes of the Corporation.

Section 9. Compensation. Except as otherwise authorized by applicable law, no Trustee may receive any compensation from this Corporation other than reimbursement for out-of-pocket expenses incurred as a result of his or her services as a Trustee.

Section 10. Equivalent Titles. Any person designated as "Chairman" or as "Vice Chairman" may use another equivalent title such as, in the case of the Chairman, "Chairperson," "Chairwoman," "Chair" or other such appropriate title.

ARTICLE V

EXECUTIVE OFFICERS -- MANAGEMENT STAFF

Section 1. Executive Officers. (a) The Executive Officers of the Corporation shall be a Chairman, a Vice Chairman, a Secretary, and the Executive Vice President. The Chairman, Vice Chairman and Secretary shall be elected at the

organizational meeting of the Board from among the Trustees then holding office. Any elected Executive Officer may succeed himself or herself. Unless sooner removed as provided in Article IV(5), the Chairman, Vice Chairman, and Secretary shall hold office until the organizational meeting of the Board following the next annual meeting of the members and until election and qualifications of his or her respective successor.

(b) The Board shall appoint an Executive Vice President who shall not be an elected Trustee of the Corporation. The Executive Vice-President shall serve at the pleasure of the Board.

Section 2. Vacancies. Whenever any vacancy occurs in any of the elected Executive Offices, the Board shall promptly fill such vacancy from among the Trustees then holding office. Any person appointed to fill such a vacancy under this section shall serve until the organizational meeting of the Board following the next annual meeting of the members and until a successor is duly elected and qualified.

Section 3. Chairman of the Board. The Chairman shall preside over all meetings of the members and all meetings of the Board; the Chairman shall also perform such other duties as the Chairman may be directed to perform by resolution of the Board not inconsistent with applicable law and these Bylaws.

Section 4. Vice Chairman of the Board. The Vice Chairman shall in the absence or disability of the Chairman or in case of a vacancy in the office of the Chairman perform the duties of the Chairman and such other duties as may from time to time be prescribed by the Board not inconsistent with applicable law and these Bylaws.

Section 5. Executive Vice President. The Executive Vice President shall be the operating Executive Officer of the Corporation and shall manage the affairs of the Corporation, including the management of the Corporation's employees, under the control and direction of the Board.

Section 6. Secretary. The Secretary shall prepare and maintain full and correct records of all meetings of the Board. The Secretary shall give or cause to be given in the manner prescribed by these Bylaws proper notice of all meetings of the members and of the Board, and shall perform such other duties as the Secretary may be directed by the Board not inconsistent with applicable law and these Bylaws.

ARTICLE VI

FINANCIAL MANAGEMENT

Section 1. Records. The officers of the Corporation shall keep the books or accounts in the manner the Commissioner of Credit Unions require.

Section 2. Annual Report. On or before February 1 of each year the Corporation shall file with the Commissioner of Credit Unions a full and detailed report of its business conducted during the preceding year, and of its condition as of December 31 of the preceding year, in such form and containing such information as said Commissioner may prescribe.

Section 3. Annual Budget. During the last quarter of each calendar year, the Executive Vice-President of the Corporation shall prepare a budget for the ensuing calendar year. The budget shall be presented for approval by the Board and the Commissioner of Credit Unions.

Section 4. Reports to Members. At least annually, member credit unions shall receive a copy of the Balance Sheet and the Profit and Loss Statement of the Corporation in such form as the Commissioner of Credit Unions shall prescribe.

Section 5. Examination Reports. Copies of all examination reports of member credit unions and all correspondence relative thereto shall be confidential and shall not be disclosed to any person or organization other than the Corporation, its employees, or the Office of the Commissioner of Credit Unions.

Section 6. Fiscal Year. The fiscal year of the Corporation shall be the calendar year.

Section 7. Bonds. As a condition precedent to qualification and entry upon discharge of his or her duties, every person employed by the Corporation and every person appointed or elected to any position in the Corporation requiring the receipt, payment or custody of money or other personal property owned by the Corporation or in its custody or control as collateral or otherwise, shall be bonded by a responsible corporate surety company licensed to do business in Wisconsin in such adequate sum as the Board shall require. Such bonds shall satisfy in all respects the requirements of applicable law relating to such bonds.

ARTICLE VII

AMENDMENT OF BYLAWS

Section 1. Amendment by Board. These Bylaws may be amended, altered or repealed in any manner not inconsistent with applicable law by a majority vote of the Board at any duly convened meeting of the Board.

Section 2. Amendment by Members. These Bylaws may be amended by a vote of a majority of the members present at any annual or special meeting of the members, if all notice and other requirements applicable to amendment of these Bylaws are satisfied under Article III(5).

Section 3. Approval. No amendment, alteration, or repeal of these Bylaws shall become effective until filed with and approved by the Commissioner.

ARTICLE VIII

GENERAL PROVISIONS

Section 1. Confidentiality; Oath. Officers, Trustees and employees of the Corporation shall hold in confidence all transactions of the Corporation with its members, as well as all information respecting each member's affairs. Immediately following each annual meeting, all Trustees and employees shall take an Oath of Office in the form prescribed by the Commissioner, and each oath shall be filed with the other records of the Corporation.

Section 2. Pecuniary Interest. (a) No Trustee, Officer, agent or employee of the Corporation shall in any manner, directly or indirectly, participate in the deliberation upon or the determination of any question affecting the person's individual pecuniary interest or the pecuniary interest of any corporation, partnership or other business association in which the person directly or indirectly controls a significant ownership interest.

(b) No Trustee, Officer, agent or employee of the Corporation shall in any manner, directly or indirectly, participate in the deliberation upon or determination of any question regarding the Corporation's evaluation of or course of action toward any particular credit union insured by the Corporation in which the person is a director, officer or employee.

(c) In the event of disqualification of any Trustee under Paragraph (a) or (b), such Trustee shall withdraw from the deliberation or determination. If a Trustee withdraws from any deliberation or determination, the remaining qualified Trustees present at the meeting may exercise all powers of the Board, provided the number of Trustees present, including the disqualified Trustees, constitutes a quorum.

Section 3. Conduct of Meetings. All meetings of the Board and all annual and special meetings of the members shall be conducted in accordance with the procedures defined in the most recent edition of Roberts Rules of Order.

(Revised July 20, 1984)

WCUSIC
WISCONSIN CREDIT UNION SAVINGS INSURANCE CORP.

5011 Monona Drive
Madison, Wisconsin 53716

Donald J. Schaefer,
Executive Vice-President

Post-Closing
BALANCE SHEET
December 31, 1984

		1984	1983
ASSETS			
Cash - Checking Account		$ 5,714.90	$ 5,983.81
Cash - Money Market Account		5,007.13	5,123.00
Investments			
U.S. Government Agencies	$22,496,625.78		18,854,732.69
Bank & S&L Certificates	1,520,772.77		1,309,882.81
Wis. Corporate Central C.U.	2,114.18		-0-
Monona Grove St. 3k NOW Acct.	24,301.52		23,038.43
Other Investments	1,029,400.00		729,400.00
First Bk. Milwaukee Repur. Acct.	107,000.00		35,000.00
Mid-States Corporate F.C.U.	-0-		56,224.52
Advance to Credit Unions	50,000.00		50,000.00
		25,230,214.25	21,069,385.26
Furniture, Fixtures & Equip.	12,422.99		
Less Allow./Deprec. Fur. F. & E.	-10,891.06		
		1,531.93	2,244.32
Purchased Autos	33,782.17		
Less Allow./Deprec. Pur. Autos	-11,480.00		
		22,302.17	32,142.17
Prepaid Surety Bond		942.45	2,827.35
Other Prepaid Insurance		396.45	763.30
Accrued Interest Paid		482.22	65.28
Travel Advance		1,250.00	1,250.00
		$25,267,841.50	$21,108,677.68
LIABILITIES			
Primary Regular Reserve		$ 1,798,665.02	$ 1,830,825.71
Secondary Regular Reserve		22,218,553.88	17,804,740.39
Contractual Commitments		1,146,201.16	1,369,088.77
Reserve for Contingencies		100,580.77	100,580.77
Federal Withholding Taxes Payable		1,752.00	1,572.40
State Withholding Taxes Payable		659.20	652.50
Social Security Taxes Payable		506.47	437.38
CAP Deferral Payable		923.00	779.76
		$25,267,841.50	$21,108,677.68

Note:
Net claims paid in
1984: $127,918.70

Donald J. Schaefer, Executive Vice-President

Area Code 608/221-2251

WCUSIC
WISCONSIN CREDIT UNION SAVINGS INSURANCE CORP.

5011 Monona Drive
Madison, Wisconsin 53716

Donald J. Schaefer,
Executive Vice-President

Post-Closing
BALANCE SHEET
December 31, 1983

		1983	1982
ASSETS			
Cash - Checking Account		$ 5,983.81	$ 2,237.89
Cash - Money Market Account		5,123.00	-0-
Investments			
U.S. Government Securities	$ -0-		75,000.00
U.S. Government Agencies	18,854,732.69		16,010,426.36
Bank & S&L Certificates	1,309,882.81		700,000.00
Monona Grove St. Bk NOW Acct.	23,038.43		26,662.33
Other Investments	729,400.00		429,400.00
First Bk Milwaukee Repur. Acct.	35,000.00		10,000.00
Mid-States Corporate F.C.U.	56,224.52		51,569.14
Advance to Credit Unions	50,000.00		50,000.00
		21,058,278.45	17,355,295.72
Furniture, Fixtures & Equipment	11,975.14		
Less Allow./Deprec. F.F.&E.	-9,730.82		
		2,244.32	2,439.83
Purchased Automobiles	33,782.17		
Less Allow./Deprec. Pur. Autos	-1,640.00		
		32,142.17	19,386.30
Prepaid Surety Bond		2,827.35	4,712.25
Other Prepaid Insurance		763.30	706.28
Accrued Interest Paid		65.28	-0-
Travel Advance		1,250.00	1,250.00
		$21,108,677.68	$17,383,790.38
LIABILITIES			
Primary Regular Reserve		$ 1,830,825.71	$ 1,830,820.71
Secondary Regular Reserve		17,804,740.39	14,232,820.97
Contractual Commitments		1,369,088.77	1,216,020.53
Reserve for Contingencies		100,580.77	100,580.77
Federal Withholding Taxes Payable		1,572.40	1,786.80
State Withholding Taxes Payable		652.50	607.00
Social Security Taxes Payable		437.38	428.72
CAP Deferral Payable		779.76	-0-
Retirement Contributions Payable		-0-	724.88
		$21,108,677.68	$17,383,790.38

Note:
Net claims paid in
1983: $126,502.96

Donald J. Schaefer, Executive Vice-President

Area Code 608/221-2251

OPERATING STATEMENT

December 31, 1983

	DECEMBER	1983	1982
INCOME			
Interest on Investments	$136,165.64	$2,238,185.73	$1,693,629.51
EXPENSES			
Salaries	$ 11,132.58	$ 115,403.67	$ 106,815.12
Social Security Taxes	481.38	6,741.85	6,419.65
Unemployment Compensation Taxes	-0-	168.00	336.00
Retirement Costs	1,087.88	13,030.11	12,006.64
Employee Hospital Ins. Benefits	522.59	6,180.65	5,758.19
Other Employee Insurance Benefits	220.83	2,782.17	2,280.54
Surety Bond Expense	-0-	1,884.90	1,626.40
Workmen's Compensation Ins. Premium	16.16	558.08	114.72
Automobile Insurance	120.23	1,490.57	1,511.88
All Other Insurance	10.01	127.67	457.56
Public Relations	250.00	867.25	2,190.07
Promotion	-0-	10,575.25	10,121.28
Annual Meeting	-0-	3,452.65	3,938.11
All Other Advertising & Promotion	-0-	500.00	-0-
Rent	357.00	4,284.00	4,084.00
Trustee's Expense	-0-	2,917.53	2,979.20
Stationery and Supplies	301.24	1,134.72	939.96
Postage	175.71	1,617.41	1,578.44
Telephone	408.48	5,114.66	5,358.94
Other Office Expense	16.00	1,042.94	557.73
Depreciation, Furnitures, Fix., & Equip.	785.48	1,492.31	1,317.58
Depreciation, Purchased Automobiles	820.00	9,440.00	9,360.00
Legal and Collection Expense	306.20	2,891.14	2,901.75
Exam. Fee - Office of Commissioner	-0-	1,955.00	1,800.00
Department Service Fee	-0-	1,085.91	955.09
Investment Expense	-0-	274.00	3.00
Employees Automobiles	73.64	1,024.71	869.76
Employees Travel Expense	2,089.16	26,016.87	27,726.85
All Other Expense	65.00	4,506.12	6,182.14
	$ 19,239.57	$ 228,560.14	$ 220,190.60
		$2,009,625.59*	

*Transferred to Secondary Regular Reserve

WCUSIC
WISCONSIN CREDIT UNION SAVINGS INSURANCE CORP.

5011 Monona Drive
Madison, Wisconsin 53716

Donald J. Schaefer,
Executive Vice-President

Post-Closing
B A L A N C E S H E E T
December 31, 1982

		1982	1981
ASSETS			
Cash		$ 2,237.89	$ 6,681.36
Investments			
U.S. Government Agencies	$16,010,426.36		12,794,069.66
U.S. Government Securities	75,000.00		75,000.00
Bank & S&L Certificates	700,000.00		700,441.26
Monona Grove St. Bk NOW Acct.	26,662.33		114,014.64
Other Investments	429,400.00		674,400.00
First Bk Mil. Repur. Agreement	10,000.00		-0-
Mid-States Corporate F.C.U.	51,569.14		-0-
Advance to Credit Unions	50,000.00		50,000.00
		17,353,057.83	14,414,606.92
Furniture, Fixtures & Equipment	10,838.45		
Less Allow./Deprec. F.F. & E.	-8,398.62		
		2,439.83	3,757.41
Purchased Automobiles	30,306.30		
Less Allow./Deprec. Pur. Autos	-10,920.00		
		19,386.30	28,746.30
Prepaid Surety Bonds		4,712.25	683.95
Other Prepaid Insurance		706.28	673.64
Travel Advance		1,250.00	750.00
		$17,383,790.38	$14,449,218.22
LIABILITIES			
Primary Regular Reserve		$ 1,830,820.71	$ 1,830,810.71
Secondary Regular Reserve		14,232,820.97	11,764,010.27
Contractual Commitments		1,216,020.53	750,634.30
Reserve for Contingencies		100,580.77	100,580.77
Federal Withholding Taxes Payable		1,786.80	1,665.90
State Withholding Taxes Payable		607.00	530.20
Social Security Taxes Payable		428.72	390.53
Retirement Contributions Payable		724.88	595.54
		$17,383,790.38	$14,449,218.22

Donald J. Schaefer, Executive Vice-President

Note:
Net claims paid in
1982: $48,388.00

OPERATING STATEMENT

December 31, 1982

	DECEMBER	1982	1981
INCOME			
Interest on Investments	$87,579.35	$1,693,629.51	$1,243,334.84
EXPENSES			
Salaries	$10,426.50	$ 106,815.12	$ 96,576.38
Social Security Taxes	348.32	6,419.65	5,745.57
Unemployment Compensation Taxes	-0-	336.00	504.00
Retirement Costs	1,013.43	12,006.64	10,248.13
Employee Hospital Ins. Benefits	524.58	5,758.19	4,431.62
Other Employee Insurance Benefits	208.86	2,280.54	1,589.30
Surety Bond Expense	-0-	1,626.40	1,223.89
Workmen's Compensation Ins. Premium	9.56	114.72	114.72
Automobile Insurance	129.20	1,511.88	1,333.60
All Other Insurance	11.19	457.56	1,081.40
Public Relations	-0-	2,190.07	1,682.77
Promotion	-0-	10,121.28	15,147.91
Annual Meeting	-0-	3,938.11	4,373.93
Rent	357.00	4,084.00	3,810.65
Trustee's Expense	-0-	2,979.20	2,484.28
Stationery and Supplies	143.97	939.96	1,442.73
Postage	53.55	1,578.44	1,290.88
Telephone	506.33	5,358.94	5,620.44
Other Office Expense	-0-	557.73	813.53
Depreciation, Fur., Fixtures & Equip.	658.79	1,317.58	1,270.41
Depreciation, Purchased Automobiles	780.00	9,360.00	1,560.00
Legal & Collection Expense	433.80	2,901.75	3,197.52
Exam. Fee - Office of the Commissioner	-0-	1,800.00	-0-
Department Service Fee	-0-	955.09	1,045.82
Investment Expense	-0-	3.00	-0-
Employees Automobiles	177.68	869.76	8,176.17
Employees Travel Expense	1,804.12	27,726.85	26,481.85
All Other Expense	65.75	6,182.14	4,259.00
	$17,652.63	$ 220,190.60	$ 205,506.50
		$1,473,438.91*	

* - Transferred to Secondary Regular Reserve

WCUSIC
WISCONSIN CREDIT UNION SAVINGS INSURANCE CORP.

5011 Monona Drive
Madison, Wisconsin 53716

Donald J. Schaefer,
Executive Vice-President

Post-Closing
B A L A N C E S H E E T
December 31, 1981

		1981	1980
ASSETS			
Cash		$ 6,681.36	$ 6,778.83
Investments			
U.S. Government Agencies	$12,794,069.66		10,401,237.07
U.S. Government Securities	75,000.00		174,281.25
Bank & S&L Certificates	700,441.26		603,874.98
Wis. Corporate Central C.U.	-0-		55,293.96
Wis. Corporate Central C.U. PCB	-0-		106,200.00
Monona Grove St. Bk. NOW Account	114,014.64		-0-
Other Investments	674,400.00		914,525.00
Advance to Credit Unions	50,000.00		-0-
		14,407,925.56	12,262,191.09
Furniture, Fixtures & Equipment	10,838.45		
Less Allow./Deprec. F.F. & E.	-7,081.04		
		3,757.41	4,403.79
Purchased Automobiles	30,306.30		
Less Allow./Deprec. Purch. Autos	-1,560.00		
		28,746.30	-0-
Prepaid Surety Bonds		683.95	1,619.94
Other Prepaid Insurance		673.64	621.12
Accrued Interest Paid		-0-	679.95
Travel Advance		750.00	750.00
		$14,449,218.22	$12,270,265.89
LIABILITIES			
Primary Regular Reserve		$ 1,830,810.71	$ 1,834,830.73
Secondary Regular Reserve		11,764,010.27	9,486,449.39
Contractual Commitments		750,634.30	845,405.47
Reserve for Contingencies		100,580.77	100,580.77
Federal Withholding Taxes Payable		1,665.90	1,601.60
State Withholding Taxes Payable		530.20	512.80
Social Security Taxes Payable		390.53	331.03
Retirement Contributions Payable		595.54	554.10
		$14,449,218.22	$12,270,265.89

Donald J. Schaefer, Executive Vice-President

Note:
Net claims paid in
1981: $144,754.93.

OPERATING STATEMENT

December 31, 1981

	DECEMBER	1981	1980
INCOME			
Interest on Investments	$30,823.34	$1,243,334.84	$977,439.32
EXPENSES			
Salaries	$ 9,579.34	$ 96,576.38	$ 88,328.00
Social Security Taxes	310.72	5,745.57	4,601.23
Unemployment Compensation Taxes	-0-	504.00	294.00
Retirement Costs	858.93	10,248.13	9,457.10
Employee Hospital Insurance Benefits	390.27	4,431.62	3,585.42
Other Employee Insurance Benefits	119.79	1,589.30	1,224.72
Surety Bond Expense	-0-	1,223.89	1,079.94
Workmen's Compensation Ins. Premium	9.56	114.72	179.98
Automobile Insurance	100.88	1,333.60	1,378.27
All Other Insurance	91.95	1,081.40	959.68
Public Relations	10.00	1,682.77	1,796.60
Promotion	-0-	15,147.91	15,566.68
Annual Meeting	-0-	4,373.93	1,311.13
Rent	337.00	3,810.65	3,794.00
Trustee's Expense	-0-	2,484.28	4,929.77
Stationery and Supplies	244.92	1,442.73	1,034.89
Postage	60.56	1,290.88	1,374.49
Telephone	541.76	5,620.44	3,785.55
Other Office Expense	-0-	813.53	410.75
Deprec./Furniture, Fixtures & Equip.	658.79	1,270.41	1,152.24
Deprec./Purchased Automobiles	780.00	1,560.00	-0-
Legal and Collection	182.70	3,197.52	3,489.08
Exam. Fee-Office of the Commissioner	-0-	-0-	1,600.50
Department Service Fee	-0-	1,045.82	1,170.88
Employee Automobiles	28.16	8,176.17	9,266.61
Employee Travel Expense	1,311.47	26,481.85	20,974.66
All Other Expense	-0-	4,259.00	4,578.86
	$15,616.80	$ 205,506.50	$187,325.03
		$1,037,828.34*	

* - Transferred to Secondary Regular Reserve

LIQUIDATION AND MERGER HISTORY, 1970-83

CREDIT UNIONS LIQUIDATED/MERGED SINCE INCEPTION

NAME	YEAR	MEMBER PAYOUT	LOANS	RESERVES	WCUSIC COST-TO-DATE	REASON
C & NW No. 1	1970	100%	$ 68,759	$ 10,002	$ -0-	Lack of Interest
Cantwell	1970	110%	690	975	-0-	Lack of Interest
Dairy Land	1970	100%	57,916	7,979	18,654.00	Company Closed
Die-Cast	1970	100%	7,488	290	-0-	Lack of Interest
Franklin Municipal	1970	101.7%	1,128	229	-0-	Lack of Interest
Liberty	1970	100%	6,228	1,852	2,456.40	Lack of Interest
Liebmann	1970	100%	36,131	5,110	-0-	Lack of Interest
Marshall	1970	112.2%	3,097	1,767	-0-	Company Closed
Merrill Hanson	1970	100%	5,644	1,684	-0-	Company Closed
Pathfinder	1970	100%	6,197	636	2,725.17	Company Closed
Racine C&NW	1970	100%	28,350	2,618	-0-	Lack of Interest
St. Bernadette	1970	100%	7,379	572	-0-	Lack of Interest
St. Joseph's	1970	105.7%	22,008	10,232	-0-	Lack of Interest
Standard	1970	100%	26,359	3,557	2,585.03	Bad Management
Theatrical	1970	123.5%	1,043	2,583	-0-	Company Closed
Universal Unit	1970	126.47%	11,601	21,825	-0-	Company Closed
Weber	1970	121.0%	14,172	10,859	-0-	Lack of Interest
Wisconsin AAA	1970	105.0%	17,646	1,466	-0-	Merger
Advance	1971	100%	7,771	1,360	-0-	Lack of Interest
Chadwick	1971	100%	17,582	5,276	2,593.00	Company Closed

CREDIT UNIONS LIQUID. _D/MERGED SINCE INCEPTION

NAME	YEAR	MEMBER PAYOUT	LOANS	RESERVES	WCUSIC COST-TO-DATE	REASON
Champion	1971	106.0%	$ 5,699	$ 1,400	$ -0-	Company Closed
Chippewa Shoe	1971	106.1%	16,394	1,926	-0-	ack of Interest
Education Ass'n.	1971	100%	-0-	4	-0-	ack of Interest
G & H Products	1971	100%	12,814	955	-0-	ad Management
Gisholt	1971	105.0%	836,888	188,447	-0-	mpany Closed
Hartwig	1971	100%	8,515	932	-0-	ack of Interest
Hodag	1971	100%	30,514	1,932	544.09	ad Management
Robert Johnston	1971	107.97%	25,647	4,488	-0-	ack of Interest
Hurlbut	1971	100%	21,242	2,270	-0-	Lack of Interest
Kemba	1971	100%	352,000	49,300	-0-	Company Closed
Lodge 2043 B of RC	1971	100%	28,496	4,289	-0-	Bad Management
Marathon Battery	1971	100%	40,079	8,473	-0-	Company Closed
Menomonie County	1971	100%	200	-0-	-0-	Lack of Interest
Milwaukee Realty	1971	100%	26,292	8,601	3,054.66	Bad Management
Mueller Climatrol	1971	100%	47,572	14,908	-0-	Lack of Interest
Paine	1971	100%	92,676	11,897	32.65	Company Closed
Polly Prim	1971	107.6%	4,217	5,379	-0-	Lack of Interest
Pratt Mfg.	1971	100%	4,708	1,873	-0-	Lack of Interest
Proud-Fit	1971	101.63%	32,578	8,823	-0-	Company Closed
Racine Die	1971	100%	8,797	2,478	895.86	Lack of Interest
St. John	1971	107.23%	25,988	6,300	-0-	Lack of Interest

CREDIT UNIONS LIQUID/MERGED SINCE INCEPTION

NAME	YEAR	MEMBER PAYOUT	LOANS	RESERVES	WCUSIC COST-TO-DATE	REASON
St. Thomas	1971	127.9%	$ 8,429	$ 7,311	$ -0-	Lack of Interest
Southside	1971	100%	2,370	123	1,558.84	Insolvent
Unicare	1971	100%	11,926	1,351	5,937.90	Bad Management
Unit Structures	1971	100%	130,466	14,228	+189.00	Company Closed
Vinyl Plastics	1971	102.0%	19,964	1,811	-0-	Lack of Interest
Brewery & Allied	1972	100%	28,982	906	+138.84	Bad Management
Cornell	1972	123.22%	125,336	130,569	-0-	Company Closed
Daily News	1972	102.57%	58,398	8,835	-0-	Lack of Interest
G.E.R.A.	1972	100%	50,653	7,351	731.89	Bad Management
Glidden	1972	100%	18,035	1,599	-0-	Lack of Interest
Grand	1972	100%	8,032	3,942	-0-	Lack of Interest
Grif-Ho	1972	127.26%	6,718	850	-0-	Bad Management
Holy Trinity	1972	124.5%	1,067	3,239	-0-	Lack of Interest
Howard Industry	1972	105.1%	92,780	22,983	-0-	Lack of Interest
Huebsch	1972	100%	4,377	281	2,569.08	Company Closed
I. A. of M.	1972	100%	141,880	15,220	-0-	Bad Management
International Harv.	1972	119.89%	196,065	214,499	-0-	Company Closed
Kimberly Village	1972	102.4%	108,415	9,577	-0-	Lack of Interest
Kress	1972	101.5%	6,962	1,592	-0-	Bad Management
Lee Enterprises	1972	100%	23,085	3,800	3,401.85	Bad Management

CREDIT UNIONS LIQUID. .D/MERGED SINCE INCEPTION

NAME	YEAR	MEMBER PAYOUT	LOANS	RESERVES	WCUSIC COST-TO-DATE	REASON
Northside	1972	100%	$195,567	$ 12,361	$102,574.65	Bad Management
Omaha	1972	109.3%	29,291	10,703	-0-	Lack of Interest
Pacon	1972	100%	3,649	275	-0-	Lack of Interest
Pierce	1972	100%	15,880	673	164.71	Lack of Interest
Rotomatic	1972	111.45%	1,623	1,620	-0-	Lack of Interest
St. Croix	1972	103.11%	18,805	2,067	-0-	Lack of Interest
Sal-Cent	1972	100%	52,920	2,423	-0-	Bad Management
Scolding Locks	1972	100%	3,672	869	-0-	Lack of Interest
Silcrest	1972	100.84%	47,331	8,882	-0-	Bad Management
Spic 'N Span	1972	100%	6,161	880	-0-	Lack of Interest
Stemper	1972	115.0%	18,703	8,900	-0-	Company Closed
Wesley-Allied	1972	109.89%	37,265	7,991	-0-	Lack of Interest
Adams County Co-op	1973	100%	184,776	21,205	+1,759.94	Bad Management
Adams Employees	1973	105.91%	53,702	19,867	-0-	Lack of Interest
Amery	1973	100%	42,363	3,184	29,444.24	Bad Management
Arco	1973	100%	11,041	519	-0-	Lack of Interest
Creamery Package Emp.	1973	100%	195,758	16,308	-0-	Merger
Femco	1973	110.86%	94,625	12,062	-0-	Merger
505 Employees	1973	100%	82,395	16,966	-0-	Lack of Interest
Flambeau Community	1973	100%	84,410	4,253	11,696.37	Bad Management

CREDIT UNIONS LIQUIDATED/MERGED SINCE INCEPTION

NAME	YEAR	MEMBER PAYOUT	LOANS	RESERVES	WCUSIC COST-TO-DATE	REASON
Florence County Co-op	1973	102.26%	$ 74,651	$ 9,789	$ -0-	Bad Management
Fulton Employees	1973	100%	3,455	756	-0-	Lack of Interest
Goodwill Employees	1973	100%	13,320	1,370	1,751.18	Lack of Interest
Green Bay & Western RR	1973	128.06%	18,769	10,434	-0-	Lack of Interest
GESU	1973	132.97%	11,387	19,800	-0-	Lack of Interest
KRAL	1973	102.82%	23,050	2,635	-0-	Lack of Interest
Kupfer Employees	1973	100%	92,838	8,002	-0-	Company Forced
Lakeland Mfg. Emp.	1973	100%	52,649	4,170	-0-	Merger
Manitowoc Empls.	1973	100%	154,624	4,949	43,454.70	Bad Management
Marshfield	1973	102.68%	145,042	11,603	-0-	Lack of Interest
Metal Ware Empls.	1973	100.158%	42,718	9,081	-0-	Lack of Interest
Phoenix Green	1973	122.9%	1,406	4,484	-0-	Lack of Interest
St. Matthias Parish	1973	100%	60,188	6,052	-0-	Lack of Interest
Universal Motor Empls.	1973	100%	30,269	2,912	-0-	Lack of Interest
Altoona	1974	100%	95,000	16,779	-0-	Merger
C & P	1974	100%	21,347	2,960	-0-	Poor Management
Clintonville Co-op	1974	100%	6,818	482	-0-	Lack of Interest
Couderay Area	1974	100%	50,522	3,958	18,660.65	Insolvent
Enger-Kress Empls.	1974	112.17%	3,320	4,351	-0-	Lack of Interest
A-B	1974	100%	15,995	1,573	-0-	Lack of Interest

CREDIT UNIONS LIQUID. .D/MERGED SINCE INCEPTION

NAME	YEAR	MEMBER PAYOUT	LOANS	RESERVES	WCUSIC COST-TO-DATE	REASON
G&L Empls. (Kaukauna)	1974	100%	$100,833	$ 2,111	$ -0-	Poor Management
Greene's Empls.	1974	100%	10,150	4,445	-0-	Lack of Interest
Holy Rosary	1974	100%	5,002	578	-0-	Poor Management
Industrial, Burlington	1974	100%	21,719	881	1,260.28	Poor Management
LaCrosse Transit	1974	110.937%	21,096	4,252	-0-	Merger
Mobil Office	1974	110.01%	10,801	8,307	-0-	Company Closed
Monterey Mills	1974	100%	20,130	1,301	+324.86	Poor Management
Motor Coach	1974	100%	165,200	12,591	-0-	Poor Management
Mount Sinai Hosp. Emp.	1974	100%	108,233	5,321	7,330.79	Insolvent
Postal C.U. of Racine	1974	115.77%	153,478	37,694	-0-	Lack of Interest
St. Agnes	1974	110.9%	25,733	11,589	-0-	Lack of Interest
A.O. Smith-Elkhorn	1974	106.91%	56,278	8,393	-0-	Merger
Thorstad Employees	1974	102.22%	29,169	3,319	-0-	Lack of Interest
USAFI-CE	1974	104.27%	48,184	9,967	-0-	Company Closed
Underwood Empls.	1974	100%	73,563	10,131	-0-	Poor Management
W.K. & H. Empls.	1974	117.19%	63,007	21,352	-0-	Company Closed
Cornell Employees	1975	100%	172,196	37,481	40.15	Company Closed
Del	1975	100%	39,094	1,530	5,903.77	Company Closed
Doerflinger	1975	115.32%	24,112	7,930	-0-	Lack of Interest
Excelsior Employees	1975	100%	21,186	4,105	-0-	Lack of Interest

CREDIT UNIONS LIQUIDATED SINCE INCEPTION

NAME	YEAR	MEMBER PAYOUT	LOANS	RESERVES	WCUSIC COST-TO-DATE	REASON
Falls	1975	100%	$311,393	$ 18,096	$ 12,245.28	Insolvent
Gaylord Employees	1975	100%	7,069	2,663	3,417.36	Lack of Interest
Metro	1975	100%	742,269	47,590	91,945.46	Insolvent
New London Community	1975	100%	89,962	5,404	7,280.87	Poor Management
Norwood Mills Empls.	1975	100%	58,315	5,567	3,323.81	Poor Management
Portage Hosiery	1975	100%	27,944	2,886	-0-	Lack of Interest
St. Anthony Hospital	1975	100%	17,494	2,565	+59.50	Lack of Interest
St. Catherine's Parish	1975	100%	39,900	7,739	-0-	Lack of Interest
Walker Employees	1975	100%	69,222	5,818	-0-	Poor Management
Waukesha Fdry. Br. Emp.	1975	107.05%	12,688	5,436	-0-	Merger
Western Union Traffic	1975	100%	28,020	2,065	5,319.25	Poor Management
American Excelsior	1976	100%	72,919	31,914	-0-	Lack of Interest
Gibbs Employees	1976	100%	125,036	19,093	-0-	Company Closed
Kenosha Brassco	1976	100%	194,674	49,897	-0-	Poor Management
Kurz & Root	1976	103.24%	20,346	2,807	-0-	Lack of Interest
Lakeside Lab. Empls.	1976	110.63%	40,723	16,970	-0-	Company Closed
Litho Employees	1976	103.43%	14,978	2,246	-0-	Merger
Mead Container Empls.	1976	100%	68,253	10,213	-0-	Poor Management
Oneida	1976	100%	3,296	143	1,449.67	Insolvent
Plumbers Local #75	1976	109.75%	55,430	4,910	-0-	Lack of Interest

CREDIT UNIONS LIQUIDATED/MERGED SINCE INCEPTION

NAME	YEAR	MEMBER PAYOUT	LOANS	RESERVES	WCUSIC COST-TO-DATE	REASON
Postal	1976	119.3%	$ 19,614	$ 3,623	$ -0-	Lack of Interest
St. Joseph's Parish	1976	111.2%	16,771	3,583	-0-	Merger
Sheboygan C:NW	1976	171.38%	7,987	11,043	-0-	Lack of Interest
State Employees	1976	113.33%	55,736	15,657	-0-	Merger
UIU Industries	1976	100%	19,904	557	1,834.84	Lack of Interest
Westmoreland	1976	100%	2,190	220	-0-	Lack of Interest
Amphenol Controls	1977	101.25%	43,895	10,605	-0-	Lack of Interest
Central Fed. & Post. Em.	1977	100%	19,072	1,212	1,188.14	Poor Management
Farmers Equity	1977	101.85%	122,463	2,991	-0-	Poor Management
Garton	1977	115.74%	11,689	13,700	-0-	Company Closed
Hoerner Waldorf	1977	100%	106,928	6,854	3,884.08	Lack of Interest
Lodi Community	1977	100%	24,474	1,577	1,618.58	Lack of Interest
Milwaukee Division	1977	100%	11,242	36	+1.39	Lack of Interest
Royal-Checker	1977	100%	113,957	27,299	-0-	Company Closed
Swiss Colony	1977	100%	201,456	10,335	-0-	Merger

CREDIT UNIONS LIQUIDATED SINCE INCEPTION

NAME	YEAR	MEMBER PAYOUT	LOANS	RESERVES	COST TO WCUSIC	REASON
Hoffmaster Employees	1978	100.0%	$ 182,292	$14,720	$ -0-	Lack of interest
LaCrosse Telephone	1978	109.8%	83,738	16,695	-0-	Lack of interest
Lenox	1978	100.0%	117,585	7,863	-0-	Insolvency
PPG Employees	1978	100.0%	163,264	9,806	1,909.27	Lack of sufficient h
Presto	1978	100.0%	1,068,248	None	163,264.65	Insolvency
Retail Store Empls.	1978	100.0%	297,389	21,771	9,444.03	Merger
Terminal Railway	1978	100.17%	5,007	None	-0-	Lack of interest
Wrot Washer	1978	105.73%	13,518	1,352	-0-	Too small for servic
Yost's Employees	1978	119.54%	2,832	162	-0-	Too small for servic
Barron	1979	100.0%	1,455,542	40,006	222,936.75	Insolvent
Black River Country	1979	100.0%	190,544	7,496	40,855.57	Lack of interest and insolvent
Ellsworth	1979	100.0%	290,103	17,023	-0-	Decreasing assets an lack of income
Evening Telegram	1979	155.4%	-0-	-0-	-0-	Lack of interest
Immaculate Conception	1979	100.0%	36,178	5,742	-0-	Lack of interest and insolvent
Leyse Employees	1979	100.0%	21,322	4,049	-0-	Lack of interest
Northern Shoe Empls.	1979	111.8%	45,207	6,781	-0-	Company went out of business
St. Croix County Co-op	1979	100.0%	317,388	(1,545)	43,438.48	Insufficient income and lack of growth

CREDIT UNIONS LIQUIDATED/MERGED SINCE INCEPTION

NAME	YEAR	MEMBER PAYOUT	LOANS	RESERVES	COST TO NCUSIC	REASON
Armour Employees (Green Bay)	1980	100.39%	$201,056	$53,217	-0-	Spo. or going out of business
Consumers	1980	100.0%	36,704	3,899	7,057.62	Insolvent
Duo-Safety Ladder	1980	100.0%	9,374	1,398	1.71	Insolvent
Friendly Valley	1980	100.0%	58,978	5,493	17,075.35	Insolvent
Greater Shawano	1980	100.0%	27,745	-142	8,109.99	Lack of interest & insolvent
Hispano-Americana	1980	100.0%	5,657	1,331	-0-	Insolvent
Mercury Employees	1980	100.0%	369,943	69,387	-0-	Diminishing field of membership
H.C. Miller	1980	100.0%	69,537	8,393	4,246.25	Insolvent
Milwaukee Spring Employees	1980	112.79%	34,884	4,929	17.82	Lack of Funds
Musky	1980	100.0%	182,997	27,368	-0-	Poor managerial personnel
Projectionists	1980	100.0%	22,933	4,989	1,981.97	Lack of interest
St. Joseph's Hospital Employees	1980	100.0%	41,652	24,967	19,498.32	Lack of interest

CREDIT UNIONS LIQUIDATED/MERGED SINCE INCEPTION

NAME	YEAR	MEMBER PAYOUT	LOANS	RESERVES	COST TO WCUSIC	REASON
Centrifugal	1981	100.00%	$ 75,726	$ 7,953	-0-	Lack of Interest
El Centro	1981	100.00%	121,976	14,216	13,046.87	Insolvent
Kolmar Employees	1981	100.00%	121,481	14,669	-0-	Lack of Interest
LaCrosse Cooler Area	1981	100.00%	195,214	33,596	-0-	Dissolution of Service Center
Sprague Employees	1981	101.08%	115,962	24,161	-0-	C.U. going out of business
United	1981	100.00%	394,349	5,225	34,352.26	Dissolution of Service Center
Waushara Community	1981	100.00%	-0-	-0-	+47.21	Lack of Interest
AP Controls	1982	100.00%	324,719	51,759	-0-	Lack of Interest
Amron Employees	1982	100.00%	433,855	82,193	-0-	Heavy Lay-Offs
Badger Lumber	1982	100.00%	209,271	45,630	-0-	Parent Co. Folded
Bayland Public Empls.	1982	100.00%	1,455,298	162,173	-0-	Lack of Interest
Clark Oil Empls.	1982	102.00%	298,340	19,068	-0-	Company Sold
Greater Berlin	1982	100.00%	119,405	4,786	-0-	Poor Management
Hudson-Sharp	1982	100.00%	3,059,307	259,756	-0-	Growth Potential
Lake Community	1982	100.00%	1,116,075	52,359	21,529.99	Poor Management
Lake Shore	1982	100.00%	239,158	36,656	-0-	Lack of Potential
Russell Creamery	1982	100.00%	39,446	6,981	-0-	Company Dissolved
Spector Northwest	1982	100.00%	526,580	131,216	-0-	Company Moved Out-Of-State

CREDIT UNIONS LIQUIDATED/MERGED SINCE INCEPTION

NAME	YEAR	MEMBER PAYOUT	LOANS	RESERVES	COST TO WCUSIC	REASON
Straus Employees	1982	100.00%	$154,640	$ 16,571	-0-	Lack of Potential
Wal-Co	1982	100.00%	373,331	24,993	-0-	Lack of Potential
White House Milk	1982	100.00%	175,257	20,140	-0-	Lack of Potential
Wisconsin Appleton	1982	100.00%	216,774	49,215.	-0-	Poor Management
Wisconsin Women's	1982	100.00%	89,235	1,108	$6,070.03	Insolvent
Woodpreservers	1982	100.00%	29,929	3,394	3,759.77	Lost Sponsor
A.S.L.	1983	100.00%	51,095	4,830	-0-	Lack of Potential
Armira Family	1983	100.00%	139,619	12,841	-0-	Lack of Potential
Better	1983	100.00%	314,774	25,000	-0-	Merged into Center
Crucible	1983	100.00%	53,479	46,239	-0-	Poor Management
Downing Box	1983	100.00%	27,160	25,364	-0-	Lack of Potential
E.Z. Paintr Employees	1983	100.00%	214,953	22,015	-0-	Lost Sponsor
Evinrude Motors	1983	100.00%	2,245,316	96,046	52,488.12	Poor Management
Forsberg	1983	100.00%	126,161	6,834	-0-	Lack of Potential
Gateway Transportation	1983	100.00%	803,450	216,918	-0-	Lost Sponsor
Koehring	1983	100.00%	243,399	17,210	8,385.07	Lost Sponsor
Milwaukee Cylinder Emp.	1983	100.00%	69,418	19,031	-0-	Lack of Potential
Mobil	1983	100.00%	83,254	8,909	-0-	Lost Sponsor
Pressy	1983	100.00%	206,205	21,600	-0-	Sponsor Cut-Back
St. Nicholas	1983	100.00%	16,904	4,012	-0-	Lack of Potential

CREDIT UNIONS LIQUIDATED/MERGED SINCE INCEPTION

NAME	YEAR	MEMBER PAYOUT	LOANS	RESERVES	COST TO WCUSIC	REASON
Thonet-Wis. Inc.	1983	100.00%	$ 90,402	$ 9,150	-0-	Lost Sponsor
Village Employees	1983	100.00%	55,568	4,579	-0-	ack of Potential
Western Metal	1983	100.00%	80,662	10,971	-0-	ack of Potential

Updated June 1, 1984

WISCONSIN CREDIT UNION SAVINGS INSURANCE CORPORATION

INVESTMENT MATURITY ANALYSIS

SEPTEMBER 30, 1984

	Maturing During 1984	Maturing During 1985	Maturing During 1986	Maturing During 1987	Maturing During 1988	Maturing During 1989 & Beyond*	Total Book Value	Market Value	Current Market Appreciation (Depreciation)
U. S. Government Agency Securities	$1,199,906.25	$4,897,953.13	$4,444,531.25	$5,498,375.00	$2,650,000.00	$3,106,363.42	$21,797,129.05	$21,580,321.09	$ (216,807.96)
Other Investments:									
Bank & S&L Certificates	-0-	165,199.18	450,000.00	500,000.00	400,000.00	-0-	1,515,199.18	1,515,199.18	-0-
Monona Grove State Bank-NOW Acc.	23,981.15	-0-	-0-	-0-	-0-	-0-	23,981.15	23,981.15	-0-
Monona Grove State Bank-M.M. Acc.	4,900.94	-0-	-0-	-0-	-0-	-0-	4,900.94	4,900.94	-0-
First Bank Milw.-Repo. Agree.	242,000.00	-0-	-0-	-0-	-0-	-0-	242,000.00	242,000.00	-0-
Wisconsin Corporate Central C.U.	138,653.33	-0-	-0-	-0-	-0-	-0-	138,653.33	138,653.33	-0-
Institutional Securities	-0-	-0-	-0-	100,000.00	190,000.00	400,000.00	690,000.00	690,000.00**	-0-
Wiscub, Inc.	40,000.00	-0-	-0-	-0-	-0-	-0-	40,000.00	40,000.00**	-0-
IBM Notes	-0-	-0-	99,400.00	-0-	-0-	-0-	99,400.00	95,880.00	(3,520.00)
WCUL Service Corp. Debentures	50,000.00	-0-	-0-	-0-	-0-	-0-	50,000.00	50,000.00**	-0-
Totals	$1,699,441.67	$5,063,152.31	$4,993,931.25	$6,098,375.00	$3,240,000.00	$$3,506,363.42	$24,601,263.65	$24,380,935.69	$ (220,327.96)
Percent of Total Investments	6.91%	20.58%	20.30%	24.79%	13.17%	14.25%	100.0%	99.10%	.90%

* Maximum maturity of 1993; total dollar amount exceeding 5¼ years = $1,999,843.75 or 8.1% of total investments.
** Market quotation not available - items listed at book value.

WISCONSIN CREDIT UNION SAVINGS INSURANCE CORPORATION

INVESTMENT MATURITY ANALYSIS BY RATE

SEPTEMBER 30, 1984

Maturing During	7.99% or Less	8.0% - 9.99%	10.0% - 11.99%	12.0% - 13.99%	14.0% - 15.99%	16.0% or Greater	Totals
1984	$	$ 418,882.09	$ 680,653.33	$	$ 599,906.25	$	$ 1,699,441.67
1985	299,937.50	915,058.56	1,049,625.00	699,343.75	1,849,187.50	250,000.00	5,063,152.31
1986		446,587.50	1,848,843.75	1,648,500.00	1,050,000.00		4,993,931.25
1987	400,000.00	250,000.00	2,900,000.00	1,648,375.00	900,000.00		6,098,375.00
1988		100,000.00	1,990,000.00	1,150,000.00			3,240,000.00
1989 and beyond		56,707.17	1,799,843.75	1,349,812.50	300,000.00		3,506,363.42
TOTALS	$ 699,937.50	$2,187,235.32	$10,268,965.83	$6,496,031.25	$4,699,093.75	$ 250,000.00	$24,601,263.65
Percent of Total Investments	2.9%	8.9%	41.7%	26.4%	19.1%	1.0%	100.0%

(1) Totals are at book value.
(2) Demand-type investments are included in the totals for investments maturing in 1984.
(3) Average interest rate = 12.0%.
(4) Average interest rate on investments with maturities in excess of 5¼ years = 11.6%.

SCHEDULE A-1-b

WISCONSIN CREDIT UNION SAVINGS INSURANCE CORPORATION

ANALYSIS OF INVESTMENTS BY TYPE - AMOUNT - PERCENTAGE

SEPTEMBER 30, 1984

	Book Value	Percent of Total Investments Current	Percent of Total Investments At Last Examination	WCUSIC Investment Policy February 17, 1984
U. S. Government Agency Securities	$21,797,129.05	88.6%	90.22%	Up To 100%
Banks and Savings and Loan Certificates	1,515,199.18	6.1%	5.50%	10.0%
Institutional Securities	690,000.00	2.8%	2.19%	10.0%
Corporate Central (Wisconsin)	138,653.33	.6%	-0-	3.0%
Other Investments:				
Bank Demand Accts.	28,882.09	.1%	.14%	
Bank Repurchase Agreements	242,000.00	1.0%	.74%	
Mid-States Corporate Federal C.U.	-0-	-0-	.27%	
Wiscub, Inc.	40,000.00	.2%	.20%	
IBM Notes	99,400.00	.4%	.50%	
WCUL Services Corp. Debentures	50,000.00	.2%	.25%	
	$ 460,282.09	1.9%	2.10%	2.0%
TOTAL INVESTMENTS	$24,601,263.65	100.0%	100.0%	100.0%

C. JUNE 12, 1985, LETTER TO SUBCOMMITTEE CHAIRMAN BARNARD FROM FEDERAL RESERVE BOARD CHAIRMAN VOLCKER, REGARDING DISCOUNT LENDING TO NONFEDERALLY INSURED DEPOSITORY INSTITUTIONS FROM JANUARY 1980 TO JUNE 1985

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

PAUL A. VOLCKER
CHAIRMAN

June 12, 1985

The Honorable Doug Barnard, Jr.
Chairman
Subcommittee on Commerce, Consumer, and
Monetary Affairs
Committee on Government Operations
House of Representatives
Washington, D.C. 20515

Dear Chairman Barnard:

This is in further response to your letter of March 15, in which you requested information regarding Federal Reserve discount window lending to Ohio-chartered, privately insured building and loan associations. A preliminary response was provided to you on March 22, and further information was promised regarding other instances of discount lending to nonfederally insured depository institutions as soon as the staff had assembled the information.

Specifically, you asked whether there had been other instances of Federal Reserve discount lending or other assistance to nonfederally insured depository institutions from January 1980 to date. Pursuant to this request, staff has gathered from the discount officers at the Reserve Banks data on borrowings by nonfederally insured depository institutions during the period from January 1, 1980, through March 22, 1985. In addition, data were collected on borrowings by nonfederally insured branches and agencies of foreign banks. Although these institutions are not specifically covered by your request, we included them as additional information. The authority of branches and agencies of foreign banks to borrow at the window derives from the International Banking Act of 1978. Deposits of these branches are eligible for FDIC insurance, but the liabilities of the agencies are not.

Summary data on borrowing by nonfederally insured institutions are shown in the following table, by type of institution.

Type of Institution	Number of Institutions Borrowing	Average Number of Days of Borrowing	Average Deposit Size	Average Amount Borrowed
			--millions of dollars--	
Foreign Branches and Agencies	20	4	1,049	18.3
Savings and Loans				
Total	13	24	149	2.2
Other than those affected by the Ohio crisis	4	68	131	0.9
Commercial Banks	1	3	41	0.5
Industrial Banks	1	12	48	*
All Institutions	35	12	657	6.1

*Less than $50,000

These data indicate that nonfederally insured institutions have, on average, borrowed infrequently and in small amounts. Nearly 60 percent of all nonfederally insured borrowers during the period from 1980 through March 22, 1985, were foreign branches and agencies. On average, they have borrowed about once a year, although one branch borrowed for 21 days during the time span covered. Two small savings and loans experiencing protracted financial difficulties also borrowed for prolonged periods (84 and 161 days) although the amounts were relatively small (an average of $1.7 million for the shorter-term borrower and $0.3 million for the other). Most of the remainder of the borrowings by savings and loans was triggered by the crisis of depositor confidence in the privately insured savings and loans in Ohio in March 1985, and the information on these borrowings was included in the March 22 letter.

I hope this information is helpful to you. Please let me know if I can be of further assistance.

Sincerely,

APPENDIX 2.—NATIONAL ASSOCIATION OF SECURITIES DEALERS (NASD) DOCUMENTS CONCERNING ESM SECURITIES, INC. AND RONNIE R. EWTON

A. NASD BOARD OF GOVERNORS DECISION IN RE: DISTRICT BUSINESS CONDUCT COMMITTEE v. HIBBARD & O'CONNOR SECURITIES, INC., DATED OCTOBER 23, 1975

BEFORE THE BOARD OF GOVERNORS

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

In the Matter of	
District Business Conduct Committee For District No. 6	
Complainant	
vs.	
Hibbard & O'Connor Securities, Inc. 1300 Main Street, Suite 1010 Houston, Texas 77002	DECISION Complaint No. TEX-247 District No. 6
and	
Philip S. Hibbard, Registered Principal Aubrey D. O'Connor, Registered Principal Oscar E. Collier, Registered Principal Raymond J. Lenger, Registered Principal Edward F. Butler, Registered Principal Ronnie R. Ewton, Registered Principal Nicolas Precone, Registered Principal Mark A. Lichtman, Registered Representative Stephen H. Rifkin, Associated Person	October 23, 1975
Respondents	

This matter was appealed to the Board of Governors by respondent Hibbard & O'Connor Securities, Inc., and individual respondents Philip S. Hibbard, Aubrey D. O'Connor, Oscar E. Collier, Raymond J. Lenger, Edward F. Butler, Nicolas Precone, Mark A. Lichtman, and Stephen H. Rifkin, and was subsequently called for review as to respondent Ronnie R. Ewton pursuant to the provisions of Section 15 of the Association's Code of Procedure for Handling Trade Practice Complaints.

In a Decision of District Business Conduct Committee for District No. 6, dated June 6, 1975, respondent member was expelled from membership and fined

$25,000; respondents Hibbard and O'Connor were each censured, barred from association with any member in any capacity and fined $15,000; respondent Lenger was censured and fined $500; respondent Collier was censured and fined $2,000; respondent Butler was censured, barred from association with any member in any capacity and fined $15,000; respondent Ewton was censured; and respondents Precone, Lichtman and Rifkin were each censured, barred from association with any member in any capacity and fined $5,000. In addition, the respondents were assessed costs in various amounts.

The District Committee found that respondent member and respondents Hibbard, O'Connor, Lenger and Butler, from November 1973 to March 1974, permitted Michael Martino to effect securities transactions with customers and receive commissions prior to his effective registration, and the same respondents, together with respondent Ewton, from August 1973 to January 1974, permitted respondent Rifkin to effect securities transactions with customers and receive commissions without being effectively registered. The District Committee also found that respondent Rifkin effected securities transactions for the above-identified period of time and received commissions when he knew he had been barred from the securities industry. The Committee also found that respondent member, respondents Hibbard, O'Connor and Butler permitted respondent Precone to represent that he was effectively registered with the State of New York, and effected trades during this period of time, when in fact he was not effectively registered until some eight months later.

The Committee also found that respondent member and respondents Hibbard, O'Connor, Lenger and Butler failed to prepare and maintain books and records in that the firm's balance sheet of March 12, 1974, failed to disclose 610 bonds were sold on March 12, 1974, at a cost of $608,264.89 under a repurchase agreement, and the member's position records from January to July 1974, failed to reflect the number of bonds in transfer and the number of bonds pledged as collateral. The Committee also found that respondent member and respondents Hibbard, O'Connor, Lenger and Butler, during 1973 and 1974, permitted respondent Precone to function as manager of an office of supervisory jurisdiction and sign new account cards on behalf of the member, when he was not a registered principal. The Committee further found that respondent member and Hibbard, O'Connor, Lenger and Butler, between October 1973 and April 1974, failed to disburse all customers' monies through the special account established under a (k)(2)(A) exemption. The Committee also found that respondent member and Hibbard, O'Connor, Lenger, Butler, Lichtman and Precone, between August 1973 and April 1974, permitted Hormel Employee's Credit Union to sell securities in 34 separate transactions with late deliveries in each case.

The District Committee found that respondent member and respondents Hibbard, O'Connor, Lenger, Butler, Lichtman and Precone, from September 1973 to March 1974, made payments in the amount of $3,312.50 to John J. Hamilton, a registered representative of another member, without that other

member's knowledge or consent, thus denying it the opportunity to exercise its responsibility to supervise the activities of Hamilton. The District Committee also found that respondent member and respondents Hibbard, O'Connor, Lenger and Butler engaged in a manipulative and deceptive course of conduct in order to conceal the true financial condition of the member, when on March 12, 1974, 610 Capital First Corp. bonds were parked with Capital National Bank and on March 15 the bank sold these bonds to Mid-America Insurance Agency, Inc., a wholly-owned and controlled affiliate, and thereafter for 30 days beginning on March 18, the member sold 540 of these bonds piecemeal to other firms and customers, thereby avoiding the securities haircut, and in addition, these same respondents arranged a loan in the amount of $608,717.31 during March 1974 with Franklin National Bank in order for Mid-America Insurance Agency to purchase these bonds for carrying out the parking scheme.

The District Committee further found that respondent member and respondents Hibbard, O'Connor, Lenger and Butler, during the period February through July 1974, and respondent Collier, during the month of July 1974, hypothecated customers' fully paid securities and commingled these securities with firm securities to secure firm loans. The Committee also found that respondent member and respondents Hibbard, O'Connor, Lenger and Butler, for the months September 1973 to September 1974, and respondent Collier, for the months of July through September 1974, filed inaccurate trial balances, in that they did not reflect accrued expenses totaling approximately $372,000. The District Committee, in addition, found that respondent member and respondents Hibbard, O'Connor, Lenger, Butler and Collier permitted the member's aggregate indebtedness to exceed net capital by amounts substantially in excess of $2,000, and failed to maintain minimum capital as of July 31, 1974. The District Committee also found that respondent member and respondents Hibbard, O'Connor, Lenger, Butler, Ewton and Collier failed to supervise in connection with the above-identified violations. The above conduct was found to be in violation of Article III, Sections 1, 10, 18, 19, 21 and 27 of the Association's Rules of Fair Practice, as well as finding that these acts were contrary to high standards of commercial honor and inconsistent with just and equitable principles of trade. The District Committee also dismissed allegations that various respondents permitted respondent Precone to falsely certify that he was a registered principal; that various respondents permitted Kenneth Winters to function as a registered principal; and that various respondents failed to make adequate disclosure concerning a new issue and failed to provide a prospectus. In connection with these dismissals, the Committee also dismissed allegations of failure to supervise.

A hearing on these findings was held on August 28, 1975, before a Subcommittee of the Board of Governors in Dallas, Texas, and all respondents were present.

Initially, counsel for the member moved to dismiss the complaint or remand the matter to the District Committee as to the member and respondents O'Connor and Hibbard on the basis that they were not afforded all documentation introduced by the staff at the District Committee hearing and, to their detriment, were surprised by some of the exhibits, and alternatively, on the basis that throughout the District Committee hearing reference was made to a "written repurchase agreement," which was a deliberately inflammatory statement that prejudiced the entire hearing. These motions were taken under consideration and the hearing continued. Our hearing committee in deliberating this matter determined to deny these motions, finding no merit in respondents' contention. We concur.

Thereafter, all respondents addressed themselves to the various causes of the complaint in consecutive order, except as will be noted hereinafter. With respect to 1(a) relating to the member and the principals permitting Martino to effect securities transactions prior to effective registration, counsel for the member stated they had no substantive defense. He pointed out, however, that Martino had been previously registered with another member and that the failure to accomplish his registration was simply an oversight and there was no intent to deceive. Butler stated that from November 1973 to March 1974, he was out of the office most of the time, primarily defending lawsuits on behalf of the member. In November of 1973 he went to New York to straighten out registration problems with the State of New York for a number of different individuals on behalf of the member, but prior to this time he had not been effectively responsible for this area because of his obligations in connection with various lawsuits. He also added that others in the firm were responsible for assuring effective registration. He stated that Phil Hibbard and he had drawn up the member's policy manual and updated it periodically, but he had been relieved of his responsibilities in this area at that time. 1/

Lenger testified that he never had any responsibilities in connection with the registration of any individuals with the member, and that his responsibilities pertained strictly to the member's back office operations and financial affairs.

In connection with causes 1(b) and (c) relating to the principals permitting Rifkin to effect securities transactions prior to registration, 2/ and as to Rifkin that he did so when he knew he was barred, Rifkin stated that he was manager of the New York office from April 1972 to September 1973, in the member's Florida office as a salesman from September 1973 to May 1974,

1/ This statement was disputed by Hibbard who asserted that during this period of time Butler was responsible for compliance, including effective registration with appropriate jurisdictions.

2/ We note counsel's objection to the reference before the District Committee of a prior disciplinary matter in which respondents agreed to sanctions and findings involving 18 salesmen who had been engaging in securities transactions with the member when they were not effectively registered with the Association. We find nothing inflammatory with respect to this reference. We agree with counsel's contention that such had no probative value with respect to this allegation, but we also find this reference was perfectly appropriate, since the violations were substantively similar, for the District Committee to consider and reflects upon the background of respondents and the relative gravity of these violations.

and in the Houston office from May 1974 to September 1974. He stated that during this time he was in the member's Florida office, his superior was Mr. Ewton and that his salary was equated with his sales, which sales were handled by Ewton. In connection with his prior disqualification, Rifkin stated that he made full disclosure of his problems to the member in 1969, and Butler confirmed Rifkin's statement to this effect. Initially, O'Connor stated that Rifkin was terminated as manager because of his disqualification problem which came to light at about this time. On further questioning, O'Connor agreed that he was terminated for having over-committed the member. Ewton confirmed that he and O'Connor set up Rifkin's compensation in Florida, which was related to production from his accounts, but Ewton insisted he serviced these accounts.

In connection with one (d) relating to the principals permitting Precone to submit a false application, the member contended the application was not false and that the application was inadvertently signed in two places. Precone testified that his background before entering the industry had been involved in three banks, and that as a result of this he was used to doing what he was told to do by his superior. He stated in this connection that O'Connor had asked him to assume the role of manager of the New York office when Rifkin was transferred to Florida. O'Connor told him at that time he would have to apply to take the principal's examination and he thereafter received the application through the member's normal channels, completed it and sent it back to the Houston office for processing. He admitted that he had signed it in two places, and that this was done inadvertently. O'Connor testified that in any event, the member had temporary permission (90 days) from the Association for Precone to act as manager.

With respect to causes two (a) and (b) relating to the member's books and records in failing to reflect Capital First Corp. bonds as sold under a repurchase agreement, and the member's position records not reflecting the number of bonds in transfer and the number of bonds pledged as collateral, and the eighth and ninth allegations, alleging that the bonds were sold under a repurchase agreement to avoid a haircut and that they arranged a loan in order for Mid-America Insurance Agency (their affiliate) to purchase the bonds for carrying out the parking scheme, counsel contended that, in fact, the bonds were sold to the bank and thereafter it was discovered by the bank, for whatever reason, that the bank could not hold these bonds, and the bank thereupon contacted HO to buy the bonds back. The significance of this, counsel contended, was that the repurchase agreement was made after the sale, therefore there could be no parking scheme. He also pointed out that the member had other alternatives. He entered as an exhibit a letter from Green, the bank official with whom the alleged sale was made, which stated in essence the bank had purchased the bonds.[3/] O'Connor testified that Green

3/ The staff introduced an SEC deposition of Bennett, a bank examiner, which stated that Green had told Bennett that Green purchased the bonds with the understanding they would shortly be resold to the member, and Green had not examined the issue since it would be repurchased. The deposition also established that there was no written repurchase agreement.

had received a prospectus prior to the telephone conversation in which he had sold the bonds to Green, and affirmed the fact that Green had purchased them at O'Connor's request. He further stated that it was the policy of the member to prohibit any repurchase agreements.[4/] O'Connor testified that Green was executive vice president of a bank holding company, that he knew the sale of the bonds was important to O'Connor and that was why he agreed to purchase them. O'Connor stated he sold the bonds to the bank because otherwise the member would have to suspend operations. He stated he was not sophisticated enough to know the sale was to establish a market price for the bonds. However, Hibbard stated it was his intention to establish a market price for the bonds by the sale to the bank since the Association had informed him the bonds had no market value. Thereafter, counsel contended that the firm and its principals decided because the bank was a "good customer" to buy back the bonds "utilizing the financial resources of the parent . . . and bought it through the affiliate of the firm, Mid-America Insurance."[5/] He stated that in any event banks can purchase non-rated bonds. Upon questioning O'Connor about his relationship with Green, he stated that while he is a stockholder of the bank and the bank does a substantial amount of business with the member, they only have a good business relationship which has existed for about eight years, and no personal relationship. He testified that Green is a sophisticated individual. Hibbard testified that he felt there was no need to inform the Association when he learned that the member had agreed to repurchase the bonds from the bank notwithstanding his previous advice to the Association that the bonds had been sold. In connection with the inaccurate position records, counsel for the member contended that the rule does not require what was alleged in the complaint when the information is available from other sources, which it was in this case.

With respect to the sixth cause of complaint, which alleged that the principals and Lichtman and Precone made payments to a registered representative of another member without the other member's knowledge, counsel for Lichtman and Precone pointed out that at the initial hearing they were not represented by counsel and were not present in person, because they had been informed by Collier that they would be represented by counsel and there was no need for them to be present. In connection with the member's method of operation, they pointed out that all policies of the member were controlled from Houston. The New York office conducted no activities without the express permission of the Houston office, and the New York office was maintained primarily for publicity and prestige. He stated that Precone and Lichtman were instructed to contact Butler and Collier on all compliance matters. Lichtman testified that he met Hamilton (the registered representative with Shearson Hammill to

4/ O'Connor also contended that the repurchase after the sale was not all that uncommon to the member's business stating that such transactions occurred "probably one or two times out of a hundred."

5/ The District Committee found the bonds were sold to the bank on March 12 and subsequently repurchased by Mid-America Insurance on March 15.

.o whom payments were made) when they were both working for Reynolds, and ıe developed a relationship with Hamilton wherein he gave Hamilton many recommendations as to corporates. After Lichtman left Reynolds and went to work for HO, he kept in contact with Hamilton based upon his prior relationship and Hamilton's reliance on Lichtman's bond trading expertise. He stated at all times it was known in the member's New York office that Hamilton was a registered representative with another member and had a valuable account in the Hormel Credit Union. Hamilton continued to call Lichtman with respect to his advice for sales to the Hormel account, and eventually said that he would like a portion of the commissions generated by the account. Lichtman referred the matter to the office manager, Rifkin, who, in turn, orally referred it to Houston. The word came back from Houston that it was okay, and that they were to mark on the confirmations "pay Hamilton one-eighth as advisory fee." He pointed out that there was no attempt made to conceal the advisory fee payments to Hamilton. At a later period, Hamilton called and requested that the checks be made out to his grandfather, Joseph Koenig. Lichtman called Lenger, the member's comptroller, who said he would handle it. Thereafter, at a second call from Hamilton, Lichtman called Lenger again and was informed by Lenger that the only person he knew was Hamilton and he would only make the checks payable to Hamilton.

Lichtman testified that on August 1, 1974, he received a call from Precone at his home, while he was in the process of moving, requesting that he come to the office. Precone testified that on that date Hamilton called and was upset about the checks. Hamilton told Precone that his firm wanted to know about Hamilton's relationship with the member and that Hamilton appeared to be very upset. Precone called Houston, which advised him to try and contact Collier, who was at the New York airport, and ask him to come back and straighten out the problem. Precone contacted Collier who returned to the New York office. Lichtman testified that he came in and met with Precone and Collier. Collier thereupon dictated a letter and instructed Lichtman to sign the letter[6/] and mail it to him in Dallas. When Lichtman protested that he did not know Koenig and the letter was inaccurate and untrue, Collier said that he better get on an airplane immediately and meet Koenig.[7/] Lichtman testified that he did not want to sign the letter, but was pressured and hurried into it and did not attach that much significance to it because the arrangement with Hamilton had already been approved by management in Houston. Lichtman also added that again on September 11 Collier called the New York office with respect to a letter of inquiry from the NASD which asked about the relationship between Hamilton and Koenig. Collier dictated a letter on the telephone

6/ The letter was to the effect that Lichtman knew Koenig and that Koenig rendered valuable investment advisory services to him.

7/ Koenig's testimony before the Minnesota Securities Commission clearly establishes that he has no expertise in rendering investment advice and little, if any, knowledge of the securities industry, money market conditions or issuers.

for Lichtman's signature. He protested that the letter was untrue with respect to that relationship and was told by Collier not to worry about it.

Thereafter, Lichtman testified that on September 26, he met with Bergner 8/ Collier and Precone in the New York office, and that Don Herklotz, a trader for the member, was also present. The purpose of the meeting was to prepare Lichtman for his testimony to be given later before the Minnesota State Securities Commissioner. Mr. Lichtman testified that initially he tried to tell Collier's version that he had known Koenig and that Koenig had rendered investment advice to him, but he was unable to carry through with it and finally told Bergner and Collier that he had never met Koenig. On October 16, he met Bergner and Collier in Minnesota and was told by Bergner that he could avoid any perjury problems because he, Bergner, would object to any questions about Koenig as not being related to the subject of the State inquiry. Precone confirmed Lichtman's version of events as to all meetings at which he was present. He pointed out that Collier had been told by Lichtman on August 1, September 11 and 26, and again in October that Lichtman had never met or spoken with Koenig, but nevertheless in December had submitted a false answer to the Association on behalf of the member, which was completely contrary to the factual situation. Precone added that the first knowledge he and Lichtman had of Collier's alleged discussion of the matter with them shortly before the District Committee hearing was when they received the transcript over a month after the hearing. He stated that Collier's testimony in this respect was completely contrary to the facts and no such discussion had occurred.

Nick Wallace appeared as a witness for Precone and Lichtman. He stated that he now works for Winters and Company in Florida, but that from 1972 to 1974 he was employed in the member's New York office. He testified that the New York office was a small, close-knit group, and the physical arrangement of the office permitted everyone to know what was going on. He stated that it was common knowledge that Hamilton was a registered representative and had the Hormel account. He testified that he knew Hamilton had asked Lichtman for one-eighth advisory fee, which seemed okay, but he knew they first had to obtain approval from Houston. Word came back from Houston that it was okay, and it appeared to him that everything was aboveboard. He testified that Rifkin, the manager at the time, told Wallace that he had gotten Houston's approval. He stated that Butler's name was never mentioned as the person from whom approval was sought. Rifkin testified that he discussed the one-eighth payment with Precone, and thereafter referred it to Houston to either O'Connor or Hibbard. Rifkin testified that there was much dependence on Lichtman as a corporate trader, not just by Hamilton, and that Lichtman enjoyed an excellent reputation. Rifkin stated that he informed Houston that Hamilton was a registered representative and that it would be beneficial to the member if the member could pay the one-eighth to him. O'Connor admitted he received the call from Rifkin but denied that Rifkin had informed him that Hamilton was registered. Lenger testified that he discussed the payments with Hibbard because he was concerned that if payments amounted to more than $600 per year he would have to file tax forms, and he called O'Connor to find out if the arrangement was permissible. He was informed that it was.

8/ Bergner was the member's outside counsel.

Don Herklotz, another witness for Precone and Lichtman, testified that he is currently employed in the member's New York office at a salary of $24,000, and that he has been so employed since December 3, 1973, to develop a corporate syndicate department. He stated that he enjoys his work and is happily employed. He stated that he was with Reynolds in 1969 until joining the member in 1973, and that it was through Lichtman he went to work for the member. He also stated that he knew John Hamilton. He stated that he kept a diary, and introduced portions of it. Basically, the diary confirmed Lichtman's version of events on August 1, 1974, and the fact that Lichtman had told Collier at that time he didn't know Koenig. He also met with Bergner and Collier on September 26, 1974, in New York, and confirmed Lichtman's version of this meeting, and that Lichtman had informed them that he didn't know Koenig and that the prior letter he had signed to the effect that he did know him, was false. Mr. Herklotz said, "I particularly remember this because it troubled me that Mr. Bergner, the firm's counsel and Mr. Collier, the firm's compliance officer, were parties to this untrue letter. In fact, Mr. Collier had originated the untrue letter."

Robin Lurie appeared and testified on behalf of Lichtman and Precone. She stated that she is now employed by another member, but was employed in 1974 by HO's New York office, primarily as a secretary. She stated that on August 1, 1974, Bob Collier called her in and told her that he had a very important letter to dictate and to forget anything that she was to hear. He thereupon proceeded to dictate a letter in the presence of Lichtman and Precone, which she took in longhand. Collier instructed her to give him the original and the copy and to destroy her notes. She stated that she was extremely nervous after taking the letter because the office atmosphere was very tense, and she gave the letter to Bonnie Belkin to type. On September 11, 1974, she received a call from Collier, who proceeded to dictate a letter on the telephone and was told afterwards to destroy her notes and any copies of the letter. When she had prepared the letter, she heard Lichtman say, "I can't sign this letter." Collier testified that he did in fact dictate the letters, but only at the request of Lichtman. Lichtman denied that he ever requested such assistance. Collier testified essentially that he did not know about Hamilton being a registered representative and that he dictated the letter to help Lichtman. He also stated that he never advised Lichtman and Precone not to come to the District hearing or that they would in fact be represented at all. Lichtman emphatically denied he ever requested any assistance from Collier in writing the letters.

In connection with two (b) relating to the member's position record failing to reflect the number of bonds in transfer and the number pledged as collateral, counsel for the member argued this information was available from other records maintained by the member.

In connection with three (b) relating to Precone functioning as an OSJ manager when he was not a principal, the member contended that Precone was acting under temporary authority during most of the period of time, and there is nothing in the rule requiring that the office be an OSJ in order for someone to sign new account cards.

In connection with the fourth cause relating to 15c3-3 violations, the respondents admitted that while the payments were made, they pointed out that they were minimal in light of the total amount of monies processed through the member's account. In this connection, Butler noted that at no time did he have any responsibilities in connection with compliance with 15c3-3.

In connection with the fifth cause relating to 34 sales transactions in violation of prompt receipt and delivery, respondents argued that there were many less late deliveries than as found by the District. In connection with three transactions, they noted that the items had been released by a customer but were not received in good deliverable form, and argued that these were not within the Interpretation. In connection with several other items, the member could not find exact dates, but argued that the customer had released these bonds by telephone prior to the dates, and argued again that these did not come within the definition. They nevertheless conceded that there remained other violations.

With respect to the tenth cause relating to the hypothecation and commingling of customers' fully paid securities, counsel contended that this allegation was unfair as it related to Collier, because Collier had only been with the member on a full-time basis since April 1st, and he could hardly be held accountable for the matters which related to July since he was still in the process of familiarizing himself with the member's system, and urged that causes eleven and twelve are equally unfair to Collier for the same reason. He also contended that Franklin National Bank records were not accurate, and in fact the customers' securities were not held as collateral. Lenger stated that he was responsible to Collier as of April 1 and, therefore, should bear no responsibility for any violation occurring after this date. Concerning cause eleven, alleging inaccurate trial balances and cause twelve, which alleged a net capital violation, counsel contended that the member was motivated to write down the securities in question and transfer them to the parent for tax purposes. They contended that the books and records were not erroneous and that they did not create a false expense item or, alternatively, failed to accrue expenses, but that the matter was only done for tax purposes. Respondents admitted that the bonds had no value for capital purposes and stated that they were donated to the parent company in lieu of any expenses, to clear out the inventory of the member. The member contended that the $372,000 in expenses the member wrote off were not expenses that had been assessed, and that it was done only as an audit adjustment.

With respect to cause thirteen which alleged lack of supervision of the above described activities, counsel stated that he did not feel it would be appropriate to find a failure to supervise by an individual who had committed the violative act. Butler contended that Collier had been the compliance officer, and that during the period in question other employees of the member had been responsible for signing representatives' applications, termination notices and other matters. O'Connor testified that he had been primarily responsible for sales, and that Hibbard was primarily responsible for back office technical details and administrative problems.

We have reviewed the entire record and we believe certain adjustments should be made in the findings in light of the substantial new evidence introduced before us which was not available to the District Committee. We have not attempted to summarize all of the testimony before us, but only that which may put some perspective upon our findings and our subsequent adjustment of the penalties we have decided to impose. For convenience, we will discuss our views of the evidence under the categories that follow.

Hibbard & O'Connor Securities, Inc.,
Philip S. Hibbard and Aubrey D. O'Connor

The findings under 2(a) that the member's balance sheet failed to disclose 610 bonds sold under a repurchase agreement, and under eight and nine that these bonds were sold under a repurchase agreement to avoid a "haircut", and that respondents arranged a loan in order for their subsidiary, Mid-America Insurance Agency, to purchase the bonds to carry out the "parking" scheme, are related and we will consider these findings together.

In our opinion, these findings are clearly supported in the record before us, as well as before the District Committee, and represent most egregious violations. While under other circumstances we might classify respondents' explanation as ingenuous, we find it incredible and not worthy of belief, considering their experience in the industry, control over the member's operations, and the circumstances present in this matter. We agree with respondents' contention that there was no written repurchase agreement, but view that fact and respondents' emphasis on that as, at best, misleading. Certainly, their testimony before the District Committee in our view clearly established the "parking" and repurchase agreement, 9/ as did their testimony, together with other exhibits at our hearing. Put simply, we do not believe respondents' explanation. We regard the testimony of "a real heavy moral obligation" as a convenient shading of the truth aimed at exculpating respondents from this violation. In this connection, we note the "parking" arrangement was entered into with Green, who, by respondents' testimony, was a sophisticated businessman and bank official. We also note O'Connor was a stockholder of the bank, the member's offices were in the bank building and the member enjoyed a pre-existing banking relationship with Green and his bank. In our experience, these relationships and the facts surrounding this transaction warrant our conclusion this was something more than respondents would lead us to believe. Viewing all of the testimony from our collective experience as businessmen in the industry, we find respondents

9/ While their testimony before the District Committee, in our view clearly establishes these violations upon numerous occasions, we note in particular O'Connor's statement that "... if you can tie a real heavy moral obligation to do the best you can to get him out as quick as you can, if that can be defined as parking, then they were parked." District Committee Transcript, p. 23(b).

deliberately entered into a prearranged "parking" arrangement to circumvent net capital requirements. We are disturbed at their testimony before us which we find was in most instances deliberately evasive and a calculated attempt to justify their actions after the fact. As only one example, we note Hibbard's testimony that he felt there was no need to inform the Association that the bank "had asked you (Hibbard) to take them out of those bonds ... only a day or so before the bonds had been sold permanently." 10/ We find this statement on the part of a registered principal with Hibbard's responsibilities and experience as incredible, particularly when he admitted that at the time he informed the Association's staff of the "sale" of these bonds the staff specifically inquired as to whether there was a repurchase agreement or "parking" arrangement. 11/ We believe he was completely aware of the misleading effect the withholding of this information had on our staff's ability to monitor the financial affairs of the member. We do not believe that such attitudes toward compliance with critically important regulatory requirements on the part of registered principals can be condoned. In sum, we find, as did the District Committee, that respondents deliberately entered into a "parking" arrangement with a repurchase agreement with the customer designed to mislead the Association's staff as to the member's compliance with net capital requirements.

With respect to these respondents' responsibility for the violations under the first cause, we believe the District Committee's findings are proper and they are affirmed. While we would not ordinarily view their failure to effectively register Martino with us and their failure to effectively register Precone with the State of New York as egregious in nature, we believe that these violations in the context before us indicate an inattention to regulatory requirements which cannot be condoned on the part of registered principals. With respect to their permitting Rifkin to effect securities transactions while he was barred from the industry, we note O'Connor's testimony before the District Committee that Rifkin did not disclose this disqualification to the member when he became affiliated with it, and Rifkin's testimony, confirmed by Butler, that full disclosure had been made. We are more concerned, however, with two other aspects of this problem. In the first place, we note that Rifkin was removed as manager of the member's New York office because he had over-committed the member in the fall of 1973. Thereafter, a Membership Continuance hearing was held before us in December 1973, at which time Butler represented that Rifkin had an exemplary record with the member. No mention was made by Butler or Rifkin as to Rifkin's removal as manager in New York or the reasons therefor. 12/ We conclude this was

10/ Board of Governors Transcript, p. 131.
11/ Board of Governors Transcript, p. 130.
12/ In this connection, we view this failure to disclose equally reflective upon Hibbard and O'Connor since both were aware of the reasons for Rifkin's removal as manager and yet failed to disclose this fact to us.

a deliberate attempt to conceal relevant and important facts from us surrounding Rifkin's record with the member. Secondly, we note that Rifkin's compensation in Florida was directly related to the production from an account of a bank purchasing corporate securities, which he and Ewton maintained was serviced by Ewton. 13/ We find this is a contrived circumvention to avoid the prohibition of Rifkin engaging in the securities industry.

With respect to two(b) relating to the member's position record failing to reflect the number of bonds in transfer and the number pledged as collateral, we accept respondents' representations that these were reflected on the member's subsidiary records and dismiss this finding.

The findings under the fourth cause relating to violations of 15c3-3, were admitted by respondents and we affirm this finding of violation. In regard to the fifth cause, violations of the Prompt Receipt and Delivery Interpretation, respondents submitted new evidence, which we accept, that eliminated some of the transactions as violations. Nonetheless, respondents admitted the remaining instances and, accordingly, we affirm the findings of violation as to the remaining transactions.

In regard to the sixth cause relating to commission payments to a registered representative of another member, in our view it is irrelevant whether these respondents were misled by Rifkin as to the occupation of the recipient or not, since they should have at some point made further inquiry as to the nature of the payments, as well as the identity of the recipient, in light of the subsequent developments disclosed to us at our hearing. We, therefore, affirm this finding as it relates to these respondents.

With respect to the seventh cause, lack of disclosure and a failure to provide a prospectus, we affirm the District Committee's dismissal of the allegation. The tenth cause involved hypothecation of customers' fully paid securities and commingling of those securities with firm securities to secure loans. Respondents contended that in many instances the records of Franklin National Bank were inaccurate, and that customers' securities reflected on bank records as collateral were in the process of transfer. While we can accept respondents' contention in this respect in some instances, particularly with respect to the three matters discussed at our hearing, nevertheless, many unexplained instances remain. We also note that while respondents asserted that the monthly list received from the bank required the member to reconcile with its own records to determine the accuracy of the list, there is no evidence or testimony to

13/ Again, we point out this compensation arrangement was set up and approved by O'Connor. We believe both O'Connor and Hibbard must have been aware that such an arrangement constituted a prohibited circumvention of our requirements.

indicate that such a reconciliation was ever made by the member, and if discrepancies occurred, that such were accepted by the bank. Absent such acceptance, the customer's securities collateralizing firm loans were in jeopardy. Accordingly, we affirm this finding.

The findings under causes eleven and twelve relate to inaccurate monthly trial balances and a net capital violation as of July 31, 1974. Respondents contended that these deficiencies resulted from an intercompany transfer of approximately $372,000 from the member to the parent corporation. This figure represented the value of certain bonds in the member's inventory which were worthless for capital purposes and were transferred to the parent as accrued expenses due from the member. Respondents argued this was only done as a bookkeeping entry for capital purposes, and that the District Committee's allocation of this figure as expenses for each month for that fiscal year was erroneous. We note that respondents initiated this treatment and, therefore, in our view, are bound by their own action. We can see no reason why the District Committee's treatment of this item was in error. Even going behind respondents' treatment, and accepting their contention, their action in this respect created a false expense figure and their books at year-end were materially misleading. In any event, respondents chose to treat this figure in the fashion they did and as a consequence should have pro-rated the expenses for the entire year. We, therefore, affirm the findings of violations.

The thirteenth cause relates to respondents' failure to supervise the conduct discussed above. We affirm the violations in this respect as to all the items set forth under the findings relating to cause one, as well as to the fifth and sixth causes. We dismiss all remaining findings.

Nicholas Precone and Mark Lichtman

Lichtman and Precone were found to be in violation of the allegations of cause five, violations of the Prompt Receipt and Delivery Interpretation in sales for an account, and cause six, payments to a registered representative of another member. They were also named in cause seven, which was dismissed by the District Committee and which dismissal we affirm. We note initially that they did not appear before the District Committee because, according to them, they had been assured the member and the member's counsel would represent them. They further asserted that it was not until after the hearing before the District Committee that they became aware, after reviewing the transcript of the hearing, that Collier, on behalf of the member, not only had not represented them, but had attempted to blame Lichtman and Precone for these violations. In any event, Lichtman and Precone, with counsel and witnesses, appeared before us and introduced substantial new testimony. We feel no useful purpose would be served in a

discussion of that evidence. We find the unrebutted testimony of these witnesses 14/ effectively exposes an attempted coverup of violations and a major attempt on the part of Collier to hinder and prevent the District Committee and its staff from uncovering, not only the extent of violations, but the appropriate responsibility therefor. It further clearly establishes that Lichtman and Precone were erroneously implicated in the violative misconduct for which they should bear no responsibility and we dismiss all findings of violation involving both of them.

Oscar E. Collier

Obviously, the extent of Collier's involvement was not apparent to the District Committee. Had they been aware of his deliberate misstatements, and attempts to inhibit a full investigation of involvement in the violative activities by responsible individuals, we believe they would have viewed such activities in the same light as we have. Put another way, notwithstanding the few violations involving Collier, we view his activities as so inimical to any standard of commercial honor and just and equitable principles of trade as to warrant the severest of sanctions. Despite this view, we were originally concerned that in imposing sanctions consistent with our concern we might somehow be depriving Collier of an opportunity to rebut our findings and put some other perspective on his involvement. A careful reading of the testimony and a review of the ample opportunities given to Collier to explain his activities convinces us no useful purpose would be served by remanding the matter to the District Committee or, by the initiation of new proceedings. We are further persuaded in this belief by our own view that no responsible businessman in our industry, especially one with Collier's experience and responsibilities, can involve himself in such a fundamental and basic disruptive tampering with the investigative functioning of the staff and impairment of the proper fact finding and decision making functions of our District Committee, and not expect to receive the severest of sanctions once such activity is disclosed. Such conduct strikes at the very heart of effective self-regulation and must necessarily call into question, once discovered, the public confidence in the effective functioning of the securities markets.

Raymond G. Lenger

With respect to respondent Lenger, we do not believe he had any responsibility for the registration of employees with the Association, and

14/ We also note, in our opinion, these witnesses were credible and substantiated their testimony in all critical areas. It is only confusing to speculate as to the motives for Collier's testimony. It is clear to us that these witnesses were motivated by a desire to establish the truth, and we commend each of them, particularly when we consider that all suffered some personal expense and embarrassment and at least one risked losing his job with the member.

we dismiss these violations as they relate to him, together with the supervisory violations under cause thirteen. We do, however, affirm the remaining violations. We point out that in our view the testimony establishes that Lenger's primary responsibility lay in the back office operations of the member, particularly its books and records. While in most instances he was directed by Hibbard and by O'Connor to treat items in a particular fashion, it appears he never questioned the method even when such treatment was patently irregular. We do not believe a registered principal of a member, bearing a major responsibility over the operations of the firm, can escape responsibility for these functions by mere acquiescence in the directions of others. Our concern is reflected in our adjustment of his sanctions.

Edward F. Butler

Butler was the compliance officer of the member, a registered principal, a member of the Board of Directors, and the firm's executive representative during most of the time period in question. During some of this time, Butler was actively involved in representing the firm in lawsuits which by his own testimony required him to spend substantial amounts of time away from the member, and precluded him from fulfilling his compliance duties with the member. We have taken this latter fact into account in deciding to dismiss his involvement in certain of the violations. Nevertheless, he cannot escape responsibility for all violations, both because of his position with the member as well as his direct involvement in many of the substantive violations. With respect to cause two(a) relating to the lack of disclosure on the firm's balance sheet of the fact that 610 bonds were sold under a repurchase agreement, cause four, relating to 15c3-3 violations, and causes eight and nine, which involved the sale and repurchase of the bonds through an affiliate of the member, we believe it is appropriate under the circumstances of this case to dismiss these findings as they relate to Butler. We do, however, affirm the remaining findings, as well as the dismissals.

Stephen H. Rifkin and Ronnie R. Ewton

We can find no basis to modify the findings or penalties with respect to either of these respondents, and they are, therefore, affirmed.

In light of our views expressed above, we have determined it would be appropriate and in the public interest to impose the following sanctions:

We affirm the expulsion of the member and $25,000 fine; as to Hibbard and O'Connor, we affirm the bar in any capacity and censure and a $15,000 fine as to each; as to Lenger, we affirm the censure, $500 fine and impose a 90-day suspension in any capacity; as to Collier, censure, a $10,000 fine and a bar in any capacity; as to Butler, censure, a $1,000 fine and a two-year suspension as a principal; as to Ewton, censure; as to Rifkin, we affirm the censure, the $5,000 fine and a bar in any capacity;

and, finally, as to Lichtman and Precone, we dismiss all sanctions. The suspensions shall commence on a date to be set by the President of the Association. We affirm the District Committee's assessment of costs as to all respondents, except that we eliminate the assessments on Lichtman and Precone. We assess our hearing costs of $1,982.72 upon respondent member, Hibbard, O'Connor, Collier and Rifkin, jointly and severally.

On Behalf of the Board of Governors,

By Thomas D. Walsh
Thomas D. Walsh, Secretary

B. ESM'S BROKER-DEALER APPLICATION TO NASD (EXCERPTS), DATED NOVEMBER 19, 1975

LAW OFFICES

PETTIGREW AND BAILEY

SUITE 1820, ONE BISCAYNE TOWER
TWO SOUTH BISCAYNE BOULEVARD
MIAMI, FLORIDA 33131

TELEPHONE 358-9215
AREA CODE 305

CABLE "ABOFRE"

RICHARD A. PETTIGREW
GUY B. BAILEY, JR.
OWEN S. FREED
STEPHEN W. ARKY
LAWRENCE WEINER
JOSEPH J. WEISENFELD
EUGENE E. STEARNS
MARC M. WATSON
BRUCE W. GREER
DAVID ST. JOHN
ROGER M. BERNSTEIN
THOMAS A. GRIBBIN
JOHN C. SUMBERG

November 20, 1975

Mr. Jerry Foley
National Association of Securities
Dealers, Inc.
1735 K Street, Northwest
Washington, D. C. 20006

Dear Mr. Foley:

Pursuant to our conversation of this date, I am forwarding to you the broker-dealer application of E.S.M. Securities, Inc. As I indicated to you this firm intends to trade exempt securities and municipal securities. Please note that the financial statement submitted is dated October 14, 1975. Pursuant to our conversation I will forward an updated financial statement to you at the earliest possible date. I understand that the application will be acceptable with the existing financial statement so long as an updated statement is provided in the near future.

It is also my understanding that so long as the application has been filed prior to November 30, 1975 that the applicant will not be an N.A.S.D. member until the application is approved but will not be treated as a non-member for purposes of Rule 25.

Thank you very much for your cooperation in this matter.

Very truly yours,

PETTIGREW AND BAILEY

By _____
Stephen W. Arky

NASD SPECIAL INSTRUCTION SHEET

NASD USE
I.D. NO.

ADDENDUM TO FORM BD—This addendum must be completed and signed by all applicants for membership. Existing members need not complete this sheet or sign the certification on the reverse side, provided that all amendments on Form BD are accompanied with a completed and signed execution page. DO NOT FILE SCHEDULE F (STATE INFORMATION) WITH THE NASD.

State full name of applicant as shown in Item 2(a) of Form BD.
E.S.M. SECURITIES, INC.

INSTRUCTIONS AND REQUIREMENTS FOR NEW APPLICANTS

If Form BD is being filed as an application, the NASD Addendum must be filed in duplicate with a $500.00 filing fee together with two statements of financial condition in accordance with Rule 15b1-2 of the Securities and Exchange Act of 1934. An assessment report (complete report on bottom of this page) must be submitted with the application. Applications for registration as Principals (for any active Principal named under Schedule A, B, or C) must be submitted with Form BD with a $35.00 registration fee and a $30.00 examination fee, if appropriate, for each applicant. Forms EX-1 must be submitted in duplicate for any officer or director shown on Schedule A, or partner shown under Schedule B or principal shown under Schedule C, who is *inactive* in the securities business and/or is subject to an exemption from registration as set forth under Part III of Schedule C of the Association By-Laws. Form BO-375 with a $30.00 fee must be filed to register a branch office.

1. *Requirement for Two Principals*—Every broker and dealer making application for membership, except a sole proprietorship, must have at least two officers or partners (unless subject to an exemption) who are qualified to become registered as incipals before it shall be admitted to membership. (See Part I, subsection (3) (a), of Schedule C of the By-Laws.)

2. *Requirement for Financial Principal*—Every broker and dealer making application for membership must designate and qualify a financial principal before it shall be admitted to membership. (See Part I, subsection (2) (a), of Schedule C of the By-Laws.)

Please designate the firm's Financial Principal N/A Applicant will deal only in exempt and municipal securities.

3. *Broker/Dealer Fidelity Bond*—Is applicant subject to the Mandatory Fidelity Bonding Rule? (See Article III, Section 32 of the NASD's Rules of Fair Practice.)

YES ☐ NO ☒

If applicant claims exemption from the bond requirement, please check the appropriate box:

1. Not required to join SIPC	☐
2. No employees	☐
3. Not subject to Rule 15c3-1 (SEC Net Capital Rule)	☐
4. Municipal Securities Dealer	X

INSTRUCTIONS AS TO SPECIFIC ITEMS ON FORM BD

1. The individual shown under Item 2(c) should be considered, for NASD purposes as the firm's Executive Representative. (See Section 5 of Article I of the By-Laws.) If the firm wishes to designate an individual other than the person shown under Item 2(c) as the firm's Executive Representative, please furnish his or her name. Ronnie R. Ewton

2. If Item 7(b) is answered in the affirmative to report a merger, the member must submit a copy of the merger plan or agreement with the amendment. If the member has acquired another member (not a merger), explain details on Schedule E.

ASSESSMENT REPORT FOR NEW APPLICANTS FOR MEMBERSHIP

Firm Name E.S.M. SECURITIES, INC. Date 11/19/75

REGISTERED PERSONNEL—Report total number of Principals and Representatives who are to be registered when the firm becomes effective.

	Number of Registered Persons
REGISTERED PRINCIPALS	1
REGISTERED REPRESENTATIVES	2
TOTAL	

CERTIFICATION

(Must Be Signed By Applicant For Membership)

The undersigned, a broker and/or dealer authorized by law to transact and whose regular course of business consists in actually transacting one or more branches of the investment banking or securities business in the United States of America, hereby applies for membership in the NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. (hereinafter referred to as the Corporation), a non-stock, non-profit, membership corporation organized under the laws of the State of Delaware and registered with the Securities and Exchange Commission as a national securities association under the Securities and Exchange Act of 1934, as amended, and, if admitted to membership, the undersigned hereby agrees:

(1) To accept, abide by, comply with, and adhere to all provisions, conditions, and covenants of the Certificate of Incorporation, the By-Laws, the Rules of Fair Practice, and the Code of Procedure for Handling Trade Practice Complaints of the Corporation as they are or may from time to time be adopted, changed, or amended (copies of which Certificate of Incorporation, By-Laws, Rules of Fair Practice and Code of Procedure for Handling Trade Practice Complaints have been received and read by the undersigned applicant and which are made a part of this Application for Membership and Agreement by reference thereto); and to accept, abide by, comply with, and adhere to all rulings, orders, directions and decisions of, and penalties imposed by, the Board of Governors of the Corporation or any duly authorized committee of the Corporation;

(2) To pay such dues, assessments and other charges in the manner and amount as shall from time to time be fixed by the Board of Governors pursuant to the By-Laws;

(3) That neither the Corporation, nor any officer or employee thereof, nor any member of the Board of Governors or of any District or other Committee, shall be liable, except for wilful malfeasance, to the applicant or to any member of the Corporation or to any other person, for any action taken by such officer or member of the Board of Governors or of any District or other Committee in his official capacity, or by any employee of the Corporation while acting within the scope of his employment or under instruction of any officer, board or committee of the Corporation, in connection with the administration or enforcement of any of the provisions of the By-Laws, any of the rules and regulations as they are or may from time to time be adopted, changed or amended, or any ruling, order, direction, decision of, or penalty imposed by the Board of Governors of the Corporation or any duly authorized committee of the Corporation;

(4) To keep the answers to the information called for on Form BD accurate and up-to-date by filing supplementary information to the Secretary of the Corporation and further agree that the address listed in reply to question 2(a) shall be kept current and shall be the address of record for the receipt of all Corporation communications.

The undersigned further certifies that the statements made in this application, which includes the Assessment Report and Statement of Financial Condition, or amendment are true and complete.

Subscribed and sworn to before me

this 19th day of November 19 75

Judy C. Kaufman
(Notary Public)

E.S.M. SECURITIES, INC.
(Firm Name of Applicant)

By [signature] Secretary
(Signature of Principal) (Title)

My Commission expires NOTARY PUBLIC STATE OF FLORIDA AT LARGE Dated: November 19, 1975
MY COMMISSION EXPIRES APR. 21, 1979
BONDED THRU GENERAL INSURANCE UNDERWRITERS

FORM BD (revised 10-1-75) EXECUTION PAGE

UNIFORM APPLICATION FOR REGISTRATION, LICENSE, OR MEMBERSHIP AS A BROKER-DEALER OR TO AMEND SUCH AN APPLICATION UNDER THE SECURITIES EXCHANGE ACT OF 1934, OR UNDER THE LAWS OF THE JURISDICTIONS OR UNDER THE CONSTITUTIONS AND RULES OF THE SELF-REGULATORY ORGANIZATIONS ACCEPTING THIS FORM.

OFFICIAL USE

WARNING: Failure to keep this form current and to file accurate supplementary information on a timely basis, or to keep accurate books and records or otherwise to comply with the provisions of law applying to the conduct of business as a broker-dealer, would violate the Federal securities laws and the laws of the jurisdictions and may result in disciplinary, administrative, injunctive or criminal action.
INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

GENERAL: Read all instructions before preparing the form. Read the Special Instruction Sheets for each agency, jurisdiction, or self-regulatory organization with which this form is to be filed. Please print or type all responses. If this form is filed as an amendment, only a completed and signed execution page and those items which are being amended or which have changed since the previous filing need to be filed.

IN COMPLIANCE WITH THE APPLICABLE SECURITIES LAWS OR MEMBERSHIP REQUIREMENTS, THE UNDERSIGNED HEREBY SUBMITS THE FOLLOWING INFORMATION:

1. This form is filed with ____________________
(NAME OF AGENCY, JURISDICTION OR ORGANIZATION)
as an: ☒ APPLICATION ☐ AMENDMENT

2. (a) Exact name, principal business address, mailing address, if different, and telephone number of applicant:

Full name of applicant *(If sole proprietor, state last, first, and middle name)*: E.S.M. SECURITIES, INC.
IRS Empl. Ident. No.: Applied for

Name under which business is conducted, if different: N/A

If name of business is hereby amended, state previous name: N/A

Address of principal place of business:
Suite 1710, One Financial Plaza (NUMBER AND STREET) Ft. Lauderdale (CITY) Florida (STATE) 33394 (ZIP CODE)

Mailing Address, if different: N/A

Telephone Number: 305 (AREA CODE) 764-2600 (TELEPHONE NUMBER) -- WATS LINE *(If any)*

EXECUTION: The undersigned, being first duly sworn, deposes and says that he has executed this form on behalf of, and with the authority of, said applicant. The undersigned and applicant represent that the information and statements contained herein, including exhibits attached hereto and other information filed herewith, all of which are made a part hereof, are current, true, and complete. The undersigned and applicant further represent that to the extent any information previously submitted is not amended, such information is currently accurate and complete.

Dated the 19th day of November 19 75

E.S.M. SECURITIES, INC.
(NAME OF APPLICANT)

By: [signature] President
(SIGNATURE AND TITLE)

Attest: [signature] Secretary
(SIGNATURE AND TITLE)

Subscribed and sworn to before me this 19th day of November 19 75

STATE OF FLORIDA
COUNTY OF DADE } SS

NOTARIAL SEAL

[signature]
(NOTARY PUBLIC)

NOTARY PUBLIC STATE OF FLORIDA AT LARGE
MY COMMISSION EXPIRES APR. 21, 1978
BONDED THRU GENERAL INSURANCE UNDERWRITERS
My commission expires:

ALL OF THE ITEMS ON THIS PAGE MUST BE ANSWERED AND COMPLETED IN FULL

DO NOT WRITE BELOW THIS LINE .... FOR OFFICIAL USE ONLY

FORM BD Page 1

OFFICIAL USE

2. (b) Person to contact for further information concerning this form:

Name: Ronnie R. Ewton Title: Secretary

Mailing Address: Suite 1710, One Financial Plaza Ft. Lauderdale, Fl. 33394 Telephone No.: 305/764-2600

(c) Person authorized to receive compliance and information communications, and responsible for disseminating the same within the applicant's organization:

Name: Same Title: _____

Mailing Address: _____ Telephone No.: _____

3. Applicant is filing or has filed its application for registration, license, or membership as a broker-dealer with the following:

(Place a code number after each applicable agency, jurisdiction, or self-regulatory organization in accordance with the following: If currently applying, insert number "1," if application is pending, insert number "2," if already registered, licensed, or a member, insert number "3."

AL ___	AK ___	AZ ___	AR ___	CA ___	CO ___	CT ___	DE ___	DC ___	
FL 1	GA ___	HI ___	ID ___	IL ___	IN ___	IA ___	KS ___	KY ___	
LA ___	ME ___	MD ___	MA ___	MI ___	MN ___	MS ___	MO ___	MT ___	
NE ___	NV ___	NH ___	NJ ___	NM ___	NY ___	NC ___	ND ___	OH ___	
OK ___	OR ___	PA ___	RI ___	SC ___	SD ___	TN ___	TX ___	UT ___	
VT ___	VA ___	WA ___	WV ___	WI ___	WY ___	PR ___	Other _____ (Specify)		

SECURITIES AND EXCHANGE COMMISSION 1

NATIONAL ASSOCIATION OF SECURITIES DEALERS 1 SECO ___

AMERICAN STOCK EXCHANGE ___ INTERMOUNTAIN STOCK EXCHANGE ___

BOSTON STOCK EXCHANGE ___ MIDWEST STOCK EXCHANGE ___

CHICAGO BOARD OF TRADE ___ NEW YORK STOCK EXCHANGE ___

CHICAGO BOARD OPTIONS EXCHANGE ___ PACIFIC STOCK EXCHANGE ___

CINCINNATI STOCK EXCHANGE ___ PBW STOCK EXCHANGE ___

DETROIT STOCK EXCHANGE ___ SPOKANE STOCK EXCHANGE ___

WARNING: Failure to keep this form current and to file ac ...supplementary information on a timely basis, or ...ure to keep accurate books and records ...or otherwise to comply with the provisions of t... ...plying to the conduct of business as a broker-dealer, ...uld violate the Federal securities laws and the laws of the jurisdictions and may result in disciplinary, administrative, injunctive or criminal action. INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed execution page. No Schedule required by any item on this page need be filed with an amended item unless the Schedule itself is amended.

DO NOT WRITE BELOW THIS LINE ..... FOR OFFICIAL USE ONLY

FORM D Page 2

OFFICIAL USE

4. Applicant is a:

[X] Corporation [ ] Partnership [ ] Sole Proprietorship

[ ] Other (specify): _____

5. If applicant is a corporation:

(a) Date and place of incorporation:

Date: 10/13/75 (MONTH-DAY-YEAR) State: Florida

(b) List below each class of equity security:

Class	Voting	Non - Voting
Common Stock	[X]	[ ]
	[ ]	[ ]
	[ ]	[ ]

6. If applicant is a sole proprietor, state full residence address and social security number.

Social Security No.: N/A

(NUMBER AND STREET) (CITY) (STATE) (ZIP CODE)

7. (a) Is applicant a successor to a registered broker-dealer and taking over all or substantially all of the assets and liabilities and continuing the business of a registered broker-dealer? N/A YES [ ] NO [ ]

If "yes," state:

(1) Date of Succession: _____

(2) Full name, IRS Empl. Ident. No. and SEC File No. of predecessor:

Name: _____

IRS Empl. Ident. No.: _____

SEC File Number: _____

(b) Has applicant merged with or acquired another registered broker-dealer? YES [ ] NO [ ]

(If "yes," describe briefly on Schedule E.)

8. (a) If applicant is a corporation, complete Schedule A.

(b) If applicant is a partnership, complete Schedule B.

(c) If applicant is other than a sole proprietorship, partnership, or corporation, complete Schedule C.

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed executed copy of Schedule ... with the amended item ...

INTENTIONAL MISSTATEMEN... OR OMISSIONS OF FACTS MAY CONSTI... TE CRIMINAL VIOLATIONS.

FORM SD Page 3

OFFICIAL USE

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

		YES	NO
9. (a)	Does any person not named in Items 2(a) and 8, or any Schedule thereunder, directly or indirectly through agreement or otherwise, exercise or have the power to exercise a controlling influence over the management or policies of applicant? *(If "yes," state on Schedule E the exact name of each person (if individual, state last, first, and middle names) and describe the agreement or other basis through which such person exercises or has the power to exercise a controlling influence.)*	☐	☒
(b)	Is the business of applicant wholly or partially financed, directly or indirectly, by any person not named in Items 2(a) and 8, or any Schedule thereunder, in any manner other than by: (1) a public offering of securities made pursuant to the Securities Act of 1933; (2) credit extended in the ordinary course of business by suppliers, banks and others; or a satisfactory subordination agreement, as defined in Rule 15c3-1 under the Securities Exchange Act of 1934 (17 CFR 240. 15c3-1)? *(If "yes," state on Schedule E the exact name (last, first, middle) of each person and describe the agreement or arrangement through which such financing is made available, including the amount thereof.)*	☐	☒
10. (a)	State whether the applicant, any person named in Items 2(a), 8 or 9, or any Schedule thereunder, or any other person directly or indirectly controlling, controlled by, or under common control with applicant, including any employee:		
(i)	Has been found by the Securities and Exchange Commission or any jurisdiction willfully to have made or caused to be made any statement which was, at the time and in the light of the circumstances under which it was made, false and misleading with respect to any material fact, or to have omitted to state any material fact, which was required to be stated, in any application for registration or report required to be filed under the Federal securities laws or under the securities laws of any jurisdiction, or in any proceeding before the Securities and Exchange Commission or any jurisdiction relating to securities, the conduct of business or registration as a broker, dealer, municipal securities dealer, or investment adviser or associated person thereof	☐	☒
(ii)	Has been convicted within 10 years of any felony or misdemeanor (1) involving the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, or conspiracy to commit any such offense; (2) arising out of the conduct of the business of a broker, dealer, municipal securities dealer, investment adviser, bank, insurance company, or fiduciary; (3) involving the larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds or securities; or (4) involving the violation of Section 152, 1341, 1342 or 1343 or Chapter 25 or 47 of Title 18, United States Code (concealment of assets, false oaths and claims, or bribery, in any bankruptcy proceeding; mail fraud, fraud by wire, including telephone, telegraph, radio or television; counterfeiting, forgery; fraud, false statements); or has pleaded nolo contendere to any such felony or misdemeanor	☐	☒
(iii)	Is enjoined permanently, or within the past 10 years has been enjoined temporarily, by order, judgment or decree of any court of competent jurisdiction from acting as an investment adviser, underwriter, broker, dealer, or municipal securities dealer, or as an associated person or employee of any of the foregoing, or as an affiliated person or employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity, or in connection with the purchase or sale of any security, or arising out of any securities or investment advisory activities	☐	☒
(iv)	Has been found by the Securities and Exchange Commission or any jurisdiction or any court to have violated or to have aided, abetted, counselled, commanded, induced, or procured the violation by any other person of the Federal laws, or the laws of any jurisdiction, relating to securities or relating to the conduct of business as a broker, dealer, municipal securities dealer, investment adviser, or investment company, any rule or regulation under any of such laws, or any rule of the Municipal Securities Rulemaking Board, or to have failed reasonably to supervise another person who committed such a violation, or to have been unable to comply with any of the foregoing	☐	☒
(v)	Has been the subject of an order of the Securities and Exchange Commission entered pursuant to paragraph (C) of Section 15(b) or paragraph (4) of Section 15E(c) of the Securities Exchange Act of 1934, or an order of a court or jurisdiction (or any agency thereof), or an order of an appropriate regulatory agency entered pursuant to paragraph (5) of Section 15E(c) of the Securities Exchange Act of 1934, barring or suspending the right of such person to be associated with a broker, dealer, or municipal securities dealer	☐	☒

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FORM CD Page 4

OFFICI

10. (a)—Continued

		YES	NO
(vi)	Has been denied membership or registration with, or participation in, or has been suspended, revoked or expelled from membership, participation in or registration with any self-regulatory organization; or has been suspended or barred from being associated with any member of such self-regulatory organization	☐	☒
(vii)	Has been denied registration (license) with, or suspended, revoked or expelled from registration (license) with the Securities and Exchange Commission or any jurisdiction (or any agency thereof) as a broker, dealer, investment adviser, securities salesman, or municipal securities dealer, or has been barred from being associated with a person engaged in such business	☐	☒
(viii)	Has been found to have been a cause of (1) the denial, suspension, or revocation of any person's membership or participation in, or registration with the Securities and Exchange Commission, any jurisdiction (or any agency thereof), or any self-regulatory organization, (2) any bar or suspension of any person from being associated with a broker, dealer, municipal securities dealer, or member of a self-regulatory organization or (3) any expulsion of any person from a self-regulatory organization	☐	☒
(ix)	Has associated with him any person who is known, or in the exercise of reasonable care should be known, to be a person described by Items 10(a) (v), (vi), (vii) or (viii)	☐	☒
(x)	Has willfully made or caused to be made any statement which was, at the time and in the light of the circumstances under which it was made, false and misleading with respect to any material fact, or has omitted to state any material fact, which was required to be stated, in any application for membership or participation in, or to become associated with a member of, a self-regulatory organization, in any report required to be filed with a self-regulatory organization, or in any proceeding before a self-regulatory organization	☐	☒
(xi)	Has been, within the past 10 years, the subject of any cease and desist, desist and refrain, prohibition, or similar order which was issued by the United States or any jurisdiction arising out of the conduct of the business of a broker, dealer, municipal securities dealer, or investment adviser	☐	☒
(xii)	Has been associated at any time as an officer, director, general partner, or owner of 10 percentum or more of the voting securities, or has at any time directly or indirectly through agreement or otherwise exercised or had the power to exercise a controlling influence over the management or policies of, a broker, dealer, or municipal securities dealer which has been adjudicated bankrupt, or for which a trustee has been appointed pursuant to the Securities Investor Protection Act of 1970	☐	☒
(xiii)	Has been the subject of any order, judgment, decree or other sanction of a foreign court, foreign exchange, or foreign governmental or regulatory agency arising out of any securities or investment advisory activities	☐	☒

(b) For purposes of part (b), the terms the "Act," the "CEA," the "Secretary," the "CEC" and the "CFTC" mean, respectively, the Commodity Exchange Act, as amended, the Commodity Exchange Authority, the Secretary of Agriculture, the Commodity Exchange Commission and the Commodity Futures Trading Commission, and the terms "contract of sale," "commodity," "future delivery," "contract market," "futures commission merchant," "floor broker," "commodity trading adviser," "commodity pool operator" and "national futures association" have the meanings provided in the Act. State whether applicant, any person named in Items 2(a), 8 or 9, or any Schedule thereunder, or any person, directly or indirectly controlling, controlled by, or under common control with applicant, including any employee:

		YES	NO
(i)	Has been found by the Secretary, the CEA, the CEC, the CFTC, or any jurisdiction to have made or caused to be made any statement which was, at the time and in the light of the circumstances under which it was made, false and misleading with respect to any material fact, or to have omitted to state any material fact, which was required to be stated, in any application for registration or report required to be filed with the CEA, the Secretary, the CEC, the CFTC, or any jurisdiction under the Act or under the commodities laws of any jurisdiction or in any proceeding before the CEA, the Secretary, the CEC, the CFTC, or any jurisdiction	☐	☒
(ii)	Has been convicted within 10 years of any felony or misdemeanor (1) involving the purchase or sale of contracts of sale of a commodity for future delivery; (2) arising out of the conduct of the business of a futures commission merchant, floor broker, commodity trading adviser, commodity pool operator, member of a contract market, or member of a national futures association; (3) involving the larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds or contracts of sale of a commodity for future delivery; or has pleaded nolo contendere to any such felony or misdemeanor	☐	☒

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INTENTIONAL MISSTATEM 'S OR OMISSIONS OF FACTS MAY CONS UTE CRIMINAL VIOLATIONS.

Schedule D of FORM BD

(Answers in response to ITEM 12 of FORM BD.)

NOTE: (a) Complete a separate Schedule D for each natural person named in Items 2(a), 8 or 9, or any Schedule thereunder, except that Schedule D need not be furnished for any person who meets both of the following conditions: (1) he owns less than 10% of any class of equity security of applicant and (2) he is not an officer, director, or person with similar status or functions.
(b) Complete a separate Schedule D for each person subject to any action reported under Item 10.
(c) State all names in the order of last name, first name, full middle name. If any person legally has only an initial, so indicate after the initial.

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Date as stated on the execution page of FORM BD accompanying this Schedule: 10/14/75

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

I. Full name of applicant exactly as stated in Item 2(a) of Form BD: E.S.M. SECURITIES, INC.

IRS Empl. Ident. No.: Applied for

II. Full name of person for whom this Schedule is being completed: RONNIE RESTINE EWTON

IRS Empl. Ident. No. or Soc. Sec. No.: 400-62-1973

III. (a) Residence address of person: (Number and Street, City, State, ZIP Code)
7421 S. W. 14th Street, Ft. Lauderdale, Florida 33317

(b) Date of Birth:	(c) City of Birth:	(d) State or Province:	(e) Country:
5/23/42	Nashville	Tennessee	U.S.A.

IV. NAMES USED: Furnish below a list of all names individual has been known by or has used including maiden name if applicable. If no other names used, state "None."

Last	First	Middle
None		

V. EDUCATION: Furnish below a description of the education for the person named in Item II of this Schedule (include name and location of last high school attended, name and location of any college or university attended, degree received and year it was received.)

1959-62 Castle Heights Military Academy, Lebinon, Tenn.

1962-63 Tennessee Tech, Cookeville, Tenn.

1963-65 Georgetown College, Georgetown, Kentucky

VI. BUSINESS BACKGROUND: Furnish below a complete, consecutive statement of all business experience and employment for the past ten years. List the last position first. If none, state "None."

Name of Firm and Address	Kind of Business	Exact Nature of Connection or Employment	Beginning Date Mo.	Beginning Date Yr.	Ending Date Mo.	Ending Date Yr.
Winters and Company, One Financial Plaza, Ft. Lauderdale, Florida	Government Securities	Salesman	7	75	Present	
Bevill, Bresler & Schulman, One Financial Plaza, Ft. Lauderdale, Florida	Government Securities	Salesman	2	75	7	75
Kidder Peabody & Co., One Financial Plaza, Ft. Lauderdale, Florida	Government Securities	Salesman	11	74	2	75

Continued...

VII. PROCEEDINGS: If any answer to any paragraph of Item 10 is "Yes" with respect to the person for whom this Schedule is being completed, furnish the following details: N/A

Applicable Part and Question of Item 10	Title or Description of Action	Name and Location of Court, Agency, Jurisdiction or Self-Regulatory Organization	Nature and Date of and Disposition of Proceeding

D. C. OCT 15 1975

If any item on this page is amended, you must answer in full ...

SCHEDULE D (Ronnie Restine Ewton)

VI. BUSINESS BACKGROUND.....Continued

Name of Firm and Address	Kind of Business	Nature of Employment	Beginning Date	Ending Date
Hibbard, O'Conner & Weeks Oakland Park Boulevard Ft. Lauderdale, Florida	Municipal and Gov. Securities	Vice Pres. Branch Mgr.	9/74	11/74
Delta Securities, Inc. Worthem Bank Bldg. Little Rock, Arkansas	Municipal Sales	Salesman	4/67	6/69
M. Twain Life Ins. Co. Jefferson City, Missouri	Insurance	Salesman	2/66	4/67
New Empire Life Ins. Co. Sedalia, Missouri	Insurance	Salesman	10/65	2/66

APPENDIX 3.—THE SEC INVESTIGATION OF ESM GOVERNMENT SECURITIES, INC., 1977-1981

A. AMENDED SEC ORDER OF INVESTIGATION, DATED JANUARY 10, 1978

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION
January 10, 1978

In The Matter Of ESM GOVERNMENT SECURITIES, INC. A-918	AMENDED ORDER DIRECTING PRIVATE INVESTIGATION AND DESIGNATING OFFICERS TO TAKE TESTIMONY

The Commission having by order dated June 7, 1977, directed a private investigation in the Matter of ESM Government Securities and the Commission having duly considered the matter,

HEREBY ORDERS, that said order be amended by substituting for it the Amended Order as follows:

I

The Commission's public official files disclose that ESM Securities, Inc. is a broker-dealer, located in Ft. Lauderdale, Florida, registered with the Commission since December 24, 1975.

II

Members of the staff have reported information which tends to show that:

a) ESM Government Securities, Inc. ("ESM") is a broker-dealer, located in Ft. Lauderdale, Florida, dealing exclusively in government securities, and is a subsidiary of ESM Securities, Inc.

b) From about February, 1976, to the present, ESM, its officers, directors, and others have been and are offering to sell, selling and delivering after sale, certain securities, namely Government National Mortgage Association ("GNMA") securities, and other securities, issued or guaranteed by the United States.

c) While engaged in the offer and sale of such securities, such persons have used or employed a device, scheme or artifice to defraud, and have engaged in acts, practices or a course of business which operated as a fraud and deceit, and have made to purchasers and prospective purchasers untrue statements of material facts, and omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, concerning, among other things:

1. That transactions in such securities were authorized by purchasers thereof;

2. The safety and profitability of purchases of such securities;

3. The responsibility as to who must bear the losses incurred in connection with the transaction in such securities;

4. Markup and markdown policies, markups and/or commissions earned or charged in the purchase and sale of government securities; and

5. Other statements, representations, and omissions of similar purport or object.

d) While engaged in the offer, sale and delivery of such securities, such persons directly and indirectly, made use of the mails and means and instruments of transportation and communication in interstate commerce and the means and instrumentalities of interstate commerce.

III

The Commission, having considered the staff's report and deeming such acts and practices, if true, to be in possible violation of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder, finds it necessary and appropriate, and hereby:

ORDERS, pursuant to the provisions of Section 20(a) of the Securities Act of 1933, and Section 21(a) of the Securities Exchange Act of 1934, that a private investigation be made to determine whether the aforesaid persons, or any other persons, have engaged or are about to engage in any of the reported acts or practices, or any acts or practices of similar purport or object; and

IT IS FURTHER ORDERED, pursuant to the provisions of Section 19(b) of the Securities Act of 1933, and Section 21(b) of the Securities Exchange Act of 1934, that for the purpose of such investigation, William Nortman, Charles C. Harper, Richard J. Blumberg, Leonard H. Bloom, Marina Shank, Joseph Karten, Charles D. Hoenmuth, Kenneth J. Daras, Floyd E. Young, Nicholas Anastopoulos, Daniel Kirshbaum, John Olsen, Doran E. Bradberry Jr., Gordon R. Cox, Sammy L. Hughes and Benjamin F. Simms and each of them is hereby designated as officer of this Commission and empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence and require the production of any books, papers, correspondence, memoranda or other records deemed relevant and material to the inquiry, and to perform all other duties in connection therewith as prescribed by law.

By the Commission.

George A. Fitzsimmons
Secretary

B. TEXT OF SEC v. ESM GOVERNMENT SECURITIES, INC., (U.S. FIFTH CIRCUIT COURT OF APPEALS), DATED MAY 18, 1981

have in this case, and our examination reveals that Congress has done nothing to indicate that that reliance is misplaced. Finally, and most importantly, by retaining some room for the FTCA in the maritime context, we give effect to policy considerations Congress specifically addressed in considering the Government's exposure as tortfeasor, considerations such as *De Bardeleben* and, in another context, the lower court in *United Continental Tuna* were at pains to avoid. It need hardly be added that a comprehensive treatment of the Government's role as tortfeasor was not the point of the SAA, although that was a large part of the problem of Government shipping in the commercial maritime setting; instead, Congress was concerned with the Government's role as a member of the shipping industry. We restore that understanding.

REVERSED and REMANDED for proceedings consistent with this opinion.

In the Matter of an Application to Enforce Administrative Subpoena Duces Tecum of the SECURITIES AND EXCHANGE COMMISSION, Plaintiff-Appellee,

v.

ESM GOVERNMENT SECURITIES, INC., Defendant-Appellant.

No. 79-2968.

United States Court of Appeals, Fifth Circuit. Unit B

May 18, 1981.

The Securities and Exchange Commission applied for enforcement of administrative subpoena duces tecum against broker/dealer of government securities, and broker/dealer responded that the application should be denied because of alleged fraud and deceit by the SEC. The United States District Court for the Southern District of Florida, Norman C. Roettger, Jr., J., ordered that the subpoena be enforced, and broker/dealer appealed. The Court of Appeals, Vance, Circuit Judge, held that remand was required for district court to make findings on whether the SEC intentionally or knowingly misled broker/dealer about purposes of its review of broker/dealer's files, whether broker/dealer was in fact misled, and whether the subpoena was result of the SEC's allegedly improper access to the records; if broker/dealer would establish that answers to all three questions were affirmative, then enforcement of the subpoena would be an abuse of process and would be denied.

Reversed and remanded.

1. Grand Jury ⇐36.9(1)

Denial of motion to quash grand jury subpoena cannot be appealed.

2. Securities Regulation ⇐82

The two functions of the Securities and Exchange Commission are investigation of possible illegal activities and adjudication of alleged violations.

3. Administrative Law and Procedure ⇐441

It is clearly improper for a government agent to gain access to records which would otherwise be unavailable to him by invoking private individual's trust in his government, only to betray that trust, and when that government agency then invokes power of a court to gather fruits of its deception, there is an abuse of process.

4. Administrative Law and Procedure ⇐464

Fraud, deceit or trickery is grounds for denying enforcement of an administrative subpoena.

5. Securities Regulation ⇐86

In action brought by the Securities and Exchange Commission to enforce administrative subpoena duces tecum against broker/dealer of government securities in

which the broker/dealer alleged fraud and deceit by the SEC, remand was required for district court to make findings on whether the SEC intentionally or knowingly misled broker/dealer about purposes of its review of broker/dealer's files, whether broker/dealer was in fact misled, and whether the subpoena was result of the SEC's allegedly improper access to the records; if broker/dealer would establish that answers to all three questions were affirmative, then enforcement of the subpoena would be an abuse of process and would be denied.

Arky, Freed, Stearns, Watson & Greer, Bruce W. Greer, Gerald B. Cope, Jr., Miami, Fla., for defendant-appellant.

David A. Sirignano, Rosalind C. Cohen, Jacob H. Stillman, Frederick B. Wade, Securities & Exchange Comm., Washington, D. C., for plaintiff-appellee.

Appeal from the United States District Court for the Southern District of Florida.

Before TUTTLE, VANCE and POLITZ, Circuit Judges.

VANCE, Circuit Judge:

The Securities and Exchange Commission (SEC) applied to the district court below to enforce an administrative subpoena duces tecum against ESM Government Securities, Inc. (ESM). ESM responded that the application should be denied because of alleged fraud and deceit by the SEC.[1] The court ordered that the subpoena be enforced, and ESM appeals.

I.

The court below made no findings of fact. After hearing the opening statements of the attorneys, it held that even were all of ESM's allegations correct, there would still be no grounds to deny enforcement of the subpoena. For purposes of review, therefore, we shall accept the allegations made by ESM in its statements below as correct. We note, however, that several of the allegations are denied by the SEC.

ESM is a wholly owned subsidiary of ESM Group, Inc. It is a broker-dealer engaged exclusively in the sale of government securities. It shares a suite of offices with another wholly owned subsidiary of ESM Group, Inc., ESM Securities, Inc., a broker-dealer in other types of securities. For present purposes the important distinction between the two is the different nature of SEC supervision. Government securities are exempt from many provisions of the securities laws. *See* 15 U.S.C. §§ 77c(a)(2), 78c(a)(12). Thus while ESM Securities, Inc. is open to routine inspection by the SEC, ESM is not.

In March or April of 1977 an investigator for the SEC, Floyd Young, came to the ESM offices. He explained that he was in the building investigating another government securities firm. He added that, in addition to doing a routine audit of ESM Securities, Inc., he would like ESM to provide him with a basic education in the government securities market. Since the SEC does not routinely supervise broker-dealers in government securities, ESM found Young's request plausible. They therefore provided him with a tour of their operations, explaining all their procedures. At the end of the day, Young left, saying that he would be back for further study.

In June the SEC ordered an investigation of ESM. At Young's suggestion no subpoena was issued. Indeed, ESM was not notified that any investigation had been ordered. Instead, in November Young returned to the ESM offices with a new staff attorney. He asked that ESM repeat for them the tour it had provided earlier and that he be permitted to continue his education in government securities. ESM agreed to this. ESM ran the SEC investigators through the tour, and then ESM provided them with documents they wished to review. The SEC attorneys returned two

1. ESM also challenged enforcement of the subpoena on the grounds that it exceeded the scope of investigation authorized by the SEC order. The court rejected this argument, and it has not been appealed. We therefore treat it as abandoned.

more days for further "education." At the end of the third day, ESM finally grew suspicious when the SEC investigators asked for copies of commission schedules. At that point the SEC investigators disclosed the formal order of investigation. ESM immediately asked them to leave, which they did. On the basis of the information they had gathered during their stay at ESM, the SEC investigators issued a subpoena. When ESM refused to comply with the subpoena, the SEC applied to the district court for enforcement. *See* 15 U.S.C. §§ 77v(b), 78u(c).

II.

The question before us is whether this set of facts would be grounds for denying enforcement of an administrative subpoena. The SEC claims that this case is controlled by *United States v. Calandra*, 414 U.S. 338, 94 S.Ct. 613, 38 L.Ed.2d 561 (1974). *Calandra* dealt with grand jury testimony. Based on a warrant, federal agents searched Calandra's place of business and seized certain books and records. A grand jury was then convened, which subpoenaed Calandra to question him regarding the seized materials. The district court found that the warrant had been issued without probable cause and that the search had exceeded the scope of the warrant. It therefore ordered that Calandra need not answer the grand jury questions based on the suppressed evidence. The Supreme Court reversed, holding that the fourth amendment exclusionary rule does not apply to grand jury testimony.

[1] The SEC argues that the same principle should apply to administrative subpoenas. It is true that administrative subpoenas are in some respects analogous to grand jury investigations. *See United States v. Davis*, 636 F.2d 1028, 1037 (5th Cir. 1981). However, the Supreme Court has carefully refrained from suggesting that administrative investigations are identical in all respects to legislative or judicial investigations. *See Hannah v. Larche*, 363 U.S. 420, 449, 80 S.Ct. 1502, 1518, 4 L.Ed.2d 1307 (1960). Indeed, were this a grand jury subpoena, the case would not be before us, since denial of a motion to quash a grand jury subpoena cannot be appealed. *Compare United States v. Ryan*, 402 U.S. 530, 532, 91 S.Ct. 1580, 1581, 29 L.Ed.2d 85 (1971) (no appeal from grand jury subpoena) *with Reisman v. Caplin*, 375 U.S. 440, 449, 84 S.Ct. 508, 513, 11 L.Ed.2d 459 (1964) (administrative subpoena can be appealed). The holding of *Calandra* is thus not dispositive of the present case and we must consider whether its reasoning applies to the facts before us.[2]

We are not persuaded that *Calandra* is applicable here. The Court gave two reasons for its holding regarding grand juries. First, it emphasized the historic role of the grand jury in Anglo-American jurisprudence. In particular it noted that the grand jury is not merely an instrument of investigation, but also "essential to basic liberties." 414 U.S. at 343, 94 S.Ct. at 617.

> The grand jury's historic functions ... include ... the protection of citizens against unfounded criminal prosecutions.

Id. at 343, 94 S.Ct. at 617.

Second, the Court doubted that extending the exclusionary rule to grand juries would deter police misconduct.

> The incentive to disregard the requirement of the Fourth Amendment solely to obtain an indictment from a grand jury is substantially negated by the inadmissibility of the illegally seized evidence in a subsequent criminal prosecution of the search victim.

Id. at 351, 94 S.Ct. at 621.

[2] Neither of these two arguments fully applies to an SEC subpoena. Although the SEC has a dual function, it is not an

2. In *United States v. Davis*, 636 F.2d 1028, 1035 n.4 (5th Cir. 1981), another panel of this court suggested that *Calandra* might be applicable to an administrative summons. Since Davis did not show that the summons at issue derived from the illegal search and since it was doubtful that Davis had standing to raise the question, the court did not rule on the merits. Even were the language in *Davis* more definite than it is, we would not be bound by its unsupported dictum. *See United States v. Becton*, 632 F.2d 1294, 1296 n.3 (5th Cir. 1980).

historic guardian of individual liberties. Instead, its two functions are investigation of possible illegal activities, and adjudication of alleged violations. *Hannah v. Larche*, 363 U.S. at 446–47, 80 S.Ct. at 1516–1517. The SEC is not, like the grand jury, a protector of individuals against government prosecution. Nor is the deterrent effect of an exclusionary rule so clearly minimal when applied to the SEC. In the first place it is the SEC itself which commits the violations to which the rule would be applied. There is no division of functions comparable to that between police and the grand jury. In the second place the SEC does not rely on criminal prosecutions as its exclusive tool of enforcement. Persuasion, disclosure and rule-making are all weapons in its armory which are unaffected by exclusion of evidence in judicial proceedings. Hence, the sanction relied upon by the Court in *Calandra* is considerably less effective in this context.

We do not deduce from this line of reasoning that the exclusionary rule necessarily should or should not apply to SEC subpoenas. All we conclude at this point is that the question is not foreclosed by *Calandra*. We must, therefore, examine the law which has developed regarding administrative investigations and subpoenas.

III.

We begin our inquiry with *Reisman v. Caplin*, 375 U.S. 440, 84 S.Ct. 508, 11 L.Ed.2d 459 (1964). In *Reisman* the recipient of an IRS summons sought injunctive relief from a district court. The Supreme Court held that such relief was inappropriate, since the IRS could only enforce the summons by an action in court. At that time, the Court said, "the witness may challenge the summons on any appropriate ground." *Id.* at 449, 84 S.Ct. at 513. The Court elaborated in *United States v. Powell*, 379 U.S. 48, 85 S.Ct. 248, 13 L.Ed.2d 112 (1964). There the Court held that the IRS did not need to show probable cause to obtain enforcement of its summons. After discussing the showing required of the IRS, the Court stated that such a showing could nevertheless be attacked upon a showing of abuse of process.[3] The Court declared: "It is the court's process which is invoked to enforce the administrative summons and a court may not permit its process to be abused." *Id.* at 58, 85 S.Ct. at 255.

The Supreme Court has never provided a complete list of the "appropriate ground[s]" referred to in *Reisman*. The Court has made clear that the fifth amendment privi-

3. *Reisman v. Caplin*, 375 U.S. 440, 84 S.Ct. 508, 11 L.Ed.2d 459 (1964); *United States v. Powell*, 379 U.S. 48, 85 S.Ct. 248, 13 L.Ed.2d 112 (1964), and *United States v. LaSalle National Bank*, 437 U.S. 298, 98 S.Ct. 2357, 57 L.Ed.2d 221 (1978), all involved enforcement of an IRS summons, 26 U.S.C. §§ 7402(b) and 7604(a). It is generally agreed, however, that the principles of these cases apply to SEC subpoenas as well. *See SEC v. Wheeling-Pittsburgh Steel Corp.*, [1981] Fed.Sec.L.Rep. (CCH) ¶ 97,833 at n.5 (3d Cir. Jan. 21, 1981) (en banc); *SEC v. Arthur Young & Co.*, 584 F.2d 1018, 1024 n.39 (D.C.Cir.1978), *cert. denied*, 439 U.S. 1071, 99 S.Ct. 841, 59 L.Ed.2d 37 (1979); *SEC v. Howatt*, 525 F.2d 226, 229 (1st Cir. 1975); *SEC v. Brigadoon Scotch Distributing Co.*, 480 F.2d 1047, 1056 (2d Cir. 1973), *cert. denied*, 415 U.S. 915, 94 S.Ct. 1410, 39 L.Ed.2d 469 (1974). Although this circuit has not reached this particular issue before, we have applied IRS cases to other administrative subpoenas. *See, e. g., Atlantic Richfield Co. v. FTC*, 546 F.2d 646, 648 (5th Cir. 1977).

In applying IRS cases to the issue before us, we do not suggest that every aspect of the law regarding an IRS summons controls an SEC subpoena. *See, e. g., SEC v. Dresser Industries, Inc.*, 628 F.2d 1368, 1379–80 (D.C.Cir.), *cert. denied*, — U.S. —, 101 S.Ct. 529, 66 L.Ed.2d 289 (1980); *SEC v. Blackfoot Bituminous, Inc.*, 622 F.2d 512, 515 (10th Cir.), *cert. denied*, — U.S. —, 101 S.Ct. 362, 66 L.Ed.2d 220 (1980). These possible statutory differences are not relevant to the issues we are treating.

We note that there are numerous statutes requiring administrative agencies to turn to the courts for enforcement of their subpoenas, some statutes tracking the language of the securities laws, 15 U.S.C. §§ 77v(b), 78u(c). *See, e. g.*, 7 U.S.C. § 2717 (egg research); 12 U.S.C. § 1784(c) (Federal Credit Union Act); 16 U.S.C. § 470ff(c) (archeological resources protection); 16 U.S.C. § 1100b–5(e) (offshore shrimp fisheries). *See generally Gelbard v. United States*, 408 U.S. 41, 80–81, 92 S.Ct. 2357, 2377, 33 L.Ed.2d 179 (1972) (Rehnquist, J., dissenting) (discussing court enforcement of administrative subpoenas and citing statutes).

lege against self-incrimination is an appropriate ground. *See Couch v. United States*, 409 U.S. 322, 93 S.Ct. 611, 34 L.Ed.2d 548 (1973); *Boyd v. United States*, 116 U.S. 616, 6 S.Ct. 524, 29 L.Ed. 746 (1886). So is the attorney-client privilege. *Reisman*, 375 U.S. at 449, 84 S.Ct. at 518. Other courts, including this one, have added to the list. *See, e. g., United States v. Holmes*, 614 F.2d 985, 989 (5th Cir. 1980) (free exercise of religion); *United States v. Citizens State Bank*, 612 F.2d 1091, 1093–94 (8th Cir. 1980) (freedom of association). A fourth amendment claim has also been held to be an appropriate ground. *See United States v. Bank of Commerce*, 405 F.2d 931, 934–35 (3d Cir. 1969). *Cf. United States v. Euge*, 444 U.S. 707, 718, 100 S.Ct. 874, 881, 63 L.Ed.2d 141 (1980) (enforcing summons for handwriting on grounds, *inter alia*, that "[c]ompulsion of handwriting exemplars is [not] a search or seizure subject to Fourth Amendment protections . . . .").[4]

Nor has the Court provided a definitive analysis of "abuse of process." In *Powell*, the Court said: "Such an abuse would take place if the summons had been issued for an improper purpose, such as to harass the taxpayer or to put pressure on him to settle a collateral dispute, or for any other purpose reflecting on the good faith of the particular investigation." 379 U.S. at 58, 85 S.Ct. at 255. *United States v. LaSalle National Bank*, 437 U.S. 298, 98 S.Ct. 2357, 57 L.Ed.2d 221 (1978) indicates that the various statements concerning abuse of process in *Powell* were not meant to be exhaustive. "Future cases may well reveal the need to prevent other forms of agency abuse of congressional authority and judicial process." *Id.* at 318 n.20, 98 S.Ct. at 2368 n.20.[5] The third circuit sitting en banc recently rejected the argument that "abuse of process" has been rigidly defined. We endorse its conclusions.

> The implicit premise of the Commission's argument is that the judiciary's role is strictly confined by Supreme Court precedent and that, under these authorities, a court has little flexibility in confronting new situations. Although we agree that courts generally must defer to the agencies and that the scope of judicial inquiry is not expansive, we disagree with the Commission's premise that the Supreme Court has foreclosed incremental development of the law by the courts when we are faced with allegations of egregious abuses.
>
> . . . .
>
> . . . [B]ecause the Supreme Court has never confronted allegations like the ones before us does not mean that the federal judiciary is powerless to structure relief when necessary.

SEC v. Wheeling-Pittsburgh Steel Corp. [1981] Fed.Sec.L.Rep. (CCH) ¶ 97,833 (3d Cir. Jan. 21, 1981) (en banc). The court

4. Enforcement of a subpoena was also denied because of a fourth amendment violation in *Silverthorne Lumber Co. v. United States*, 251 U.S. 385, 40 S.Ct. 182, 64 L.Ed. 319 (1920). There government agents unlawfully seized and copied documents, returned them under court order, and then subpoenaed them from their original owner. The Court reversed a judgment of contempt of court against the owner, holding that the subpoena could not be enforced.

Silverthorne involved a grand jury subpoena. In *Oklahoma Press Publishing Co. v. Walling*, 327 U.S. 186, 206–07, 66 S.Ct. 494, 90 L.Ed. 614 (1946), the holding was incorporated into the law of administrative subpoenas as a case decided "by virtue of the presence of an actual illegal search and seizure, the effects of which the Government sought later to overcome by applying the more liberal doctrine devolved in relation to 'constructive search,'" i. e., subpoena. *Calandra* restricted the scope of *Silverthorne* as far as grand jury subpoenas are concerned. *Calandra*, 414 U.S. at 352 n.8, 94 S.Ct. at 622 n.8. *Silverthorne's* continued vitality in administrative law is still an open question. Since our holding in this case is based on abuse of process, we do not need to reach that issue, but clearly to the extent that *Silverthorne* is viable it supports the result we reach on other grounds.

5. Earlier the Court noted: "The *Powell* elements were not intended as an exclusive statement about the meaning of good faith. They were examples of agency action not in good-faith pursuit of the congressionally authorized purposes of [26 U.S.C.] § 7602. The dispositive question in each case, then, is whether the Service is pursuing the authorized purposes in good faith." *LaSalle*, 437 U.S. at 317 n.19, 98 S.Ct. at 2368 n.19.

continued: "'We conclude that from the very fact that enforcement of a ... summons is ... entrusted to the judiciary, this court has the power to fashion appropriate rules as to the fairness of the enforcement order.'" *Id.* quoting *United States v. Friedman*, 532 F.2d 928 (3d Cir. 1976).

We therefore turn to the question of whether the alleged conduct before us entails an abuse of process.

IV.

We are guided in our analysis by two prior opinions in this circuit, *United States v. Tweel*, 550 F.2d 297 (5th Cir. 1977), and *Stuart v. United States*, 416 F.2d 459 (5th Cir. 1969). In *Tweel* an IRS agent asked to review Tweel's records as part of an audit of his tax returns. Tweel's accountant, concerned that this might be a criminal inquiry, asked whether a "special agent," the type normally involved in criminal investigations, was participating in the audit. The agent said no special agent was involved. Although factually correct, this response was misleading, since a criminal investigation was in fact underway. Based on the evidence acquired in the audit, Tweel was convicted of tax evasion.

We reversed the conviction. We recognized that the IRS agent had no affirmative duty to warn the taxpayer that the investigation might result in criminal charges.[6] We held, however, that the agent could not intentionally mislead the taxpayer.

> From the facts we find that the agent's failure to apprise the appellant of the obvious criminal nature of this investigation was a sneaky deliberate deception by the agent under the above standard and a flagrant disregard for appellant's rights. The silent misrepresentation was both intentionally misleading and material.
>
> ....
>
> We cannot condone this shocking conduct by the IRS. Our revenue system is based upon the good faith of the taxpayers and the taxpayers should be able to expect the same from the government in its enforcement and collection activities.

Tweel, 550 F.2d at 299–300 (footnote omitted).

Stuart involved an IRS summons. An IRS agent was assigned to conduct a civil investigation of Stuart's tax returns. Stuart kept her records in her own custody at a place inconvenient to the IRS agent. To accommodate the agent, Stuart transferred the records to the office of her accountant, where the agent examined them at length. When indications of fraud were discovered, the IRS assigned a special agent and issued a summons to the accountant for the records.

We held that the summons could not be enforced. All parties agreed that had the papers been in Stuart's custody, she could have refused production on grounds of self-incrimination. Alternatively, once Stuart had yielded custody of the records to a third party, even her accountant, she would have waived her privilege. We held that the transfer of the records to the accountant for the convenience of the IRS agent was not a waiver of privilege.

> It should make no difference in this result that custody was changed in order to benefit the Government's employee (Agent Vaughn) and to facilitate her work. The Government should not gain an advantage because the taxpayers, acting reasonably as human beings and citizens, did it a favor and failed to insist that Mrs. Vaughn perform her inspection in uncomfortable circumstances and at

6. *Tweel* relied on principles stated in *United States v. Prudden*, 424 F.2d 1021 (5th Cir.), *cert. denied*, 400 U.S. 831, 91 S.Ct. 62, 27 L.Ed.2d 62 (1970) and *United States v. Tonahill*, 430 F.2d 1042 (5th Cir.), *cert. denied*, 400 U.S. 943, 91 S.Ct. 242, 27 L.Ed.2d 247 (1970). "*Prudden* and *Tonahill* hold that evidence received from the taxpayer after the criminal investigation commenced is admissible, even though no notice or *Miranda* warnings were given.... These cases recognize that evidence obtained for criminal use by deceit, fraud and misrepresentation might be suppressed, but held that failure to advise the taxpayer that a criminal investigation was being made did not amount to such conduct." *United States v. Ponder*, 444 F.2d 816, 819 (5th Cir. 1971), *cert. denied*, 405 U.S. 918, 92 S.Ct. 944, 30 L.Ed.2d 788 (1972).

off-hours. To penalize appellants for their good-will would not only be unjust; it would hurt the Government in the long-run by encouraging taxpayers to keep close personal custody of their records no matter what the burden on the inspecting revenue agent.

Stuart, 416 F.2d at 468 (footnote omitted).

The key to both these cases, we believe, is the nature of the relationship between the government agent and the private citizen. We recognise that much law enforcement activity relies on the use of sanctions by the government. The police officer, the undercover agent, the FBI investigator, all threaten the potential miscreant with discovery and penalties. Thus people obey the law from fear of punishment. Many governments, indeed, depend exclusively on fear for their authority.

In this country, while we have recognized the importance of sanctions, we have never been willing to rely on them exclusively. Inherent in our democracy is a belief that, since the government represents the will of the people, the people will accept its dictates voluntarily. There is a sense of trust between the government and the people. It was the abuse of this trust which we could not accept in *Twoel* and *Stuart*.[7]

[3] We believe that a private person has the right to expect that the government, when acting in its own name, will behave honorably. When a government agent presents himself to a private individual, and seeks that individual's cooperation based on his status as a government agent, the individual should be able to rely on the agent's representations. We think it clearly improper for a government agent to gain access to records which would otherwise be unavailable to him by invoking the private individual's trust in his government, only to betray that trust. When that government agency then invokes the power of a court to gather the fruits of its deception, we hold that there is an abuse of process.

Will this court by sustaining the judgment below sanction such conduct on the part of the Executive? The governing principle has long been settled. It is that a court will not redress a wrong when he who invokes its aid has unclean hands.... Where the Government is the actor, the reasons for applying it are even more persuasive.

... The court's aid is denied only when he who seeks it has violated the law in connection with the very transaction as to which he seeks legal redress. Then aid is denied despite the defendant's wrong. It is denied in order to maintain respect for law; in order to promote confidence in the administration of justice; in order to preserve the judicial process from contamination. The rule is one, not of action, but of inaction.... [T]he objection that the plaintiff comes with unclean hands will be taken by the court itself. It will be taken despite the wish to the contrary of all the parties to the litigation. The court protects itself.

Decency, security, and liberty alike demand that government officials shall be subjected to the same rules of conduct that are commands to the citizen. In a government of laws, existence of the government will be imperiled if it fails to observe the law scrupulously. Our Government is the potent, the omnipres-

7. Compare the situation in *Northside Realty Associates, Inc. v. United States*, 605 F.2d 1348 (5th Cir. 1979). There evidence of fair housing violations was obtained by testers who posed as prospective home buyers to check for compliance with the law. In rejecting a claim of fourth amendment violations, we noted that "[t]he testers did no more than what any member of the home-buying public is invited, and indeed welcomed, to do.... The testers did not enter into any restricted areas of the office, such as an employees' lounge. Nor did they examine or take any confidential or private papers. In other words, the testers behaved exactly as a prospective home buyer visiting a real estate office would be expected to behave. To the extent that Northside has held itself open to the public for just the sorts of visits that transpired here, Northside cannot complain that a privacy interest has been thwarted or embarrassed." 605 F.2d at 1355 (footnotes omitted). By contrast, in *Twoel* and *Stuart*, as in the case at hand, the government agents were given access to records not available to the general public, just because they were government agents.

ent teacher. For good or for ill, it teaches the whole people by its example. Crime is contagious. If the Government becomes a lawbreaker, it breeds contempt for law; it invites every man to become a law unto himself; it invites anarchy. To declare that in the administration of the criminal law the end justifies the means—to declare that the Government may commit crimes in order to secure the conviction of a private criminal—would bring terrible retribution. Against that pernicious doctrine this Court should resolutely set its face.

Olmstead v. United States, 277 U.S. 438, 483–85, 48 S.Ct. 564, 574, 72 L.Ed. 944 (1928) (Brandeis, J., dissenting) (footnotes omitted).

V.

[4] In holding that fraud, deceit or trickery is grounds for denying enforcement of an administrative subpoena, we exercise the well-established power of the courts to prevent abuse of process. "[T]he equitable powers of the courts of the United States, sitting as courts of law, over their own process, to prevent abuse, oppression and injustice, are inherent, and as extensive and efficient as may be required by the necessity for their exercise...." *Gumble v. Pitkin*, 124 U.S. 131, 145–46, 8 S.Ct. 379, 384, 31 L.Ed. 374 (1888). The Supreme Court's directives in *Powell* and *LaSalle* leave no doubt that this power may be properly invoked in cases involving the enforcement of administrative subpoenas. We note that this power is associated with our supervisory power which is distinct from the fourth amendment exclusionary rule, although the goals may sometimes overlap. *See United States v. Payner*, 447 U.S. 727, 735 n.8, 100 S.Ct. 2439, 2446 n.8, 65 L.Ed.2d 468 (1980).[6] An agency subpoena must conform to certain fourth amendment requirements: "It is now well settled that, when an administrative agency subpoenas corporate books or records, the Fourth Amendment requires that the subpoena be sufficiently limited in scope, relevant in purpose, and specific in directive so that compliance will not be unreasonably burdensome." *See v. City of Seattle*, 387 U.S. 541, 544, 87 S.Ct. 1737, 1739, 18 L.Ed.2d 943 (1967). We do not hold, however, that any violation of the fourth amendment in the procurement of an administrative subpoena compels denial of its enforcement.

Consequently, the court should not invoke an automatic exclusionary rule. "The correct approach for determining whether to enforce a summons requires that court to evaluate the seriousness of the violation under all the circumstances, including the government's good faith and the degree of harm imposed by the unlawful conduct." *United States v. Bank of Moulton*, 614 F.2d 1063, 1066 (5th Cir. 1980). Each case must be examined on its facts.

[5] In the case at bar, we find three points to be crucial. First, did the SEC intentionally or knowingly mislead ESM about the purposes of its review of ESM's

6. The SEC calls our attention to *United States v. Bonnell*, 483 F.Supp. 1070 (D.Minn.1979), *stayed pending appeal*, 483 F.Supp. 1091 (D.Minn.1979), for the proposition that the exclusionary rule should never apply to administrative subpoenas. The court in *Bonnell*, however, never considers the abuse of process requirement announced in *Powell* and *LaSalle*. Even assuming the SEC's interpretation of *Bonnell* is correct, we are therefore unpersuaded by its analysis.

The SEC also relies on the comment in *United States v. Janis*, 428 U.S. 433, 447, 96 S.Ct. 3021, 3028, 49 L.Ed.2d 1046 (1976), that "the Court never has applied [the exclusionary rule] to exclude evidence from a civil proceeding, federal or state." However, the Court goes on to point out that other federal courts have applied the rule to civil proceedings, and distinguishes those cases since "the officer committing the unconstitutional search or seizure was an agent of the sovereign that sought to use the evidence...." as opposed to the facts in *Janis*. *Id.* at 455, 96 S.Ct. at 3032. This case fits the pattern of the cases the Court distinguished, not of *Janis*. In *Richey v. Smith*, 515 F.2d 1239, 1245 (5th Cir. 1979) we approved the remedy applied in *Lord v. Kelley*, 223 F.Supp. 684, 690–91 (D.Mass.1963), *appeal dismissed*, 334 F.2d 742 (1st Cir. 1964), *cert. denied*, 379 U.S. 961, 85 S.Ct. 650, 13 L.Ed.2d 556 (1965), which enjoined use by the IRS of improperly seized material in "any proceeding, criminal, civil, or administrative." *Id.* at 691.

files? Second, was ESM in fact misled?[9] *See United States v. Bland*, 458 F.2d 1, 8 (5th Cir.), *cert. denied*, 409 U.S. 843, 93 S.Ct. 43, 34 L.Ed.2d 83 (1972). Third, is the subpoena the result of the SEC's allegedly improper access to ESM's records? For each item being subpoenaed, if ESM establishes that the answer to all of these questions is affirmative, then enforcement of the subpoena would be an abuse of process and must be denied. Otherwise, the subpoena should be enforced. On remand the district court should make findings on these points[10] and thereafter enter its order in conformity with this opinion.

REVERSED and REMANDED.

KEY NUMBER SYSTEM

UNITED STATES of America, Appellant,

v.

Raymond Wayne RAMOS, Appellee.

No. 79-2647.

United States Court of Appeals, Fifth Circuit. Unit B

May 18, 1981.

Defendant moved to suppress evidence seized during pat-down search at airport. The United States District Court for the Southern District of Florida, 473 F.Supp. 1109, James Lawrence King, J., granted motion, and the Government appealed. The Court of Appeals, Politz, Circuit Judge, held that: (1) defendant remained at functional equivalent of border and customs inspectors had right to detain him for further questioning; (2) it was reasonably certain that cocaine found taped to defendant's leg and secured by ace bandage had actually crossed border; and (3) pat-down search at border by customs inspector was justified.

Reversed and vacated.

1. Customs Duties ⇐126(7)

Where defendant was approached by customs officials in airport lobby within 30 minutes after leaving customs enclosure, had checked into airport hotel which was part of terminal complex but had not gone to his room, had not changed clothes since departure from customs enclosure and was carrying same briefcase, defendant remained at functional equivalent of border and customs inspectors had right to detain him for further questioning.

2. Customs Duties ⇐126(7)

Where defendant was approached by customs inspectors in airport lobby within 30 minutes after leaving customs enclosure,

9. The district court relied on *Prudden* to hold that the sophistication of ESM's personnel precluded any possibility of deception. The court was correct in recognizing that the sophistication of ESM's personnel might be relevant to a determination of whether or not they were in fact deceived. It went too far, though, in suggesting that mere sophistication, coupled with the length of the SEC's stay at ESM's offices, made deceit impossible. No degree of sophistication can guarantee that ESM would simply disbelieve a straightforward representation by a public official. Were the SEC to adopt the argument presented by the IRS in *Tweel*, to the effect that such deceptions were so common that no sophisticated person could be deceived, we would in return adopt *Tweel's* response.

During oral argument counsel for the government stated that these procedures were "routine". If that is the case we hope our message is clear. This sort of deception will not be tolerated and if this is the "routine" it should be corrected immediately. *Tweel*, 550 F.2d at 300 n.9. We note again, however, that the SEC denies that it engaged in any deception. We leave that factual dispute to the district court.

10. ESM also challenges the decision of the trial court not to grant discovery regarding certain items in Young's personnel file. The court reviewed this material in camera, and concluded that its only relevance was to affect slightly Young's credibility. Since the trial court's ruling on the main issue was not based on disputed facts, the court saw no point in releasing the material. Our holding necessitates a reconsideration of this matter by the trial court.

APPENDIX 4.—THE SEC INVESTIGATION OF AMERICAN BANCSHARES, INC., 1978–1981

A. LETTER FROM DANIEL L. GOELZER, GENERAL COUNSEL, SEC, TO HON. DOUG BARNARD, JR., DATED JUNE 12, 1985

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF THE
GENERAL COUNSEL

6-6

June 12, 1985

The Honorable Doug Barnard, Jr.
Chairman
House Subcommittee on Commerce,
Consumer, and Monetary Affairs
Rayburn House Office Building
Room B-377
Washington, D.C. 20515

Dear Mr. Chairman:

This responds to your request during hearings on April 3, 1985, that the Commission provide information concerning the Commission's investigation into transactions in the securities of American Bancshares, Inc. by Ronnie R. Ewton, Robert C. Seneca, Marvin L. Warner, and companies controlled by Mr. Warner. Pursuant to your request, I am enclosing a report on this matter.

Sincerely,

Daniel L. Goelzer

Daniel L. Goelzer
General Counsel

Enclosure

June 3, 1985

OFFICE OF THE GENERAL COUNSEL
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
REPORT ON THE INVESTIGATION CONCERNING TRANSACTIONS
IN THE SECURITIES OF AMERICAN BANCSHARES, INC.

On November 28, 1978, the Commission issued a formal order of investigation after the Office of the Comptroller of the Currency advised the Commission's staff that, in March 1977, Ronnie R. Ewton and Robert C. Seneca had purchased a significant amount of the stock of American Bancshares, Inc. ("ABI"), a bank holding company with its principal place of business in North Miami, Florida. A review of six Schedule 13D's and Schedule 13D amendments filed between 1977 and 1979 by Ewton, Seneca, Marvin L. Warner, and several companies controlled by Warner indicated that those individuals and companies did not disclose, among other things, that they constituted a "group," within the meaning of Section 13(d)(3) of the Securities Exchange Act of 1934, for the purpose of acquiring control of ABI. If they constituted a group at the time of the filings, the failure to disclose the existence of the group would violate Section 13(d) of the Securities Exchange Act and Rules 13d-1 and 13d-2 thereunder.

Pursuant to the formal order, the staff of the Miami Branch Office took the testimony of Ewton, Warner, and Stephen W. Arky, Warner's son-in-law and senior partner in a law firm that represented Warner and many of his financial interests. */

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*/ Seneca's testimony was not taken because his whereabouts were unknown.

Upon completing its investigation, the staff investigators determined not to recommend that the Commission take enforcement action. That determination was based on a number of factors. For example, while there was circumstantial evidence indicating that at the time of the May 6, 1977 filing there existed a group intending to acquire control of ABI, there was no direct evidence that such a group existed, and all of the witnesses who testified on this issue unequivocally denied the existence of a group. The staff believed that the circumstantial evidence was not strong enough to warrant enforcement action. In addition, while the investigation disclosed that one of the required documents was filed one and one-half months late, the staff believed enforcement action based on this technical violation was inappropriate, since it had occurred several years earlier and since there was no evidence indicating that either public investors or ABI shareholders had been harmed. Further, the staff noted that the subjects of the investigation intervened in the affairs of ABI when it was on the verge of economic collapse and had infused needed capital, thereby improving ABI's financial health.

B. SEC. INTERNAL MEMO, "TELEPHONE CONVERSATION WITH LOUIS FRANK, OCC, RE AMERICAN BANCSHARES", DATED JULY 13, 1978

Office Memorandum • SECURITIES AND EXCHANGE COMMISSION

DATE: July 13, 1978

TO : Files
Miami Branch Office

FROM :
Special Counsel

SUBJECT: Telephone conversation with Louis Frank, Comptroller of the Currency re American Bancshares

At 11:30 a.m. I placed a telephone call to Louis Frank ("Frank"), Supervisor, Office of the Comptroller of the Currency, Atlanta, Georgia. I advised Frank of my interest in the American Bancshares ("American") Combanks acquisition.

Frank advised that his office was "delighted" with the acquisition of American by Combanks since American was "floundering" and since Combanks put approximately 2.5 million into American in the following manner:

Capital Accounts American National Banks	$800,000
Capital Accounts American State Banks	$800,000
Working Capital American	$800,000

As part of the acquisition Combanks and American will have to enter into an agreement not to do business with ESM Government Securities ("ESM"). Frank stated that Combanks appears reluctant to enter into such an understanding. In this regard I advised Frank of our pending subpoena enforcement action against ESM. Frank said that ESM had apparently "gotten Egland Federal Credit Union into trouble" and that there had been "some discussions with the SEC in Washington about that.

I next discussed with Frank American's earnings of 1974, 1975, 1976 and particularly the loan loss reserves which our information indicates had been artifically inflated to reflect lower earnings to enable Combank to acquire American's shares at a lower price.

Frank said that we were "all wet" on that issue. Frank said that his office had been in a continuing fight to get the loan loss increased during this period, that the view of his office was that despite all the pressure they could bring, the loan loss was not high enough. Further any tack taken by our office that the loan loss was artificially inflated would be "180°" from the truth, in that Americans management always attempted to keep the loan loss reserve low.

Frank repeated his belief that Ewton and Seneca had acted as nominees to avoid the requirements of the Bank Holding Company Act and that although he was pleased with the result "the end did not justify the means". I advised Frank that I would get back with him if I needed any further information.

/mv

C. SEC ORDER OF INVESTIGATION, DATED NOVEMBER 28, 1978

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION
November 28, 1978

In The Matter Of

AMERICAN BANCSHARES, INCORPORATED,
COMBANKS CORPORATION,
MARVIN L. WARNER,
RONNIE R. EWTON, and
ROBERT C. SENECA

A-962

ORDER DIRECTING PRIVATE INVESTIGATION AND DESIGNATING OFFICERS TO TAKE TESTIMONY

I

The Commission's public file discloses that:

A. American Bancshares, Incorporated ("ABI") is a Florida corporation headquartered in North Miami, Florida. The common stock of ABI is registered with the Commission pursuant to Section 12 of the Securities Exchange Act of 1934 ("Securities Exchange Act"). ABI files periodic and other reports with the Commission pursuant to Section 13 of the Securities Exchange Act. ABI is also a bank holding company registered under the Bank Holding Company Act of 1956.

B. ComBanks Corporation ("ComBanks") is a Florida corporation headquartered in Winter Park, Florida. The common stock of ComBanks is registered with the Commission pursuant to Section 12 of the Securities Exchange Act. ComBanks files periodic and other reports with the Commission pursuant to Section 13 of the Securities Exchange Act. ComBanks is also a bank holding company registered under the Bank Holding Company Act of 1956.

Effective March 30, 1977, ComBanks registered with the Commission $25,000,000 in subordinated debentures pursuant to the Securities Act of 1933.

C. Marvin L. Warner ("Warner") is a controlling stockholder of ComBanks and may be deemed to be its parent within the meaning of the Securities Exchange Act.

D. Ronnie R. Ewton ("Ewton") is the Secretary and Chairman of the Board of Directors of E.S.M. Securities, Inc. ("ESM") a registered broker-dealer. Ewton is also a director of ABI.

E. Robert C. Seneca ("Seneca") is the President of ESM. Seneca is also a director of ABI.

F. During the period from on or about February 15, 1977 to the present ABI, ComBanks, Ewton and Seneca have filed certain reports concerning the acquisition of securities of ABI on Schedule 13 D's.

II

Members of the staff have reported information to the Commission which tends to show that:

A. Combanks, Warner, Ewton and Seneca have failed to file with the Commission reports required by Section 13(d) of the Securities Exchange Act and Rule 13d-1 thereunder, and have filed reports pursuant to that Section and Rule which contain misleading facts and omit material facts concerning the formation of a group for the ultimate purpose of acquiring control of ABI, and

B. ABI has filed periodic reports with the Commission pursuant to Section 13(a) of the Securities Exchange Act and Rules 13a-1 and 13a-13 thereunder, which contain false and misleading facts and omit material facts concerning, among other things:

1. the financial condition of ABI;

2. the book value of ABI's loans receivable; and

3. the nature and extent of loan transactions between ABI and its "affiliates".

III

The Commission, having considered the staff's report and deeming such acts and practices, if true, to be in possible violation of Section 10(b), 13(a) and 13(d) of the Securities Exchange Act of 1934 and Rules 10b-5, 13a-1, 13a-13 and 13d-1 thereunder, finds it necessary and appropriate, and hereby

ORDERS pursuant to the provisions of Section 21(a) of the Securities Exchange Act of 1934, that a private investigation be made to determine whether the aforesaid persons or any other persons have engaged or are about to engage in any of the reported acts or practices or in any acts or practices of similar purport or object; and

IT IS FURTHER ORDERED, pursuant to the provisions of Section 21(b) of the Securities Exchange Act of 1934, that for the purposes of such investigation William Nortman, Charles C. Harper, Richard J. Blumberg, Leonard H. Bloom, Jack Stein, Marina Shank, Nicholas Anastopoulos, Remo Catalano, Kenneth J. Daras, Charles D. Hochmuth, John D. Mahoney, and each of them is hereby designated an officer of this Commission and empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence and require the production of any books, papers, correspondence, memoranda, or other records deemed relevant and material to the inquiry, and to perform all other duties in connection therewith as prescribed by law.

By the Commission.

George A. Fitzsimmons
Secretary

APPENDIX 5.—THE SEC INVESTIGATION OF MARVIN WARNER'S PROXY FIGHT WITH CENTURY BANKS, INC., 1981-82

A. LETTER FROM STEVEN W. ARKY TO GARY LYNCH, ASSISTANT DIRECTOR OF ENFORCEMENT, SEC, DATED OCTOBER 12, 1981

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OF COUNSEL
ROGER M. BERNSTEIN
ALFREDO G. DURAN
WILLIAM L. PALLOT

October 12, 1981

Mr. Gary Lynch
Assistant Director
Division of Enforcement
Securities and Exchange Commission
Washington, D.C. 20549

Re: Century Banks Shareholders Committee

Dear Mr. Lynch:

This letter is in response to your letter of October 6, 1981.

On Thursday, October 1, 1981, we received telephone advice from your office that SEC Enforcement was considering a recommendation to the SEC that an injunctive action be brought against the Century Banks Shareholders Committee for what the staff regarded as potentially false and misleading proxy materials. We were asked to specifically discuss:

1. The representations relating to the Barnett "preliminary proposal;"

2. The exclusion of "goodwill" in the evaluation of the sale price of the four Century banks scheduled by Sun to be divested after the merger;

3. The intentions of Marvin L. Warner.

These are, of course, the three issues which Fried, Frank has been complaining about since the proxy contest commenced and we expressed to you our concern that these attorneys, on behalf of their clients, have totally misled you with misinformation on these issues. With respect to

each of these issues we advised you as follows:

1. The discussion in the Committee's proxy materials about the Barnett proposal for Century is, in our opinion, absolutely fair. In fact, most of the material consists of the testimony of Century's directors in sufficient detail so that no one could reasonably argue that the testimony was out of context. The statement on the front cover of the letter accompanying the proxy solicitation clearly states that the value of the Barnett proposal would depend upon a number of uncertainties, some of which are listed.

Contrast this presentation with Century's material, which among other things:

a) fails to point out that the "representative" of Barnett who approached Century was Guy Botts, Chairman of the Board;

b) fails to point out that the Barnett proposal was considered side by side with Sun's as the two offers to choose between at the May 13th directors meeting;

c) fails to point out that in the two week period prior to May 8, 1981, Sun's officers had been working on agreements with Century's management to save Century's management from Warner and that Sun's offer to help was "with no strings attached." (Was Century's management obligated to Sun?)

d) opines that the Barnett proposal was worth only $15.75 a share without stating the reasonable basis for that opinion and without stating that such an opinion could not be reached without knowing whether dividends would be cumulative or whether the preferred had a liquidation preference;

e) opines that the Sun offer has a "value" of $16, when, in fact, such an assumption is patently false.

f) fails to point out that no one even called back Guy Botts of Barnett to obtain Barnett's highest offer until after the Sun deal was signed.

2. The amount of "goodwill" booked at the holding company level and allocated to a unit bank is irrelevant to a determination of the value of the unit bank. To include goodwill in measuring the effective sale price of a bank as compared to book value (which Century has done) is totally misleading. By contrast, the amount of goodwill at the holding company level is properly considered in determining the sale price of the entire system.

In this case, three of the four Century banks being sold by Sun are being sold at approximately two times hard book value. The entire company is being sold to Sun for 1.12 times book value, including goodwill. If goodwill is excluded from the holding company the multiple increases to 1.47 times book. However, if the effect of the divestiture is calculated, Sun is paying an effective price of between 1.1 and 1.27 times hard book, excluding goodwill (the multiple depending upon the sale price of the Pinellas bank).

The sale price of Century assumes that the price will be $16 per share which it very well may not be. Even still, the effective price to be paid by Sun is so substantially below the sale price for comparable sales in Florida that full disclosure requires that Century acknowledge this material fact. They, of course, have not acknowledged or disclosed this fact.

3. The intentions of Marvin Warner have been fully disclosed.

We indicated to you our willingness to issue new proxy materials to resolve any problems which you might have.

On Friday, October 2, 1981, Mark Bryn delivered to you proposed new materials and we talked by telephone. You advised me that unless the Committee was willing to solicit new proxies and release all which had been previously obtained, the staff was going to recommend the filing of an injunctive action. We advised you that:

1. In our opinion your staff decision was absolutely incorrect and was the result of your being misled by our adversaries;

2. If an injunctive action was filed we were confident that we would win easily in front of any reasonable judge;

3. There was not sufficient time to resolicit proxies unless Century also was required to resolicit;

4. The mere filing of an enforcement action by the SEC, even one without any merit, would decide the result in favor of management so that who ultimately won the case would be irrelevant.

5. Century had so completely misled its shareholders by its false, misleading and omissive proxy materials that the election was really not in doubt in any event unless Century was required to comply with the securities laws.

6. Chasing the Committee out of the proxy context without requiring full disclosure by Century of its previous wrongful conduct would leave the Century shareholders totally unprotected.

You advised us that you could not comment on what, if anything, you were doing with respect to Century's materials but that if the Committee cancelled its proxy solicitations the staff would not proceed with any enforcement action. We advised you that we simply had no choice but to comply with the request, but that we were certainly concerned about where this left Century's shareholders.

We then asked you what we should tell Century's shareholders in withdrawing from the contest. You said you did not want any disclosure of these conversations or the SEC staff's recommendations. We later read you a letter to shareholders, a copy of which is attached. You suggested that it sounded acceptable but that we should have it reviewed by the Division of Corporation Finance, which we did. It was subsequently mailed to all Century shareholders as of the record date of August 24, 1981.

The effect of the foregoing is that management will have no organized opposition to its proposed merger with Sun, scheduled for vote on October 14th. There will be no

one to effectively oppose the continuing misrepresentations being made by management about this proposed merger agreement. We believe that is extremely unfortunate for the shareholders of Century Banks.

Very truly yours,

Stephen W. Arky

SWA:jm
Enclosure

B. LYNCH'S RESPONSE LETTER, DATED OCTOBER 20, 1981

October 20, 1981

Stephen W. Arky, Esq.
Arky, Freed, Stearns, Watson & Greer
One Biscayne Tower
Miami, Florida 33131

Re: Century Banks Shareholder Committee

Dear Mr. Arky:

The staff desires to clarify several points that are addressed in your letter of October 12, 1981. While the staff agrees that your position was that your client's proxy materials were not false and misleading, the staff's position, as stated in its letter of October 6, 1981 to you, was that your client's proxy materials were false and misleading and that it intended to recommend an injunctive action to the Commission against your client. We also discussed the possibility that your client would file revised proxy materials with the Commission and resolicit proxies. At no point in our discussions, however, did the staff suggest that your client abandon its efforts to solicit proxies in opposition to the merger between Sun Banks and Century Banks. In a conversation occurring late in the afternoon of October 2, 1981, you informed the staff that because of the staff's position regarding your client's proxy materials, your client had determined not to vote the proxies that it had obtained and not to resolicit proxies. The staff responded that you should advise your client as you thought appropriate.

Further, the staff did not attempt to restrain you or your client from disclosing the conversations with the staff of the Division of Enforcement. Certainly, we did not take the position that Mr. Warner was required under the federal securities laws to disclose our conversations regarding the staff's view of the proxy materials. We indicated that if the substance of our conversations were disclosed by Mr. Warner, care should be taken to accurately characterize our discussions and the staff's position.

If you have any need to discuss this matter further, please contact Duane Cheek at (202) 272-2242 or me at (202) 272-2248.

Sincerely,

Gary Lynch
Assistant Director

APPENDIX 6.—THE SEC'S INVESTIGATION OF HOME STATE FINANCIAL SERVICES, INC. (HSFS), 1984–85

A. SEC INTERNAL MEMO, "CHRONOLOGY OF STAFF INQUIRIES CONCERNING REPURCHASE TRANSACTIONS BETWEEN ESM GOVERNMENT SECURITIES, INC. AND HOME STATE FINANCIAL, INC. (NOW HOME STATE SAVINGS BANK)", UNDATED

CHRONOLOGY OF STAFF INQUIRIES CONCERNING REPURCHASE TRANSACTIONS BETWEEN E.S.M. GOVERNMENT SECURITIES, INC. AND HOME STATE FINANCIAL, INC. (NOW HOME STATE SAVINGS BANK)

DATES	ACTIVITY
7/12 - 7/25/84	Survey conducted of Savings & Loan Holding Companies engaging in significant levels of repurchase transactions to determine if other companies engaged in FCA type dollar roll transactions.
7/25/84	Staff called Home State to discuss nature of significant repurchase transactions with E.S.M. Government Securities, Inc. Transactions not similar to FCA, but nature of transactions raised other possible disclosure issues.
7/25/84	Commission meeting held concerning issuance of letter to FCA requesting restatement of financial statements. Commission members informed that the staff was still conducting inquiries into another Savings & Loan's repurchase transactions and will continue to monitor transactions in June 30, 1984 Form 10-Q filings by Holding Companies required to be filed by August 14, 1984.
8/7/84	Comment letter issued on Amendment No. 3 to Form S-2 filed on July 16, 1984 by Home State. Various supplemental information requested concerning the Company's repurchase transactions.
8/14/84	Supplemental letter dated August 13, 1984 received responding to our letter of August 7, 1984.
8/17/84	Meeting held between Company representatives and staff members from Office of Chief Accountant, Division of Corporation Finance and Division of Market Regulation to obtain a better understanding of the repurchase transactions engaged in by Home State.

DATES	ACTIVITY
8/24/84	Comment letter issued in response to Company's letter dated August 13, 1984. Various additional disclosures requested concerning repurchase agreements including requested revisions of the notes to financial statements to indicate the significant transactions with one broker-dealer and the Company's rights, remedies, claims and contingencies in the event of the bankruptcy of the broker-dealer.
8/29/84	Information Memorandum sent to the Commission concerning the staff's conclusions (that Home State's GNMA repurchase transactions were sufficiently different from FCA type transactions that a restatement of its financial statements was not necessary) and that a comment letter had been sent to Home State on August 24, 1984.
9/6/84	Form 8-K filed disclosing August 27, 1984 merger of the Holding Company into its subsidiary savings bank (Home State Savings Bank) to facilitate issuance of debt without registration under the 1933 Act. Home State Savings Bank, the surviving entity, continues to file Exchange Act reports with the Commission.
10/1/84	Form 8 amendments to the Form 10-K for the period ended December 31,, 1983 and the Form 10-Q for the period ended June 30, 1984 filed as a response to the staff's August 24, 1984 comment letter. In this regard, Company disclosed that in the event of the bankruptcy of the broker-dealer, the repurchase agreements effected through it would not be adversely affected since the broker-dealer acted as agent.
10/11/84	Request for withdrawal of S-2 filed.
10/15/84	Request for withdrawal granted.
11/15/84	Form 10-Q for September 30, 1984 filed.

DATES	ACTIVITY
12/7/84	Members of staff of Divisions of Corporation Finance and Market Regulation called the Company to get clarification of the Company's position on the broker-dealer bankruptcy issue as disclosed in the amended 1934 Act reports filed October 1, 1984.
12/12/84	Comment letter issued (requesting additional supplemental information to clarify Company's position on broker-dealer bankruptcy question) on amended 1934 Act reports filed October 1, 1984.
12/18/84-1/10/85	Various correspondence from registrant and telephone calls concerning the registrant's requests for additional time to respond to the staff's letter dated December 12, 1984.
1/22/85	Response dated January 21, 1985 to our comment letter of December 7, 1984 received. The Company indicated that it had retained new counsel and as a result, was changing its position with respect to its relationships with E.S.M. and that it was in the process of preparing amendments to its previously filed reports.
2/20/85	Proposed amendments to December 31, 1983 10-K and March 31, 1984, June 30, 1984 and September 30, 1984 10-Q filings submitted to the staff. Proposed amendments contained proposed disclosures indicating that the Company had been advised by new counsel that it is likely that the Company would not be successful in advancing its previous position that E.S.M. served it in an agency capacity and therefore it would be found to have dealt with E.S.M. as a principal in the repurchase transactions.
3/4/85	The staff of the Division of Corporation Finance called representatives of the registrant and informed them that the staff had looked at the proposed amendment, had no further comments and felt it was appropriate to file the amendments immediately with whatever updating as may be appropriate.

B. LETTER FROM JOHN F. MURPHY, BRANCH CHIEF, DIVISION OF CORPORATION FINANCE, SEC, TO HSFS, DATED FEBRUARY 27, 1984

DIVISION OF CORPORATION FINANCE

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

STOP 3-10

February 27, 1984

Gary P. Kreider, Esq.
Keating, Muething & Klekamp
One East Fourth Street
Cincinnati, Ohio 45202

Re: Home State Financial, Inc.
File Nos.: 2-88983
22-12927

Dear Mr. Kreider:

The staff has examined the Forms S-2 and T-1 filed for the Company with the Commission on January 20, 1984, along with the Form 10-K for Warner National Corp. for the period ended December 31, 1982 and has the following comments.

Cover Page

The amount of securities offered should more accurately be presented as $30,000,000 principal amount.

The cover page and other disclosure throughout the prospectus should make it clear that the Registrant is registering and offering two series of 1989 Debentures, fixed and variable rate, and that initial debentureholders may chose which series they will get in exchange for their 10-3/4% Debentures.

The second paragraph should state when the redemption feature will take effect.

Indicate in the second paragraph by whom the maturity of the 1989 Debentures may be extended and what notice debentureholders will receive in this case.

Please disclose the maximum period for which he Company may extend the offer, and what notice will be provided of such extension.

The terms of the proposed public offering, as far as they are presently known, should be summarized here, including the proposed duration and nature (i.e., "best efforts") of that offering.

Inside Front and Outside Back Cover Pages

Please advise the staff why the legend required by Item 502(e) has not been included. We may have further comments.

Forepart of the Prospectus

The forepart of the prospectus should contain a "Special Factors" section. This new section should discuss:

(a) Any material operating and financial problems the Company or its savings and loan subsidiaries have been or may be experiencing.

(b) Lack of market for the Debentures.

(c) Type of offering: i.e., exchange and "best efforts".

(d) Subordination of the Debentures and no Sinking Fund.

(e) The source of funds in the event the Company is required to pay off all or substantially all of the 10-3/4% Debentures.

The Registrant should provide a comparison chart which would briefly summarize the major differences between the outstanding securities and the securities to be offered. The chart could contain such items as type of security, including the existence of a guarantee, interest rate, interest payment, maturity, repurchase on death of holder, redemption, sinking fund, etc.

Incorporation of SEC Filings- Pages 4-5

Please advise the staff why the Company has not delivered audited financials to securityholders since 1977. We may have further comments upon receipt of your response.

Also, pursuant to Item 502(b), state whether reports to be delivered to securityholders in the future will contain audited financials.

c.

The Exchange Offer- Page 7

The letter of transmittal should be provided as an exhibit.

Federal Income Tax Consequences- Page 8

Please resolve the apparent discrepancy between the second and third paragraphs under this heading, regarding the creation of an original issue discount.

Please advise supplementally why no tax opinion was filed as an exhibit. It is noted that the Company has been advised of the tax consequences. The advisor should be named. We may have further comments upon receipt of your response.

Effects of the Exchange Offer- Page 9

A similar section addressing the effects of the public offering and the proposed corresponding use of proceeds from that offer should be included.

Use of Proceeds

The extent to which funds from the proposed public offering may be used to repay the 10-3/4% debentures should be specifically disclosed.

Business- Pages 9-16

This section should be expanded to provide a brief summary of the restructuring of the Company in the past year. More specifically, it should be noted that Home State Financial Services was incorporated in 1974 as a wholly owned subsidiary of Warner National and that in November of 1983, Home State was merged into its parent, Warner National, and the name of the Company was subsequently changed to Home State Financial, Inc.

Savings Associations- Page 9-15

It is noted that the deposits of the associations constitute 18.6% of the deposits of the Ohio Deposit Guarantee Fund. It would appear that the Fund's "guarantee" of deposits could be illusory if such deposits are only backed by member deposits in the Fund and potential commitments of

members. If such is the case, this risk should be disclosed. Please advise the staff supplementally of the insurance arrangements required by the Fund.

Reference is made to the second paragraph on page 10. The terms of the loans to AMI, especially interest rates, should be disclosed.

Reference is made to the third paragraph on page 10. It should be disclosed whether the Company will continue its policy ot granting loans to officers and directors at rates lower than market.

The "details" incorporated by reference to Item 13 of the Form 10-K, concerning certain transactions, should be included in this filing.

Reference is made to paragraph (4) on page 11. Please indicate whether the terms of the lease are the same as would be available to unaffiliated third parties.

Reference is made to Item (5) on pages 11 and 12 concerning Freedom Savings and Loan ("Freedom"). Please disclose from whom and for what compensation the Company acquired the 200,000 shares of Freedom.

Mr. Warner's agreement with the FHLBB is noted on page 12. If this agreement is embodied in the form of a written document, it should be filed as an exhibit.

The transactions referred to in Item (6) on page 12 and in the related tables on pages 13 and 14 should reflect information from the beginning of the Registrant's last fiscal year to the latest practicable date. See Item 404(c) of Regulation S-K.

The second sentence of Item 6 on page 12 should more accurately reflect that many of such loans were in fact made at favorable interest rates and should indicate the range of rates charged.

Financial Services- Page 15

It is suggested that it would be helpful for the disclosure hereunder to be accompanied by a chart. The relative importance of these subsidiaries, and especially the insurance subsidiaries, should be discussed.

It should be disclosed whether purchasers in the public offering will have a choice between the two series of Debentures being offered and, if so how purchasers will be able to exercise such choice.

It should be disclosed how the fixed interest rate on the fixed rate debentures will be determined.

Disclose how debentureholders will be notified should the auction rate no longer be announced by the Fed, as discussed in the last sentence of the carryover paragraph on pages 16-17.

Description of 1989 Debentures- Pages 16-19

The name of the trustee should be disclosed pursuant to Item 202(b)(10) of Regulation S-K.

Frequency of Interest Payment- Page 17

It is noted on page 8 that election of compound interest payable at maturity will result in the securities being deemed to be offered at an "original issue discount." This fact should be disclosed on page 17 and a brief description of the effects of this should be included pursuant to Item 202(b)(9) of Regulation S-K.

Plan of Distribution- Page 20

This section should be expanded to clarify that the 1989 Debentures are to be sold to the public only to the extent that they are not fully issued in connection with the exchange. It should also indicate how soon after the closing of the exchange offer the public offering will occur.

Disclose what procedures the Company will follow should more shares be "reserved" than become available for cash sale.

Please indicate the Company's present anticipations with respect to the amount of debentures to be sold with or without the assistance of NASD members.

It should be noted here that dealers who may assist in the selling of the debentures may be deemed "underwriters" under the Securities Act of 1933.

Management's Discussion and Analysis- Pages 24-27

It is suggested that the Management's Discussion & Analysis tends toward a reiteration of numbers from the financial statements and broad general statements rather than a meaningful discussion and analysis of changes in the financial condition of the Registrant as required by Item 303 of Regulation S-K. This section should be revised accordingly. The following comments will provide some guidance as to the nature of the changes to be made.

It is noted that in each of the last three years the Company has engaged in certain one time transactions (such as significant acquisitions or sales of assets) which have materially affected the financial condition and direction of the Company. The Management's Discussion & Analysis should clearly identify such transactions on a year by year basis and outline, in accordance with Instruction 3 to Item 303(a) of Regulation S-K, the immediate and future, if any, impact on the Company of those transactions. Results of "continuing operations" should be similarly discussed.

Reference is made to the second sentence of the first paragraph on page 24. Indicate the source of funds with which $300,000,000 of GNMA pass-throughs and $400,000,000 of government securities were acquired by the Savings Association subsidiaries.

In light of the recurring losses from operations before equity in undistributed earnings of partially owned companies (the major company being Combanks which has been liquidated), a tabular analysis of rate sensitive assets and liabilities by type which shows maturity of such rate sensitive assets and liabilities by appropriate maturity grouping seems necessary, along with a narrative discussion of the company's rate sensitive position.

Also, in light of the trend of operations, a table of scheduled items by category and the ratio of scheduled items to total assets appears necessary for the last three fiscal years and latest interim period.

Please provide supplemental details regarding the company's viability as a going concern in the light of continuous losses before equity in partially owned subsidiaries. Since its major source of net income was derived from its investment in Combanks which has been sold, the future generation of net income from operations appears to be in question.

Results of Operations and Inflation- Pages 24-25

If, as is indicated, the Company is engaged in substantial "day trading," the risks of such activity should be briefly described here and more fully described in the Special Factors section requested elsewhere in this letter.

In this regard, the fifth sentence of the first paragraph on page 24 should be expanded to disclose the reasons for the $10.7 million decrease in net gains on securities transactions; i.e., was the day trading strategy unsuccessful?

Reference is made to the last sentence of the second paragraph on page 24. The discussion should be expanded to address more fully the reasons for and continuing impact of the addition of commercial loans in 1983.

Liquidity- Pages 25-27

The balance sheet conditions or income or cash flow items which the registrant believes may be indicators of its liquidity condition should be itemized.

Liquidity should be discussed on both a long term and a short term basis. See Item 303(a)(1) of Regulation S-K.

Bank Lines of Credit- Page 26

The interest rates on such lines of credit, the fact that compensating balances are maintained to sustain such credit, and that such lines of credit may be withdrawn at any time should be disclosed. See Note (7) on page 40.

Please indicate in pagagraph 3 how the Savings Associations were able to effect such increases in 1980, 1981 and 1982 in savings deposits.

Disclose in the last paragraph on page 26 the amount of company debt still outstanding.

We note the fourth sentence in the first paragraph on page 27. Please identify or give an example of such assets.

The second sentence of the second paragraph on page 27 is noted. Identify the regulation or regulatory agency imposing the reserve and net worth requirements, and disclose the regulatory consequences of not meeting these requirements.

The last sentence of the second paragraph on page 27 is noted. If the associations have been restricted from paying dividends to the parent in 1982 and 1981 as well as 1983, this should be disclosed.

Indenture Section 11.12

It is assumed that when the blank in the variable provision specifying the trustee's combined capital and surplus is filled in, it will comply with the provisions of Section 310(a)(2) of the Trust Indenture Act. Please confirm.

Indenture Section 7.1(a)

This section should be revised to parallel Section 315(c) of the Trust Indenture Act. Alternatively, the registrant may submit supplementally a letter from the Trustee acknowledging that the "prudent trustee" standard imposes a standard of care no less stringent then the "prudent man" standard.

Accounting Comments

Reference is made to Rules 3-12 and 3-01 of Regulation S-X. If available, the audited financial statements for the year ended December 31, 1983 shall be included in the filing.

Reference is made to Note 1(d) to the financial statements on page 51. It is assumed that the finance receivables accounted for under the pro rata method generally have balances of $5,000 or less and initial maturities of less than 61 months. Please advise, if otherwise.

Reference is made to Note 3 to the financial statements on page 54. The note should be made clear regarding the circumstances under which the company was able to purchase AMI at such a substantial bargain price. Regarding the write-down of AMI's assets and liabilities due to the bargain purchase, please advise supplementally regarding the amount of write-down ot the four major real estate parcels and book value of such parcels at the date of sale. Please provide supplementally the Balance

Sheet of AMI at the date of acquisition, with details regarding how the pro rata write-down was determined. Reference is made to pages 7 and 8 of the company's 1982 Form 10-K. In light of APB Opinion No. 16, paragraph 87, please explain why the sales value of the four parcels sold were not the value at which such property was recorded at the date of acquisition and please justify the recognition of a gain on the sale as the economic substance of the transaction.

Reference is made to Note 4 to the financial statements on page 58. The investment in Global Natural Resources at December 31, 1983 should be carried at its market value of $2,201,875 in accordance with SFAS No. 12, with the unrealized loss shown as a reduction of equity. It is noted that this investment was recorded properly at its market value in the financial statements for the nine months ended September 30, 1983. We note that it is stated in Note 11 to the financial statements on page 66 that unrealized gains on Great American stock held indirectly through the company's equity investment in Combanks was offset against unrealized losses on its investment in Global. Since the Great American stock is not part of the Company's marketable securities portfolio and is not an equity security owned by Home State, the unrealized gain should not be considered in the determination of aggregate lower of cost or market. In light of the sustained decline in value of Global stock during 1982 and 1983, please justify why such decline has not been realized as a permanent impairment with the amount of the write-down accounted for as a realized loss.

Reference is made to Note 9 on page 64 and Note 7 on page 40 to the financial statements. It appears that the $800,000 note payable due on demand should be classified as short-term and that the current portion of the $1,555,851 ($1,381,085 at September 30, 1983) note should be classified as short-term. Please revise as necessary. Also, the Selected Financial data on page 23 should be revised accordingly.

Please justify supplementally the recognition of litigation settlement expenses of $1,447,425 as an extraordinary item for the year ended December 31, 1980 under the provisions of APB Opinion No. 30. Please clarify Note 15 on page 70 to explain how the refund of commercial standby fees relates to the litigation settlement.

The notes to the financial statements should include disclosure regarding what comprises the $10.6 million net gain on securities transactions for the year ended December 31, 1983. The reference to Note

11 regarding the gain is not clear since the gain on the liquidation of Combanks was recognized in the financial statements for the nine months ended September 30, 1983. Please respond.

Note 1 to the financial statements for the nine months ended September 30, 1983 should disclose the accounting policy afforded GNMA and T-note futures contracts.

Reference is made to Note 3 to the financial statements on page 34. It is assumed that no GNMA certificates or related future contracts were sold or liquidated during the nine months ended September 30, 1983. Please advise. Also, please advise regarding the extent to which GNMA's purchased were hedged by futures contracts. Please advise regarding the accounting treatment afforded gains or losses on futures contracts that are not properly matched against the appreciation or depreciation of the GNMA certificates as an effective hedge and the amount of such gain or loss for the period. Please disclose on page 34 the cost, carrying value and market value of the GNMA's and unrealized gain or loss on related futures contracts in the format used on page 36 for treasury bonds.

Reference is made to Note 4(a) to the financial statements on pages 35-36. It is assumed that no T-notes or related futures contracts were sold during the nine months ended September 30, 1983 or thereafter. Please advise. Also, please advise of the extent to which T-notes were hedged by futures contracts, the accounting treatment afforded gains or losses on futures contracts that are not properly matched against appreciation or depreciation of the T-notes as an effective hedge and the amount of any such gain or loss for the period.

Since the T-notes are not being held as long-term investments, please justify why these securities and related futures contracts are not recorded at market value with the amount of any write-down accounted for as a realized loss. Reference is made to the Guide for Savings and Loan Associations in this respect. Furthermore, please advise if it is management's intent to dispose of these securities in the foreseeable future and, if so, this investment should be written down to market value.

Reference is made to the disclosure requirements under SFAS No. 5 regarding any contingent losses attributable to GNMA participations and treasury notes and related futures contracts.

Interest expense should be broken down into two categories on the fact of the income statements to disclose interest on savings deposits and on borrowings.

Note 14 to the financial statements for the year ended December 31, 1982 should be expanded to address the litigation disclosed in Item 3 of the company's 1982 Form 10-K. Also, note disclosure concerning contingencies should be added to the interim financial statements even if no significant change has occurred since year-end.

Reference is made to Exhibit 12 to the company's 1982 Form 10-K. Earnings for the nine months ended September 30, 1983 which includes a gain of $12,086,000 from the sale of Combanks does not agree to the $8,528,952 gain included in the income statement for this period. It is not clear why the cost basis used to compute the $12,086,000 gain amounts to $4,248,000 while the equity basis in Combanks amounted to $7,970,121 at December 31, 1982. Please advise and revise as necessary.

A note should be added to the table on page 6 to state that earnings for the years 1979 and 1980 were inadequate to cover fixed charges and to disclose the dollar amount of coverage deficiency.

Line items should be added to the Selected Financial data on page 23 to disclose loans and other receivables, marketable and nonmarketable securities, savings deposits and the provision for loan losses for all periods presented. Also, line items should be added to separately disclose average yield on loans and investments; combined weighted average yield on loans and investments; average rate paid on savings and borrowings; combined weighted average rate paid on savings and borrowings; and the interest rate margin. Reference is made to Instruction 2 to Item 301 of Regulation S-K in this respect. Please also note for future filings.

Please provide a Capitalization table as of the latest interim date setting forth historical and proforma capitalization giving effect to the exchange with presentation of the range of possible results that may occur under the provisions of the exchange which involve two series of bonds with varying methods of interest payment. The proforma effects on the Balance Sheet and Income Statement for the latest year and the latest interim period should be presented, taking into consideration the possible range of results. Adequate explanation of the proforma effects should be provided.

Please advise supplementally regarding the accounting treatment afforded the company's joint venture interest in Canterbury Gardens which is discussed on page 11. Reference is made to APB Opinion No. 18 and interpretation thereto and Statement of Position 78-9 in this regard. Please advise of the company's amount of participation in future profits from ultimate sales of the condominiums and any profits realized to date from any sales and the amount of sales and the amount of advances to the joint ventures. Any advances should be presented separately in the Balance Sheet as Advances to Joint Ventures. Footnote disclosure should be made regarding the accounting afforded its interest in the joint venture.

Management's Discussion and Analysis should be revised to include a discussion of the results of operations, liquidity and capital resources for the fiscal years ended December 31, 1982 and 1981. See Item 11(b)(7) to Form S-2.

Management's Discussion and Analysis for the nine months ended September 30, 1983 should be expanded to discuss the company's purchases of GNMA's and Treasury notes and related sales of futures contracts and the effect of such activities on its financial position and results of operations. Any uncertainties or risks of loss associated with these activities that may have a material effect on the results of operations, liquidity or financial condition should be discussed.

Management's Discussion and Analysis should include a discussion of the $2.1 million write-down of the company's investment in Global Natural Resources and the reasons for the significant decline in the value of this investment and whether such decline is permanent with appropriate discussion of the risk of actual loss due to the decline in its market value.

If the increase in the provision for loan losses for the year ended December 31, 1982 is attributable to a few specific loans or a category of loans, such should be discussed in Management's Discussion and Analysis. The causes for any material changes in any line items of the financial statements should be described in Management's Discussion and Analysis.

The liquidation of Combanks should be discussed in Management's Discussion and Analysis with respect to the impact of this investment

on the historical results of operations and the effects on future results of operations that is expected to result from the loss of this major revenue source. See Instruction 3 to Item 303(a) of Regulation S-K.

Management's Discussion and Analysis should discuss the continued losses from operations before equity in undistributed earnings and funds absorbed by such losses and the expected future results of operations in light of this negative trend. A discussion of the effect of fluctuating interest rates and the net spread should be provided in this respect.

Reference is made to Note 3 to the financial statements of Combanks included in the Company's 1982 Form 10-K. Please provide supplemental details regarding what certain entries were recorded that caused uncertainties about the correctness of certain amounts determined for 1982 regarding Great American. Since the sale of Barnett did not occur until 1983, please advise how Combanks lost its ability to exercise influence over American which therefore led to the discontinuance of the use of the equity method. Please advise of the amount of Great American's net income for the year ended December 31, 1982 and Combank's share if it had continued to record this investment on the equity basis.

New manually signed and currently dated consents of both accountants should be provided in any amendment.

Please provide us with a supplemental copy of Form 10-Q for the period ended June 30, 1983.

Undertakings

The undertaking set forth in Item 512(e) of Regulation S-K should be provided.

The registrant should undertake to amend this registration statement by means of a post-effective amendment at such time as the public offering, if any, is to take place.

Warner National Corporation - 10-K for
Period Ended December 31, 1982
Item 11 - Management Remuneration

It is assumed that the value of loans made at reduced interest rates are included in the Remuneration Table of officers and directors. Please confirm.

General

Please advise the staff as supplemental information of the business purpose for the "reorganization merger" of Home State with Warner National.

Any questions concerning the foregoing comments may be directed to Deborah Silberman at (202) 272-7368. Accounting comments may be referred to Louise Dorsey at (202) 272-2711.

Sincerely,

John F. Murphy
Branch Chief

JMURPHY/rjg: Branch #1

PROOFED BY	Initials	Name
Accountant:	LHD	DORSEY
Analyst :		
Attorney :	dlc2	SILBERMAN

C. HSFS INTERNAL MEMO FROM DAVID J. SCHIEBEL TO MARVIN L. WARNER CONCERNING ESM, DATED JULY 11, 1984

INTER-OFFICE MEMORANDUM

TO: Marvin L. Warner DATE: July 11, 1984

FROM: David J. Schiebel

SUBJECT: ESM

I have reviewed the broker confirmations from ESM as they related to the purchase of the $460 million in U. S. Treasury Bills that were purchased from ESM in May and June. The purchase tickets indicate that they acted as principals from their own account and sold to us the Treasury Bills. On the Repos they indicate that they have acted as a principal from their own account and have purchased for us and finally, on the confirmation ticket verifying the maturity of the Repo, they again acted as a principal from their own account, indicating they have sold to us.

It is our opinion that, as the transaction now stands, we are dealing with them as principal and not with the other parties. We have no problem as it relates to the purchase of the Treasury Bills, inasmuch as we bought from them and they sold to us the Treasury Bills. The problem is in the Repurchase Agreement where they are acting as a principal and not as an agent. It would require a reissue of the confirmation tickets to verify their agency capacity. But, this in itself will not make them an agent. As we discussed, it would require the Repo lender to confirm the relationship.

I have reviewed Alexander Grant's proposal for confirmation of the Repos and it is not satisfactory. This is the same report that Home State has been receiving for the past three years. On December 12, 1983, I sent a letter to Allen requesting additional information for the December 31, 1983 confirmation. This information was not included in their report. I think it should have been, as it is vital to the confirmation process. (See copy of December 12, 1983 letter attached, as well as, our report of December 31, 1983)

D.J.S

DJS/bb

Attachment

EXHIBIT
145
4-20-85
5-20-85 RH

D. FOLLOW-UP LETTER FROM MURPHY TO HSFS, DATED AUGUST 7, 1984

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
CORPORATION FINANCE
STOP 3-11

August 7, 1984

Gary P. Kreider, Esq.
Keating, Muething & Klekamp
18th Flobr Provident Tower
One East Fourth Street
Cincinnati, Ohio 45202

Re: Home State Financial, Inc.
File Nos.: 2-88983 and 22-12927

Dear Mr. Kreider:

The staff has examined Amendment No. 3 to the Form S-2 filed on July 16, 1984 and has the following comments.

Financial Data- Page 8

It is noted that the six month data for the period ended June 30 is not presented on a comparative basis. Please revise or advise. We may have further comments.

Other Activities- Pages 15-16

The last full paragraph on page 16 should be substantially expanded to further clarify the nature of these transactions, the character of the properties and the status of the loans. For example, it is unclear how the Company was able to purchase in May 1984 a loan which was due in November 1983. That loan is characterized as a "development" loan yet is secured by a cemetery, which implies that it is the cemetery which is proposed to be developed. Please clarify.

The nature of the interest acquired by the Company in the non-interest bearing second mortgage (i.e., a 32% participation?) is unclear and should be disclosed; the property securing such mortgage should be identified. Finally, it should be confirmed that both mortgage loans were made by unaffiliated third parties.

Important Considerations- Pages 10-11

A factor should be added discussing the risks associated with the substantial purchases of GNMA's, T-notes and T-bills financed under agreements to repurchase, and a cross reference should be added to more complete discussion in the management's discussion.

Management's Discussion and Analysis- Pages 35-48

The first unnumbered paragraph on page 39 is noted. Please advise the staff supplementally what, if any, impact the ownership of these shares by the Company has on the previously disclosed (but now deleted) agreement between Mr. Warner and the FHLBB.

The relationship between this investment in Freedom, and the Company's previous investment as described on page 19 (i.e., what is the purpose of the present investment) should be disclosed. See our comment letter of June 8, 1984.

Also, please provide the basis for the Company's belief, expressed in the last sentence of this paragraph, that the decline in value of these investments is temporary.

The second paragraph on page 74 of Note (5) of the financial statements is noted. The terms of the repurchase agreement should be discussed in the body of the prospectus. Please advise the staff supplementally how or under what circumstances the Company was able to arrange repurchase agreements with maturities of one year, when such instruments more usually mature in no more than 30 days. We may have further comments.

Accounting Comments

With regard to the concurrent purchase and sales of loans and investment securities under agreements to repurchase, please advise supplementally prior to amendment whether or not the exposure to loss from these transactions were effectively hedged in full by futures contracts. If otherwise, please advise of the extent that the exposure to loss was not effectively hedged by futures contracts and the amount of exposed loss on loans and on investment securities at each balance sheet date.

Reference is made to the telephone conversation with the staff on July 25, 1984 in which you stated that the Company rolls over its repurchase agreements upon their maturity. Also, you stated that such repurchase agreements involve specific securities which are titled in the name of the Company, and that the Company does not enter into any dollar repurchase agreements. Please confirm supplementally.

Regarding the purchase of GNMA certificates which are substantially financed by repurchase agreements, please advise supplementally regarding the original cost, carrying value and market value of these loans at December 31, 1983 and June 30, 1984. Please also advise of the principal payments and accrued interest received on the GNMA's as of each of these dates. Please advise if the repurchase agreements used to finance the GNMA purchases which matured in June, 1984 were rolled over, and if so, the accounting for these transactions and market values at such date. For purposes of clarity, please provide journal entries used to record the flow of transactions from the original purchase and concurrent sale of GNMA's under agreements to repurchase through the maturity and rollover of these repurchase agreements.

Reference is made to Note 5(a) to the 1983 financial statements and Note (3) to the June 30, 1984 financial statements. Since, as stated in Note 5(a), it was not management's intent to hold the T-notes as long-term investments and they were sold in June, 1984, please justify supplementally why such investments are not recorded at their market value at each reporting date with the amount of any write-down accounted for as a loss. Please advise of the carrying and market values of these T-notes and any gain or loss recognized upon the sale of the T-notes in June, 1984.

In this regard, reference is made to the last paragraph on page 46 of Amendment No. 2. Please advise supplementally how the sale of the T-notes and the repayment of the repurchase agreements in May and June, 1984 would result in a cash inflow to the Company of $50 million when repurchase agreements are rolled over at maturity. Please advise whether the repurchase agreements which matured in May and June, 1984 were rolled over and used to finance the purchases of T-bills at these times. Please explain in detail the accounting for these transactions, if they are rolled over and give market values at such dates. In this regard, please supplementally explain what is meant by the statement in Note 5(a) on page 74 that, under the terms of the repurchase agreements, the amount outstanding may be increased or decreased from time to time in order to compensate for changing market values of the T-notes. For purposes of clarity, please provide journal entries used to record the purchase of the T-notes, sale of the T-notes, rollovers of the repos, and purchases of the T-bills and any increases or decreases in outstanding repurchase agreements.

All of the above requested information should be provided supplementally prior to amendment. We may have further comment.

Note (2) to the June 30, 1984 financial statements should disclose the date on which the repurchase agreements mature.

We note that all futures contracts to hedge the repurchase agreements were closed in April and June, 1984. Management's Discussion and Analysis should also discuss management's intent regarding these transactions in light of the exposure to loss in market value of the GNMA's and T-bills and the role that an increase or decrease in interest rates plays in management's decision to continue these transactions on the date that they mature.

Management's Discussion and Analysis should include a discussion of the risks associated with the substantial purchases of GNMA's, T-notes and T-bills that are financed by securities and loans sold under agreements to repurchase and the effects of changes in interest rates on the risks of loss. See Instruction 3 to Item 303(a) of Regulation S-K.

Reference is made to your response letter dated July 13, 1984 regarding the accounting for the investments in Crane and Unicorn Associates under the provisions of SFAS No. 12. It appears that the use of the equity method would not apply to these limited partnership interests because these investments amounted to less than a 20% interest in these partnerships. Therefore, your argument that the use of the equity method would, in effect, result in writing these investments up to their market value as would accounting for these investments as marketable equity securities under SFAS No. 12 does not appear to apply to these limited partnership interests. The Company does not effectively control these investments because their withdrawal from the partnerships was restricted to a specified future date or special consent of the general partner. Therefore, these investments were not, in substance, readily marketable equity securities and should not be accounted for under SFAS No. 12 as marketable securities for purposes of determining lower of aggregate cost or market at December 31, 1983.

Please state in Note 1 to the December 31, 1983 financial statements the Company's accounting policy afforded futures contracts which are not effective as hedges. Reference is made to FASB Technical Bulletin No. 81-1, paragraph 7 in this respect.

It is assumed that the futures contracts used to hedge GNMA's and T-notes were effective hedges, as defined by the AICPA Exposure Draft entitled Accounting for Futures Contracts dated July 13, 1983, at all times since their inception and up to the point the contracts were closed in April and June, 1984. Please confirm supplementally.

It is noted that marketable equity securities with a carrying value of $3,745,023 at June 30, 1984 does not agree to the carrying value of $5,764,000 stated on page 48. Please revise as necessary.

Reference is made to page 16 regarding the sale and repurchase of AMI mortgage loans. It is assumed that the $1,060,000 is due November, 1984 (not 1983). Also, please disclose on page 16 whether the $294,250 loan due July, 1983 has been repaid.

It is assumed that the $348,000 deferred gain on the sale and repurchase of mortgage loans described in Note (4) to the June 30, 1984 financial statements was determined by a pro rata allocation of the $2.3 million gain to the net book value of the repurchased loans in relation to the net book value of AMI's assets at the date of sale. If otherwise, please advise.

Note (4) to the June 30, 1984 financial statements is not complete.

Reference is made to Note (3) to the June 30, 1984 financial statements regarding the sale of the interests in Crane and Unicorn Associates. It is assumed that the $13,436,000 non-interest bearing note received as payment on the sale is secured by the limited partnership interest or other sufficient collateral which should be disclosed in the note. If otherwise, please advise including the appropriateness of gain recognition.

We note that the market values of the investments in Global Natural Resources and Freedom Savings and Loan have consistently declined below cost since their purchase. Please justify why such declines are still considered to be temporary and why these investments should not be written down to market value. Management's Discussion and Analysis should be expanded to discuss the above and the reasons for the significant declines in market value below cost for these investments.

General

In future amendments, in order to assist the staff, please assure that all changes are properly blacklined.

Any questions concerning the foregoing comments may be referred to Deborah Silberman at (202) 272-7368; questions concerning the accounting comments may be addressed to Louise Dorsey at (202) 272-2712.

Sincerely,

John F. Murphy
Branch Chief

jMURPHY/rjg: Branch #1

PROOFED BY

	Initials	Name
Accountant:	LMD	L. Dorsey
Analyst :		M/A
Attorney :	DS	D. Silberman

E. HSFS INTERNAL MEMO CONCERNING MEETING BETWEEN SEC OFFICIALS AND HSFS, DATED AUGUST 21, 1984

INTER-OFFICE MEMORANDUM

TO: FILE **DATE:** August 21, 1984

FROM: David J. Schiebel

SUBJECT: Meeting with the Representatives of the SEC in Washington, D.C. on Friday, August 17th at 1:30 p.m.

Home State was represented by David J. Schiebel, George Turk, Arthur Andersen of Cincinnati, Gary Kreider, KMK and John Stewart of Arthur Andersen's World Headquarters. Howard P. Hodges, Jr., Chief Accountant for Corporate Financial Division, Mike McLaughlin, Louise Dorsey, Savings and Loan Reviewer and four other individuals represented the SEC.

We went to the meeting with several packages to present to the SEC. They were as follows:

1. GNMA Package

This was to demonstrate to the Commission that at all times Home State has had title to the GNMA's and our sampling showed the purchase of the GNMA's originated in 1983. The extension of the repo in April of 1984. A servicing report from a GNMA servicer indicating that Home State was still the registered owner. This was done by identifying a particular pool of GNMA's. We also showed them that the repos money went in and out and showed them to get advices from the Fifth Third Bank. We also reviewed our short sale position on the GNMA's and pointed out to them our positive position when we sold the $100,000,000 back in May and June of 1983 and illustrated that we did show a minuscule loss of $1,000 on the transaction.

2. Treasury Note Package

Showed them sample documents in the Treasury Note Package and also the short sale document from the Statler and Virginia Trading Company.

3. Treasury Bill Package

Showed the acquisition of the Treasury Bills in May and June of 1984.

Although we had other documents to show them such as investments, liquidity reports and the amount of dumbo deposits, at no time did they ask for them.

A presentation was made indicating that Home State was the registered owner of the GNMA's from the day we acquired them in

the second quarter of 1983 to the most current time being the 15th of August, 1984. It was emphasized we have always been the registered owner and that we have an equity position in the GNMA's. As we were only borrowing 90% of market. They questioned the par off no deliver on the first broker ticket we showed them and asked for an explanation of that. We indicated that this was done _____ as we were simultaneously reporting the GNMA's although we have made several downpayments on the acquisition. They questioned the delivery instructions of the funds to Bradford Trust. They questioned one ticket number 121772961. The delivery instructions to Canadian Imperial Bank. We indicated that was strictly an error as we no longer use Canadian Imperial for safekeeping. They questioned the dates on the ticket trade date being April 30th and settlement date being June 25th. Why was there a month and 25 days difference when we were getting a ticket once a month. We could not specifically answer that but did indicate to them that the interest shown on this ticket was 25 days interest to E.S.M. on our repo. This ticket indicated that we bought the securities back from repo which confused them. We indicated that every month for E.S.M.'s computerization they recorded buy them back so that they could bill us the interest to E.S.M. that although our report was a firm one year repo, we went through this transaction monthly to enable E.S.M. to bill us the interest monthly. There was a question again as to the dates. If this was a monthly date, why the intervening date of June 25th. They then questioned ticket number 121772960 where we sold back the GNMA's for repo. They noticed that the sale back ticket we was numbered one number prior to the purchase ticket. They queried why and my answer was simply their data processing and I could not speak to the reason why. Did indicate that the end result was the same. Further told them that the reason for the June 25th date was that there was obviously a margin call. Pointed out to them the servicing ticket from Bankers Mortgage Corporation of Florence, South Carolina, indicating that GNMA pool #36238 was still titled in our name as of August 7, 1984. They cursively reviewed other sample tickets. Reviewed the changes in repo and the credit indebit advices from Fifth Third Bank demonstrating that we were meeting the calls with cash.

Hodges indicated that it was rather obviously with the recent development with the Financial Corporation of America as to why they were so concerned with the GNMA's transaction. Their big concern being was their equal treatment. We again pointed out to the Commission that these GNMA's were registered in our name and that we held them in portfolio and were not rolling them in and out. Further indicated that we had never done a dollar roll and that these securities were not TBA's (to be announced) nor were they in the box (previously owned by ESM).

They were concerned as to how we can obtain an interest rate on our GNMA's for a year period of time and that we had no confirmation indicating that the rate was locked in for one year. I indicated that we had been doing business at ESM for six to

seven years and that they have honored their obligation each time. Further indicated that if they didn't honor a verbal commitment, they would be out of business if the word ever got out.

We then passed out our package on Treasury Bills which they very cursively looked out and questioned the interest rates. For example, why would the repo "lender" enter into a repo at 11.33%, 11.55%, and 11.60% when they could just as easily have purchased the Treasury Bills at a rate of return of 11.87%, 12.10% and 12.10% respectively. I indicated I can't speak to why I can only report that they did it. Further reported that most of the people on the other side were some form of governmental agency and that on an annual basis on December 31st of each year, Alexander Grant and Company, ESM's CPA's, confirmed other side of our repo. Further explained that although we dealt with ESM, they were acting on someone else's behalf and ESM was acting as a conduit for the repo transaction. Their comment was that is a pretty good deal, why didn't you do a billion dollars instead of just sixty million. I indicated that we felt this was a sufficient amount. Very briefly they spoke of the element of risk relating to ESM's ability to sell us back the GNMA's our T-Bills at the maturity of the repo. They indicated that obviously the other side of the repo could be repoed out many times _____ ESM's other client.

Passed out the Treasury Note package which they showed no interest in reviewing. We only reported to them the initial transaction and our short sale position of 2400 contracts. The meeting then adjourned with Hodges indicating to us that we would receive a call on Monday, August 20th, indicating the Commission's position and a possible disclosure that they would want us to make. They indicated that our transaction is not similar to FCA. I indicated that at that time I felt that our transaction was nothing like FCA's. More that we were the registered owner of the GNMA's and we are still the registered owners. As I believe we have demonstrated today and that I would pass judgment on any disclosure after I have had an opportunity to review it.

F. FOLLOW-UP LETTER FROM MURPHY TO HSFS, DATED AUGUST 24, 1983

DIVISION OF
CORPORATION FINANCE

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

August 24, 1984

Stop 3-11

Gary P. Kreider, Esq.
Keating, Muething & Klekamp
18th Floor Provident Tower
One East Fourth Street
Cincinnati, Ohio 45202

Re: Home State Financial, Inc.
File Nos. 2-88983, 22-12927 and 0-3897

Dear Mr. Kreider:

The staff has reviewed your letter dated August 13, 1984 in response to our comment letter of August 7, 1984 and has the following comments.

Important Considerations

Reference is made to the proposed language, set forth on page 2 of your letter dated August 13, 1984, to be included in the "Important Considerations" section of the prospectus. The language should be expanded to include disclosure of the following matters. Significant concurrent purchases and sales of GNMA's and U.S. Treasury bills under agreements to repurchase were entered into with one broker dealer firm. Should these repurchase agreements not be extended or refinanced, the GNMA's may have to be sold at which time any decline in market value below carrying value would be recognized as a loss. Full and complete disclosure should be provided of the Company's rights, remedies, claims and contingencies regarding these purchase and repurchase agreements in the event of the bankruptcy of the broker dealer. Detailed disclosure also should be made of the accounting which would be afforded these purchase and repurchase agreements in this event.

Accounting Comments

Note (4) to the December 31, 1983 financial statements and Note (2) to the June 30, 1984 financial statements should be expanded to discuss the following matters. GNMA loans were purchased from the broker dealer firm with approximately 10% of the purchase price paid in cash and the remaining 90% financed through the concurrent sale of these loans under agreements to repurchase with that broker dealer. Under the terms of the repurchase agreements, as the market value of the GNMA's declines, the Company will repay the repurchase agreements in cash to compensate the broker dealer for the market value decline. At the time the GNMA's were purchased, interest rate futures contracts were sold to hedge $250 million of the $300 million of GNMA's against market value declines. These hedges were closed in April and June, 1984 at a gain of $1.4 million which is being deferred and amortized over the term of the GNMA loans.

Also, the gross cost, carrying value and market value of the GNMA's shall be disclosed in the note as of each Balance Sheet date. Note (2) to the June 30, 1984 financial statements should be expanded to include the same disclosures that are made in Note (4) to the December 31, 1983 financial statements.

Note (5) to the December 31, 1983 and Note (3) to the June 30, 1984 financial statements should disclose the following matters. T-notes with a face value of $400 million were purchased from one broker dealer firm and ___% of the purchase price was paid in cash and the remaining __% of the purchase price was financed through the concurrent sale of the T-notes under agreements to repurchase with that broker dealer. As the market value of the T-notes declines, the repurchase agreements must be repaid in cash to compensate the broker dealer for the decline.

Note (3) to the June 30, 1984 financial statements should disclose the following matters. In May and June 1984, the Company purchased $460 million in one year U.S. T-bills from the same broker dealer firm from whom the GNMA securities were purchased of which __% of the purchase price was paid in cash and by the delivery of U.S. Treasury Notes and bonds in the face amount of $26.4 million with a market value of $18 million, and ___% of the purchase price was financed through the sale under agreements to repurchase the Treasury Bills at maturity. Also, the amount of cash and the market value of securities on deposit at June 30, 1984 as well as carrying value and market value of the T-bills shall be disclosed in Note (3) to the June 30, 1984 financial statements.

In accordance with SFAS No. 5, the notes to the December 31, 1983 and the June 30, 1984 financial statements regarding contingencies shall include disclosure as to the issues that follow. The Company has entered into significant concurrent purchases and sales of securities under agreements to repurchase with one broker dealer firm. The broker dealer may pledge as collateral for its own borrowings any GNMA's, T-bills and other U.S. obligations held by it or on behalf of the Company. Full and complete disclosure should be provided of the Company's rights, remedies, claims and contingencies regarding these purchase and repurchase agreements in the event of the bankruptcy of the broker dealer. Detailed disclosure also should be made of the accounting which would be afforded these purchase and repurchase agreements in this event.

The proposed language on page 13 of your letter dated August 13, 1984 to be added to Note (3) to the June 30, 1984 financial statements should be expanded to state the name of the corporation whose capital stock is pledged to secure the $13.4 million note receivable and, if true, that this capital stock has a market value which is sufficient to substantially secure the collectibility of this receivable. If otherwise, please advise.

Management's Discussion and Analysis

In the forefront of Management's Discussion and Analysis, there shall be included a detailed discussion of the concurrent purchase and sale of GNMA's, T-notes and T-bills under agreements to repurchase which deals with all of the issues set forth below.

From December 31, 1982 to June 30, 1984, total assets of the company increased from $700 million to $1.4 billion. A major portion of this increase is attributable to a series of transactions between the company and one broker dealer firm. The purchases included the purchase of $300 million GNMA certificates and $460 million of one year U.S. Treasury bills. These transactions were financed by concurrently reselling the same securities to the broker dealer and agreeing to repurchase these securities from the broker dealer approximately one year later. If the broker dealer will not finance the GNMA purchases on favorable terms at the end of the one year period, the Company would be forced to find other sources of financing or sell the GNMA certificates. If the GNMA certificates had been sold at June 30, 1984, the Company would have been required to record a loss on the sales of $_____.

At June 30, 1984, the Company had advanced cash in the amount of $75.4 million and had delivered U.S. Treasury bonds and notes with a market value of approximately $18 million to the broker dealer as the Company's equity in the purchase of GNMA's and treasury Bills. The Company pays interest monthly to the broker dealer for the portion of the purchase price that has been borrowed from the broker dealer through the resale transaction. The GNMA securities are registered in the name of the Company. The institutions that service the mortgages underlying the GNMA certificates make principal and interest payments directly to the Company. The amount on deposit with the broker dealer fluctuates with the market value of the GNMA and Treasury securities purchased. The Company accretes interest on the Treasury bills which were purchased at a discount from their face amount and do not pay interest.

As a part of the arrangements to finance the purchase price of the GNMA securities and Treasury bills, the broker dealer has the right to use the GNMA securities and Treasury bills as collateral to secure loans made by the broker dealer. Full and complete disclosure should be provided of the Company's rights, remedies, claims and contingencies regarding these purchase and repurchase agreements in the event of the bankruptcy of the broker dealer. Detailed disclosure also should be made of the accounting which would be afforded these purchase and repurchase agreements in this event.

Management's Discussion and Analysis on page 36 should be expanded to disclose the amount of unrealized depreciation on the $300 million of purchased GNMA's as of each Balance Sheet date. It also should be clarified here that although the repurchase agreements have had a favorable impact on interest margin, any unrealized depreciation on these purchased GNMA's erodes this favorable impact. Also, disclosure should be made to the effect that these repurchase agreements are entered into with one broker dealer and that the favorable positive interest margin earned on these transactions is dependent upon the continued roll-over of these repurchase agreements with the broker dealer at favorable interest rates.

Please disclose in Management's Discussion and Analysis on pages 36 and 37 the actual amount of interest margin contributed to net income by the concurrent purchase and sale under agreements to purchase of GNMA's, T-notes and T-bills on a separate basis for the year ended December 31, 1983 and for the six months ended June 30, 1984.

Item 2 on page 46 under the discussion of Liquidity and Capital Resources should be revised to include disclosure of the following issues. The repurchase agreements entered into in the concurrent purchases of GNMA's and T-bills do not result in any immediate net cash inflow of funds to the Company and do not provide any funds to the Company for other corporate uses. Furthermore, these concurrent purchases and sales under agreements to repurchase have caused a net cash outflow since their inception to June 30, 1984 in the amount of approximately $75 million which represents the cash advanced on the original purchases and margin payments made on the repurchase agreements to compensate for market declines in the value of the securities purchased.

The discussion on page 46 under Liquidity and Capital Resources shall include a reference to other sections of Management's Discussion and Analysis and shall include a brief discussion regarding the uncertainties and risks of loss in these repurchase transactions should the broker dealer enter into bankruptcy or should the repurchase agreements on the GNMA's not be renewed at favorable interest rates at their maturity and the Company be required to sell these securities.

Please assure that the disclosures in Management's Discussion and Analysis of the amounts of the incremental increases in interest income and interest expense attributable to these repurchase transactions agree with the amounts of interest income and expense reflected in Exhibits B, C, and D of your letter dated August 13, 1984.

Other

The Company's June 30, 1984 Form 10-Q should be amended on Form 8 to reflect all of the above additional disclosures to the Notes to the financial statements and to Management's Discussion and Analysis.

In view of the revisions of the footnotes to the financial statements, it is requested that the independent accountants manually sign a new report in the amended filing on Form S-2. A currently dated and manually signed consent should be provided in the amendment to the report on Form S-2.

Please advise supplementally whether the concurrent purchase and sales of securities under agreements to repurchase, all of which transactions were done with one broker, discussed above are in compliance with regulations of the Division of Savings and Loan Associations of the State of Ohio. Also, please advise supplementally regarding the statutory reserve and net worth requirements under regulations of the State of Ohio and the actual statutory reserves and statutory net worth of the Company at December 31, 1983 and June 30, 1984. We may have further comments.

Any questions concerning any of the above accounting comments may be directed to Ms. Louise Dorsey at (202) 272-2712. Other questions may be directed to Ms. Deborah Silberman at (202) 272-7368.

Sincerely,

John F. Murphy
Branch Chief

G. HOME STATE'S AMENDMENTS TO SEC FORM 10-Q FOR QUARTER ENDING JUNE 30, 1984, DATED SEPTEMBER 28, 1984

Heme State Savings Bank

ORGANIZED 1890

EXECUTIVE OFFICES: 2727 Madison Road, Cincinnati, Ohio 45209-2295, (513) 871-3400

September 28, 1984

Filing Desk
Securities & Exchange Commission
450 Fifth Avenue, N. W.
Washington, D. C. 20549

Re: Commission File No. 0-3897

Gentlemen:

Enclosed for filing are one manually signed and seven conformed copies of Form 8 amending our Form 10-Q filing for the quarter ended June 30, 1984.

Very truly yours,

David J. Schiebel
Chairman of the Board
& Chief Executive Officer

DJS:am
Encls.

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 8

AMENDMENT TO APPLICATION OR REPORT
Filed Pursuant to Section 12, 13 or 15(d) of
THE SECURITIES EXCHANGE ACT OF 1934

HOME STATE SAVINGS BANK

(Exact Name of Registrant as Specified in Charter)

AMENDMENT NO. 1

The undersigned Registrant hereby amends the following items, financial statements, exhibits or other portions of its Form 10-K, Annual Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934, for the calendar year ended December 31, 1983.

1. The language appearing on page 29 of the Form 10-K in the paragraph entitled "General" under the sub-heading "Comparison of 1983 to 1982" of Item 7 is deleted in its entirety and the language set forth on Exhibit "A" attached hereto and made a part hereof is deemed substituted therefor.

2. The language appearing on page 34 of the Form 10-K in paragraph numbered 2 entitled "Repurchase agreements" under the sub-heading "Liquidity and Capital Resources" of Item 7 is deleted in its entirety and the language set forth on Exhibit "B" attached hereto and made a part hereof is deemed substituted therefor.

3. The language appearing on page 59 of the Form 10-K in the subparagraph entitled "Loans", being the first unnumbered paragraph of Footnote (1)(d) to the Notes to Consolidated Financial Statements December 31, 1983, 1982 and 1981 ("Footnotes") is deleted in its entirety and the language set forth on Exhibit "C" attached hereto and made a part hereof is deemed substituted therefor.

4. The first unnumbered paragraph appearing on page 65, being the first paragraph following the summary of "Loans and Other Receivables" at December 31, 1983 and 1982 in Footnote 4 to the Footnotes is deleted in its entirety and the language set forth on Exhibit "D" attached hereto and made a part hereof is deemed substituted therefor.

5. The last paragraph appearing on page 67, being the second full paragraph following the summary of Marketable Securities at December 31, 1982 to Footnote (5)(a) to the Footnotes is deleted in its entirety and the language set forth on Exhibit "E" attached hereto and made a part hereof is deemed substituted therefor.

6. The language on Exhibit "F" attached hereto and made a part hereof shall be inserted on page 78 as the first unnumbered paragraph of Footnote (14) to the Footnotes.

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Amendment to be signed on its behalf by the undersigned, thereunto duly authorized.

HOME STATE SAVINGS BANK

By _____
David J. Schiebel, Chairman of the Board and Chief Executive Officer

By _____
Robert J. Weeder, Senior Vice Preside Treasurer and Chief Financial Officer

Dated: September 27, 1984

General - From December 31, 1982 to December 31, 1983, total assets of the Company increased from $700 million to $1.35 billion. A major portion of this increase is attributable to a series of transactions effected by the Company through one broker-dealer firm. These transactions included the purchase of $300 million of GNMA certificates at approximately par and $400 million of U.S. Treasury Notes, at approximately par. The GNMA certificates are registered in the name of the Company, and the institutions that service the underlying mortgages make principal and interest payments directly to the Company. The Company receives interest on the U.S. Treasury Notes which mature in 1988 on a semi-annual basis.

These transactions were financed by concurrently reselling the same securities and agreeing to repurchase them approximately one year later. The Company pays interest monthly for the portion of the purchase price that has been financed. At December 31, 1983, the Company had advanced cash in the approximate amount of $103 million ($62.4 on GNMA loans and $32.0 on T-Notes) as the Company's equity in the transactions. The amount so advanced fluctuates with the market value of the GNMA loans and securities purchased.

Should be 94.4

To the extent that the Company does not arrange financing of the GNMA purchase through the same broker dealer at the end of the one year period the Company would need to find other sources of financing or sell the GNMA certificates. Such other financing could include similar repurchase agreements with other parties (at December 31, 1983 the GNMA loans have a carrying value of $288,705,000 market value of $273,255,000 and related borrowings of $222,562,000) or be financed through internal funding raised through deposits. Management of the Company currently believes if such an occurrence should arise that such financing could be obtained.

As of June 30, 1984 the Company had GNMA loans (cost of $284,537,000 and carrying value of $276,106,000) yielding approximately 11.5% with the related repurchase agreements amounting to $213,714,000 that mature in June 1985 paying interest at approximately 9.625%. The maintenance of the interest yield on this transaction is dependent on future interest rates at the time of the maturing repurchase agreement of June 1985. In regards to the T-Note transactions see footnote 5 to the financial statements.

The effect on net interest margin taking into account interest earned on GNMA loans and T-Notes and the respective cost to finance those assets (repurchase agreements and deposits) is approximately $2,800,000 for GNMA loans and $150,000 for T-Notes for the period from purchase to December 31, 1983.

These transactions and the financing thereof have been effected with different principals. Generally, in the event of the bankruptcy of a principal, the Company would, in accordance

with customary industry practices, have the right to (i) liquidate all outstanding repurchase agreements with that principal and cover all related positions, (ii) offset all amounts due from that principal against all amounts owed by the Company to that principal and (iii) seek to recover the Company's equity held by that principal under such repurchase agreements. Recovery of the Company's equity would be subject to the same risks to which unsecured creditors of a bankrupt are generally subject. The exercise of such rights would be subject to the automatic stay and avoidance provisions of the Bankruptcy Code with respect to any case filed on or before October 1, 1984. With respect to any case filed after October 1, 1984 such rights would be immediately exercisable. In the event of the bankruptcy of the broker-dealer, the repurchase agreements effected through it would not be adversely affected since the broker-dealer acted as agent. In the event of the bankruptcy of a principal, the Company would need to estimate the amount of recovery on equity held by the principal and reserve for the estimated loss, if any.

In 1983 net income increased by $3,926,000. Total revenues increased $20,398,000 or 22% while total costs and expenses increased $20,373,000 or 21% over 1982 amounts. Equity in undistributed earnings of partially owned companies decreased $1,300,000 while gain on the sale of partially owned companies increased $5,201,000 between years, with a decrease in earnings of a partially owned company held for sale of $2,736,000.

2. Repurchase agreements -- As previously discussed, the Company has been able to raise funds by selling securities and loans under agreements to repurchase at a later date. Substantially all of these repurchase agreements have been arranged through E.S.M. Government Securities, Inc. As described in the general section of management's discussion and analysis the Company as of December 31, 1983, has purchased GNMA loans with a carrying value of $288,705,000 and T-Notes with a carrying value of $399,300,000 by financing such transactions with $222,562,000 and $342,222,000 in repurchase agreements, respectively. The remaining financing of the transactions has been obtained through savings deposits. A more detail discussion of these transactions in regards to interest rate factors on such assets and financing arrangements, matters regarding the issuance of such repurchase agreements, and the repurchase of GNMA's and T-Notes along with discussion of the Company's remedies if a principal to the repurchase agreement should enter bankruptcy is included in the general section of management's discussion and analysis of financial condition and results of operations.

EXHIBIT "B"

Loans---During 1983, the Company used financial futures to hedge the value of fixed rate loans. Gains and losses on futures contracts are accounted for as discount or premium on the loans up to the amount of unrecognized loss or gain on the loans. Amortization of the discount or premium begins when the futures contracts are closed. Gains and losses on futures contracts in excess of unrecognized loss or gain on the loans are recorded in income currently.

EXHIBIT "C"

During the year the Company's savings association subsidiaries purchased, at approximately par, 11% and 11.5% GNMA pass-through certificates in the face amount of $300,000,000. The GNMA loans were purchased from the broker dealer firm with approximately 10% of the purchase price paid in cash and the remaining 90% financed through the concurrent sale of these loans under agreements to repurchase (the repurchase agreements) arranged with that broker dealer. Under the terms of the repurchase agreements, as the market value of the GNMA's declines, the Company may be required to repay a portion of the repurchase agreements in cash to compensate the broker dealer for the market value decline, whereas an increase in market value may result in the Company increasing the amount of its repurchase agreements. At the time the GNMA's were purchased, interest rate futures contracts were sold to hedge $250 million of the $300 million of GNMA's against market value declines. As of December 31, 1983 net deferred gains, amounting to $1,532,000 on such futures contracts have been deferred and are to be accreted into income over the estimated life of the GNMA loans.

As of December 31, 1983, the above GNMA's carrying value, adjusted for principal payments since the date of purchase, accretion of discount and the deferral of the above described deferred gain on hedge transactions, was $288,705,000 and the market value was $273,255,000. At December 31, 1983, the Company had outstanding $222,562,016 under related repurchase agreements which bear interest at 9.375% and mature in April through June 1984.

In June 1983, Home State Savings purchased at approximately par, 10½% U.S. Treasury Notes (the T-Notes) with a face value of $400,000,000 and a maturity of August 1988 from E.S.M. with approximately 5% of the purchase price paid in cash and the remaining 95% of the purchase price financed through the concurrent sale of the T-Notes under agreements to repurchase arranged with that broker dealer. As the market value of the T-Notes declines, the Company may be required to repay a portion of the repurchase agreements in cash to compensate the broker dealer for market value decline, whereas an increase in market value may result in the Company increasing the amount of repurchase agreements. As of December 31, 1983, the Company had outstanding $342,222,486 under these repurchase agreements which bear interest at 9.625% and mature in June 1984.

Subsequent to March 29, 1984, the date of the auditors' report, certain provisions of the Bankruptcy Code were clarified with respect to repurchase agreements and related collateral. As previously noted, the Company has entered into significant concurrent purchases and sales of securities under agreements to repurchase with one broker dealer firm. These transactions and the financing thereof have been effected with different principals. Generally, in the event of the bankruptcy of a principal, the Company would, in accordance with customary industry practices, having the right to (i) liquidate all outstanding repurchase agreements with that principal and cover all related positions, (ii) offset all amounts due from that principal against all amounts owed by the Company to that principal and (iii) seek to recover the Company's equity held by that principal under such repurchase agreements. Recovery of the Company's equity would be subject to the same risks to which unsecured creditors of a bankrupt are generally subject. The exercise of such rights would be subject to the automatic stay and avoidance provisions of the Bankruptcy Code with respect to any case filed on or before October 1, 1984. With respect to any case filed after October 1, 1984 such rights would be immediately exercisable. In the event of the bankruptcy of the broker-dealer, the repurchase agreements effected through it would not be adversely affected since the broker-dealer acted as agent. In the event of the bankruptcy of a principal, the Company would need to estimate the amount of recovery on equity held by any one principal and reserve for the estimated loss, if any.

H. FOLLOW-UP LETTER FROM MURPHY TO HOME STATE DATED DECEMBER 12, 1984

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
ORPORATION FINANCE

Certified Mail
Return Receipt Requested

December 12, 1984

Mr. David J. Schiebel, President
Home State Savings Bank
2727 Madison Road
Cincinnati, Ohio 45209

Re: Home State Savings Bank
Form 8 Amendment No. 1 to Form 10-Q
for the period ending June 30, 1984
and Form 8 Amendment No. 1 to Form
10-K for the period ending 12/31/83

Dear Mr. Schiebel:

The staff has monitored the bankruptcy discussion in the above-referenced documents and has the following comments pursuant to our telephone conversation of December 7, 1984. Additional comments relating to other aspects of these documents and the Form 10-Q for the period ended September 30, 1984 may be forthcoming under separate cover.

Pursuant to our conversation, please provide supplementally to the staff the following information.

Describe the exact nature of the agreement with E.S.M. concerning reverse repurchase agreements effected with them, your understanding of the terms of the agreement and your rights and responsibilities with respect to such transactions including, among other things, any mark-to-market requirements, delivery requirements, payments requirements, and the basis for your understanding. Please identify the flow of securities and funds following initiation of such transactions.

Provide a detailed discussion of the basis for your position that E.S.M. is not the principal to the transactions discussed, and that the confirmations sent to you by E.S.M. in those transactions, which indicate that E.S.M. is acting as principal, are not controlling.

Indicate the basis for your position that a confirmation received from E.S.M. by a party which receives securities registered in Home State's name pursuant to a repurchase agreement effected by that party through E.S.M., which confirmation indicates that E.S.M. sold such securities to that party as principal, is not controlling with respect to E.S.M.'s role in the transaction.

Furthermore, indicate which parties you consider to be the principals to Home State's transactions with E.S.M. and the basis for that determination with specific reference to any documentation, conversations, or agreements effected directly by Home State with those parties.

Please describe in detail the exact nature of your procedure for identifying the parties considered by you to be the principal in these transactions, when such identity is known to you relative to the initiation of the transaction, and any contact you have at any point with such parties. Furthermore, describe in detail the procedure for confirming the location of securities given by you to E.S.M. as collateral for such transactions and the fact that such securities remain registered in your name. Indicate your relationship with the parties responsible for such confirmation.

Provide a discussion of the rights in the event of the bankruptcy of E.S.M. of Home State relative to those of the bankruptcy trustee and other parties to reverse repurchase agreements effected by Home State with E.S.M. with respect to the securities which are the subject of such agreements. Specifically discuss the rights of such other parties relative to the rights of Home State and the bankruptcy trustee with respect to securities held by such other parties which are registered in Home State's name and endorsed in blank or accompanied by a "stock power". In addition, indicate whether the securities held by such parties or any proceeds from the liquidation of such securities would be the property of E.S.M.'s estate and the basis for that determination. Finally, provide your understanding of the sequence of events which would occur in the event of the bankruptcy of E.S.M. beginning with your actions upon notification of such bankruptcy.

Assuming that E.S.M. is acting in a agency capacity, you have indicated on page 6 of Exhibit "C" of your mpany's Form 8 amendment filed October 1, 1984, that "the aximum amount of the Company's equity held by any one rincipal is $23,000,000." Assuming, however, that E.S.M. is deemed to be the principal in these transactions, advise what the dollar amount of Home State's equity held by E.S.M. on an unsecured basis would be.

Please clarify your statement that Home State would not effect such transactions with E.S.M. on a principal basis because of the net worth of E.S.M. and reference any regulatory provision which would prohibit transactions on that basis.

We hereby reiterate our request in our comment letter of August 24, 1984, that you advise the staff supplementally whether the concurrent purchase and sale of securities under agreements to repurchase, al. of which transactions were done with one broker, are in compliance with the regulations of the Division of Savings and Loan Associations of the State of Ohio and the actual statutory reserves and statutory net worth of the Company at December 31, 1983, June 30, 1984 and September 30, 1984.

It is requested that the information requested above be submitted immediately and not later than December 21, 1984. If such information is not received by that date, the Division will consider what additional actions may be appropriate to obtain the information.

Any questions may be addressed to Deborah Silberman at (202) 272-7368.

Sincerely,

John F. Murphy
Branch Chief

I. LETTER FROM HOME STATE TO SEC, DATED DECEMBER 18, 1984

KELLEY DRYE & WARREN

ONE LANDMARK SQUARE

STAMFORD, CT. 06901

(203) 324-1400

CABLE "LAWYERLY" NEW YORK

TELEX 12369

TELECOPIER (203) 327-2669

TAGGART D. ADAMS
TRACY B. AMBLER
DAVID E. BARRY
RICHARD G. BRODRICK
JOHN M. CALLAGY
DAVID R. CHIPMAN
SAMUEL S. CROSS
BUD GEO. HOLMAN
LELAND J. MARKLEY
HOWARD S. TUTHILL III

JOSEPH W. DRAKE, JR.
NEIL T. PROTO
COUNSEL

JOHN T. CAPETTA
RICHARD S. CHARGAR
WILLIAM P. FORNSHELL
JUDITH L. HARRIS
RICHARD S. LAND
JULIA V. PARRY
BARBARA B. SCHADT

101 PARK AVENUE
NEW YORK, NY 10178
(212) 808-7800

30 MAIN STREET
DANBURY, CT 06810
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1333 NEW HAMPSHIRE AVE., N.W.
WASHINGTON, D.C. 20036
(202) 463-8333

100 NORTH BISCAYNE BLVD.
MIAMI, FL 33132
(305) 372-0030

624 SOUTH GRAND AVENUE
LOS ANGELES, CA 90017
(213) 689-1300

50 CALIFORNIA STREET
SAN FRANCISCO, CA 94111
(415) 989-3530

175 SOUTH STREET
MORRISTOWN, NJ 07960
(201) 267-4949

NISHIDATE & SOGI
IMPERIAL TOWER
1-1, UCHISAIWAICHO
1-CHOME, CHIYODA-KU
TOKYO 100, JAPAN

December 18, 1984

FEDERAL EXPRESS

Deborah Silberman, Esq.
Branch One
Securities and Exchange Commission
Washington, D.C. 20549

Re: Home State Savings Bank

Dear Ms. Silberman:

This letter will follow up on the telephone conversation earlier today among you, me and Gehl Babinec, General Counsel of Home State Savings Bank (the "Bank"), with respect to the letter dated December 12, 1984 from John F. Murphy, Branch Chief of the Securities and Exchange Commission, to David J. Schiebel, President of the Bank.

As we discussed, the Bank is not in a position to respond to the letter within the time frame set forth therein due to the year-end business demands on the Bank (with respect to servicing its customers, closing out its books at year-end, planning for the new year and other matters) and the fact that the Bank did not receive the letter until late afternoon on December 17, 1984. The Bank desires to cooperate fully with the Commission in this matter, and expects that it will be able to respond to the letter by January 7, 1985, if not sooner.

In addition to the matters we discussed, we would appreciate it if you would furnish to the Bank the additional comments referred to in the letter so that the Bank can respond to the Commission's requests without unnecessary delay or duplication of effort.

Your cooperation is greatly appreciated.

Sincerely,

M. Ridgway Barker

cc: Gehl P. Babinec, Esq.

J. FOLLOW-UP LETTER FROM HOME STATE TO SEC, DATED JANUARY 3, 1985

HOME STATE SAVINGS BANK
Since 1890
2727 Madison Road • Cincinnati, Ohio 45209-2295 • (513) 871-3400

David J. Schiebel
Chairman of the Board
Chief Executive Officer

Recd & 1
1/4/85

January 3, 1985

Via: Federal Express
Airbill No. 951925730

Ms. Deborah Silberman
United States Securities
and Exchange Commission
Washington, D. C. 20549

Re: Letter dated December 12, 1984 from
John F. Murphy, Branch Chief

Dear Ms. Silberman:

This will confirm our telephone conversation of January 3, 1985 wherein we requested a two week extension, that is until January 18, 1985, in order to respond to the above referenced letter. It is our desire to respond to you as quickly as possible but found it necessary to engage additional counsel so that the subject of the letter can be thoroughly evaluated.

The new counsel has requested time to enable them to review the files and do the proper research in order that we would respond to you in the proper manner.

Very truly yours,

HOME STATE SAVINGS BANK

David J. Schiebel
Chairman of the Board

DJS:ms

K. LETTER FROM HOME STATE TO MURPHY, DATED JANUARY 21, 1985

HOME STATE BANK
SAVINGS
Since 1890

January 21, 1985

Mr. John F. Murphy
Branch Chief
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

RECEIVED IN BR. 1
JAN 22 1985

Dear Mr. Murphy:

We are writing with respect to your letter of December 12, 1984 addressed to Home State and with reference to telephone conversations our attorney Gary P. Kreider of Keating, Muething & Klekamp has had since January 9 with Deborah Silberman of the Staff.

The matters discussed in your letter of December 12, 1984 pursuant to an earlier telephone conversation with us, generally relate to those that were raised in your comment letter of August 24, 1984 to the Company's Registration Statement 2-88983. Even though we elected to withdraw the Registration Statement as a result of a certain consolidation transaction reported in the Company's Form 8-K dated September 5, 1984, our counsel in that process advised us that we should consider the comments with respect to the Company's filings on Forms 10-K and 10-Q. At that point the Company engaged other counsel with whom you have been in contact with respect to the technical bankruptcy related questions raised by the comment letter of August 24. The thrust of the disclosure questions concerns the effect upon the Company in the event E.S.M. Government Securities, Inc. ("E.S.M.") should become bankrupt.

By way of illustration, a typical transaction would be as follows. The Company would contact E.S.M. desiring to purchase a $10 million GNMA certificate to be partially financed through a repurchase agreement. E.S.M. would buy this certificate for the Company for $10 million financed by a $1 million deposit made by the Company with E.S.M. plus a credit advance to date of settlement of $9 million by E.S.M. The certificate would be registered in the name of Home State but be accompanied by a bond power signed by it. The Company would then enter into a repurchase agreement whereby it received $9 million from E.S.M. and had the right to repurchase the $10 million GNMA certificate in one year for $9 million. The Company's understanding with E.S.M. was that E.S.M. would immediately enter into another repurchase agreement with a third party whereby E.S.M. would receive $9 million for the same GNMA certificate which would then be delivered to the third party under a repurchase agreement. That third party repurchase agreement would call for E.S.M. to repurchase the instrument the same date as its obligation to meet the Company's

repurchase agreement matured. The Company received confirmations from E.S.M.'s accountants, Alexander Grant & Company, as to the existence of the third party repurchase agreements as of December 31, 1983.

These transactions were entered into orally, as is common in the industry, with the only papers evidencing the transactions being trade slips submitted to the Company by E.S.M. In developing our response to your comments of August 24th, we concluded that these transactions resulted in a direct repurchase agreement between the Company and the third parties and that E.S.M. was acting solely as our agent in arranging these transactions. The counsel we engaged to study the matter with respect to our filings advised us similarly and the filings were made on that basis.

After receiving your letter of December 12, the Company again consulted with the counsel which had advised it to take the position that E.S.M. was acting as an agent in the transaction and received a confirmation of that approach. Because of the thrust of your letter of December 12, however, the Company then decided to engage other counsel and asked the counsel which had represented us in connection with the Registration Statement to examine the matter again. As a result of their examination and advice, the Company has rethought its position with respect to the relationships between it and E.S.M. The Company's position on this matter can now be summarized as follows.

In the event of the bankruptcy of E.S.M. the Company would take the position in any action that E.S.M. was acting as its agent and that therefore the Company's repurchase commitment was with the third party involved and not E.S.M. and that therefore it was unaffected by E.S.M.'s bankruptcy. However, our present counsel, Keating, Muething & Klekamp, has advised us that while the matter is not free from doubt due to the lack of court interpretation in this area, it is likely that the Company would not be successful in advancing this theory. Therefore, we acknowledge that it is likely that a Court would reject our approach and find that the Company was dealing with E.S.M. as a principal. In that instance the Company would stand as an unsecured creditor with respect to the obligations of E.S.M. to it. Absent the intervention of a Securities Investors Protection Corporation trustee, the Company believes that it could liquidate its repurchase positions with E.S.M. upon any such bankruptcy of E.S.M. based upon recent amendments to the U. S. Bankruptcy Code. Upon liquidation in the above example the Company could cancel its $9 million obligation to E.S.M.; E.S.M. would keep its rights with regard to the GNMA certificate; and the Company would have an unsecured claim for $1 million it deposited with E.S.M. plus or minus the effect of any increase or decrease of the market value of the GNMA certificate due it.

Therefore, the Company intends to amend its Form 10-K for the year ended December 31, 1983 and its Form 10-Q's filed for the quarters ended March 31, June 30 and September 30, 1984 to reflect this position. The total amount of its exposure in the

event of a bankruptcy of E.S.M. at specified dates would be included. We will continue the disclosure in required filings with you as long as repurchase arrangements with E.S.M. or any other individual broker results in a similar exposure in excess of 5% of shareholders equity.

We can also advise you that there are no regulations in the Division of Savings and Loan Associations in the State of Ohio which bear upon this subject. Furthermore, the actual statutory net worth, including statutory reserves, of the Company at December 31, 1983, June 30, 1984 and September 30, 1984 were $17,774,665, $19,195,000 and $20,567,000 respectively, as reported to the Division of Savings and Loan Associations, State of Ohio.

We trust we have adequately addressed all of the elements raised in your letter of December 12, but if further clarification is needed, please feel free to call either the undersigned or our counsel, Gary P. Kreider at (513) 579-6411.

We are in the process of preparing amendments to the Forms referred to above and will discuss the filing of those amendments with your shortly.

Sincerely,

HOME STATE SAVINGS BANK

David J. Schiebel
President

DJS/kea
LEG-1120

cc: Deborah Silberman

APPENDIX 7.—FEDERAL RESERVE DOCUMENTS

A. LETTER FROM H. TERRY SMITH, VICE PRESIDENT, FEDERAL RESERVE BANK OF ATLANTA, TO BOARD OF DIRECTORS, AMERICAN BANCSHARES, INC., DATED MARCH 18, 1977

FEDERAL RESERVE BANK
OF ATLANTA
ATLANTA, GEORGIA 30303

OFFICE OF
VICE PRESIDENT

March 18, 1977

Board of Directors
American Bancshares, Incorporated
11601 Biscayne Boulevard
North Miami, Florida 33161

Dear Sirs:

There is enclosed a Report of Inspection of Operations and Condition of your organization as of December 31, 1976 which was prepared by examiner Sonny L. Bivins. Your attention is directed to the memorandum appearing on the cover of this report, examiner's comments and other information presented therein.

The financial position of American Bancshares, Incorporated ("American") is of serious concern. In view of this concern, the Reserve Bank will afford continued close supervision to the activities of American and the following submissions are requested by the dates specified:

March 31, 1977

Regulation R Notification

Regulation R of the Board of Governors of the Federal Reserve System is made applicable to bank holding companies by paragraph 4705 of the Board's Published Interpretations. (12 CFR 218.114). The Regulation prohibits any officer, director or employee of a corporation, association, or partnership or any individual engaged in the issue, flotation, underwriting, public sale or distribution, at wholesale or retail, of stocks, bonds or similar securities, from serving as an officer, director, or employee of a member bank. The Regulation provides an exception for individuals so employed if their activities are confined to those securities which national banks may lawfully underwrite and deal in under paragraph seven of section 5136 United States Revised Statutes and prescribed by regulation of the Comptroller of the Currency. Therefore, a director, officer or employee of a bank holding company may deal in or underwrite United States obligations or general obligations of a state or political subdivision. A director, officer or employee may not deal in or underwrite corporate bonds or non-general obligations (such as most revenue bonds) of a state or political subdivision.

Accordingly, please review the business activities of each member of the directorate to assure that the service of each is beyond question with respect to the provisions of Regulation R and section 32 of the Banking Act of 1933. Final determination of the applicability of the statutes is the responsibility of the Board of Governors of the Federal Reserve System.

Advice of Change in Stock Ownership and Information Regarding Directors

Pursuant to authority granted by section 5 of the Bank Holding Company Act, the following is requested:

1. Notice of change in control of shares resulting from any transactions consummated after December 31, 1976, amounting in the aggregate to 5 percent or more of American's shares. Notification is to include:

   a. Name of seller
   b. Name of purchaser
   c. Number of shares transferred and percent of outstanding stock.
   d. If purchaser pledged shares so acquired against any borrowings, notice must include full information as to name of lender, terms of indebtedness, collateral restrictions and other covenants to such loans.
   e. Description of any changes in management and the directorate resulting from the transfer.

2. Biographical information and financial statements on any such purchasers on the forms enclosed.

These submissions are required by the date specified for recent transfers of shares and within two weeks of any future transactions involving 5 percent or more of American's shares.

April 15, 1977

Management Fees and Dividends

1. Statement of corporate policy with respect to management fees to be charged to subsidiaries, including description of the services to be provided and method of allocation of expenses.

2. Statement of dividend policies of banking subsidiaries.

3. Projections, by subsidiary, of 1977 management fees to be paid and dividend payments.

Cash Flow Projections

Attachment, entitled "Funds Flow Analysis," is to be completed and submitted.

April 25, 1977

Resolution Regarding Certain Transactions

In view of the recent transfer of a substantial number of shares of American and the accompanying uncertainties regarding the application of section 32 of the Banking Act of 1933 and the Board's Regulation R, it is requested that the enclosed resolution be adopted by the board of directors of American in order to provide assurances to the Reserve Bank that the conduct of the affairs of the organization will be in accordance with sound banking principles. A certified copy of the resolution should be forwarded to the Reserve Bank.

Monthly, within 15 days of the end of each month

1. Balance sheets and income statements of:
   a. American (parent only and consolidated)
   b. each subsidiary bank.

2. Comparison of actual to projected management fees and dividends paid by subsidiaries.

Please sign the receipt form under the cover of this report and return it to this office. After your review of this report, please advise of the date of the meeting at which it was considered and any initiatives implemented toward improvement in the condition of American.

The Reserve Bank is ready to assist management and the directorate in a manner consistent with its supervisory responsibilities. Your cooperation in meeting the requests contained herein is appreciated.

Very truly yours,

H. Terry Smith

H. Terry Smith

PROPOSED RESOLUTION

Whereas, the Board of Directors of American Bancshares, Incorporated, ("American") wishes to assure the Board of Governors of the Federal Reserve System of the intent of American and its subsidiaries to refrain from any transactions which might place the banking subsidiaries at risk beyond the parameters considered ordinary and customary for commercial banks;

Be it resolved that:

As of and after this date American and its subsidiaries will not knowingly purchase or repurchase, assume or acquire in any manner, in their own capacity or as a fiduciary or nominee, any loan, loan participation, security or other assets, directly, indirectly or in an agency capacity, from the following:

a. E.S.M. Securities, Incorporated, Fort Lauderdale, Florida; ("ESM")

b. any officer, director or employee of ESM or any of their relatives by blood or marriage;

c. any affiliate of ESM (as defined by the Banking Act of 1933);

d. any other corporation, partnership, sole proprietorship, or business association in which any of the persons described in a. b. c. above is employed as an officer, director or employee or has a financial investment.

B. COMMENTS OF FIRST MARINE BANKS, INC. IN OPPOSITION TO COMBANKS' APPLICATION TO ACQUIRE CONTROL OF FIRST MARINE (EXCERPTS), DATED OCTOBER 31, 1980

BEFORE THE BOARD OF GOVERNORS

OF THE

FEDERAL RESERVE SYSTEM

- x

In the Matter of the Applications : of ComBanks Corporation and Great American Banks, Inc. for : Prior Approval to Acquire up to 49% of the Common Stock of : First Marine Banks, Inc. :

- x

COMMENTS OF

FIRST MARINE BANKS, INC.

IN OPPOSITION TO

APPROVAL OF THE APPLICATIONS

Council to Com Banks, Inc

CHADBOURNE, PARKE, WHITESIDE & WOLFF
Attorneys for First Marine
Banks, Inc.
30 Rockefeller Plaza
New York, New York 10112

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INTRODUCTION

These comments are submitted on behalf of First Marine Banks, Inc., Riviera Beach, Florida ("First Marine"), a Florida corporation registered as a bank holding company under the Bank Holding Company Act of 1956, as amended ("the Act"). The comments relate to the applications ("the Applications") filed pursuant to Section 3(a)(3) of the Act by ComBanks Corporation, Winter Park, Florida ("ComBanks") and Great American Banks, Inc., North Miami, Florida ("American"), which also are registered as bank holding companies under the Act, for approval by the Board of Governors of the Federal Reserve System ("the Board") of the proposed acquisition by ComBanks and American of up to 49% of the Common Stock of First Marine.

First Marine stated its preliminary objections to the Applications in a letter dated September 5, 1980 from its counsel to the Board. These comments are intended to provide a more detailed basis for First Marine's view that the Applications fail to meet the criteria for Board approval set forth in Section 3(c) of the Act and therefore should not be approved by the Board. First Marine respectfully submits that the Applications should not be approved by the Board for the following reasons, which are discussed more fully herein:

GAB & ComBanks seeking First Marine

(a) First Marine believes that the financial resources of American and ComBanks are insufficient to be a source of financial strength to First Marine, as required by Section 3(c) of the Act and previous Board decisions thereunder. Moreover, the financial strengths and resources of First Marine are so much greater than those of American or ComBanks that the Board should be extremely reluctant to approve a transaction that might have a materially adverse effect on an otherwise financially strong bank holding company.

(b) On the basis of a review of the limited information as to which it has access, First Marine believes that there are serious questions as to the adequacy and integrity of the managerial resources of American and ComBanks, as required by Section 3(c) of the Act. At the very minimum, First Marine believes that the incidents referred to herein raise sufficiently disturbing questions regarding the managerial resources of American and ComBanks to require a full and thorough investigation by the Board of these and related incidents, both through the subpoena of documents and the sworn testimony of witnesses at a public hearing.

(c) First Marine believes that the proposed acquisition would substantially lessen potential competition in the relevant banking markets, and that these anticompetitive

effects would not be outweighed by any compensating increase in the satisfaction of the needs and convenience of the communities to be served.

(d) First Marine believes that the applications utterly fail to demonstrate that the present needs of the communities served by First Marine are not being met and do not describe in any meaningful way how these needs would be better served if the Applications are approved. Moreover, on the basis of the relative weaknesses of the financial and managerial resources of ComBanks and American as compared to those of First Marine, it is difficult to believe that American and ComBanks would improve upon, or even maintain, First Marine's very favorable record of serving the convenience and needs of the communities in which it operates.

(e) First Marine believes that the terms of American's proposed exchange offer for First Marine Common Stock are grossly unfair to First Marine's shareholders.

For the foregoing reasons, First Marine respectfully requests that the Board determine not to approve the Applications. In the event that the Board decides that further investigation and a public hearing are necessary and desirable prior to making any decision regarding the Applications, First Marine respectfully requests an opportunity to be informed about and participate in such investigation and public hearing in view of its obvious substantial interest in the outcome thereof.

SOURCES OF INFORMATION

A substantial portion of First Marine's comments concerning the managerial resources of ComBanks and American is based on information that First Marine is not in a position to confirm as to accuracy or completeness. Where possible this information is based upon publicly available documents; but in addition a substantial source has been interviews with a number of individuals, including former officers and directors of ComBanks, American and their subsidiary banks. All interviews were freely given, and obviously no economic or other inducements were provided by or on behalf of First Marine. First Marine has no reason to believe the information provided in the interviews is not accurate.* At the same time, however, it is noted that the information provided or suggested in interviews sometimes appeared to have been based more on inference or opinion than on a first-hand knowledge of the facts. While much of this evidence is hearsay, we believe it is appropriately directed to the Board's attention for two reasons: first, there was corroboration since a number of persons at different times and locations made similar comments; and second, First Marine does not have access, as the Board does, to the records and personnel of American and ComBanks that would be needed to document the accuracy of the information.

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* Many of the people interviewed were concerned that their identities not be disclosed in this memorandum, for they did not wish to become parties to this proceeding or be subject to suit by the Applicants. While the names of interviewees are therefore omitted, any reasonable investigation, would, we believe, be likely to include many if not all the persons from whom information was obtained.

FACTS

ComBanks/American. ComBanks is a registered bank holding company with principal executive offices in Winter Park, Florida. ComBanks owns substantially all of the stock of six subsidiary banks which are chartered by the State of Florida and are members of the Federal Deposit Insurance Corporation ("FDIC"). The banks are located in the Orlando-Winter Park area. ComBanks also owns 100% of the stock of three non-bank subsidiaries.*

American is a registered bank holding company with principal offices in North Miami, Florida. American's eight subsidiary banks, which are substantially owned by American, are located in the southeastern, Tampa-Clearwater and Gainesville, Florida areas. The banks are chartered by the State of Florida and are members of the Federal Deposit Insurance Corporation. American also owns all of the stock of four non-bank subsidiaries.**

Marvin L. Warner is the principal shareholder of ComBanks; Warner, his affiliates and other officers

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* ComBanks' non-bank subsidiaries are ComBanks Mortgage Company, Consolidated Recovery Services, Inc. and ComBanks Insurance Agency, Inc.

** The non-bank subsidiaries of American are American Bancshares Mortgage Company, Inc. (which has been inactive since 1979), American Properties Holding Company, American Bancshares Insurance Agency, Inc. and American Bancshares Services, Inc.

and directors of ComBanks together own approximately 95% of ComBanks Common Stock.* Warner and his associate Hugh Culverhouse took control of ComBanks in May 1976 pursuant to a tender offer as a result of which they acquired 40.6% and 42% respectively, of the outstanding shares of ComBanks.** Warner is currently the beneficial owner, directly or indirectly, of 317,000 shares (53.2%) of the Common Stock of ComBanks. He is also the holder of 84.77% of the common stocks of Warner National Corporation, which holds 100% of the shares of Home State Saving Association ("HSSA") and Home State Financial Services ("HSFS"), the latter of which holds 126,424 shares (21.2%) of the voting stock of ComBanks.

ComBanks owns 589,604 shares (28.4%) of the Common Stock of American, as well as 100,000 shares of American Class A Preferred Stock (which are convertible into 385,000 shares of American Common Stock) and warrants for the purchase of 704,842 shares of American Common Stock. Assuming

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* See Amendment No. 1 to ComBanks' Registration Statement on Form S-1 filed with the Securities and Exchange Commission ("SEC") on September 12, 1980 ("ComBanks' Amended S-1"), p. 2. Exhibit A. (All references to exhibits are to the volumes of exhibits submitted herewith.) Amendment No. 1 to American's Registration Statement on Form S-1 filed with the SEC on September 16, 1980 ("American's Amended S-1") is provided herewith as Exhibit B.

** In December 1977, Culverhouse sold his shares of ComBanks Common Stock to Marvin Warner, Home State Financial Services, and ComBanks' Pension and Profit Sharing Plans. See letter dated January 25, 1978 from ComBanks to the Board. Exhibit C.

ComBanks were to convert such American Preferred Stock and exercise such American warrants, ComBanks would own 1,679;446 shares (53.1%) of American's Common Stock. ComBanks has received regulatory approval to acquire all of the stock of American through the issuance of ComBanks Preferred Stock, and has stated that although it has not decided to seek 100% ownership of American's Common Stock at this time, it may in the future propose a transaction that would retire the publicly held stock of American.*

The common core of stock ownership of ComBanks and American is reflected in their management as well, with the result that a group whose hub is Marvin Warner controls the managerial decisions of both companies. Warner is Chairman of the Board and President of both ComBanks and American and Chairman of the Executive Committees of both. Of the seven persons serving as ComBanks' Directors, six also serve on American's Board, and six of the eight persons serving as American's Directors also serve on ComBanks' Board. The persons who do not hold positions on both boards are certainly not far removed from the Warner orbit: one of the remaining two American Directors is Stephen Arky, the son-in-law of Warner, the husband of a ComBanks Director and a partner in the law firm of Arky, Freed, Stearns, Watson

* See ComBanks' Amended S-1, p. 1. Exhibit A.

& Greer, which is counsel to both ComBanks and American; the other American Director is Alfredo Duran, who is currently "Of Counsel" to the Arky firm. The one ComBanks Director who is not also a Director of American is Marlin Arky, daughter of Marvin Warner and wife of Stephen Arky. Each member of the Executive Committee of American is a ComBanks Director. Three of American's Directors, Warner, Ronnie R. Ewton and Burton M. Bongard, beneficially own or control substantially all of the Common Stock of ComBanks.

Furthermore, some of these Directors have also been and presently are affiliated with other Warner entities. For example, Burton M. Bongard, a Director of both ComBanks and American, is also President and a Director of HSSA, the President, Director and Acting Chairman of Warner National Corporation and President and a Director of HSFS. Donald J. Glazer is Executive Vice President and a Director of both ComBanks and Great American, and was with the Arky firm from 1976-79.* Ronnie R. Ewton, a 14% stockholder of ComBanks, is a Director of both ComBanks and American, and President and Chairman of the Board of E.S.M. Group, Inc., which provides investment services to ComBanks and American. This same cluster of persons related to or affiliated with

* Persons interviewed have suggested that Glazer also may be Warner's brother-in-law or otherwise related to Warner.

Marvin Warner has controlled both companies over the last few years.*

First Marine. First Marine is a registered bank holding company with principal offices in Riviera Beach, Florida. First Marine owns 93.7% of First Marine Bank and Trust Company of the Palm Beaches, which has 13 banking facilities. First Marine has no non-banking subsidiaries. ComBanks presently holds 4.9% of the voting stock of First Marine, and 15,300 shares (.4%) of First Marine's voting stock are held by Burton M. Bongard as Trustee under an irrevocable trust agreement dated June 21, 1980 for the benefit of certain persons who are beneficiaries of the estate of Marvin Warner.

Proposed Transactions. American proposes to exchange up to 1,550,070 shares of its Series I Cumulative Preferred Stock ("American Preferred Stock") for up to 1,550,070 shares (49%) of the Common Stock of First Marine. American also proposes to issue one Series I Common Stock Purchase Warrant ("American Warrant"), which will entitle the holder to purchase one share of American Common Stock, for each three shares of First Marine Common Stock tendered.

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* See Exhibits D and E which set forth the respective Boards of Directors for ComBanks and American, respectively, from 1976 to date.

American has stated that it is unable to determine whether a market in the American Preferred Stock will develop and that shareholders who tender their First Marine stock should expect to hold American Preferred Stock for investment.* The likelihood of a market developing for the American Preferred Stock and the American Warrants could be affected by an exchange offer ComBanks proposes to make for the Common Stock of American.

ComBanks has announced that it intends to offer to exchange up to 426,403 shares of its Series I Cumulative Preferred Stock ("ComBanks Preferred Stock") for up to 426,403 shares of American Common Stock. Assuming the maximum of 426,403 shares of American Common Stock are acquired by ComBanks pursuant to that offer, the concentration of American Common Stock in ComBanks' hands would increase to 49% (1,016,007 shares) of the total number of shares of American Common Stock outstanding. Assuming further that ComBanks converted its American Preferred Stock and exercised its warrant for the purchase of American Common Stock, ComBanks would own 66.5% of the Common Stock of American.

Status of Proposed Transactions. Earlier this year, ComBanks and American filed with the SEC Registra-

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* See American's Amended S-1, p. 4. Exhibit B.

tion Statements on Form S-1 regarding the proposed transactions. Amendments to these registration statements were filed on September 12, 1980 and September 16, 1980 by ComBanks and American, respectively.* On October 1, 1980 First Marine's counsel submitted to the SEC a letter that referred to certain areas of disclosure in American's Amended S-1 that were believed not to provide adequately information that would be material to a decision by a shareholder of First Marine whether or not to tender any shares of First Marine Common Stock held by such shareholder. As of October 30, 1980 it is believed that neither ComBanks' Amended S-1 nor American's Amended S-1 has been declared effective by the SEC.

The exchange offers proposed by ComBanks and American are conditioned on obtaining the requisite regulatory approvals. Accordingly, on June 30, 1980 ComBanks and American filed applications with the Board for prior approval of the proposed transactions under Section 3(a)(3) of the Act ("Applications"). The Applications are subject to comments from the public and interested government agencies. As mentioned above, First Marine's counsel sub-

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* See ComBanks' Amended S-1 and American's Amended S-1. Exhibits A and B.

mitted a preliminary letter of comments to the Board on September 5, 1980, outlining the objections of First Marine to the proposed transactions and requesting a public hearing on the Applications. Various shareholders of First Marine who own in the aggregate more than 30% of its outstanding Common Stock have also submitted letters to the Board registering their objections to the proposed transactions. American's Application to the Comptroller of Florida for approval of the acquisition by American of up to 49% of the voting shares of First Marine was approved on October 24, 1980, before First Marine had an appropriate opportunity to present its objections to such Application.*

* First Marine had been led to believe that its comments to the Board would also be considered by the Florida Comptroller and that presenting these comments on or before October 31, 1980 would be timely.

DISCUSSION

I. THE APPLICANTS DO NOT POSSESS THE FINANCIAL AND MANAGERIAL RESOURCES REQUIRED FOR APPROVAL OF THE APPLICATIONS

Section 3(c) of the Act requires the Board to consider "in every case" of an application of a bank holding company to acquire direct or indirect control of a bank, "the financial and managerial resources and future prospects of the company or companies and the banks concerned . . . ." The Board has repeatedly stated in its decisions under Section 3(a) of the Act that a holding company "should be a source of financial and managerial strength" for the banks in its system and that the Board will review each application for approval under Section 3(a) of the Act to see if the applicant would be able to provide such strength if the proposed transaction were to be consummated. See, e.g., Seilon, Inc., 63 Fed. Res. Bull. 156 (1977).

The Board has taken the position that it can reject an applicant's proposal if it finds the applicant to be financially or managerially unsound. The United States Supreme Court has agreed with the Board's interpretation and has held that a rejection premised on these grounds was valid "regardless of whether that unsoundness would be caused or exacerbated by the proposed transaction." Board of Governors

of the Federal Reserve System v. First Lincolnwood Corporation, 439 U.S. 234, 252 (1978).

A. Financial Resources

In order to satisfy the financial strength standard set forth in Section 3(c) of the Act, the Board will have to consider the relative financial strengths and weaknesses of American and First Marine. In addition, such comparison should include ComBanks, which controls American through the ownership of approximately 28.4% of its Common Stock (approximately 49% assuming successful completion of ComBanks' proposed exchange offer for American Common Stock). First Marine believes that the following comparative analysis of certain principal measures of size, performance and asset quality clearly indicates that American and ComBanks do not have sufficient financial resources, especially when compared to those of First Marine, to permit a finding by the Board that they would be a source of financial strength to First Marine. As a result, First Marine believes that application of this test should preclude the Board from approving the Applications under Section 3(a) of the Act.

The following analysis focuses on the relative financial strengths and weaknesses of American and ComBanks compared to First Marine. However, see Exhibit F hereto for a detailed statistical analysis that compares the per-

formance of other comparable bank holding companies in Florida, regional markets and nationwide.

Relative Size. First Marine had average assets of $385,870,000 in 1979 compared to $329,128,000 in 1979 for American. For the years 1977-1979, First Marine and American had average assets of $353,133,000 and $313,364,000, respectively. ComBanks had average assets of $262,019,000 in 1979 and $229,037,000 for the years 1977-1979. As a result, the size of First Marine and American are sufficiently close to provide a reasonable basis for comparison without adjustments, and it is assumed for purposes of the following analysis that the different size of ComBanks does not materially affect the comparability of its financial information on a relative basis.

Relative Performance. The inability of American (or ComBanks) to be a source of financial strength to First Marine is most emphatically shown by a comparison of three traditional criteria for determining financial performance. First, the average return on average assets, which most bank analysts consider to be a key indicator of profitability, for the three companies for the years 1977-1979 was as follows: First Marine -- .88%, American - .37% and ComBanks -- .70%. Thus, First Marine's average return was more than double that of American. Second, First Marine's average net operating income (before securities gains or losses) for the

ears 1977-1979 was $3,113,000, or more than 4 1/2 times ne $677,000 average net operating income (before securities ains or losses and extraordinary item) of American for the comparable period and just less than two times the $1,619,000 average net operating income (before securities gains or losses) of ComBanks for the comparable period. Third, the return on average equity once again shows that First Marine's performance is substantially better than that of the two companies which are supposedly to provide it with financial strength after the proposed acquisition of control: First Marine's average return on average equity for the years 1977-1979 was 12.62% compared to 6.22% (or actually 4.93% if the 1977 loss is averaged in at its actual negative percentage rather than as zero) and 8.33% for American and ComBanks, respectively, for the comparable periods.

. .. Relative Ratios of Debt to Total Capital.* In order to determine whether a bank holding company would be a source of strength to a proposed banking subsidiary, the Board has focused particular attention on the applicant's debt-equity ratio as an indication of whether the applicant would be financially flexible enough to provide the proposed subsidiary bank with any needed assistance. See, e.g.,

* Debt divided by the aggregate of debt plus equity.

Bank Shares, Inc., 62 Fed. Res. Bull. 626 (1976) and Seilon, Inc., supra. While First Marine had an average debt ratio of 2.2% for the years 1977-1979, American and ComBanks had average debt ratios of 42% and 53%, respectively, for the comparable period. Since financial analysts generally consnider a debt ratio of more than 30% to indicate that a bank of the approximate deposit size of American or ComBanks may be over-leveraged, the foregoing numbers raise serious questions regarding whether American and ComBanks are too over-committed in their own debt service to provide First Marine with back-up financial strength, as required by the Board in its determinations under Section 3(c) of the Act.

Relative Equity to Total Assets. A significant part of First Marine's strong capitalization is its high ratio of equity to total assets, which was approximately 7% for the years 1977-1979. On the other hand, American's capital difficulties are caused, in part, by its low ratio of equity to total assets, which was approximately 5.5% for the years 1977-1979.

Relative Ratios of Earnings to Fixed Charges and Preferred Dividends. American's historical ratios of earnings to fixed charges and preferred dividends indicate that during most of the past five years it has been barely able to achieve sufficient earnings to cover fixed payments

under its existing debt instruments, which does not bode well as to its future ability to be a source of financial strength to First Marine. American's parent only ratios of earnings to fixed charges and preferred dividends were less than 1.00x for 1976, 1977, 1978 and 1979 and for the six months ended June 30, 1980, during which time fixed charges and preferred dividends exceeded earnings by an aggregate of $2,456,000.* In addition, American's consolidated ratios of earnings to fixed charges and preferred dividends (both excluding and including interest on deposits as a fixed charge) also were less than 1.00x for 1975, 1976 and 1977, during which time fixed charges and preferred dividends exceeded earnings by an aggregate of $6,864,000.** Moreover, even though American finally achieved consolidated ratios of earnings to fixed charges and preferred dividends of more than 1.00x for 1978 and 1979, these ratios still were very low in comparison to Florida, regional and nationwide peer group ratios: the consolidated ratios (excluding interest on deposits) were 2.15x and 2.70x for 1978 and 1979, respectively, and the consolidated ratios (including interest on deposits) were only 1.21x and 1.33x for 1978

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* American's Amended S-1, p. 23 (Note A). Exhibit B.

** American's Amended S-1, p. 23 (Note B). Exhibit B.

and 1979, respectively.* However, for the twelve months ended June 30, 1980, American's ratios of earnings to fixed charges and preferred dividends once again became precariously low: 1.12x for parent only and 1.37x on a consolidated basis.** Assuming the issuance of 1,550,070 shares of American Preferred Stock in its proposed exchange offer and a $.80 annual dividend rate on such stock, American would add an annual dividend requirement of $1,240,000 to its already over-leveraged capitalization, thereby reducing its consolidated ratios of earnings to fixed charges and preferred dividends for the twelve months ended June 30, 1980 to .89x for the parent only and 1.31x on a consolidated basis (these ratios include interest on deposits as a fixed charge).***

Relative Ratios of Loans to Deposits. Further evidence of the relative strengths of First Marine and American and ComBanks can be seen by comparison of their ratios of loans to deposits, which can be a useful indication of their respective abilities to react to increased loan demand in the communities they serve, as well as an

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* American's Amended S-1, p. 22. Exhibit B.

** Id., p. 19.

*** Id., p. 19.

ndication of their respective liquidities. First Marine ad an average ratio of loans to deposits for the years 977-1979 of approximately 43%, while American and ComBanks ad ratios for such period of approximately 60% and 61%, espectively. Accordingly, First Marine is in a relatively lexible position to meet additional loan requirements, hereas American and ComBanks may not be able to respond as vigorously to any increased loan demands in their market areas. This relative lack of capacity to make additional loans provides further evidence that American and ComBanks may not be viewed as a source of financial strength for First Marine in the event the proposed acquisition were to be approved.

Relative Asset Quality. An additional factor to be considered in determining the potential financial strength that could be provided by American and ComBanks to First Marine is the relative quality of their respective assets, which not only is significant with respect to the financial condition of each but also is relevant with regard to the potential adverse impact upon future operations of their respective lending practices. With respect to non-performing loans* for the years 1977-1979,

* Including only loans in a non-accrual status.

First Marine had an average of $700,044 of non-performing loans, or only .5% of its year-end loans** plus other real estate; its ratio of non-performing assets to stockholders' equity was 3%; and its ratio of non-performing assets to loan loss reserve was 40%. By contrast, American's average non-performing loans* for the years 1977-1979 were approximately $7,090,000, or almost ten times as high as those of First Marine. Accordingly, American's ratio of non-performing assets to year-end loans* plus other real estate was 4%; its ratio of non-performing assets to stockholders' equity was 38%; and its ratio of non-performing assets to loan loss reserve was 316%. ComBanks' record with regard to non-performing loans, while not as disturbingly high as that of American, is nevertheless substantially worse than that of First Marine. For the years 1977-1979 ComBanks had average non-performing loans* of $2,516,000, and ComBanks' ratio of average non-performing assets to year-end loans* plus other real estate was 2.3%; its ratio of non-performing assets to stockholders' equity was 12.7%; and its ratio of non-performing asets to loan loss reserve was approximately 151%.

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* Including only loans in a non-accrual status.

** Net of unearned income, but before deducting loan loss reserve and including lease receivables.

Further questions regarding the asset quality of American and ComBanks are raised by analysis of their loan loss provisions and net loan charge-offs. While First Marine had an average loan loss provision for the years 1977-1979 of $490,000, for the comparable years American had a loan loss provision of $1,480,000 and ComBanks had a loan loss provision of $885,000. In addition, while First Marine had average net loan charge-offs during the years 1977-1979 of only $251,000, during the comparable period American had average net loan charge-offs of $1,702,000 and ComBanks had $580,000 of net loan charge-offs. Accordingly, net loan charge-offs as a percentage of loan loss provision for First Marine during the years 1977-1979 was only 41%, while it was 101% and 71% for American and ComBanks, respectively. In addition, while the average loan loss reserve at year-end divided by net charge-offs during the year for the years 1977-1979 for First Marine was 142x, the comparable numbers for American and ComBanks were only 2.4x and 3.2x, respectively.

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B. Managerial Resources

Section 3(c) of the Act also requires the Board to assess the managerial resources of ComBanks and American in connection with the Board's review of the Applications. Part of this assessment requires a review of both applicants' managerial competence in conducting their business. See First of Iowa Bank Shares, Inc., 63 Fed. Res. Bull. 1015 (1977), Chickasha Bankshares, Inc., 63 Fed. Res. Bull. 1082 (1977) (citing 60 Fed. Res. Bull. 123 (1974)) and Jackson Hole Banking Corporation, 63 Fed. Res. Bull. 934 (1977). The previous section detailing both ComBanks' and American's financial resources further highlights their significant weaknesses in the managerial area and demonstrates that neither of these two companies possesses the requisite managerial competence which could serve as a source of strength to First Marine.

Moreover, "managerial resources" includes not only business abilities or competence of management, but also its integrity and disposition to obey the law. In National Banks of Florida, Inc., 62 Fed. Res. Bull. 696, 698 (1976) the Board expressly stated that:

> "[M]anagerial resources does not, however, refer solely to the business abilities of management or its past financial success. The legislative history of this provision makes clear that this factor relates not only to management's competence but also to management's integrity and

> disposition to conduct the affairs of the company in accordance with the requirements of the law."

See also Country Bankshares Corporation. 63 Fed. Res. Bull. 495 (1977).

In The Berlin City Bank, 63 Fed. Res. Bull. 268 (1977), an application by the Berlin City Bank to retain control over the voting shares of a bank and thus continue to be a bank holding company, was denied where the applicant had failed to file an application with the Board before acquiring a majority of the target bank's outstanding voting shares. The Board observed that whether or not such violation of the law in that case was "willful," such conduct reflected so adversely upon the managerial factors being considered in connection with the application that denial was justified. It did not matter that the applicant had been advised by a lawyer that it need not obtain prior approval. The application was denied since the applicant displayed an insufficient "disposition" to conform to the requirements of the Act.

On the basis of limited information available to it, as described below, First Marine believes that there are a series of incidents involving the management

of ComBanks and American* and their affiliates that raise serious questions as to their integrity and disposition to obey the law. While First Marine obviously is not in a position to formulate final conclusions regarding the legality or propriety of these incidents, it believes that the incidents described below "establish a pattern of conduct that has a significant adverse bearing on the management factor, and that the Board may deny the application on that ground alone." Benson Bancshares, Inc., 63 Fed. Res. Bull. 1009, 1010 (1977). Short of such a determination by the Board, First Marine believes that it is incumbent on the Board to utilize its substantial investigatorial powers, which obviously are not available to First Marine, to ascertain all the facts underlying these incidents in order to make a reasoned determination about the managerial resources of ComBanks and American.

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* It should be recalled that the management of ComBanks and American in reality is essentially one small group of individuals dominated by Marvin Warner as evidenced by the stock ownership by Warner and his affiliated interests in both ComBanks and American and the interlocking directorates of both companies. Supra, p. 8.

1. Managerial disposition to conduct the affairs of ComBanks and American in accordance with the requirements of law.

Three days prior to the filing of these comments with the Board, a newspaper in Cincinnati reported that a criminal information had been returned against HSSA, one of Warner's affiliated companies.* The very limited information we have been able to gather during the past two days about this extremely disturbing matter is set forth below. As soon as we are able to obtain a more complete report and assimilate the information within the context of these comments, we will make a further submission to the Board. In addition to this criminal information matter, there are a number of other areas where grave questions exist with respect to the managerial disposition of both Combanks and American to conduct their affairs in accordance with the law. ComBanks' past conduct in gaining and exercising control over American indicates possible violations by ComBanks of the Act and possible violations by ComBanks and Warner-related interests of the Securities Exchange Act of 1934. Morover, further indications suggest that ComBanks may have recently violated the Act in connection

* As described above (p. 8), HSSA is a wholly-owned subsidiary of Warner National Corporation. Warner owns 84.77% of the voting shares of Warner National Corporation.

with ComBanks' acquisition of its interest in First Marine and Century Banks, Inc. ComBanks' management also may have violated the Employee Retirement Income Security Act of 1974.

a. Home State Savings Association, a Warner Affiliate, Pleads No Contest to a Criminal Information Charging a Scheme to Defraud Commercial Borrowers and Mail Fraud

A Cincinnatti newspaper report* disclosed that on October 28, 1980, Home State Savings Association (previously referred to herein as HSSA) had pleaded no contest to a criminal information presented by a U.S. Attorney and Federal Bureau of Investigation Special Agent. The criminal information contained two counts: (1) unlawfully inducing interstate travel to promote a scheme to defraud commercial borrowers and (2) mail fraud.

The substance of the alleged wrongdoing, according to the newspaper report, was a scheme by HSSA to defraud commercial borrowers by charging a fee for standby loan commitments at a time when HSSA had no intention of making the long-term loans for which the commitment fees were levied. A press release issued by the United States Attorney for the Southern District of Ohio, dated October

* See a copy of an article which appears in the Cincinnati Enquirer, dated October 29, 1980, p. 1, entitled "S&L Pleads 'No Contest' to Charges." Exhibit G.

28, 1980, further stated "that as best as can be ascertained this is the first case in the country where a financial institution was charged with a scheme to defraud borrowers by means of a commercial stand-by loan commitment."*

The full breadth of the serious implications of this criminal information with regard to the issue of the integrity of the management group of Combanks and American, lead by Marvin Warner,** cannot be assessed at this point in time. However, it can be said that these changes cast grave doubt on the manner in which Warner's affiliated businesses conduct their affairs and more particularly their banking businesses. It should also be noted that the role that HSSA played, among others, in the transacting of a $4.5 million loan to American in 1977, discussed herein (infra, p. 70-81) will have to be even more closely reviewed.

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* See copy of press release dated October 28, 1980. Exhibit H.

** Combanks' Amended S-1 (p. 102) describes Warner as a "parent" of HSSA. Burton Bongard, the President and Director of HSSA, is also a director of both Combanks and American (p. 65). Exhibit A.

b. ComBanks May have Acquired Control over American in Violation of the Act

The method by which ComBanks acquired its controlling interest in American, as described below, raises serious questions regarding whether such acquisition was in violation of Section 3(a) of the Act. The following information was obtained from public documents filed with the SEC and the Board by ComBanks, American and their affiliates, as well as from interviews with various persons.

In essence, this information suggests that the acquisition in 1977 by Ronnie R. Ewton and Robert C. Seneca (who represented that they were not acting on behalf of anyone else) of a 22.5% interest in American (then called American Bancshares, Inc.)* may have been made on behalf of ComBanks. If this is correct, then such acquisition was made by ComBanks in violation of the Act since it had not previously obtained or even sought the approval by the Board of such acquisition.

In late 1976 or early 1977, shares of American Common Stock held by Alfred W. Slobusky, the then President and Chairman of American, and various other principals of American became available for purchase. Stephen W. Arky,

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* Great American Banks, Inc. and American Bancshares, Inc. are both referred to herein as "American."

Marvin Warner's son-in-law and a partner with Arky, Freed, Stearns, Watson and Greer, which represented ComBanks after Warner and Culverhouse took control,* arranged for Warner to meet with Slobusky regarding the purchase of the American stock. It has been suggested to us that Warner was interested in American but that neither Warner nor Slobusky was willing to wait for the Board approval that would have been required for ComBanks to purchase an interest in American directly,** or that might have been advisable because of Warner's position with regard to ComBanks, if Warner had decided to make the purchase personally.***

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* ComBanks' 1977 Annual Report on Form 10-K (p. 37) states that "Mr. Stephen Arky, son-in-law of Mr. Marvin L. Warner, is a partner in the law firm of Pettigrew, Arky, Freed, Sterns, Watson and Greer [the firm's former name] which has represented ComBanks in various matters and is counsel to ComBanks with regard to the registration statement." Exhibit I.

** The facts suggest that it might well have taken a year or so to obtain such approval. When ComBanks did make application to gain control of American, it filed its request in June 1977 and did not receive approval until June 1978.

*** As the Chairman of the Board and then 40% shareholder of ComBanks, Marvin Warner's acquisition of an interest in American would have raised the implication that Warner had made such a purchase on behalf of ComBanks, in an effort to circumvent the requirements of Section 3(a)(3) of the Act. See Third National Corporation, 61 Fed. Res. Bull. 815, 817 (1975): "Arrangements in which bank holding company direc-

(Cont'd on following page)

The day after the meeting between Warner and Slobusky, during which they apparently concluded that neither could accommodate the timing problems that would attend ComBanks' or Warner's involvement in the acquisition of the American shares, we are told that Arky arranged for Slobusky to meet two of his other clients, Ewton and Seneca, who were principals in E.S.M. Securities, Inc., a brokerage firm in Fort Lauderdale and E.S.M. Financial Group, Inc., an investment banking firm. Ewton and Seneca apparently were not strangers to ComBanks, one of Arky's other clients. While it is not clear when they were first retained by ComBanks, Ewton and Seneca, through one of their firms, had apparently been buying and selling securities for ComBanks' investment portfolio during 1977.*

(Cont'd from preceding page)

tors, officers, or employees, or their close relatives, have a personal financial interest in an acquisition proposed by the holding company will be closely scrutinized by the Board to ensure . . . that they do not involve an effort by the Company to circumvent the requirement that prior approval of the Board be obtained for such an acquisition. . . ." The series of transactions between Ewton and Seneca and the Warner-related companies, including ComBanks, by which ComBanks obtained the American stock purchased by Ewton and Seneca strongly suggest that Ewton and Seneca (who would not be subject to the same regulatory scrutiny as Marvin Warner) were acting as conduits to lock up, for ComBanks, the shares of American Common Stock that ComBanks ultimately intended to acquire.

* See letter dated June 20, 1977 from ComBanks to the Federal Reserve Bank in Atlanta which discloses that ComBanks had employed the services of E.S.M. Securities, Inc. during 1977. Exhibit J.

On March 8, 1977 Ewton and Seneca purchased 409,330 shares (19.7%) of the American Common Stock from Slobusky and other major shareholders of American.* Approximately two-thirds of the purchase price of $3,049,666 (409,330 shares at approximately $7.50 per share) was funded by a loan from E.S.M. Financial Group, Inc. and the balance came from their personal funds.** Although none of the material filed with the SEC by Ewton and Seneca indicates any motive for their investment other than a traditional investment motive or any other sources of financing of the transaction, a review of the ensuing relationships among Ewton, Seneca, ComBanks and the other Warner-affiliated interests provides a very strong implication that Ewton and Seneca may in fact have been merely stakeholders of the American Common Stock until such time as ComBanks could obtain the requisite Board approval for the direct acquisition of such shares in its own name.

The American Common Stock acquired by Ewton and Seneca thereafter travelled a complicated and circuitous route, which perhaps suggests an effort to obfuscate the

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* Eventually Ewton's and Seneca's holdings of American Common Stock increased to a total of 22.5% of the outstanding American shares.

** See Schedule 13D of American dated February 15, 1977, filed by Ewton and Seneca with the SEC. Exhibit K.

real interests of the parties, but eventually ended up being acquired by ComBanks. The first step in this process came only weeks after Ewton and Seneca purchased their shares, when a Warner-related company turned up to finance the purchase. On April 26, 1977, Ewton, Seneca and their wives refinanced their purchase of the American Common Stock with a $3 million loan for one year at 9.5% interest from HSFS.* Not only did HSFS refinance the purchase of the American Common Stock by Ewton and Seneca, but there are indications that it also may have assumed a $1 million personal loan that Ewton and Seneca had made to Slobusky when they purchased his stock.

It seems remarkably coincidental that a company controlled by Warner, who had expressed an interest in purchasing the American Stock but was deterred by potential regulatory problems, ended up financing the purchase of the American Stock by Ewton and Seneca. Even more remarkable, and perhaps revealing, is the fact that as part of the loan transaction, HSFS received options from both Ewton and

* See Amendment No. 2, dated May 10, 1977, to Schedule 13D dated February 14, 1977, filed by Ewton and Seneca with the SEC. Exhibit L. As described earlier, HSFS, a 21.2% shareholder of ComBanks, is a wholly-owned subsidiary of Warner National Corporation, 84.77% of the Common Stock of which is owned by Warner.

Seneca to purchase one-half (approximately 204,700 shares) of their shares of American Common Stock.

The granting of these options strongly suggests that Ewton and Seneca were merely acting as custodians of the stock since the options were structured in such a way that Ewton and Seneca had no genuine economic interest in their American Common Stock. It is obvious that people normally do not enter into transactions for no economic gain -- yet that is what appears to have happened here. The options stated that the base purchase price of the American Common Stock was $7.45 per share, to be adjusted in accordance with a contractual formula. The Schedule 13D* filed by HSFS with the SEC fails to set forth the terms of the option in detail, and neglects to attach copies of the option agreements as exhibits. However, the application filed by ComBanks with the Board in June 1977 for approval of its acquisition of 22.5% of the Common Stock of American (discussed below), states that HSFS "has an option to buy 204,700 shares of [American] stock from Messrs. Ronnie R. Ewton and Robert C. Seneca at their cost [emphasis added]."**

* See Schedule 13D of American dated May 5, 1977, filed by HSFS with the SEC. Exhibit M.

** See Application by ComBanks to the Board to acquire 22.5% of the Common Stock of American, received by the Board on September 1, 1977, p. 4. Exhibit N.

The possibility that Ewton and Seneca were merely acting as temporary repositories of American Common Stock for the benefit of ComBanks more clearly emerges in the light of subsequent events. In May 1977, less than three months after Ewton and Seneca embarked on their ostensibly long-term investment in American, and with working control of American safely in their hands, Warner and F. Philip Handy, the then President of Combanks, met with representatives of the Federal Reserve Bank of Atlanta and delivered a copy of a draft of an application for approval by the Board of the acquisition by ComBanks of all of the shares (22.5%) of the American Common Stock held by Ewton and Seneca.*

* Just as was done in the deal with HSFS, the transaction between Ewton, Seneca and ComBanks seems to have been structured so that Ewton and Seneca would neither lose nor gain money as a result of their investment in American. Furthermore, it appears to have been intended from the very beginning that Ewton and Seneca would obtain an interest in ComBanks when they sold their American shares to ComBanks. A draft of an agreement received by the Board on September 1, 1977, reveals that, at that time, the sale of the American Common Stock to ComBanks was to be conditioned on the simultaneous sale of 100,000 shares of Culverhouse's ComBanks Common Stock to Ewton and Seneca: ComBanks was to purchase 466,000 shares of American Common Stock from Ewton and Seneca for $7.87 per share, which represented Ewton's and Seneca's purchase price, plus any loss incurred during their ownership, and Ewton and Seneca would then purchase 100,000 shares of ComBanks Common Stock from Culverhouse at $30 per share (stock which incidentally Culverhouse bought at $20 per share the previous year). In addition, it was contemplated that Ewton and Seneca would be made directors of ComBanks. See Memorandum prepared by Assistant Examiner William B. Estes regarding a meeting of May 23, 1977 of the Federal Reserve Bank of Atlanta among Marvin L. Warner, F. Philip Handy, Robert E. Heck, H. Terry Smith, Zane R. Kelley and William B. Estes. Exhibit O.

The terms of the agreements giving ComBanks the option to purchase the American Common Stock from Ewton and Seneca also suggest that the investment by Ewton and Seneca in American was not an independent one but rather an effort to "warehouse" the stock for ComBanks. These option agreements between Ewton and ComBanks and Seneca and ComBanks, which were dated November 15 and 18, 1977, respectively, provided that in consideration for $1,000 paid by ComBanks to each of them, ComBanks had the right to purchase from each of them the 141,055 shares of American Common Stock held by them not already subject to the HSFS option. The options were exercisable at a base price of $7.45 per share,* which would be adjusted by adding to it the direct costs incurred by Ewton and Seneca in acquiring the shares (interest, points, commitment fees, attorney's fees and recording costs) and deducting "any and all income hereafter earned or received [by Ewton and Seneca] as direct incidence of ownership".**

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* See copies of Option Agreements between Ewton and ComBanks dated November 18, 1977 and Seneca and ComBanks dated November 15, 1977. Exhibits P and Q. Ewton and Seneca had purchased the stock from Slobusky et al. for approximately $7.50/share.

** The options also provided that one half of the gross income derived by Ewton and Seneca from executing "securities transactions on behalf of American and its subsidiaries" would also be deducted from the base price.

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On the same day that the option agreements on Ewton and Seneca's shares of American Stock were executed, ComBanks gave Ewton and Seneca an option to purchase 15% of the outstanding shares of Common Stock (90,000 shares) of ComBanks for $3 million, contingent upon the purchase by ComBanks of their American Stock. Once again the financing for Ewton and Seneca's stock purchase was to come from a Warner-related company - the options provided that HSFS would lend them $3 million.*

On March 7, 1978, Ewton and Seneca re-executed their agreements with both HSFS and ComBanks. The agreements were basically the same as those executed on November 18 and 15, 1977. However, a new provision in both the

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Id. This provision appears to be a further indication that Ewton and Seneca had no economic interest, either from a loss or profit standpoint, in their American investment. If Ewton and Seneca made any profit on their investment, including fees they charged American for executing securities transactions (which business their control position in American made possible), then this provision reveals that they would have to give up one-half of this profit, since it would be charged against the price ComBanks was to pay for purchasing their interest. Furthermore, this provision also suggests that any insider arrangement between Ewton, Seneca and American with respect to these fees might have been improper and the same may be said with respect to the propriety of Ewton, Seneca and ComBanks agreeing, in effect, to divide up these profits.

* See Schedules 13D of ComBanks, both dated January 10, 1978, filed by Ewton and Seneca with the SEC. Exhibits R. and S.

ComBanks and HSFS option agreements (and perhaps the reason the new agreements were drafted) stated that Ewton and Seneca would provide advice regarding the investment portfolios of the subsidiary banks of American for three years from the date of the agreement.* . . .

On July 5, 1978, ComBanks ultimately bought 486,844 shares of American Common Stock from Ewton** at $8.4682 per share, having obtained from HSFS, for $10,000, an assignment of its option to purchase Ewton's and Seneca's American shares.*** Approximately $3 million plus interest from the

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* See agreements dated March 7, 1978 between Ewton and ComBanks, Seneca and ComBanks, Ewton and HSFS, and Seneca and HSFS. Exhibit T.

** Seneca sold his American Common Stock (245,422 shares) to Ewton on June 21, 1978 for $8.4682/share ($7.45 per share plus expenses incurred by Seneca in purchasing the shares). Ewton paid for these shares by assuming the portion of Seneca's liability for the $3 million loan from HSFS and a $2 million loan from E.S.M. Group, Inc. See Amendment No. 4 dated September 12, 1978 to Schedule 13D of American dated February 14, 1977, filed by Ewton and Seneca on 2/14/77 with the SEC. Exhibit U.

*** The role of the HSFS option (for 204,690 shares held by Ewton and Seneca) in the final purchase by ComBanks is somewhat confusing. The initial agreement among ComBanks, Ewton and Seneca required that Ewton and Seneca obtain a release from HSFS in August 1977. See letter from ComBanks to Federal Reserve Board dated August 24, 1977. Exhibit V. Although HSFS released its option, it also assigned its option on the 204,690 shares to ComBanks for $10,000 on December 18, 1977. See Schedule 13D of American dated January 10, 1978, filed by ComBanks with the SEC. Exhibit W. HSFS and ComBanks executed another assignment of the HSFS options and right of first refusal on Ewton and Seneca's American Common Stock on March 7, 1978. On the same day Ewton and ComBanks executed their final option agreements regarding the remaining 282,110 shares of American Common Stock.

proceeds of the sale was paid by Ewton to HSFS in order to pay off the HSFS loan to Ewton and Seneca. The price per share would appear to represent approximately the amount Ewton and Seneca paid for the stock ($7.45/share) plus interest charges at 9-1/2% to HSFS for 14 months.* Thus, Ewton appears neither to have made any profit nor suffered any loss on his investment in American Common Stock.

On September 15, 1978 Ewton exercised the option to acquire 14.046% of ComBanks Common Stock (82,946 shares).** He paid $36.168 per share and received 3,000 shares from ComBanks Profit Sharing Plan, 62,370 shares from Marvin Warner and 17,576 shares from HSFS.*** Once again HSFS lent to Ewton

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* ComBanks' Annual Report on Form 10-K for 1978 (p. 106) shows that the 486,844 shares of the American Common Stock were purchased for $4,122,700, which equals $8.4682 per share. Exhibit X. It should be noted, that the American proxy statement for 1979 states that the shares of American stock were sold for approximately $7.45/share. Exhibit Y.

** As was the case with Seneca's shares in American, Seneca likewise transferred his option to acquire 7.5% of ComBanks' stock to Ewton on June 21, 1978. See Schedule 13D of ComBanks dated September 12, 1978, filed by Seneca with the SEC. Exhibit Z.

*** See Amendment No. 2 dated September 15, 1978 to Schedule 13D of ComBanks dated January 10, 1978 filed by Ewton with the SEC. Exhibit AA. The publicly filed documents do not explain why Ewton received all the ComBanks' shares from Warner, HSFS and the Profit Sharing Plan when the option was given to him and Seneca by ComBanks.

the $3 million to buy such shares. The loan as reported appears to contain conventional terms, including giving HSFS a security interest presumably in the ComBanks Common Stock.*

As additional evidence of the possibility that Ewton and Seneca purchased their American Common Stock on behalf of ComBanks, it is significant that the connections between Ewton and the Warner group have multiplied substantially since 1977. Ewton is today a Director of both ComBanks and American, a member of the Executive Committee of both companies, a member of the Audit Committee of American and a 14% shareholder of ComBanks Common Stock.

First Marine is not alone in suspecting that Ewton and Seneca were acting on behalf of Combanks from the moment they purchased their interest in American. In a meeting on October 25, 1977 between Warner, Handy and members of the Board's staff, Warner and Handy were apparently questioned by staff members of the Board on that very subject. In addition, in a letter dated November 17, 1977, Handy assured the Board's staff that Ewton and Seneca

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* The Schedule 13D of ComBanks dated January 10, 1978 filed by Ewton with the SEC contains a copy of the promissory note between Ewton and HSFS, but does not contain a copy of the Loan Agreement, Hypothecation Security Agreement or Stock Pledge Agreement referred to in the Promissory Note. Thus there is no way to be certain that ComBanks stock, rather than some other securities, was used as collateral for the loan.

had not acted as nominees for either ComBanks or Warner in making their purchase.* While we are aware of this denial and a similar denial by Arky, there are recurring indications that Ewton and Seneca were merely stalking horses who warehoused the American shares for ComBanks. The intricate trail of arrangements described above can hardly lead to another conclusion. A public hearing with witnesses and testimony under oath may well be the only way the facts can be fully ferreted out.

Furthermore, the SEC apparently gave the foregoing analysis of the transactions enough credence to warrant its ordering a private investigation in November 1978 on the subject. ComBanks has characterized the investigation as "an inquiry to determine whether ComBanks and others failed to file or filed reports on Schedule 13D which were misleading in that they failed to disclose the formation of a group for the ultimate purpose of acquiring control of American."** American has revealed that the SEC is "reviewing whether the information concerning such 'group' was withheld in violation of the tender offer regulations. The

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* Exhibit BB.

** See ComBanks' Amended S-1, p. 74. Exhibit A.

SEC has requested a number of documents from American and has taken a number of depositions."* Information gathered from persons who were questioned and in some cases deposed by the SEC suggests that the SEC has been reviewing the same line of facts set forth herein. However, the SEC has refused to make its records available to First Marine in response to a request made under the Freedom of Information Act on the ground that the enforcement proceeding was still pending. The Board has been informed of this fact and we have been orally advised by the Board that it is presently pursuing this line of inquiry directly with the SEC. If further investigation reveals that the theory set forth above accurately reflects the true state of affairs, then ComBanks will have violated the Act, and ComBanks and possibly other Warner affiliates will have violated Section 13(d) of the Securities Exchange Act of 1934.

. . . First Marine believes that the foregoing information is sufficient to establish "a pattern of conduct that has a significant adverse bearing on the managerial factor, and the Board may deny the application on that ground alone."** Failing that, First Marine submits that the

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* See American's Amended S-1, p. 65. Exhibit B.

** See Benson Bancshares, Inc., 63 Fed. Res. Bull. 1009, 1010 (1977)

Board should conduct a further investigation of these matters, including coordination with the SEC's investigation and hold a public hearing in which First Marine respectfully requests the right to participate. This information is obviously vital to the Board's complete evaluation of the management integrity of ComBanks.

c. ComBanks May Have Acquired its Interest in First Marine and Century Banks, Inc. in Violation of the Act

ComBanks' apparent disregard of the requirements of the Act detailed above seems to be part of a continuing course of conduct. First Marine has reason to believe that ComBanks acquired more than a 5% interest in First Marine without obtaining the necessary approval from the Board, and may also have disregarded the need for approval of its acquisition of 6.8% of the outstanding common stock of another Florida bank holding company, Century Banks, Inc.*

Acquisition of Common Stock of First Marine.

Under Section 3(a)(3) of the Act, it is unlawful, except with prior approval of the Board,

> "for any bank holding company to acquire direct or indirect ownership or control of any voting

* Although we advised the Federal Reserve Bank of Atlanta about this matter on April 21, 1980, and were informally advised by the Atlanta staff on July 3, 1980 that the matter was being referred to the Board in Washington, we have had no response to date.

> shares of any bank if, after such acquisition, such company will directly or indirectly own or control more than 5 per centum of the voting shares of such bank."

ComBanks appears to have violated this stricture of the Act during the course of its transactions in the Common Stock of First Marine in two instances: (a) by acquiring an option to purchase and an irrevocable proxy to vote 200,000 shares (6.3%) of First Marine Common Stock at a time when ComBanks already held 4.95% of that stock, and (b) by virtue of the acquisition by Burton Bongard, as the trustee for the benefit of certain beneficiaries of the estate of Marvin Warner, of .4% of the Common Stock of First Marine at a time when ComBanks already owned 4.95% of the Common Stock of First Marine.

Under option agreements dated March 13, 1980, ComBanks appears to have acquired from two shareholders of First Marine "an irrevocable proxy coupled with an interest to be voted on any matter presented to the shareholders of First Marine for a vote."* Although the terms of the option agreements are not clear, if the irrevocable proxy was effectively granted, ComBanks would have acquired control over a total of approximately 11% of the voting

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* See Schedule 13D of First Marine dated March 13, 1980, filed by ComBanks with the SEC. Exhibit CC.

shares of First Marine without having obtained the Board's prior approval.

Combanks might also have violated these dictates of the Act on June 23, 1980, when Burton Bongard, as Trustee pursuant to an Irrevocable Trust Agreement executed just two days before for "certain persons who are the beneficiaries of the estate of Marvin L. Warner" acquired .4% of the outstanding stock of First Marine.* The funds to purchase the shares were loaned to the Trust on a demand basis, without interest, by Warner.

Mr. Bongard, as can be seen from the description of his background set forth in the Schedule 13D he filed on July 14, 1980, plays a central role in the complex of Warner-affiliated interests: he is President and a Director of HSSA; a Director of both ComBanks and American; President, Director and Acting Chairman of the Board of HSFS; and President, Director and Acting Chairman of the Board of Warner National Corporation.

Despite Bongard's disclaimer in his Schedule 13D of membership in any "group" with ComBanks and American, the coincidence of circumstances surrounding the establishment of the Trust just two days before Bongard made the

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* See Amendment No. 3 to Schedule 13D of First Marine dated July 14, 1980, filed by Bongard with the SEC. Exhibit DD.

purchases with money loaned by Warner, as well as Bongard's relationship to ComBanks and the other Warner interests, strongly suggest that Bongard purchased shares of First Marine as part of a group whose central member was ComBanks and/or Warner.

Acquisition of Common Stock of Century Banks, Inc. ComBanks' apparent sidestepping of the requirements of the Act seems to have been repeated in its transactions in the Common Stock of Century Banks, Inc. ("Century"), another bank holding company in Florida. Century's proxy statement for its annual meeting of April 16, 1980, states that ComBanks owns, directly or indirectly, 6.8% of its Common Stock.* We understand that once again ComBanks did not seek prior Board approval for that acquisition.

If the foregoing facts are correct, then these transactions in the stock of First Marine and Century were acquisitions for which the Board's prior approval should have been obtained. If these transactions are then considered in conjuction with the manner in which ComBanks obtained control over American, ComBanks will have shown itself to have a chronic disinclination to conduct itself

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* Exhibit EE. The proxy statement reveals that ComBanks owns 331,100 shares (5.039%) and HSFS owns 119,410 shares (1.81%) of Century's 6,570,218 outstanding shares of stock.

in accordance with the requirements of the Act and the Board can make no determination other than to deny the pending Applications. See The Berlin City Bank, 63 Fed. Res. Bull. 495 (1977).

d. ComBanks' Management May Have Violated the Employee Retirement Income Security Act of 1974

ComBanks' management may also not be "disposed" to abide by the laws governing their fiduciary obligations to their employees. Indeed, ComBanks has disclosed in its Amended S-1 filed with the SEC discloses that ComBanks "may be subject to civil penalties" in connection with certain transactions relating to its employee Pension and Profit Sharing Plans ("Plans").*

On January 3, 1978, "ComBanks' Pension and Profit Sharing Plans purchased 1,482 shares and 5,928 shares, respectively, of ComBanks Common Stock from Hugh Culverhouse, a director and major shareholder, at a purchase price of $33.60 per share."** As stated earlier, Culverhouse had purchased his shares of stock (a 42% interest) in ComBanks pursuant to a tender offer in 1976, for $20 per share.*** Accordingly,

* See ComBanks' Amended S-1, p. 73. Exhibit A.

** Id.

*** See ComBanks' Prospectus dated March 30, 1977 for $25,000,000 of 9 1/4% Subordinated Debentures due December 31, 1983 ("ComBanks' 1977 Prospectus"), p. 37. Exhibit I.

Culverhouse made a profit of $100,776 on the sale of his shares of ComBanks stock to the Pension and Profit Sharing Plans.*

Section 406(a) of the Employee Retirement Income Security Act of 1974 ("ERISA") provides that a "fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect sale or exchange, or leasing, of any property between the plan and a party in interest . . . ." Culverhouse, a "director and major shareholder", was at the time of the sale a "party in interest" as that term is defined in ERISA.** Thus, ComBanks' Board of Directors, or those managerial officials who had the power of control, management or disposition over the funds of the Plans (i.e., the "fiduciaries" of the Plans), would appear to have violated ERISA by purchasing the ComBanks stock from Culverhouse, irrespective of the terms of the sale.

Furthermore, if the fair market value of the ComBanks stock purchased by either Plan exceeded 10 percent

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* ($248,976 [7410 shares x $33.60] minus $148,200 [7410 shares x $20] = $100,776)

** ERISA Section 3(14)(H) provides that an "employee, officer, director . . . or a 10 percent or more shareholder [of the employer] is a party in interest."

of the fair market value of the assets of each Plan (ERISA Section 407(a)(2)), ComBanks may have engaged in a prohibited transaction with respect to one or both Plans. ERISA Section 406(a)(2) forbids a fiduciary from permitting a plan to purchase employer securities exceeding this 10 percent limit.* We have been advised during an interview that the Profit Sharing Plan may have had approximately $400,000 in assets in 1978. Such Plan spent $199,180.80 to purchase the 5,928 shares of stock of ComBanks at $33.60 per share. If the price paid represented the fair market value of the stock (about which there is some question) then the stock would have constituted almost 50% of the assets of such Plan. Information should be obtained from ComBanks documenting the fair market value of the assets of both Plans in 1978.**

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* This rule absolutely prohibits such purchases by pension plans. Profit sharing plans can, if their terms so provide, own more than 10% of the employer's securities. ERISA Sections 407(b)1 and 407(d)(3). ComBanks Profit Sharing Plan, to which First Marine has not had access, would have to be reviewed to see if it contained such a provision.

** A request has been made to the Internal Revenue Service for production of the 1978 Annual Report by ComBanks (Form 5500), which should report the value of the assets of the Plans in 1978. We presently have no information about the fair market value of the assets of the Pension Plan in 1978. The $49,795 paid by the Pension Plan for the shares of stock it purchased from Culverhouse may well have exceeded the 10% standard.

In the same connection, if the shares of stock purchased from Culverhouse constituted a substantial portion of the assets of the Plans, then the fiduciary duty owed to the participants and beneficiaries of the plans to diversify "the investments of the plan so as to minimize the risk of large losses," as provided in ERISA Section 404(a), would also have been breached by the ComBanks' officials with responsibility to manage the Plans.

Moreover, the price paid by the Plans ($33.60/share) for purchasing the Culverhouse shares of stock may also have triggered a breach of the fiduciary duty set forth in ERISA Section 404(a). That section directs a fiduciary of a plan to "discharge his duties solely in the interest of the participants and beneficiaries of the plan" and "for the exclusive purpose of providing benefits to participants and their beneficiaries."

The National Quotation Bureau reports that the low and high bid prices for ComBanks' Common Stock for the years 1977 through 1978 ranged from 18 1/2 to 23.* One individual whom we interviewed advised that he had heard that at the time that the Plans purchased the Culverhouse stock, officers

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* The quotations represent prices between dealers and do not include retail markup, markdown or commission. They do not represent actual transactions, and have not been adjusted for stock dividends or splits.

and/or directors of ComBanks may have been purchasing stock in the company at approximately $20 per share. Serious questions arise as to whether the officials managing the Plans were acting in the interests of and for the exclusive purpose of the employees or the exclusive purpose of providing profits to Mr. Culverhouse.*

2. Managerial Integrity in Conducting the Business of ComBanks and American

First Marine's concern about the integrity of the managerial core of the ComBanks/American group is based not only upon the foregoing questions about possiible violations of law but also upon suggestions that ComBanks' conduct in running its own affairs and those of American may

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* ComBanks reports that on September 15, 1978, 3,000 shares held by the Profit Sharing Plan were sold to Ewton at $36.168 per share. The Plan therefore made a $7,678.84 profit. The balance of the shares held by the Plans was "subsequently sold to an unaffiliated party for a profit and later reacquired by the Company." The profit that the Plans may have made would not absolve the ComBanks' management from the alleged fiduciary breaches described above. See ComBanks' Amended S-1, p. 73. Exhibit A.

Moreover, the management style of Mr. Warner and his associates is also reflected in their purchases and sales. ComBanks paid a dividend of $.50 per share in 1978 -- or an annual return of 1.48% on the $33.60 price paid by the Plans. Even if the profit of $2.568 per share is factored in, the overall return to the Plans is less than more conventional investments would produce.

have involved self-dealing and other insider abuses.

Frequent suggestions have been made that once the Warner interests took control of ComBanks and American substantial amounts of income from both companies were channelled out, at the expense of both the holding companies and the subsidiary banks, into the hands of a closely intertwined group of Warner's relatives, friends and business affiliates, in the form of payments of fees which may have been excessive for various services, such as insurance, legal counseling and investment advice.

Furthermore, we have been led to believe that officers and directors at the subsidiary banks have been troubled by the number and quality of insider loans allegedly imposed upon the subsidiary banks since the Warner interests took over.

Warner and his affiliates appear to have managed not only to insinuate themselves into the position of servicing most of the legal, insurance and investment needs of ComBanks, American and their subsidiary banks, but to have involved themselves as well in the provision of funds to American. In this connection, the loan obtained by American on October 26, 1977 from HSSA, the circumstances

and terms of which are outlined below, also raises troubling questions.

Moreover, there are indications that substantial and perhaps unjustifiable operating expenses, in such forms as management fees and dividends payable to the holding companies, may have been imposed upon the subsidiary banks of both ComBanks and American to the potential detriment of their financial well-being.

The unprecedented turnover, discussed below, of key personnel at all of these entities since the Warner interests took control may well reflect dissatisfaction with and rejection of this mode of conducting business. If past behavior is viewed as an indicator of what will happen in the future to First Marine if the Combanks/American Applications are approved by the Board, then there is reason to be seriously concerned.

The domination of both ComBanks and American by one group, with Marvin Warner at the helm, must be fully appreciated before any analysis of the managerial decisions of ComBanks and American can be made.* The net impact of this domination is that any insider transaction or course

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* See pp. 8-9, supra, for a description of the interrelationships among the principal shareholders, directors and officers of ComBanks and American.

of conduct designed to benefit an insider or affiliate may well have little opportunity to be subjected to the scrutiny and vote of an independent board of directors. In such circumstances a board of directors may function more like a rubber stamp for the promotion of the interests of insiders at the expense of the corporation and minority stockholders than like an independent decision-making body. Thus, the traditional safeguard against insider abuses has not been and seems unlikely in the future to be present in the board rooms of both ComBanks and American. The material set forth below suggests that this environment may well have been the breeding ground for numerous transactions that may have involved insider profits.

a. Insurance Business

Soon after Warner took control of ComBanks, all of the insurance business of the holding company and the subsidiary banks seems to have been transferred to Warner's son-in-law, Herbert Kuppin, who works for Thomas E. Wood Insurance Company, in Cincinnati, Ohio.* This insurance company was paid $250,000 in premiums in 1977, $119,000 in 1978 and $153,000 in 1979.** The propriety of

* The public filings by ComBanks state that insurance premiums were paid to a relative of Warner's but do not disclose his identity or that of the insurance company.

** See ComBanks' Amended S-1, p. F-16. Exhibit A.

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these payments has been a matter of concern to a number of persons interviewed and frequent questions were raised by them as to whether insider profits were made by the Warner group when the insurance was directed to Warner's son-in-law.

The persons interviewed were of the opinion that the coverage provided by Kuppin's company was not as complete as that offered by American's previous carrier and referred particularly to the fact that Kuppin's company was apparently unable to obtain a blanket bond. We were also led to believe that American's insurance rates were higher with Kuppin's company than they were with American's previous carrier. There were indications that American's insurance business was at some point apparently transferred back to its original carrier, Dade Underwriters Insurance Agency. The possibility was raised that the Comptroller of the Currency might have looked into the question of who was providing American's insurance and insisted that the business be taken away from Kuppin's company.* The Comptroller of the Currency has refused to produce any documents in response to First Marine's Freedom of Infor-

* The Comptroller of the Currency had jurisdiction over all but three of the American banks until December 1978, when they were converted to state banks.

mation Act request which specifically included a request for documents relating to any investigations the Comptroller may have conducted with regard to American.

Warner's son-in-law was not the only Warner affiliate who received insurance business from banking organizations with which Warner was involved. In 1979, an unnamed subsidiary of ComBanks entered into an agreement with an insurance company affiliated with Warner, "for which it acted as agent for the sale of credit life, accident and health insurance related to the bank's lending operations." The Warner affiliate was paid $141,000 in premiums in 1979.*

b. Legal Business

The legal business of ComBanks, American and their subsidiary banks constitutes another area in which income seems to have been channelled to one of Warner's relatives. We have been led to believe that the fees paid by ComBanks and American to Arky's law firm (Arky, Freed, Stearns, Watson & Greer), may have been excessive. Arky's firm received the following fees from ComBanks:**

* See ComBanks' 1979 Annual Report on Form 10-K, p. 64. Exhibit FF.

** See ComBank's Annual Reports on Form 10-K for 1977 (Note 11 to Financial Statements), 1978 (p. 64), and 1979 (p. 64). Exhibits GG, HH and FF.

1977 - $ 90,000

1978 - $ 56,000

1979 - $105,000

For those same years the other legal business of ComBanks was also kept "in the family" and referred to firms whose members were described in various SEC filings as Directors of ComBanks or its subsidiary banks. Fees paid to these firms were as follows:*

1977 - $134,000

1978 - $143,000

1979 - $ 52,000

The fees paid to Arky's law firm by American were even higher than those paid by ComBanks during the same years:**

1977 - $149,459

1978 - $305,461

1979 - $415,514***

* See ComBanks' Annual Reports on Form 10-K for 1977 (Note 11 to Financial Statements) 1978, (p. 64), and 1979 (p. 64). Exhibits GG, HH and FF.

** See American's Amended S-1, p. 60.

*** The size of the fees paid to Arky's law firm may be significantly contrasted to the legal fees paid by First Marine's holding company for the same years:

1977 - $25,738
1978 - $14,474
1979 - $24,151

c. Brokerage and Investment Services

Another way in which income may have been directed to insiders of ComBanks and American is through the retention of brokers or investment advisers to handle the securities portfolios of both holding companies and their subsidiary banks. The recipients of fees for these services were (1) Argent Investors Management Corporation ("Argent"), a company in which HSFS owned 20% of the common stock and 100% of the preferred stock and (2) some or all of the financial companies owned or directed by Ewton and Seneca (E.S.M. Securities, Inc. and E.S.M. Group, Inc.).

As soon as Warner took over ComBanks, one of the subsidiary banks, ComBank/Winter Park, according to a ComBanks' prospectus,* entered into an agreement with Argent to have Argent manage portions of each subsidiary bank's portfolios of U.S. Treasury and Federal agency securities for one year. Pursuant to that agreement, Argent received a fee of $257,000 for the services it rendered in 1976. The fee was paid pro rata by each of the subsidiary banks. ComBanks' public filings for subsequent years do not make reference to Argent. Serious

* See ComBanks' Prospectus dated March 30, 1977, in connection with an offering of $25,000,000 of 9 1/4% Subordinated Debentures due December 31, 1983, p. 36. Exhibit II.

questions exist with respect to this arrangement with Argent including what services were in fact rendered and the propriety of the fees charged.

Another troubling relationship in this area of payment of fees to insiders is the retention of companies affiliated with Ewton and Seneca for the purchase and sale of securities for the ComBanks and American investment portfolios. The references to this relationship in the publicly filed documents of ComBanks and American are vague and First Marine is unable to confirm exactly what services were rendered, when the services were performed and the total amounts of the fees paid.

ComBanks apparently used E.S.M. Securities, Inc. to buy and sell securities for ComBanks' investment portfolio as early as 1977.* ComBanks and its subsidiaries continued to use the investment services provided by Ewton and Seneca at least through 1978, although during that year E.S.M. Group, Inc., not E.S.M. Securities, Inc., was listed as providing such services.** In 1978, E.S.M. Group

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* See Letter dated June 20, 1977 from ComBanks to the Federal Reserve Bank of Atlanta. Exhibit J .

** American's Amended S-1, p. 72. Exhibit B. This document mentions services rendered in 1978, but is silent with respect to whether ComBanks continued to use E.S.M. Group's services in 1979 and 1980. ComBanks' Annual Report on Form 10-K for 1979 provides no additional information.

"companies" also purchased and sold, as a principal, not as an agent, government and municipal securities to ComBanks and its subsidiaries.

With respect to the retention of the E.S.M. companies' services by American, several individuals have indicated to us that when Ewton and Seneca purchased their controlling interest in American, the Comptroller of the Currency may have prohibited the subsidiary banks from using their investment services.* We were told that the Comptroller of the Currency apparently was not enthusiastic about the investment by Ewton and Seneca when it was proposed and was concerned about the possibility of self-dealing if their investment services were used. Several persons interviewed recalled that each subsidiary bank was required to sign an agreement stating that it would not use those services, but their sources have further suggested that the agreements may have been violated, and on more than one occasion. The Comptroller of the Currency may well have records concerning these agreements and their violation, but refused to produce any documents of that nature in response to First Marine's Freedom of Information Act request.

FOI

* At the time that Ewton and Seneca purchased their interest in American, most of its banking subsidiaries were national banking associations. As such they came within the jurisdiction of the Comptroller of the Currency.

American did publicly disclose in June 1979 that since 1978 it had used the investment services of E.S.M. Group, Inc. and that it paid E.S.M. Group, Inc. $20,000 in that year.* American may not have been operating under the Comptroller's alleged restrictions during the whole of 1978, since it converted its subsidiaries to Florida banking corporations in December 1978, and the Florida Department of Banking and Finance may not have had the same concerns as the Comptroller of the Currency apparently had about the the use of Ewton's and Seneca's investment services. However, inasmuch as the conversion did not take place until December 1978, the $20,000 in fees would all have had to be paid in one month, unless the restrictions allegedly placed by the Comptroller of the Currency on the use of Ewton's and Seneca's services were modified some time in 1978. No further information about the magnitude of any fees paid by American in 1979 or 1980 to E.S.M. Group, Inc. or any other E.S.M. companies appear to have been provided in American's public filings.

The close affiliation between Ewton and Seneca on the one hand, and ComBanks, HSFS, Warner and Arky, on the other, from the date of Ewton and Seneca's investment

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* See Proxy Statement filed by American with the SEC in June 1979. Exhibit Y.

Stalking horse

in American, and the role that they played in allegedly warehousing their shares of American Common Stock for ComBanks, provides a suspicious backdrop to their rendering of services to ComBanks and American and raises serious questions regarding such arrangement.

d. Insider Loans

Certain individuals interviewed have expressed serious concerns about the magnitude and quality of loans to members of the Warner group and their affiliated interests. Although First Marine has no way of obtaining precise data revealing the individual amounts of these loans, their terms, the circumstances under which they were granted and their purposes, there are reasons to believe that (1) a substantial amount of loans to Warner's relatives and other interests and affiliates have been made, (2) Warner's dominant position in both holding companies may have been used to pressure the subsidiary banks into participating in these loans over their objections with respect to their risk and propriety, (3) these loans appear to favor the needs of Warner and his affiliates rather than servicing the needs of the communities in which the subsidiary banks do their business and (4) out-of-area loans or participations in out-of-area loans may be more prevalent than normal servicing of the needs of the com-

munity would dictate.

ComBanks' Annual Reports on Form 10-K for the years 1976 (when Warner and Culverhouse took control) through 1979 reflect substantial "loans to directors and officers of ComBanks and/or its subsidiaries and their related corporations and interests." These loans totalled $12,657,000 in 1976, $10,000,000 in 1977, $8,300,000 in 1978 and $6,420,000 in 1979.*

With respect to such loans by American, the information available is less complete. American reports its "aggregate balance of loans to directors and officers (or their interests or affiliates) of American and its principal subsidiaries" as follows: in 1977 the holding company alone (the only figure reported) made loans of $6,909,000; in 1978 the total loans made by both the holding company and subsidiaries was $5,437,000; in 1979 the loans totalled $4,958,000; and during the first six months of 1980 directors and officers (no mention is made of "their interests or affiliates") alone borrowed $5,769,000.**

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* See ComBanks' Annual Reports on Form 10-K for 1976 (p. F-21), 1977 (Note 11 to Financial Statements), 1978 (p. 64) and 1979 (p. 64). Exhibits JJ, GG, HH and FF.

** See American's Annual Reports on Form 10-K for 1977- (Note 3 to Financial Statements) and 1979 (p. 43 [includes data for both 1978 and 1979]). Exhibits KK, and LL. The 1980 figures are reported in American's Amended S-1 (p. 61). Exhibit B.

When the totals of these loans are compared to the total equity of (a) ComBanks for the period from 1976 to 1979 and (b) American for the period from 1977 through the first six months of 1980, the results reveal that these insider loans represent a very substantial percentage of the total equity of both companies. The tables below set forth the relevant figures:

COMBANKS CORPORATION*

	1976	1977	1978	1979
Total Loans to Insiders	$12,657,000	$10,000,000	$ 8,300,000	$ 6,420,000
Total Stock-holder Equity	$18,585,000	$18,642,000	$19,581,000	$21,383,000
Insider Loans as a Percent-age of Stock-holder Equity	68.10%	53.64%	42.39%	30.02%

* The figures appearing in this table were derived from Combanks' Amended S-1 (p.7) and Combanks' Annual Report on Form 10-K for 1976 (p.F-2), except for the percentages, which were computed. Exhibits A and M.

GREAT AMERICAN BANKS, INC.*

	1977	1978	1979	1980 (Six months ended June 30)
Total Loans to Insiders	$ 6,909,000**	$ 5,437,000	$ 4,958,000	$ 5,769,000
Total Stockholder Equity	$14,138,000	$16,600,000	$20,983,000	$24,114,000

GREAT AMERICAN BANKS, INC.

	1977	1978	1979	1980 (Six months ended June 30)
Insider Loans as a Percentage of Stockholder Equity	48.86%	32.75%	23.63%	23.92%***

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* The figures appearing on this table were derived from American' Amended S-1, except for the percentages, which were computed.

** The insider loans reported for 1977 apparently include loans to directors and officers but not to their interests or affiliates. See American Annual Report on Form 10-K for 1977 (Note 3 to Financial Statements). Exhibit KK.

*** American's Amended S-1 filed with the SEC on September 16, 1980 discloses that "as of June 30, 1980 the directors and officers as a group had outstanding loans aggregating $5,769,000 which represented 21.89% of American's total equity (p.61). If American's total equity is $21,114,000, as is stated on their certified financial statement, then their percentage figure is inaccurate. See Exhibit B.

As the above tables reveal, to the extent that these loans were (or are) of doubtful quality, they may have had (or may have) an adverse impact on ComBanks' and American's financial condition.

We have received only very general indications about which insider loans were considered questionable and were perceived or having been imposed by Warner and his affiliates on the subsidiary banks. One such indication concerns what was described as a $2 or $3 million loan to Culverhouse that had been carried for approximately six years by either HSSA or HSPS without any of the principal having been amortized. It has been suggested that the loan may have been for the purchase by Culverhouse of real estate in Florida. We have had interviews that suggest that pressure may have exerted within the last year on the subsidiary banks of both holding companies, and perhaps ComBanks itself, to take over the loan. One of the American subsidiary banks may have refused to participate. One individual advised us that he believed that it was unlikely that the loan would be repaid. Another example of a questionable insider transaction related to an alleged loan of approximately $2-3 million to Warner National Corporation, or some other affiliated business interest of Warner's, to purchase a controlling interest in an insurance company

in Florida (possibly Founders Financial Corporation located in Tampa).

It has also been suggested to us that the subsidiary banks may have been pressured to take over a loan made by HSFS to Ewton and Seneca. First Marine has no information as to purpose of this loan or its size. It would, however, be the final ignominy if the loan in question was the one given to Ewton by HSFS in 1978 to finance his purchase of a 14% interest in ComBanks.

In addition, one person interviewed indicated that he understood that within the last six months a strong request had been made by Warner or his representatives that ComBank/Winter Park finance the purchase of a new $1.5 million corporate jet and that the bank's management was extremely disturbed by the proposal. The outcome of the alleged controversy is not known.

There may of course be many other instances in which the subsidiary banks were compelled to extend questionable loans to insiders. The aforementioned information raises troublesome questions about the managerial integrity and financial well-being of both ComBanks and American and casts doubt on the willingness of their management to respond to the needs of local customers. Some of those persons interviewed on this point were of the opinion that

since the Warner interests took over the control of ComBanks and American, the banking subsidiaries of those companies had shifted their orientation away from the local community to Warner's affiliates and other non-local businesses. They also suggested that the subsidiaries of both Combanks and American may be participating in or making much greater numbers of out-of-area loans at the expense of serving the needs of the communities.

e. Loan to American by Home State Savings Association

Marvin Warner and his affiliates may have garnered benefits from their association with ComBanks and American, not only because of the opportunity to receive extremely advantageous loans, but also because of the opportunity to make advantageous loans, as well. On October 26, 1977, at a time when Ewton and Seneca were principals of American, a $4.5 million second mortgage loan was obtained by American from Home State Savings Association ("HSSA"), the Warner-affiliated company described above as the subject of the recent criminal information charging a scheme to defraud commercial borrowers.* As part of the loan transaction, warrants to purchase 600,000 shares of Common Stock of American were granted by American to HSFS, another Warner affiliate. The loan has been char-

* Supra, p. 29.

acterized by both ComBanks and American as "favorable" to American,* yet a preliminary review of the terms of the loan suggests that its provisions were clearly favorable to the lender, although in fairness we recognize that does not preclude the possibility of the loan also being fair to the borrower. The information presently available does not, however, suggest any way in which the loan could be viewed "as favorable to American." We have been informed that the serious questions raised herein as to the propriety of the terms of the loan are being explored in the pending SEC investigation of ComBanks and American.**

The loan granted by HSSA to American bore interest at the rate of 1% above the prime rate, with a minimum of 10% interest.*** The setting of such floor on the interest rate is a term favorable to the lender, not to the borrower. Moreover, the lender, in agreeing to extend the loan, appears to have requested that substantially all of

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* See ComBanks Amended S-1, pp. 72 and 102 and American's Amended S-1, p. 60. Exhibits A and B.

** This information has been provided to us by persons who have been deposed or questioned by the SEC during its investigation. ComBanks' and American's Amended S-1's (pp. 112 and 65, respectively) appear to skirt a direct disclosure on this subject by stating that the SEC is inquiring into, among other things, "the nature and extent of loan transactions between American and its affiliates." Exhibits A and B.

*** See American's Amended S-1, p. 60. Exhibit B.

American's assets be used to secure the loan. The security included, among other things, all of the subsidiary banks' real property, which in 1977 had an aggregate net book value of $7,222,000,* based on historical cost rather than market value.** The holding company also conditionally assigned its leases on the real property. More importantly, all of the stock of six of American's subsidiary banks and the stock of American's non-banking subsidiaries were also given as security.*** According to American's 1977 financial statements, the net worth of this stock was approximately $16.5 million.**** Thus, the total value of the security given by American for the $4.5 million loan, even without marking up the value to current market value, was approxi-

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* See American's 1977 Annual Report on Form 10-K, "Item 3. Properties." Exhibit NN.

** One can readily assume that the market value in Florida for this real estate was substantially higher than the amount at which it was being carried on the books, so that in all likelihood the collateralization for the $4.5 million loan was extremely favorable to HSSA.

*** See ComBanks' 1979 Annual Report on Form 10-K, p. 9. Exhibit OO.

**** American's 1977 Annual Report on Form 10-K, sets forth that American's investment in its banking subsidiaries, at equity, was $18,980,000. Once the equity investment in the Clearwater and Gainesville banks, whose stock was not given as security, is deducted, the total net worth of the stock of the six subsidiary banks totals approximately $16.5 million. Exhibit PP.

mately $23.7 million. The financial statement discloses that the real property was also subject to a first mortgage in the amount of approximately $6.5 million and that the stock of the subsidiaries was pledged as collateral for a term note in the amount of $2 million. Assuming that these were the only other loans secured by the same collateral, even if these prior lenders foreclosed on the collateral, $15.2 million of security would remain -- a hefty amount to secure a $4.5 million loan. The security provisions would thus hardly seem to have been "favorable" to American.

One individual interviewed recalled that the terms of the loan were justified by Stephen Arky, among others, on the ground that American was in desperate financial straits and unable to find financing from regular commercial lending sources. Various persons indicated, however, that credit may have been available to American from either its traditional commercial banking contacts, Southeast First National Bank of Miami and Manufacturers Hanover Trust Company, or from other established commercial lending institutions. We have been led to believe that before Ewton and Seneca took over American in March 1977, a new $3-4 million line of credit was being negotiated with Manufacturers Hanover, with Manufacturers Hanover expressing

a willingness to increase that amount if necessary. It has been indicated to us that the lending officer at Manufacturers Hanover in charge of American's account may have been deposed by the SEC. The SEC also apparently inquired, during one of the depositions it conducted, as to whether other lines of credit were available to American during the period when the HSSA loan was obtained.*

The more provocative aspect of the loan transaction centers around the aforementioned warrants to purchase 600,000 shares of American Common Stock. The warrants, which were exercisable over 10 years at prices ranging from $4.50 to $7.50, were given to HSFS, not HSSA, "as a finder's fee" "in consideration of the favorable terms of the loan."** If the terms of the loan were so favorable (an arguable point, as set forth above), this consideration presumably should have been given to HSSA,

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* We have also been informed that an offer was apparently made to the Board of Directors of American, at the time the loan from HSSA was being considered, to purchase the stock of one of American's subsidiary banks for $6 million. Our information is that the offer was turned down.

** See ComBanks' Amended S-1, pp. 72 and 102. Exhibit A.

the lender.* It is difficult to believe that HSFS was needed as a finder or acted in that capacity, since at the time the loan was negotiated, we are told that Arky played a substantial role in managing American. As Warner's son-in-law, it seems unlikely that he was unaware of the fact that one of his father-in-law's companies (HSSA) had money to lend to American. Moreover, if Ewton and Seneca were acting as fronts for the Warner interests during this time period, then the need for HSFS to "find" HSSA as a lender becomes even less believable.

ComBanks purchased the warrants from HSFS in June 1978 for $600,000. The warrants "were subsequently adjusted pursuant to anti-dilution provisions, giving ComBanks the right to purchase 704,842 of American for prices ranging from $4.50 to $7.50."** The pricing of these war-

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* Obviously, if a determination is made that the terms of the loan were not favorable to American, then the entire justification for granting the warrants to HSFS evaporates.

** See ComBanks Amended S-1, p. 72. Exhibit A. The warrants were issued in three series: Series A totalling 304,842 warrants, of which 200,000 are exercisable at $4.50 per share and 104,842 are exercisable at $6.493 per share; Series B totalling 100,000 warrants exercisable at $5.50; and Series C totalling 300,000 warrants exercisable at $7.50 (after October 26, 1980 Series C warrants become exercisable at book value per share of Common Stock). See American's Amended S-1, p. F-18. Exhibit B. The warrants were not exercisable before October 26, 1978. See American's 1977 Annual Report on Form 10-K, note 9 to Financial Statements. Exhibit QQ.

rants was apparently geared to the market value of American's shares, not to any multiple of book value, the more traditional method used to price banking transactions--and generally a premium price of 1.5 to 1.8 (or sometimes even 2) times book is paid when the transaction involves, as it did here, a change of control. As a result, HSFS initially and ComBanks later were able to acquire warrants to purchase American's Common Stock at a substantially reduced price. If HSFS had exercised all the warrants in 1980,* it would have received stock valued at $7,788,358 more

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* This assumes an exercise date prior to October 26, 1980 for the Series C warrants.

than it would have paid.* The book value of American's

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* The computations are as follows:

$ 11.51	(Book value)	
x 1.5	(Multiple)	
$17.265	(Value per share)	
$17.265	(Value per share)	
- 4.50	(Exercise price of Series A warrants)	
$12.765		
x 200,000	(Number of warrants exercisable at $4.50) =	$2,553,000.00
$17.265	(Value per share)	
- 6.493	(Exercise price of Series A warrants)	
$10.772		
x 104,842	(Number of warrants exercisable at $6.493) =	1,129,358.00
$17.265	(Value per share)	
- 5.50	(Exercise price of Series B warrants)	
$11.765		
x 100,000	(Number of warrants exercisable at $5.50) =	1,176,500.00
$17.265	(Value per share)	
- 7.50	(Exercise price of Series C warrants if exercised before 10/26/80)	
$ 9.765		
x 300,000	(Number of warrants exercisable at $7.50) =	2,929,500.00
	Total Value over total exercise price	$7,788,358.00

stock in 1980 is stated to be $11.51 per share.* If ComBanks had exercised the warrants in 1980, it would have received property worth $7,188,758 more than it would have paid ($7,788,758 less $600,000 paid by ComBanks to HSFS when it purchased the warrants).

Moreover, the fact that the value of the property received would substantially exceed the amount paid for it was perfectly foreseeable in 1977, when the warrants were issued. If one assumes that the warrants had been exercised in 1977 (although, as stated supra, p. 75, they could not by their terms be exercised before October 1978), HSFS would have received American Common Stock worth $2,998,976.51 more

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* See American's Amended S-1,p. 7. Exhibit B.

than the total price it would have had to pay.* If ComBanks

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* The computations are as follows: Book value of American common stock in 1977 was $6.98 per share ($14,475,000 [shareholder equity] divided by 2,073,484 [total number of outstanding shares]). See American's 1977 Annual Report on Form 10-K, Balance Sheet (Parent Company Only). Exhibit RR.

	$ 6.98	(Book value)	
x	1.5	(Multiple)	
	$10.47	(Value per share)	
-	4.50	(Exercise price of Series A warrants)	
	$ 5.97		
x	200,000	(Number of warrants exercisable at $4.50)	= $1,194,000.00
	$10.47	(Value per share)	
-	6.493	(Exercise price of Series A warrants)	
	$ 3.977		
x	104,847	(Number of warrants exercisable at $6.493)	= 416,976.51
	$ 10.47	(Value per share)	
-	5.50	(Exercise price of Series B warrants)	
	$ 4.97		
x	100,000	(Number of warrants exercisable at $5.50)	= 497,000.00
	$ 10.47	(Value per share)	
-	7.50	(Exercise price of Series C warrants)	
	$ 2.97		
x	300,000	(Number of warrants exercisable at $7.50)	= 891,000.00
		Total Value over total exercise price	$2,998,976.51

had exercised the warrants in 1977 it would have received property worth $2,398,976.51 more that it would have had to pay ($2,998,976.51 less $600,000 paid by ComBanks to HSFS when it purchased the warrants).

Moreover, the aforementioned value received by HSFS as an alleged "finder" should be compared to the more customary finder's fee -- usually no more than 5%. On a $4.5 million loan, such a fee would be about $225,000, far less than the value received by HSFS. Additionally, the warrants aspect of the transaction is even more suspect when one considers that the exercise price of warrants (especially, as in this case, warrants exercisable over 10 years) is usually pegged at 20-25% above the market value of the underlying securities at the time such price is established -- not at or below market.

The following observations can be made about this transaction. HSFS received the right to obtain property (the American Common Stock) that was valued at $2,998,976 more than it would have had to pay for it in 1977 and valued at $7,788,758 more than it would have had to pay for it in 1980. It received this benefit either gratuitously or in return for rendering undocumented services, valued at an undocumented amount. If some

services were indeed rendered by HSFS to American -- the "finding" of the "favorable" HSSA loan -- a question then arises as to why the management of American, which could and should have performed these services for their corporation, did not do so. Moreover, the management of American appears to have given away the right to purchase stock in their corporation at a bargain price. Certainly at the very least, these facts, if proven at a full hearing, would strongly suggest that a possible waste of corporate assets and breach of fiduciary duty may have occurred in this transaction.

In addition, the purchase by ComBanks of the warrants from HSFS may have provided Warner with a way to "upstream" $600,000 from ComBanks to HSFS, a corporation more closely held by Warner. While First Marine has no access to information as to how the price was determined or negotiated, or what independent appraisals were sought, or whether directors affiliated with Warner (substantially the entire ComBanks Board) refrained from voting on this matter, certainly the Board should, we believe, examine this transaction carefully in view of its potential for disclosing whether the Warner management group meets the standards of managerial integrity required under Section 3(c) of the Act.

f. Operating Expenses

ComBanks' and American's reported financial information reveal, as set forth below, that substantial management fees and dividends have been paid to them by their subsidiary banks. Moreover, these fees appear to have increased significantly since the Warner interests took control of both companies. Some individuals who were interviewed complained about increased operating expenses, citing management fees in particular as one example, and expressed doubt that the services being rendered in return for such fees were worth the increased cost.

In the context of ComBanks' apparent efforts to channel such items as insurance premiums, legal fees and fees for investment advice to Warner's affiliates and relatives, as discussed earlier, these increased operating costs may be viewed as another example of a possible attempt to "upstream" income into the holding company so that it can then be siphoned off to the Warner interests and affiliates. Conceivably, the same technique might be tried with any new acquisitions as is already in practice at ComBanks and American.

Prior decisions by the Board indicate that evidence that abuses have been perpetrated upon the subsidiary banks or the minority shareholders of a bank holding company will

have substantial impact upon the Board's assessment of the applicant's managerial resources. In First Southwest Corporation, 58 Fed. Res. Bull. 301 (1972), for instance, the Board, in denying the acquisition of a bank, indicated that it was disturbed by the excessive management fees paid by the potential subsidiary banks of the applicant to the applicant's management subsidiary. The Board found that to the extent the fees were excessive, "their imposition has operated to the detriment of the bank's minority shareholders and possibly to the bank itself." 58 Fed. Res. Bull. at 302. In rejecting the application the Board stated (58 Fed. Res. Bull. at 303):

> "the Board's decision is not based on a subjective judgment of any particular shareholder's feelings, but rather on a judgment of general management attitude toward the operations of the proposed subsidiary banks as reflected by the totality of circumstances discussed."

Similarly, in a 1975 decision, the Board denied an application by Citizens Bancorp of Maud, Oklahoma to become a bank holding company on the ground, inter alia, that the bank's management (the same group that would manage the holding company) had been receiving salaries and retainers from the bank that were excessive in relation to the services rendered. Citizens Bancorp, 61 Fed. Res. Bull. 806 (1975). To the extent that such practices exist, said the Board, "they constitute a use of bank

assets to the detriment of the minority shareholders of bank and therefore reflect adversely on management considerations." 61 Fed. Res. Bull. at 807.

In its decision in The Adair Corporation, 60 Fed. Res. Bull. 309 (April 1974), the Board expressed its dissatisfaction with the high management fees being charged to a bank by the principals of the applicant. The Board noted that the principals of the applicant drew large management and directors' fees and liberal dividends from other banks in which they had significant interests. The Board asserted that it would "not sanction the use of a holding company structure to perpetuate management practices that will in due course impair the financial condition of the bank to be acquired." 60 Fed. Res. Bull. at 310.

The tables set forth below detail the substantial increase in the management fees and dividends that has attended the accession to control of the applicant bank holding companies by Marvin Warner and his affiliates.

COMBANKS CORPORATION

	1979	1978	1977	1976	1975
Management fees from Subsidiaries*	$ 895,000	$1,768,000	$1,178,000	$ 390,000	$360,000
Dividends from Subsidiaries**	$1,266,000	$ 858,000	$ 637,750	$ 630,934	$349,000

GREAT AMERICAN BANKS, INC.***

	6/30/80	1979	1978	1977	1976
Management fees from Subsidiaries	$ 677,000	$ 815,000	$ 508,000	$ 253,000	$504,000
Dividends from Subsidiaries	$ 973,000	$1,318,000	$ 231,000	$ 188,000	$337,000

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* See ComBanks' Annual Reports on Form 10-K for the years 1976, p. F-7 (Exhibit SS) and 1979, p. 42 (Exhibit TT), and ComBanks' Amended S-1, p. F-8 (Note A) (Exhibit A).

** See ComBanks' Annual Reports on Form 10-K for the years 1976, p. F-7 (Exhibit SS); 1977, Statements of Income (Parent Company Only) (Exhibit UU); and 1979, p. 42 (Exhibit TT).

*** See American's Amended S-1, p. 21 (Exhibit B).

The adverse implications of the fact that the foregoing payments have increased so substantially should be a factor in the Board's evaluation of ComBanks' and American's "general attitude toward the operations of proposed subsidiary banks."

As stated previously, we cannot vouch for the accuracy or completeness of the information First Marine has assembled, for without a thorough analysis of documents and other information regarding ComBanks and American to which First Marine does not have access -- but which the Board and FDIC can obtain -- a definitive evaluation cannot be made. But it is clear that there is enough smoke to suggest that there might be a fire, and that the Board must undertake a full scale investigation and analysis to see how competently and fairly the Warner management team discharges its fiduciary duties and responsibilities and fulfills the substantial standards of Section 3(c) of the Act.

g. Turnover in Executive Personnel

A review of the lists of the officers and directors of the subsidiary banks of both ComBanks and American over the years since the Warner interests took control reveals a significant turnover of executive personnel, particularly on the

presidential level.* On the holding company level, both presidents appointed by boards controlled by the Warner interests have resigned. The sheer number of executive officers who have left may well be further smoke signals requiring the Board to see if there is something awry within these organizations.

These statistics alone are troubling. But they become even more so when we note indications provided to us about the reasons why a substantial number of these officers and other managerial personnel have left. We have been led to believe that central to their decisions to leave may have been a strong sense of dissatisfaction with the managerial attitudes and policies of Warner and his aides.

The specific sources of this dissatisfaction were described to us by various individuals in very similar terms: excessive domination by Warner and the small control group at the holding company level over the affairs of the subsidiary banks; the pressure put on the banks to participate in insider loans; the increased operating expenses imposed on the banks which seemed excessive and designed to enrich the holding companies; the channelling of seemingly excessive fees for professional services to Warner's affiliates and relatives; and the apparent goal of directing the

* Exhibits D, E, VV and WW hereto are lists of officers and directors of ComBanks and American, respectively, including their subsidiary banks, for the years shown thereon.

resources of the banks to larger, remote customers rather than the local community.

While we recognize that these statements made to us may be "sour grapes", and that they have not been tested by cross-examination in the context of an administrative hearing, the statements were volunteered to us without prompting or pressure and we have no reason to believe they may not be reliable. Whether they represent an accurate picture of Warner's style of management can only be determined in a full Board hearing or vigorous Board investigation. At the very least, these indications about the apparent reasons for executive dissatisfaction strongly suggest the need for a full Board investigation of the issues we have raised in these comments concerning what seem to be improper managerial policies and questionable actions of the Warner managerial group.*

* This may be even more so in light of the report in the Miami Business Journal dated October 27, 1980, pp. 4-5, that Warner was offered an ambassadorship by none other than Bert Lance, whose conduct in other bank relationships is presumably well known to the Board. Exhibit XX. While we have not had sufficient time or resources to investigate the relationship between Warner and Bert Lance, we have heard unsubstantiated suggestions that Warner may have been actively involved in assisting Bert Lance and the National Bank of Georgia in connection with a public offering of its securities under somewhat questionable circumstances. We assume that the Board may want to pursue this to determine whether or not it is true and whether or not any improprieties were involved.

Bert Lance

50-923 O—85——40

The statistics regarding American executives is particularly startling. Only one of eight* presidents of the subsidiary banks who held that office in 1977, after Ewton and Seneca -- or indirectly ComBanks -- took over, remains today.** Of the seven presidents who left, five were appointed to office in 1977, after Ewton and Seneca obtained control.*** They were not holdovers from the two presidents who left, David E. Berger, former President of Great American Bank of North Miami Beach, had been President since 1973. The second, William Stine, former President of Great American Seminole Bank of Tampa, had been President of the bank for 24 years until he resigned in July 1980. At the same time Mr. Stine left the North Miami Beach bank, the entire Board of Directors and all the key executive officers of that bank resigned and joined the Popular Bank previous regime of Alfred W. Slobusky. One of the other

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* Although there are only eight subsidiary banks today, prior to July 1979 there were nine. In July 1979, the First American Bank of Homestead merged with the First American Bank of Dade County.

** Mr. H. Thomas Johnston remains President of Great American Bank of Broward County. Exhibit WW.

*** The five include George Apelian (Great American Bank of Dade County), Robert Ruckman (Great American Bank of Davie), Floyd Garvin (Great American Bank of the Florida Keys), James Emerson (Great American Bank of Gainesville), and R. Paul Umberg (Great American Bank of Pinellas).

of Tampa. We are advised that R. Paul Umberg, who was appointed as temporary President to replace Mr. Stine, has also since resigned.

On the American holding company level, Donald E. Beazley, the President, Chief Executive Officer and Vice Chairman of the Board, who was appointed in April 1977, after Ewton and Seneca took over, resigned in 1979, along with Albert C. Little, who had been Vice President since September 1977.

The records with respect to the ComBanks' subsidiaries evidence basically the same lack of management continuity. Only one of the six presidents of the subsidiary banks in office in 1977 remains today.*

The ComBanks holding company has also witnessed some major upheavals. F. Philip Handy, appointed as President on September 28, 1976, after Warner and Culverhouse had taken control, resigned in April 1980.** Gavin H. Watson, Jr., and Robert J. Caldwell, both Executive Vice Presidents since March 1978, and William G. Bledsoe, Vice

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* John B. Burke has been President of ComBank/Fairvilla since 1977. The other five men who were presidents in 1977 have left: Gary A. Rue (ComBank/Apopka); Louis M. Rawls, Jr. (ComBank/Casselberry); Dwight Mentzer (ComBank/Pine Castle); (ComBank/Union Park); and Gavin H. Watson (ComBank/Union Park). Exhibit W.

** See ComBanks' Amended S-1, p. 67. Exhibit A.

President since June 1978, all left one year later.

This information available to date regarding the repeated and comprehensive turnovers in executive talent in the ComBanks/American organizations suggests extremely weak executive resources and an inability to maintain managerial continuity. A ComBanks/American takeover of First Marine could hardly provide First Marine, which has maintained a steady record of growth and community service under a stable, well-respected management team, with a source of management strength.

APPENDIX 8.—FEDERAL HOME LOAN BANK BOARD DOCUMENTS

A. DOCUMENTS RELATING TO THE FHLBB'S SUPERVISION OF UNITY SAVINGS ASSOCIATION (CHICAGO, IL)

1. INTERIM EXAMINATION REPORT, DATED OCTOBER 10, 1980

Federal Home Loan Bank Board

Memo

INTER-OFFICE COMMUNICATION

FROM : Harry J. Strass

DATE October 10, 1980

TO : Burton N. Vanerio
Assistant District Director

SUBJECT: Unity Savings Association
Schaumburg, Illinois
FHLBB Docket No. 6290
Examination as of:
August 4, 1980
Third Interim Report

Reverse Repurchase Agreements

The dollar amount of reverse repurchase agreements with E.S.M. Government Securities, Incorporated, based in Fort Lauderdale, Florida has increased from $54,269,000 at the previous examination to $156,387,000 at September 30, 1980, a 188% increase. The association as of September 30, 1980, has assigned $249,943,489 of securities for collateral to this firm. The net book value of these securities exceeds the loan amount by $93,556,489, which is the potential loss to the association in the event of the financial demise of E.S.M. Currently, E.S.M. is the only dealer firm with which the association has outstanding reverse repurchase agreements.

The reverse repurchase agreements involve the association entering into a simultaneous agreement to sell and then repurchase the identical security at a subsequent date. In this transaction, the association files form 1832-PD in blank with E.S.M., which entitles E.S.M. to assign the collateral.

Our review of the (GNMA) remittances indicated that in several instances the association was the issuer of the security and in all instances the security holder. In all instances principal and interest payments were remitted to the association by the issuer.

We are unable to determine for what purpose E.S.M. uses these securities. A common industry practice is for the firm to sell these securities to municipalities or large corporations with the agreement to repurchase at a subsequent date. At the time of the security sale, E.S.M. assigns the collateral to the investor. This constitues a significant risk to the association if E.S.M. is unable to repurchase these securities. The question of ownership becomes uncertain.

It was noted that the reverse repurchase amount as a percent of the market value of the collateralized securities was currently 77.4%. Two large dealer firms were contacted and these firms indicated that their general policy was that the reverse repurchase amount would not exceed 95% of the market value of the collateralized securities.

These dealer firms further indicated that the deposit of a large amount of collateral whereby the market value of these securities exceeded the reverse repurchase amount was an unusual practice through out the industry.

In return for this large deposit of collateral, E.S.M. usually offers the association interest rates on the borrowings that are approximately 1.5% to 2.0% below comparable dealer firms. The following tabulation reflects the total dollar amount of outstanding reverse repurchase agreements, the net book value and approximate market value of the collateral deposited with E.S.M., and the reverse repurchase amount as a percentage of the market value.

	Balance		
	9/30/80	7/31/80	7/31/79
Reverse repurchase agreements outstanding	$156,387,000	$132,922,000	$54,269,000
Net book value of collateral	249,943,489	195,851,103	68,843,700
Approximate market value of collateral	202,106,570	168,729,755	64,038,330
Percent of reverse repurchase amount to market value	77.4	78.8	84.8

The following tabulation sets forth the unusual variances of the reverse repurchase amounts as compared to the approximate market values of the collateral at September 30, 1980.

FHLBB Docket No. 6290

ype of Security ollaterazing Loan	Reverse Repurchase Agreement: Date Opened	Maturity Date	Interest Rate	Balance 9-30-80	Collateral: Net Book Value 9-30-80	Market Value 9-30-80	% Reverse Repurchase Amt. to Market Value
bligations of United States reasury or Agencies	7-80	Open	11.25	$15,222,000	$18,713,826	$15,602,336	97.6
overnment National Mortgage ssociation Certificates (GNMA's)	9-80	10-15-80	10.5	17,685,000	21,750,086	19,450,675	90.9
N s)	9-80	10-29-80	12.375	3,295,000	4,160,915	3,643,820	90.4
NMA's)	6-80	12-10-80	9.0	45,630,000	62,185,355	49,427,601	92.3
NMA's)	9-80	1-19-81	9.375	8,883,000	13,488,294	11,726,904	75.7
NMA's)	8-80	2-17-81	11.0	9,890,000	13,353,339	10,931,314	90.5
nited States Treasury Bonds	8-80	2-17-81	8.0	34,400,000	44,475,588	38,360,194	89.7
NMA's)	6-80	3- 2-81	11.75	9,305,000	51,264,557	36,665,357	25.4
ederal Home Loan Mortgage orporation Certificates and (GNMA's)	9-80	3-16-81	8.75	12,077,000	20,551,529	16,298,369	74.1
		Totals		$156,387,000	$249,943,489	$202,106,570	

The association has dealt with this firm since 1976; however, the amount of activity has continually increased. Other services provided by E.S.M. include broker functions for the purchase and sale of securities, and warehousing services where E.S.M. maintaining securities for subsequent delivery to the association.

Our review of the three most recent financial statements of E.S.M. Government Securities, Incorporated disclosed the following assets and retained earnings.

	Most Recent Fiscal Year Ended		
	12-31-79	12-31-78	12-31-77
Assets	$588,919,000	$623,223,000	$386,224,000
Retained Earnings, (Deficit)	$1,889,000	($ 1,617,000)	$480,000

It is apparent from these financial statements that the association provides E.S.M. with an unusually large amount of business. In addition, the volatility of E.S.M's retained earnings would indicate another potential risk to the association.

It was noted that on July 26, 1978, the association simultaneously purchased and sold $10 million of GNMA certificates for settlement on March 20, 1980. This transaction locked in a $545,000 gross profit. In return for this profit the association paid E.S.M. $363,500 in fees and deposited as initial and maintenace margin $2,160,625 during the period of this transaction.

At settlement the net profit to the association was $194,024. In effect this was an unsecured loan to E.S.M., which is a prohibited transaction. The association's profit could be considered interest on the loan. In addition, it is questionable if the association received an equitable return on this loan.

Senior Vice President Howard Bass said that other dealer firms are used for reverse repurchase agreements periodically. However, the favorable interest rates obtained from E.S.M. more than exceeded any risk of this dealer firm's financial demise.

/s/ Harry J. Strass
Examiner

2. UNITY RESPONSE TO FHLBB, DATED NOVEMBER 20, 1980

UNITY SAVINGS

Docket No. 6290

INTER-OFFICE MEMO

TO FEDERAL HOME LOAN BANK BOARD DATE NOVEMBER 20, 1980

FROM HOWARD I. BASS

SUBJECT: RESPONSE TO FHLBB EXCEPTION SHEET: E.S.M. REPO AGREEMENTS

The Association agrees that it should spread its large concentration of securities presently held as collateral for reverse repurchase agreements with E.S.M. Government Securities (E.S.M.). The Association intends to repay E.S.M. as individual repos mature, receiving its collateral in consideration thereof. (In one instance, Unity has previously committed to rollover its repo with E.S.M.) Where necessary, the Association intends to repledge this collateral with a variety of dealer firms with whom it has discussed the placement of this business. These firms include Goldman Sachs, First Boston, ACLI Government Securities, and Continental Illinois National Bank.

Kindly see my letter to Mr. William Schilling, Commissioner, dated November 20, 1980.

Exhibit C

UNITY
SAVINGS

November 20, 1980

Mr. William Schilling, Commissioner
Office of the Savings & Loan Commissioner
160 North LaSalle Street
Chicago, Illinois 60601

Re. E.S.M. Government Securities
Workout Program

Dear Mr. Schilling:

As per your request, the following is our written response, setting forth a program to repay our existing block of reverse repurchase agreements with E.S.M. Government Securities (E.S.M.).

We have been in contact with a number of reverse repo lenders with a view towards refinancing our position presently held at E.S.M. Among these lenders are Goldman, Sachs & Co., First Boston Company, ACLI Government Securities and Continental Illinois National Bank. We presently have refinanced a small portion of our repo loans with Goldman Sachs. On December 10, 1980, a loan of $45.6 million matures at E.S.M. Unity has a commitment from E.S.M. since late September to roll-over this loan at a fixed rate of 9.75% per annum for an additional nine months. For Unity not to avail itself of this commitment in a 15% environment would create a considerable increased borrowing cost to the Association. Thus, we intend to roll-over this loan at E.S.M.

It is also our intention to repay each of the other repo borrowings at maturity, either by way of refinancing same with other lenders, or by repaying same with cash generated through operations. Thus, by mid-March, 1981, E.S.M. will be just one of a number (at least four) of reverse repo lenders.

In the event you have any questions or comments with respect to this matter, please feel free to contact me.

Very truly yours,

Howard I. Bass
Senior Vice President

HIB/js

CC: Mr. Jack Battaglia

Docket No. 6290

UNITY SAVINGS

INTER-OFFICE MEMO

TO FEDERAL HOME LOAN BANK BOARD DATE NOVEMBER 20, 1980

FROM HOWARD I. BASS

SUBJECT: RESPONSE TO FHLBB EXCEPTION SHEET: $23 MILLION PURCHASE OF GNMA PASS-THROUGHS ON JUNE 18, 1980

1. The dramatic decline in the price of GNMA modified pass-throughs between May, 1979 and March, 1980 caused the Association to advance significant margin deposits in this case. The requirement of a margin deposit in and of itself is not unreasonable; however, the amount of funds advanced pursuant to the margin requirement was totally unforeseen, and was caused by the unprecedented decline in prices of all fixed rate obligations during the period mentioned above.

2. The Association bargained to receive a yield which was, in fact, received, although the coupon rate for actively traded GNMA's was changed on several occasions during the commitment period. A par-cap commitment generally is more desirable in volatile markets, and the Association intends to include that requirement in the future.

3. The interest rate on margin deposits resulted from the over-all negotiation of this transaction. In retrospect, that rate, being fixed, resulted in an opportunity loss to the Association.

4. The Examiner indicates that the Association paid a higher price than "market" for subject securities. However, Examiner indicates that the furthest month quoted in the cash market was October, 1979. Thus, he is comparing an October, 1979 quote with a price for a transaction which settled in June, 1980.

Exhibit C 2

UNITY SAVINGS

Docket No. 6290

INTER-OFFICE MEMO

TO FEDERAL HOME LOAN BANK BOARD DATE NOVEMBER 20, 1980

FROM HOWARD I. BASS

SUBJECT: RESPONSE TO FHLBB EXCEPTION SHEET: PURCHASE OF $8 MILLION GNMA'S

The original commitment of February, 1979 contemplates settlement in December, 1980. At the request of our independent auditors, settlement did occur in June, 1980. Kindly see a companion response concerning no par-cap transactions. This transaction involves a margin requirement, which margin was interest bearing (at 9.59%). Written documentation supporting the transactions will be provided.

Exhibit C-3

Docket No. 6290

UNITY SAVINGS

INTER-OFFICE MEMO

TO FEDERAL HOME LOAN BANK BOARD DATE NOVEMBER 20, 1980

FROM HOWARD I. BASS

SUBJECT: RESPONSE TO FHLBB EXCEPTION SHEET: VIRGINIA NATIONAL MORTGAGE CORPORATION

A net profit of $767,912.00 was recorded with respect to $4 million of GNMA standbys issued in favor of Unity during 1979. Also in 1979, Unity issued $4 million of GNMA standbys, and received delivery of $4 million of GNMA pools pursuant to these standbys. Unity immediately sold in the marketplace $2 million GNMA's so delivered, and a loss of approximately $73,000.00 was recorded.

The Examiner questions whether the net profit recorded as current income should have been deferred since the $2 million of GNMA's retained in Unity's portfolio are held at a cost which is current market. A discussion with our independent auditor was held concerning this transaction. Our auditor indicated it was appropriate to record the entire net profit immediately.

Exhibit C 4

Docket No. 6290

UNITY SAVINGS

INTER-OFFICE MEMO

TO FEDERAL HOME LOAN BANK BOARD DATE NOVEMBER 20, 1980

FROM HOWARD I. BASS

SUBJECT: RESPONSE TO FHLBB EXCEPTION SHEET: ARBITRAGE #55

1. The commitment letters requested are attached hereto.

2. The Federal Examiner contacted Salomon Bros. to determine the market for commitment fees paid to obtain standbys ranging from three months to one year. The input received related to commitment fees paid for the issuance of primary market standbys, that is, standbys which are issued and paid for and constitute the whole of the transaction. This was not the case in Arbitrage 55. E.S.M. had issued as a broker a series of $39 million of standbys to a financial institution early in 1978 (Original Standbys). That institution desired to sell its position in those original standbys for a fee paid during 1978, instead of waiting to book profits at the various settlement dates in March through December, 1979. E.S.M. was requested to find a lender who would pay a standby fee reflecting the inherent value of the Original Standbys (which had considerable value by late 1978, due to the falling prices during calender 1978). Unity agreed to pay 2.9% in commitment fees to take over the prices of the Original Standbys; the documentation was drawn on the basis that the Original Standbys were cancelled, and the December, 1978 standbys that were issued to Unity contained the identical terms of the Original Standbys.

E.S.M's position in this transaction was that of a broker. The recipients of the standby fees paid in connection with the Original Standbys were a series of financial institutions, primarily savings and loans, and Wall Street investment houses such as Lehman Bros., First Boston, etc.

3. Unity paid a 3.0% commitment fee to get a 3.8% return in 90 days. This is a 26.7% return for 90 days, or over 100% return on an annualized basis.

(continued)

Exhibit C5

Docket No. 6290

UNITY SAVINGS

INTER-OFFICE MEMO

TO FEDERAL HOME LOAN BANK BOARD DATE NOVEMBER 20, 1980

FROM HOWARD I. BASS

SUBJECT: RESPONSE TO FHLBB EXCEPTION SHEET: ARBITRAGE #55

4. An analysis of the yield to our Association from Arbitrage #55 indicates that we received an annualized return of 22.5%, based upon the average outstanding investment in said Arbitrage.

Exhibit C-5a

Docket No. 6290

UNITY SAVINGS

INTER-OFFICE MEMO

TO FEDERAL HOME LOAN BANK BOARD DATE NOVEMBER 20, 1980

FROM HOWARD I. BASS

SUBJECT: RESPONSE TO FHLBB EXCEPTION SHEET: ARBITRAGE #11

The Association does not concur that the payment of standby fees of $363,500 constituted an unsecured loan to E.S.M. The Association paid standby fees in this instance to acquire standby commitments which replaced a series of original standbys entered into by a separate institution at an earlier date. The facts here closely resemble those in Arbitrage 55.

Kindly see my response in connection with Arbitrage #55.

Exhibit C 6

3. Examination Report, Dated January 6, 1981

Federal Home Loan Bank Board
Department of Examinations
TRANSMITTAL AND ANALYSIS SHEET
FOR REPORT OF EXAMINATION

DIST. NO. 7 | DOCKET NO. 6290
COMPLETION NO. 5947-48*-49**-50***-51****-52*****

NAME AND LOCATION OF INSTITUTION (Home Office)
Unity Savings Association
1805 East Golf Road
Schaumburg, Illinois 60195

DATE FIELD WORK COMPLETED: December 2, 1980
DATE TRANSMITTED: 1-6-81

NAME OF MANAGING OFFICER: Saul Z. Bass
NAME OF INDEPENDENT AUDITOR: Ernst and Whinney
DATE OF LAST AUDIT: March 31, 1980

OWNERSHIP OR CONTROL (Including Proxy Control)
Bass Financial Corporation owns all outstanding permanent reserve shares of the association.

EXAMINATION	EXAMINER-IN-CHARGE	TYPE OF EXAMINATION	DATE OF EXAMINATION	COMPOSITE EVALUATION EIC	COMPOSITE EVALUATION DD	COMPOSITE EVALUATION SA	CRA EVALUATION EIC	CRA EVALUATION DD	CRA EVALUATION SA
Current	Harry J. Strass	Supervisory Joint	8/ 4/80	4	4		3	3	
Previous	Harry J. Strass	Supervisory Joint	8/25/79	3	3	3	3	3	3

*UNITY SAV. ASSOC.-**PLAZA INS. AGEN.-***UNITY MORT. CORP. ****FIRST CHART.SER.CORP.*****UNITY SERV.***BASS FIN. CORP.

	AMOUNT	PERCENT TO ASSETS	PERCENTAGES
Total assets	$977,908,425		
Savings accounts	725,782,418	74.2	
Percent increase in savings accounts since previous examination			17.7
Specific reserves (563.17-2)	1,216,537	1.2	
Total net worth	30,179,668	3.1	
Percent to savings accounts			4.2
Indicated losses (Unreserved)	1,299,813	.13 1.3	
Slow loans	41,415,328	4.2	
Real estate owned	4,392,900	.4	
Total scheduled items	46,050,772	4.7	
Gross operating income to average assets #			9.3
Operating expense to average assets #			1.9
Operating expense to operating income			19.9
Net income to gross operating income			7.5

Annualized

	YES	NO
Review of this report by Regional Director recommended	X	
Assets were re-evaluated by means of independent appraisals		X
Cease-and-desist order recommended		X
Issuance of subpoenas recommended		X
Administration of oaths recommended		X
Suspension of officer or director recommended		X

RECEIVED FEDERAL HOME LOAN BANK BD CHICAGO JAN 8 1981

WASHINGTON OFFICE USE ONLY

O.K. to Pay
Referred to

DATE REPORT RECEIVED | ASSIGNED TO:

SUBJECT TO REVIEW ☐ Yes ☐ No

Report Reviewed: DATE | INITIALS:

Reason for Review (If appropriate)
☐ Composite Rating ☐ Financial Condition
☐ Field Recommendation ☐ Spot Check
☐ Problem Book Case ☐ Other

Supervisory Letters: FOLLOW-UP DATE	Supervisory Letters: DATE	Association Responses: FOLLOW-UP DATE	Association Responses: DATE

FHLBB Form 168
REV. APRIL 1979

FHLBB Docket No. 6290

Report of Supervisory Joint Examination of: UNITY SAVINGS ASSOCIATION
Schaumburg, Illinois

Date of Examination: As of August 4, 1980

SUMMARY

The board of directors is not being apprised of the major activities and potential problems so that it can effectively monitor decision making, and foster objectives and long range goals. (Item I-A)

The association has assigned securities with an aggregate book value of $249,943,489 to E.S.M. Government Securities, Incorporated for borrowings totaling $156,387,000. The differential of $93,556,489, or 3.2 times the association's net worth, is a potential loss. In addition, several unusual transactions were engaged in with this dealer firm. (Item I-B)

Scheduled items have increased 68.3% over the previous examination's total primarily because of the inclusion of delinquent or past due straight loans to multiple borrowers. (Item I-C)

First Charter Service Corporation, a wholly owned subsidiary of Unity Savings, has net investments in 17 projects aggregating $4,819,871, or 49.3% of assets that are substandard. Junior financing was provided to Unity Saving's lien on eight of the projects. The service corporation's operations have been adversely affected by the substandard assets. (Item I-D)

The mortgage banking operations of Unity Mortgage Corporation, and a potential conflict of interest situation are discussed under Item I-E.

The association's operations has been materially affected by the high volume of scheduled items, high operating expenses and the increase in the cost of money. A $2,357,200 operating loss was sustained for the semiannual period ended September 30, 1980. The loss would have been greater, had not a $1,138,000 extraordinary profit been recorded in September 1980. (Item I-F)

High risk loans to two major borrowers are discussed in Comment Sections I-G and I-H.

A large loan commitment totaling $23.5 million, equal to 77.9% of the association's net worth, on a single condominium conversion project is discussed in Item I-I.

COMMENTS AND CONCLUSIONS

Item I

The following matters are considered to be of immediate supervisory concern.

A. Management and Organizational Structure

Although the board of directors meet regularly, we saw little evidence in the minutes record that members are fully informed of the association's major activities and potential operational or financial problems. This report discloses material concerns relating to outside borrowings and investments, delinquent loans, operations, loans to major borrowers, and inadequate recordkeeping and internal control. Of equal importance, is the apparent lack of established objectives, long range goals, and policy and decision making. All of these indicate that the board is not acting as an independent board.

Saul Z. Bass, is president and managing officer of this association, and has served in this capacity for many years. Senior Vice President Howard I. Bass, however, manages the day to day operations of the association. It appears, from our observation, that Saul Bass has relinquished his responsibility as managing officer to Howard Bass.

The Executive Committee, consisting of Saul Z. Bass, Louis L. Spear, and James G. Flannery, was appointed by the board of directors at its organizational meetings of May 1980, and May 1979. The resolution requires the Executive Committee to meet upon call of the Chairman, and a written report of the action of the committee to become a part of the minutes of the board of directors' meetings. Inasmuch as there were no reports of this committee attached to directors' meetings during the period covered by this report, we must conclude that this committee is inactive.

From our observation, there is no delegation of authority entrusted to department heads and senior officers normally found in an association of this size. In our contacts with department heads or senior officers we were frequently referred to Howard Bass for discussions, decisions and answers that they should have been able to provide themselves. Their lack of authority to respond to our inquiries and findings caused extended delays in the examination process.

There was a reluctance on the part of Howard Bass to certify to the content of our discussions, and his responses. Copies of these exception sheets were furnished to Vice President Stephen Garfield and Corporate Controller Robert Taylor for their acknowledgment before he would certify these sheets. Further, Howard Bass wished to respond to several major exceptions by separate letter.

Howard Bass, in a memorandum attached as Exhibit A of this report, acknowledges that there are problems in management, and what is being done to correct the problems.

B. Outside Borrowings and Investments

1. E.S.M. Government Securities, Incorporated

This firm, located in Fort Lauderdale, Florida, was incorporated in the state of Florida on October 8, 1975. The association has dealt with E.S.M. since 1976, however, the volume of activity has increased significantly since the previous examination. Services provided by E.S.M. include loans to the association through reverse repurchase agreements, warehousing securities and brokering functions. In addition, E.S.M. assembles various arbitrage packages for the association which are detailed elsewhere in the report.

The three most recent financial statements of E.S.M. Government Securities, Incorporated disclosed the following assets, retained earnings, and net worth.

	Most Recent Fiscal Year Ended		
	12-31-79	12-31-78	12-31-77
Assets	$588,919,000	$623,223,000	$386,224,000
Retained Earnings, (Deficit)	$ 1,889,000	($ 1,617,000)	$ 480,000
Total Net Worth	$ 6,050,000	$ 2,544,000	$ 1 140,000

It is apparent from these financial statements that there is substantial risk to the association due to the structure of various reverse repurchase agreements with this dealer firm. Details concerning the reverse repurchase agreements and other activities engaged in with E.S.M. follow.

2. Reverse Repurchase Agreements

The dollar amount of reverse repurchase agreements with E.S.M. Government Securities, Incorporated has increased from $54,269,000 at the previous examination to $156,387,000 at September 30, 1980, or an 188 percent increase. The association as of September 30, 1980, has assigned $249,943,489 of securities for collateral to this firm. The net book value of these securities exceeds the loan amount by $93,556,489 or 3.2 times the association's net worth. This is the potential loss to the association, should the association fail to get back its collateral from E.S.M. Currently, E.S.M. is the only dealer firm with which the association has outstanding reverse repurchase agreements.

The reverse repurchase agreements entail the association entering into a simultaneous agreement to sell and then repurchase the identical security at a subsequent date. In this transaction, the association files with E.S.M. United States Treasury Form PD-1832 for the Government National Mortgage Corporation Certificates and Federal Home Loan Mortgage Corporation Form 548. This entitles this dealer firm to assign the collateral. We are unable to determine for what purpose E.S.M. uses these securities; however, the large differential of $47,836,919 at September 30, 1980, between the market value and the reverse repurchase amount provides E.S.M. significant leverage. E.S.M. indicated through written correspondence that the collateral purchased from the association is assigned to large corporations or municipalities to obtain borrowings.

The risk to the association is high because of the large difference between the reverse repurchase amount and the market value of the securities. In addition, if E.S.M. fails to return the collateral, the location of these securities and the question of ownership is uncertain. These risks are magnified considering E.S.M.'s thin capitalization and volatile retained earnings position.

Our review of the remittances on the securities assigned to E.S.M., indicated that in all instances the association was the security holder and received principal and interest payments. In several instances, the association was the issuer of the security. This would reduce some of the risk if E.S.M. fails, but it may involve costly and lengthy litigation to recover the securities.

At September 30, 1980, the reverse repurchase amount as a percent of the market value of the collateralized securities totaled 77.4%. Two large dealer firms were contacted and these firms indicated that their general policy was that the reverse repurchase amount would not exceed 95% of the market value of the collateralized securities. These dealer firms further indicated that it is an unusual practice throughout the industry to deposit collateral, whereby, the market value of the securities substantially exceed the reverse repurchase amount. In return for this large deposit of collateral, E.S.M. in most instances offers the association interest rates on the reverse repurchase agreements that are approximately 150 to 200 basis points below comparable dealer firms. The following tabulation presents information on the total dollar amount of outstanding reverse repurchase agreements.

	Balance		
	9-30-80	7-31-80	7-31-79
Reverse Repurchase Agreements Outstanding	$156,387,000	$132,922,000	$ 54,269,000
Net Book Value of Collateral	249,943,489	195,851,103	68,843,700
Approximate Market Value of Collateral	202,106,570	168,729,755	64,038,330
Percent of Reverse Repurchase Amount to Market Value	77.4	78.8	84.8

A more detailed schedule of the reverse repurchase agreements at September 30, 1980, is set forth in Exhibit B of this report. This exhibit discloses no apparent pattern between the reverse repurchase amount and the market value of the collateralized securities. The percentage of the reverse repurchase amount compared to the market value of the pledged securities ranged from 25.4% to 97.6%.

Senior Vice President Howard Bass said each reverse repurchase agreement is negotiated individually and the amount of collateral assigned to E.S.M. and the interest rates are a function of money market conditions at the time of the agreement. He further stated no written agreements exist other than the individual confirmations on each reverse repurchase agreement.

We inquired as to why the reverse repurchase agreement entered into June 1980 was only 25.4% of the market value of the assigned securities.

Mr. Bass explained that this agreement was a renegotiation of an agreement entered into in March 1980. He stated that by mutual agreement the interest rate was reduced by 250 basis points and the maturity was extended from December 1980 to March 1981. In return for these considerations, the association paid down the reverse repurchase amount from $25 million to $17.5 million. Subsequent to June 1980 the amount was reduced to $9,305,000 at September 30, 1980. He further stated that reverse repurchase agreements can be reduced but not be repaid prior to maturity. He said that E.S.M. does not release any of the collateral prior to maturity.

Mr. Bass said the association previously considered the favorable interest rates and flexible maturities on the reverse repurchase agreements and these considerations exceeded the risk of concentration with the dealer firm of E.S.M. He further stated that the financial position of E.S.M. is closely monitored. He produced unaudited financial statements for the nine months ended September 30, 1980, indicating net income in excess of $9 million. He said the association has reevaluated its position with E.S.M. and has notified this firm of the intention to repay these reverse repurchase agreements at maturity.

Mr. Bass said that many reverse repurchase agreements with E.S.M. were repaid and the collateral released. He cited 11 instances involving GNMAs totaling $10.9 million par value and seven instances involving U.S. Government obligations totaling $27 million par value. Twelve of these instances were subsequent to our examination date and occurred in September and October 1980, whereas, only four occurred in April 1980 and two in October 1979.

Mr. Bass said it is anticipated that all reverse repurchase agreements with E.S.M. will be repaid by March 16, 1981. He also said that no further reverse repurchase agreements will be entered into with E.S.M.; however, the association may use this firm in other functions. A further written response was provided by Howard Bass, which is shown as Exhibit C and C-1.

3. Activity in the Futures Market

Since the previous examination, the association has had outstanding commitments to purchase or sell GNMAs in the futures markets in amounts ranging from no outstanding commitments (no open positions) in June and July 1980 to $30,000,000 to sell in August 1980. These commitments are for the purpose of attempting to balance the amount of purchases and sales in its various trading packages. These "arbitrages" are discussed elsewhere in the report. Also on August 6, 1980, Unity Mortgage Corporation commenced using the futures market as a hedge for interest rate fluctuations in regards to the mortgage banking operations. It was noted that the association had not met the following eligibility requirements at the time of the futures transactions and no request to supervision had been made for approval.

a. Association scheduled items exceed 2.5 percent of specified assets.

b. All appraised losses have not been offset by specific loss reserves. (Sections 571.12,545.29(c)(2)and(3))

4. Agreements to Purchase $31 Million of GNMAs

Although no written documentation was available, the records indicate that the association entered into two commitments to purchase from E.S.M. $5 million and $3 million, respectively, 9.5% coupon rate GNMAs. The purchase prices were 99.4% and 98.48% of the par value, respectively. These agreements were modified on March 3, 1980. The settlement dates were shortened from December 1980 to June 18, 1980.

On May 25, 1979 the association entered into an agreement to purchase from E.S.M. $23 million of GNMAs, 9.5 percent coupon rate for settlement on June 18, 1980. The purchase price was 98.94% of the par value. None of the above listed agreements contained a par cap provision which prohibits the seller from delivering securities in excess of par. The purpose is that traditionally investors require a higher yield in return for a higher coupon rate. Therefore, a higher coupon rate is generally worth less than a lower rate. The opportunity loss to the association because of the lack of a par cap provision, approximated $2.6 million. This is the difference between the loss that would have been sustained if the securities were sold on June 18, 1980, with a par cap provision and the loss that would have been incurred with no such provision.

In addition, the association had to pay $36,158,395 for a par value of 12.5% coupon rate GNMAs which is approximately $5.1 million more than was necessary had the agreement contained a par cap provision. Also, in a period of rising interest rates, these securities decrease in value more rapidly than a lower coupon rate security.

Another provision of these agreements that had an adverse impact on the association was the stringent margin requirements imposed by E.S.M. These agreements stipulated that the association deposit margin funds, if interest rates increase; however, conversely E.S.M. was not required to deposit margin funds with the association if rates declined.

Prior to the settlement of the agreement to purchase the $23 million of GNMAs, the association deposited with E.S.M. margin amounts ranging from an initial deposit of $2,775,000 to $6,818,075. The association was paid interest on the initial deposit only in the amount of 7.65%. The composite return on the margin deposits was substantially below alternative short term investments during this commitment period.

Regarding the two commitments to purchase totaling eight million dollars of GNMAs, the association deposited margin amounts ranging from $43,177 to $2,325,000 on which no interest was paid.

Mr. Bass' written responses are shown as Exhibits C-2 and 3.

5. Standby Commitments to Purchase and Sell

In August 1979, the association entered into agreements to purchase and sell securities on a standby basis from Virginia National Mortgage Corporation (VNMC) and E.S.M., respectively. Standby fees received from VNMC totaled $30,000 and standby fees paid to E.S.M. totaled $25,000. The agreements were identical in that they involved $4 million 9.5% coupon rate GNMAs at a price of 96.75% of the par value for settlement in April and May 1980.

On March 3, 1980, the association purchased $4 million GNMAs from E.S.M. at a price of 77.63% of the par value to deliver against the standby commitments sold to E.S.M. This guaranteed a net profit of $762,911.

In May 1980, the association recorded a net profit of $762,911 on the securities sold to E.S.M., and purchased $4 million GNMAs from VNMC. Two million of these securities were sold at a loss of $73,000 and the remaining $2 million GNMAs which were 9.5% coupon rates were maintained in the association's portfolio.

We feel that it would be appropriate to defer some portion of this net profit of $762,911 against the two million of GNMAs retained in the portfolio, due to the fact that both standby commitments were entered into at approximately the same time with identical terms.

Mr. Bass' written response is presented as Exhibit C-4.

6. "Arbitrage"

Since the previous examination, six "arbitrage" transactions were closed out. The approximate net gains from these transactions for the fiscal year ended March 31, 1980, totaled $617,500 and for the six months ended September 30, 1980, approximated $1,138,000. These gains do not reflect the opportunity cost to the association on substantial amounts of funds that were paid in fees and margin deposits that earned no interest or were at submarket rates for the duration of these arbitrages. However, no composite return on all six arbitrage transactions was available, the annualized return on four of these arbitrages ranged from 9.6% to 36.6%.

These "arbitrages" attempt to balance outstanding commitments to purchase and sell securities and profit on the increase or decrease in the spread between the securities. It appears that the intent of these transactions is to guarantee a minimum return to the association with the possibility of a larger return if interest rates move significantly in the direction upon which the transactions are based. These transactions in no way resemble arbitrage as defined in Section 563.8k, but are merely an accumulation of trades in the cash and futures markets speculating that interest rates will move significantly in one direction.

Several of these transactions are grouped into packages and termed "arbitrages." However, there is no written strategy on these arbitrages conceptualizing the intent or the possible outcome based on certain interest rate scenario's. This lack of written strategy may result in not recognizing or deferring losses on transactions involved in these "arbitrages." Current accounting methodology records all gains and losses at the time the "arbitrage" is closed out. It appears that all investment decisions are made by Senior Vice President Howard Bass. It is interesting to note that four of these "arbitrages" were assembled by E.S.M., and the net profits from these transactions were contingent upon E.S.M.'s ability to perform under various commitments detailed elsewhere in the report.

Details of the various arbitrages follow:

a. "Arbitrage" No. 44

This arbitrage was initiated in May 1978, and prepared by E.S.M. The association entered into standby commitments to sell E.S.M. $10 million of GNMAs for delivery in July, August and September 1980. In June 1978, the association entered into similar agreements with E.S.M. for an additional $10 million of GNMAs with settlement dates of July, August and September 1980. The association paid E.S.M. $462,500 in commitment fees which was 2.3% of the total commitments. Market practice at that time indicated standby commitment fees approximated 1% per annum. Also, it is unusual for a dealer firm to issue standby commitments for a term in excess of one year. This was corroborated by reviewing market data obtained from Solomon Brothers, a large dealer firm.

In May 1980, the association deposited with E.S.M. $1,400,000 in a non-interest earning margin deposit. In return, E.S.M. accepted early delivery of $20 million of GNMAs against the standby commitments for settlement in July, August and September 1980. The net profit on these standby commitments totaled $2,361,250. During the period of this standby, E.S.M. transferred no margin funds to the association against the standby even though the market moved favorly for the association. This transfer of funds is common throughout the industry.

The remaining transactions in the "arbitrage" entailed various commitments to purchase and sell GNMAs via the cash forward and futures markets. The gains on these transactions ranged from $12,756 to $721,875 and losses ranged from $6,934 to $861,250. This "arbitrage" closed out in September 1980, and the net profit approximated $1,138,000. The association indicated that the annualized return on all funds disbursed was 36.6%.

It appears that this arbitrage attempted to balance commitments to purchase and sell; however, it was noted that on May 2, 1980, outstanding commitments to purchase exceeded commitments to sell by $24.4 million. This imbalance was reduced by $18.4 million by May 19, 1980. As of July 31, 1980, purchases exceeded sales by $3 million.

b. "Arbitrage" No. 55

On December 18, 1978, the association entered into standby commitments to sell E.S.M. $39 million of GNMAs with settlement dates ranging from March to December 1979. These commitments consisted of $30 million of GNMAs with a coupon rate of 8.25% and prices ranged from 94.38% to 95.75% of the par value. For the remaining $9 million 9% coupon rate GNMAs, the prices ranged from 97.25% to 97.87% of the par value. All agreements contained par cap provisions.

The association paid standby fees in the amount of $1,150,000 which was 3% of the total commitment. A review of the standby commitment offered by Solomon Brothers, a major securities dealer firm, indicated commitment fees ranging from 3/4% to 1% for similar type commitments.

In a direct comparison of the 9% coupon rate standby commitments, the market data indicated that the prices agreed upon between the association and E.S.M. were 1.25% to 1.875% over the prices quoted by Solomon Brothers.

Although no standby market data was available for the 8.25% coupon rates, it was noted that the prices quoted by Solomon Brothers for March settlement in the cash market were 3.8% of the par value under those prices that E.S.M. agreed to pay the association.

Also, on December 18, 1978, the association purchased from E.S.M. $25 million of 9.0% coupon rate GNMAs at 95% of par value for settlement on January 19, 1979. To balance the commitments to sell, the remaining $14 million of GNMAs were to be provided from mortgage banking operations.

On December 19, 1978, the association entered into an agreement with E.S.M. to reverse repurchase the $25 million of GNMAs purchased in January 1979. The reverse repurchase rate was 9.0% and the duration was for six months. It was also agreed that the association would maintain a five percent differential between the reverse repurchase amount and the market value of the assigned collateral. Upon delivery of the securities in January 1979, the association entered into a reverse repurchase agreement in the amount of $22,498,000 and deposited a margin of $1,250,000. The margin amounts during the period of the agreemant ranged from $1,250,000 to $3,276,855 on which no interest was earned.

The arbitrage was closed out on March 31, 1980, and the auditor's reported a net income of $404,772. We were advised that this approximated a 22.5% return on all funds disbursed.

The response, by management, to this arbitrage is shown at Exhibit C-5.

c. "Arbitrage" No. 11

On July 26, 1978, the association entered into an agreement with E.S.M. to simultaneously purchase and sell $10 million of 9% coupon GNMAs for settlement on March 20, 1980. This guaranteed a gross profit of $545,000 at settlement. In return for this profit, the association paid E.S.M. $363,500 in standby fees and agreed to subject the securities purchased to margin calls in the case of adverse market fluctuations. Margin deposits ranged from $223,750 to $2,160,625 during the duration of this commitment. In effect, the standby fees and margin deposits were unsecured loans to E.S.M. which is a prohibited transaction. (Commissioner's Rules and Regulations, Article VI, Section 8(a))

The following listing details the unusual nature of this transaction.

1. The association paid 3.63% of the total commitment in standby fees which is more than twice the industry average for this type of commitment. In addition, this commitment was for 1.75 years and market data indicated that one year was the longest duration of standby commitments offered at the time of this transaction.

2. Confirmations indicate a firm commitment to sell; however, a standby agreement between the association and E.S.M. indicates optional delivery. Also, market data indicated that the furthest cash delivery month offered at the time of this commitment was October 1978. The price quoted was 91.66% of par value. The association sold these securities to E.S.M. at 96.88% of par value which was 5.2% of the par value over the market data.

3. We wonder why the association would agree to subject the agreement to purchase to margin requirements. The securities sold would increase in value as the securities purchased declined.

   This transaction was closed out on March 20, 1980, and the net profit was $194,024. The association indicated that the annualized return on all funds disbursed was 10.7%. This profit is less than if the amount of standby fees and margin deposits were invested in other alternative investments such as mortgages or obligations of the Federal Government.

Mr. Bass' written response is shown as Exhibit C-6.

d. "Arbitrage" No. 22

In July 1978, the association entered into standby commitments to sell $20 million of GNMAs to E.S.M. for settlement in August and September 1979; standby fees paid totaled $250,000 or 1.25% of the commitment amount.

To balance this commitment, various securities were purchased and subsequently sold during the period of this arbitrage. This arbitrage was closed out in August 1979, and the net profit was $86,159. The association indicated that the annualized return on all funds disbursed was 9.5%. This profit does not reflect the opportunity loss from margin deposits against collateral assigned to E.S.M. for reverse repurchase agreements. These deposits ranged from $127,000 to $1,158,775. In addition, $13 million of Federal Home Loan Mortgage Corporation certificates were transferred to the association's portfolio. Coupon rates on these certificates range from 9% to 9.5% at prices ranging from 97.75% to 98.75% of the par value. If these securities were sold at settlement of this transaction, the loss would eradicate the gain from this arbitrage many times over.

e. "Arbitrage" No. 88

This arbitrage was initiated in December 1979, It involved the simultaneous purchase and sale of GNMA contracts traded on the Chicago Board of Trade and outstanding commitments in the cash forward market. This arbitrage attempted to profit on the spread differential between the two markets. The spread differential can be attributed primarily to the standard 8% coupon rate traded in the futures market and variation of coupon rates traded in the cash markets. It was noted that the coupon rates on this arbitrage for trades in the cash market ranged from 11.0% to 12.5%. These trades were not balanced, but merely speculation that the spread between these securities would increase. To balance the trades would have required substantially more outstanding commitments in the futures market due to the lesser coupon rate.

All outstanding commitments were conducted through the dealer firms of ACLI Government Securities, Incorporated and Paine, Webber, Jackson and Curtis, Incorporated. The outstanding commitments in the futures market ranged from $1 million to $5 million and were offset by similar commitments in the cash market. The net income from this arbitrage was $22,775. This net income does not reflect the opportunity loss of non-interest earning margin deposits; however, due to the lack of segregation of these funds from those at "Arbitrage" No. 44, we are unable to determine the specific amount of margin funds applicable to this arbitrage. It appears that most outstanding positions in the futures markets were closed the same day that they were opened or lasted for a relatively short duration.

f. Cran-Newell "Arbitrage"

This arbitrage initiated in 1976 involved the simultaneous purchase and sale of government obligations with different coupon rates and settlements. It attempted to profit on the fluctuation in the spread between the securities. This concept was assembled by Cranford D. Newell, Associates, an investment management firm located in San Francisco, California.

This arbitrage was closed out in January 1980, at which time a net loss of $90,214 was incurred. This loss will be reduced by a $30,924 valuation reserve maintained against the various arbitrages. The aggregate estimated net loss from this arbitrage totaled $195,000.

Vice President George Chase said this type of activity was terminated because it was not related to mortgage banking operations. He further stated that no activity of this type is anticipated. Mr. Howard Bass concurred with the above responses.

7. Inadequate Documentation, Records and Procedural Deficiencies

Our review of the association's records in regard to activity in the cash, futures markets and reverse repurchase agreements disclosed numerous deficiencies. This review was thwarted by the lack of documentation that is ordinarily complied to support investment decisions. There is no clear corporate record disclosing the business strategies and how management's decisions are arrived at. It appears that all investment decisions are made by Senior Vice President Howard Bass. We were frequently referred to Mr. Bass for explanations of transactions that could not be supplied by persons in the accounting department.

There is no evidence from the minutes of the board of directors that the directors are apprised of the dollar amount of the reverse repurchase agreements with E.S.M. or the book and market value of the collateral assigned to this dealer firm. In addition, the minutes lack detail as to the association's activity in the cash or futures markets.

The following regulatory deficiencies were noted in regards to recordkeeping for activity in the cash and future markets.

1. The minutes of the board of directors authorize certain individuals to engage in forward commitment transactions; however, there is no limit on their authority. Not all dealer firms through which transactions are conducted have been authorized. In addition, there is no dollar limit on transactions with any brokerage firm. (Section 563.17-3(b))

2. The minutes authorize certain individuals to conduct mortgage futures transactions solely through Paine Webber, Jackson and Curtis Incorporated. No other authorizations were noted in regards to individuals engaging in mortgage futures through other dealer firms. Transactions were conducted through several other dealer firms. (Section 571.12 and 545.29(e)(4))

3. A satisfactory register of all outstanding commitments in the cash forward and futures markets required by Regulations 563.17(e)(1), 571.12 and 545.29(e)(1) is not maintained.

4. No record is maintained of specific futures contracts, the present or anticipated cash market transactions against which they are matched and in the case of an anticipated transaction, a statement of facts adequately justifying the anticipated transaction. (Section 571.12 and 545.29 (e)(2))

The responsibility for recording transactions in the cash and futures markets is vested in Mr. James Barr. He also has the responsibility for the transferring of margin deposits to the dealer firms involved in these activities. This is a serious breach of internal control.

The board of directors should establish limitations on the dollar amount of outstanding agreements to purchase or sell mortgage related securities. Also, the dollar amount of collateral assigned to an individual dealer firm under reverse repurchase agreements. These limitations should consider the financial status of the firms involved.

We recommend that an investment committee comprised of directors independent of daily management decisions be organized to evaluate the prudence and soundness of investment activity.

FHLBB Docket No. 6290

Docket No. 6290

Exhibit B

Type of Security Collateralizing Loan	Reverse Repurchase Agreement: Date Opened	Maturity Date	Interest Rate	Balance 9-30-80	Collateral: Net Book Value 9-30-80	Collateral: Market Value 9-30-80	% Reverse Repurchase Amt. to Market Value
Obligations of United States Treasury or Agencies	7-80	Open	11.25	$15,222,000	$18,713,826	$15,602,336	97.6
Government National Mortgage Association Certificates (GNMA's)	9-80	10-15-80*	10.5	17,685,000	21,750,086	19,450,675	90.9
(GNMA's)	9-80	10-29-80*	12.375	3,295,000	4,160,915	3,643,820	90.4
(GNMA's)	6-80	(1) 9-10-81 12-10-80	9.75 9.0	37,084,000 45,630,000	62,185,355	49,427,601	92.3
(GNMA's)	9-80	(2) 1-19-81	9.375	7,848,000 8,883,000	13,488,294	11,726,904	75.7
(GNMA's)	8-80	(3) 2-17-81	9.75 11.0	10,926,000 9,890,000	13,353,339	10,931,314	90.5
United States Treasury Bonds	8-80	(4) 2-17-81	8.0	33,540,000 34,400,000	44,475,588	38,360,194	89.7
(GNMA's)	6-80	(5) 3- 2-81	11.75	11,520,000 9,305,000	51,264,557	36,665,357	25.4
Federal Home Loan Mortgage Corporation Certificates and (GNMA's)	9-80	(7) 3-16-81	8.75	12,077,000	20,551,529	16,298,369	74.1
		Totals		$156,387,000	$249,943,489	$202,106,570	
				140,385,000	247,650,000	190,107,000	
11/18	(6) 2-18-81*	12.5		25,382,000			
12/18	(7) 12-31-80	19.4		4,337,000			

1270

4. CEASE-AND-DESIST ORDER, DATED FEBRUARY 27, 1981

UNITED STATES OF AMERICA
Before the
FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

No. 81-106

Date: February 27, 1981

WHEREAS, the Federal Home Loan Bank Board, as operating head of the Federal Savings and Loan Insurance Corporation, has considered a proposed Notice of Charges and Hearing and Temporary Order to Cease and Desist to be issued against Unity Savings Association, Schaumburg, Illinois:

IT IS HEREBY ORDERED that said Notice and Temporary Order is hereby approved and adopted and the Secretary is hereby directed to execute said Notice and Temporary Order. Service of such Notice and Order shall be made in person by a duly authorized representative of the Bank Board located in Chicago, Illinois. Following the issuance and service of such Notice and Temporary Order, the staff is authorized to negotiate with Unity Savings Association for the purpose of obtaining the association's consent to the issuance of a final cease-and-desist order.

By the Federal Home Loan
Bank Board

J. J. Finn
Secretary

RECEIVED
FEDERAL HOME LOAN BANK
OF CHICAGO
FEB 27 1981
OK TO FILE_____
REFERRED TO_____

cc: John Valek 2/27/81
Wm. J. Schilling

UNITED STATES OF AMERICA
Before the
FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

IN THE MATTER OF	
UNITY SAVINGS ASSOCIATION	Federal Home Loan Bank Board
Schaumburg, Illinois	Re: Resolution No. 81-106
	Dated: February 27, 1981

NOTICE OF CHARGES AND HEARING

In accordance with the provisions of Sections 407(e) and (f) of the National Housing Act, as amended ("Act"), (12 U.S.C. §§ 1730(e)-(f) (1976)), the Federal Savings and Loan Insurance Corporation ("FSLIC"), being of the opinion that Unity Savings Association, Schaumburg, Illinois ("Unity"), has violated provisions of the Rules and Regulations for Insurance of Accounts ("Insurance Regulations") (12 C.F.R. § 561.1 et seq. (1980)) administered by the FSLIC, and further has engaged in unsafe or unsound practices certain of which the FSLIC has determined are likely to cause a substantial dissipation of the assets or earnings of the association as well as to seriously weaken the condition of the institution, hereby issues its Notice of Charges against Unity.

I

JURISDICTION

Unity is a savings and loan association chartered by the State of Illinois that maintains its principal place of business at 1805 East Golf Road, Schaumburg, Illinois 60195. As an institution the accounts of which are insured by the FSLIC pursuant to Title IV of the Act, (12 U.S.C. § 1724 et seq. (1976)), Unity is subject in all respects to the Act and the Insurance Regulations issued thereunder.

II

VIOLATIONS OF THE INSURANCE REGULATIONS

1. Unity has violated Section 563.17-3(b) of the Insurance Regulations (12 C.F.R. § 563.17-3(b) (1980)) by failing to state in the minutes of its board of directors: (a) the current limits of authority given the association's personnel to engage in forward commitment transactions for the institution; (b) all of the

brokerage firms through which authorized personnel may conduct forwards activity; and (c) the dollar limits on transactions with each such firm.

2. Unity has violated Section 563.17-3(e) by failing to establish and maintain a current register of all outstanding forward commitments containing the information provided in said Section 563.17-3(e).

III

UNSAFE OR UNSOUND PRACTICES

In addition, Unity has engaged in and committed unsafe or unsound practices within the meaning and intent of Sections 407(e) and (f) of the Act. It is specifically charged that:

1. Unity has assigned to E.S.M. Government Securities, Inc. ("E.S.M.") mortgage-related securities owned by Unity, as collateral for reverse repurchase agreements entered into between Unity and E.S.M. During 1980, the market value of the securities so assigned to E.S.M. greatly exceeded the amount of funds loaned to Unity by E.S.M. pursuant to the reverse repurchase agreements. For example, at September 30, 1980, Unity had assigned securities with a market value of $202,106,570 to E.S.M. while outstanding loans from E.S.M. totalled only $156,387,000, or a difference of $45,719,570.

This practice is deemed to present a serious risk to the earnings and assets of Unity as well to threaten the overall financial condition of Unity. Should E.S.M. be unable, for any reason, to redeliver the collaterialized securities to Unity at the maturity of the reverse repurchase agreements, Unity could face losses that would render the association insolvent. For example, at December 31, 1980, Unity had $140,385,000 of reverse repurchase borrowings from E.S.M. secured by $190,102,000 (market value) of securities assigned to E.S.M. The difference of $49,717,000 was 1.75 times Unity's net worth at December 31, 1980.

While the FSLIC recognizes that Unity may have received lower interest rates in return for the excessive collateralization described above, this does not compensate for the seriously unsafe and unsound nature of the transactions.

2. Unity has failed to maintain sufficient records of its transactions in the mortgage futures market to enable it to conduct

such mortgage futures transactions on a safe and sound basis. Although the FSLIC's policy statement contained in Section 571.12 of the Insurance Regulations urges state-chartered institutions to follow the restrictions of Section 545.29 of the Rules and Regulations for the Federal Savings and Loan System, Unity has not done so. Specifically, Unity has failed to maintain (a) a register of all of its outstanding futures contracts including all brokers' confirmations; (b) a record of specific future contracts, the present or anticipated cash market transactions against which they are matched, and in the case of an anticipated transaction, a statement of facts adequately justifying the anticipated transaction; and (c) a list of association personnel authorized to engage in mortgage futures transactions in its behalf as well as the duties, responsibilities and limits of authority of each of them.

IV

NOTICE OF HEARING

Notice is hereby given that an administrative hearing will be held, pursuant to Section 407(e) of the Act, to determine whether an order to cease-and-desist should be issued against Unity. Said hearing shall commence on April 13, 1981, in Chicago, Illinois, the exact time of day and location to be announced at a later time. Such hearing will be conducted in accordance with the provisions of Chapter 5 of Title 5 of the United States Code and the Rules of Practice and Procedure set forth in Part 509 of the General Regulations of the Federal Home Loan Bank Board (12 C.F.R. § 509.1 et seq. (1980)).

Unity is hereby directed to file an Answer to the allegations contained in this Notice within ten days after receipt by the association. The requirements of the Answer and the consequences of failure to file an Answer are set forth in Sections 509.5(b) and (c) (12 C.F.R. § 509.5(b)-(c) (1980)).

Dated: 2/27/81

By the Federal Home Loan Bank Board

J. C. Finn
Secretary

UNITED STATES OF AMERICA
Before the
FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

IN THE MATTER OF	)	Federal Home Loan Bank Re: Resolution No. 81-106 Dated: February 27, 1981
UNITY SAVINGS ASSOCIATION	)	
Schaumburg, Illinois	)	

TEMPORARY ORDER TO CEASE AND DESIST

In accordance with the provisions of Section 407(f) of the National Housing Act, as amended (12 U.S.C. § 1730(f) (1976)), authorizing grounds and procedures for the issuance of temporary cease-and-desist orders; and

WHEREAS, the Federal Savings and Loan Insurance Corporation ("FSLIC") is of the opinion that Unity Savings Association, Schaumburg, Illinois ("Unity"), has engaged in regulatory violations and unsafe or unsound practices as set forth in the accompanying Notice of Charges and Hearing ("Notice"); and

WHEREAS, the FSLIC has determined that one such unsafe or unsound practice specified in such Notice, specifically Charge No. 1 on page 2 of the Notice, is likely to cause a substantial dissipation of the assets or earnings of Unity and is also likely to seriously weaken the financial condition of Unity;

NOW THEREFORE, IT IS HEREBY ORDERED that Unity shall from the date of this Order restrict the amount of collateral pledged in connection with its reverse repurchase agreements so that the market value of such collateral does not exceed the amount borrowed by more than 5%. If the amount of specific reverse repurchase agreements is thereafter modified (increased or decreased), the amount of collateral pledged in connection therewith shall likewise be modified so that the 5% limitation shall be met at all times.

This Order shall become effective upon its service upon Unity and, unless set aside, limited, or suspended by a court in a proceeding authorized by Section 407(f)(2) of the Act (12 U.S.C. § 1730(f)(2) (1976)), shall remain effective and enforceable pending the completion of the administrative proceedings provided for in the Notice and until such time as the FSLIC shall dismiss the charges specified in the Notice or issue a permanent cease-and-desist order against Unity.

Dated: February 27, 1981

By the Federal Savings and Loan Insurance Corporation

J. J. Finn
Secretary

5. Special Limited Examination Report, Dated March 23, 1981

Federal Home Loan Bank Board
Department of Examinations
TRANSMITTAL AND ANALYSIS SHEET
FOR REPORT OF EXAMINATION

DIST. NO. 7 | DOCKET NO. 6290
COMPLETION NO. 6168

NAME AND LOCATION OF INSTITUTION (Home Office)
Unity Savings Association
1805 East Golf Road
Schaumburg, Illinois 60195

DATE FIELD WORK COMPLETED: March 11, 1981
DATE TRANSMITTED: 3-23-81

NAME OF MANAGING OFFICER: Mitchell H. Bass
NAME OF INDEPENDENT AUDITOR: Ernst and Whinney
DATE OF LAST AUDIT: March 31, 1980

OWNERSHIP OR CONTROL (Including Proxy Control)
Bass Financial Corporation owns all outstanding permanent reserve shares of the association.

EXAMINATION	EXAMINER-IN-CHARGE	TYPE OF EXAMINATION	DATE OF EXAMINATION	COMPOSITE EVALUATION EIC	COMPOSITE EVALUATION DD	COMPOSITE EVALUATION SA	CRA EVALUATION EIC	CRA EVALUATION DD	CRA EVALUATION SA
Current	Steve W. Marko	Special Limited	2-23-81	–	–	–	–	–	–
Previous	Harry J. Strass	Supervisory Joint	8- 4-80	4	4	4	3	3	3

	AMOUNT	PERCENT TO ASSETS	PERCENTAGES
Total assets			
Savings accounts			
Percent increase in savings accounts since previous examination			
Specific reserves (563.17-2)			
Total net worth			
Percent to savings accounts			
Indicated losses (Unreserved)			
Slow loans			
Real estate owned			
Total scheduled items			
Gross operating income to average assets			
Operating expense to average assets			
Operating expense to operating income			
Net income to gross operating income			

RECEIVED
FEDERAL HOME LOAN BANK
OF CHICAGO
MAR 23 1981
REFERRED TO
OR TO FILE

	YES	NO
Review of this report by Regional Director recommended	X	
Assets were re-evaluated by means of independent appraisals		X
Cease-and-desist order recommended (Issued February 27, 1981) #		X
Issuance of subpoenas recommended		X
Administration of oaths recommended		X
Suspension of officer or director recommended		X

The institution is in compliance with the outstanding Cease and Desist Order.

WASHINGTON OFFICE USE ONLY

DATE REPORT RECEIVED | ASSIGNED TO:

SUBJECT TO REVIEW: ☐ Yes ☐ No

Report Reviewed: DATE | INITIALS:

Reason for Review (If appropriate)
☐ Composite Rating ☐ Financial Condition
☐ Field Recommendation ☐ Spot Check
☐ Problem Book Case ☐ Other

Supervisory Letters		Association Responses	
FOLLOW-UP DATE	DATE	FOLLOW-UP DATE	DATE

FHLBB Form 168
Rev. April 1979

March 11, 1981

FHLBB Docket No. 6290

Commissioner of Savings and Loan Association, State of Illinois
Springfield, Illinois

and

Supervisory Agent, Federal Home Loan Bank Board
Chicago, Illinois

Gentlemen:

Pursuant to instructions, we have conducted a special limited examination of UNITY SAVINGS ASSOCIATION, SCHAUMBURG, ILLINOIS as of February 23, 1981. The scope of the examination was limited to an analysis of other borrowings and investments and a review of the minutes of directors' meetings held since August 4, 1980.

The results of our findings are submitted in the comments that follow.

Steve W. Marker
Federal Home Loan Bank Board Examiner

FHLBBB Docket No. 6290

Report of Special Limited Examination of: UNITY SAVINGS ASSOCIATION
Schaumburg, Illinois

Date of Examination: As of February 23, 1981

COMMENTS AND CONCLUSIONS

A. Cease and Desist Order

Pursuant to Federal Home Loan Bank Board Resolution No. 81-106, Unity Savings Association was issued a Temporary Cease and Desist Order dated February 27, 1981. This Order restricts the amount of collateral pledged in connection with Unity's reverse repurchase agreements so that the market value of such collateral does not exceed the amount borrowed by more than 5%. If the amount of specific reverse repurchase agreements is thereafter modified (increased or decreased), the amount of collateral pledged in connection therewith shall likewise be modified so that the 5% limitation shall be met at all times.

No violations of the Order were noted during the course of our limited examination.

President Howard I. Bass said the association will comply with the provisions contained in the Order. Nevertheless, he did want to discuss the several interpretations of the restrictions contained in the Order with supervision.

B. Outside Borrowings

Outside borrowings as of February 23, 1981 and March 3, 1981 are detailed on Exhibits A and B. The primary purposes of the exhibits are two fold. First, to reflect the status of outside borrowings from ESM Government Securities, Inc. after the maturities of four reverse repurchase agreements totaling $79,455,000 between February 17, 1981 and March 2, 1981, and secondly, to denote the degree of diversification with other lenders.

The exhibits also reflect fails by ESM for nondelivery of collateral on reverse repurchase agreements that matured February 18, 1981 and March 2, 1981. Funds allocated for repayment of these loans were reinvested in Federal Funds until the collateral is delivered to the trustee, Bradford Trust Company, New York, New York. Meanwhile, the payment of interest on the borrowings terminated at the maturity dates.

The following reverse repurchase agreements had maturities between February 17, 1981 and March 2, 1981.

FHLBB Docket No. 6290

Date of Loan	Maturity Date of Loan	Reverse Repurchase Amount
12-10-80	2-17-81	$10,428,000
8-20-80	2-17-81	32,250,000
10-30-80	2-18-81	25,382,000
9-18-80	3- 2-81	11,395,000
	Total	$79,455,000

The $10,428,000 borrowing was rolled over at maturity on February 17, 1981 with the substitution of new collateral and an extension of the maturity date to September 10, 1981. There was a tardy delivery of collateral for the three other reverse repurchase agreements that matured. Each of these matters are discussed separately.

1. Tardy Delivery of Collateral

The tardy delivery of collateral by ESM is exemplified in the following schedule for two loans that matured February 17 and 18 totaling $57,632,000 and one for $11,395,000 that matured March 2, 1981.

	(000's Omitted)	
Date	Aggregate Loan Repayments	Book Value of Collateral Returned
February 17 and 18 Maturities		
2-17/18	$50,616	$55,513
2-19		10,973
2-20		2,864
2-25	7,016	9,315
Totals	$57,632	$78,665
March 2, 1981 Maturity		
3- 2	$ 3,945	$16,929
3- 3	819	2,835
3- 4	2,652	13,078
3- 5	537	4,133
3- 6	807	3,424
3- 9	964	5,745
3-10	317	804
3-11	1,354	3,917
Totals	$11,395	$50,865

President Howard I. Bass advised us that he had been in contact with ESM daily in an effort to obtain prompt return of the collateral. The principals of ESM would not furnish explanations as to why the delays occurred. Nevertheless, Mr. Bass expected their eventual return. He added that ESM has been advised of the association's intention to repay the borrowings that mature March 16, 1981.

2. Rollover of February 17, 1981 Maturity

On February 17, 1981, the association purchased $12 million of United States Treasury Bills from E.S.M. Government Securities, Incorporated. The purchase price was $11,060,417 or 92.17% of the par value. This purchase was funded through a reverse repurchase agreement in the amount of $10,460,000, with E.S.M. The interest rate on this agreement is 9.75%. The United States Treasury Bills and the reverse repurchase agreements have identical maturity dates of September 10, 1981.

On February 17, 1981, the association sent E.S.M. $600,417 as settlement for the difference between the purchase price of the Treasury Bills and the amount borrowed under reverse repurchase agreement.

The difference between the interest earned on the Treasury Bills and the accrued interest payable at maturity on the reverse repurchase agreement totaled $358,836. Based upon the $600,417 of cash deposited with E.S.M., the annualized return to the association exceeded 100 percent.

Mr. Howard Bass indicated in a letter dated March 2, 1981 that the amount borrowed under the reverse repurchase agreement dated February 17, 1981 was a rollover, with a substitution of collateral of a reverse repurchase agreement entered into on December 10, 1980. He explained that the $18 million of GNMA's collateralizing the December 10, 1980 reverse repurchase agreement in the amount of $10,428,000 were returned to the association. Treasury Bills, were substituted for the GNMA's, thus, substantially reducing the spread between the market value of the collateral and the loan amount.

The association board of directors approved the February 17, 1981 transaction the subsequent day at their regular meeting.

3. Diversification of Borrowings

Outside borrowings from E.S.M. Government Securities Inc. decreased by $92,111,000 or 58.9% between September 30, 1980 and March 3, 1981. The aggregate book value of the collateral securing the borrowings at the two dates decreased $126,546,000, or 49.3%. Most of this reduction occurred after reverse repurchase agreements with E.S.M. matured on February 17, and 18 and March 2, 1981, resulting in net repayments of $68,995,000. Since February 17, 1981, there has been a substantial increase in outside borrowings from other lenders. The following schedule depicts this situation.

Lender	Total Borrowings	Book Value of Collateral	Market Value of Collateral	% Market Value to Loans
September 30, 1980				
ESM	$156,387	$249,943	$202,106	77.4%
All Others	None	-	-	-
December 19, 1980				
ESM	136,048	242,544	185,783	73.2
All Others	4,337	5,106	4,319	100.4
February 23, 1981				
ESM	76,056*	152,612	119,907	63.4
All Others	73,532	91,321	77,837	94.5
March 3, 1981				
ESM	64,276*	123,397	93,173	69.0
All Others	99,125	131,132	104,348	95.0

* Includes fails February 23, 1981 $7,016; March 3, 1981 $6,631.

At various times after October 1, 1980, outside borrowings were obtained from other brokerage firms ranging from $4.3 million to $36.4 million, with the latter being obtained from Goldman, Sachs and Company on February 13, 1981. Prior to February 13, 1981, the upper end of this range was $8.7 million. As of March 9, 1981, there was a further diversification of borrowings under reverse repurchase agreements with three new brokerage firms which brings the total number to six, exclusive of E.S.M.

C. Treasury Bill Hedge

In November 1980, the association commenced using United States Treasury Bill futures as a hedge against higher interest rates on the renewal of association six month money market certificates. The hedge is predicated that if interest rates rise, the profits on the sale of the U.S. Treasury Bill futures should offset the higher interest costs on the money market certificates. However, interest rates primarily declined during the period the association had sold U.S. Treasury Bill future contracts. These transactions were conducted through the brokerage firm of Baltour, Maclaine, Incorporated. On November 5, 1980 to January 16, 1981, the association had outstanding commitments to sell U.S. Treasury Bill futures contracts ranging from $40 million to $80 million. On January 16, 1981, all outstanding commitments to sell were offset by commitments to purchase. The loss on all U.S. Treasury Bill futures totaled $462,850 which is being amortized on a straight line basis relative to money market certificates scheduled to mature in May and June 1981. These certificates approximate $110 million.

On November 5, 1980, the association made inquiry to the Office of the Savings and Loan Commissioner as to the permissibility of these futures transactions. The Deputy Commissioner indicated that if the hedging is done in a prudent and knowledgeable manner, the Commissioner's Office would take no supervisory exception.

OTHER BORROWINGS

(000's Omitted)

ır and Type ıcurity ıteralizing Loan	Reverse Repurchase Agreement Date Opened	Maturity Date	Interest Rate	Balance 2-23-81	Collateral Net Book Value 1-31-81	Market Value	% Reverse Repurchase Amount to Collateral Book Value	Market Value
Government Securities, Inc.								
MA's	10-30-80	2-18-81*	-	$ 7,016	$ 9,315	$ 8,028	75.3	87.4
MA's	9-18-80	3- 2-81	11.75	11,395	50,865	37,836	22.4	30.1
MA's & FHLMC's	9-15-80	3-16-81	8.75	10,251	20,145	15,229	50.9	67.3
MA's	12-10-80	9-10-81	9.75	36,934	61,227	47,754	60.3	77.3
S. Treasury Bills	2-17-81	9-10-81	9.75	10,460	11,060	11,060	94.6	94.6
Totals to ESM				$ 76,056	$152,612	$119,907	49.8	63.4
Government Securities, Inc.								
Treasury Bonds	2-23-81	2-24-81	14.625	$ 9,305	$ 10,245	$ 9,669	90.8	96.2
Treasury Bonds	2-19-81	2-26-81	16.0	4,312	5,074	4,399	87.3	98.0
's	2-13-81	3- 2-81	17.25	12,630	17,060	13,794	74.0	91.6
Totals to ACLI				$ 26,247	$ 32,379	$ 27,862	81.1	94.2
man, Sachs and Co.								
Treasury Bonds	2-23-81	2-24-81	14.5	$ 35,045	$ 44,459	$ 36,999	78.8	94.7
Treasury Bonds	2-19-81	2-26-81	16.0	4,612	5,021	4,645	91.9	99.3
Totals to Goldman, Sachs				$ 39,657	$ 49,480	$ 41,644	80.1	95.2
ıe Webber Real Estate Securities, Inc.								
's	2-13-81	3-16-81	17.375	$ 7,628	$ 9,462	$ 8,331	80.6	91.6
Grand Totals				$149,588	$243,933	$197,744	61.3	75.6

Represents fails.

OTHER BORROWINGS

(000's Omitted)

: and Type :urity :eralizing Loan	Reverse Repurchase Agreement Date Opened	Maturity Date	Interest Rate	Balance 3-3-81	Collateral Net Book Value 2-28-81	Market Value 2-28-81	% Reverse Repurchase Amount to Collateral Book Value	Market Value
overnment Securities, Inc.								
A's	9-18-80	3- 2-81*	-	$ 6,631	$ 31,083	$ 21,959	21.3	30.2
A's and FHLMC's	9-15-80	3-16-81	8.75	10,251	20,109	14,469	51.0	70.8
A's	12-10-80	9-10-81	9.75	36,934	61,090	45,632	60.5	80.9
. Treasury Bills	2-17-81	9-10-81	9.75	10,460	11,115	11,113	94.1	94.1
Totals to ESM				$ 64,276	$123,397	$ 93,173	52.1	69.0
Government Securities, Inc.								
. Treasury Bonds	3- 3-81	3- 4-81	16.50	$ 4,300	$ 5,072	$ 4,410	84.8	97.5
. Treasury Bonds	3- 3-81	3- 4-81	16.50	4,616	5,088	4,736	90.7	97.5
MA's	3- 2-81	3-13-81	15.875	12,766	17,248	12,996	70.3	98.2
MA's	3- 2-81	3-18-81	16.0	20,188	27,977	21,982	72.1	91.8 (99.2% at 3-2-81)
MA's	3- 3-81	3-31-81	16.5	11,454	16,910	12,043	67.7	95.1
Totals to ACLI				$ 53,324	$ 72,295	$ 56,167	73.7	94.9
an, Sachs and Co.								
. Treasury Bonds	3- 3-81	3-10-81	15.875	$ 18,720	$ 24,812	$ 19,912	75.4	94.0 (97.3% at 3-3-81)
MA's	3- 2-81	3-31-81	15.875	8,165	10,254	8,519	79.6	95.8
MA's	3- 2-81	3-31-81	16.0	11,288	14,304	11,777	78.9	95.8
Totals Goldman, Sachs				$ 38,173	$ 49,370	$ 40,208	77.3	94.9
& Webber Real Estate Securities, Inc.								
MA's	2-13-81	3-16-81	17.375	$ 7,628	$ 9,467	$ 7,973	80.6	95.7
Grand Totals				$ 163,401	$254,529	$197,521	64.1	82.7

Represents fails.

B. INTERNAL FHLBB MEMO REGARDING PROPER ACCOUNTING TREATMENT OF DOLLAR REVERSE REPOS AND LOANS OF SECURITIES, DATED JANUARY 29, 1980

FEDERAL HOME LOAN BANK BOARD
OFFICE OF EXAMINATIONS AND SUPERVISION

M E M O R A N D U M #R-48

TO: Professional Staff January 29 , 1980

FROM: L. David Taylor Securities Transactions

SYNOPSIS: DOLLAR REVERSE REPURCHASE AGREEMENTS AND LOANS OF SECURITIES WITH DIFFERING INTEREST RATES MUST BE ACCOUNTED FOR AS SALES AND PURCHASES.

A number of FSLIC insured associations are engaging in transactions involving the exchange of securities with different interest rates without properly accounting for such transactions. Previously, the Bank Board's Supervisory Agents have advised associations found engaging in these transactions as to the proper accounting. The purpose of this memorandum is to advise all FSLIC insured institutions on the proper accounting for such transactions.

The proper accounting treatment for these transactions depends on whether the transactions are to be treated as sales and purchases or as financing transactions. The issue turns on the application of existing accounting principles to the facts of the transaction. Where the risks of ownership are transferred to the buyer, or the security to be repurchased is not substantially identical to the security sold, the transaction involves a sale and purchase and is not a financing transaction. Thus, when transactions involve the exchange of securities with different coupon interest rates, the securities exchanged are not substantially identical and must be recorded as sales and purchases of securities at market prices with profits and losses recorded in the period incurred.

There are two types of transactions that have surfaced in the market place recently: (1) dollar reverse repurchase agreements, and (2) loans of securities. In discussing these transactions, reference to Government National Mortgage Association (GNMA) securities is made only to serve as an example of the underlying security, and such reference should not be construed as delimiting this memorandum.

Dollar Reverse Repurchase Agreements

Dollar reverse repurchase agreements involving GNMA securities are generally written in the following two forms:

1. Fixed-coupon agreement. This agreement provides that the association is guaranteed delivery of GNMA securities having an identical certificate interest rate and a similar collateralizing pool of mortgages as the securities sold by the association.

2. Yield-maintenance agreement. This agreement provides that the association will receive GNMA securities that will provide the association a yield specified in the agreement.

Consonant with the accounting principles expressed above, fixed coupon agreements, where the transaction involves the exchange of GNMA securities which are from different GNMA pools, but the coupon interest rates are the same and the securities are substantially identical in other respects, may be accounted for as financing transactions. Yield maintenance agreements, on the other hand, because they involve an exchange of securities with different coupon interest rates must be accounted for as sales and purchases of securities at market prices, with profits and losses recorded in the period incurred. This conclusion is supported by observation of market practice which indicates that the several GNMA coupons are priced differently in the market.

Loans of Securities

Federal associations which engage in the practice of lending GNMA securities under the provisions of Federal Regulation 545.7-1, and state-chartered associations which do so under comparable state law, must account for such "loans" following the criteria set out above. For example, when the security delivered back to the association does not have the identical certificate interest rate as the security loaned, the association must record this transaction as a sale and a purchase of securities at market prices.

L. David Taylor
Director

Distribution to State supervisory authorities will be made by District Directors-Examinations.

C. INTERNAL FHLBB MEMO REGARDING OVERCOLLATERALIZATION OF REVERSE REPOS, DATED JULY 13, 1981

FEDERAL HOME LOAN BANK BOARD

OFFICE OF EXAMINATIONS AND SUPERVISION

M E M O R A N D U M #R 6-2

TO: OES Professional Staff

July 13, 1981

FROM: L. David Taylor

Over-collateralization of reverse repurchase agreements

SYNOPSIS: OVER-COLLATERALIZATION OF REVERSE REPURCHASE AGREEMENTS MAY BE AN UNSAFE AND UNSOUND PRACTICE.

The purpose of this memorandum is to alert examiners that institutions engaging in reverse repurchase transactions have, in some instances, assigned as collateral securities with market values greatly exceeding the amount of funds received. In one reverse repurchase case, the Board issued a cease and desist order limiting the amount of collateral permitted to no more than 105% of the amount borrowed. The ground for the Board's action was that excessive over-collateralization is an unsafe and unsound practice which poses a serious risk to the earnings and assets of the institution.

Over-collateralization can be an unsafe and unsound practice because extremely large losses, possibly causing an institution's insolvency, may result should the purchaser be unable for any reason to redeliver the securities upon maturity of the repurchase agreement. Therefore, examiners must carefully scrutinize the provisions of the assignment of collateral, rights to re-hypothecate, collateral maintenance, and the extent of initial over-collateralization. The basic purpose of this review is to determine the extent of risk to the institution involved in a given over-collateralization arrangement. The term of the agreement and the type of collateral transferred also are important factors for consideration by the examiners. Since the risk to the purchaser generally increases in a longer term transaction, there is justification for more extensive collateralization for longer term instruments. Also, the type of collateral transferred and the likelihood of its market value fluctuating during the course of the reverse repurchase agreement's term normally will affect the extent of collateralization permissible for a given transaction.

Generally, the appropriate amount of collateralization in a reverse repurchase transaction is dependent on the type of securities sold and the length of the transaction. For example, in transactions involving Government National Mortgage Association (GNMA) securities, the normal collateralization may be 104% for 30-day transactions, 106% for 60-day transactions, 107% for 90-day transactions and 108% for 120-day transactions. However, for reverse repurchase agreements involving United States Government Treasury Bills or Bonds, the collateralization requirements are normally much lower. As an example, these transactions may have a collateralization level of 100.5% for 30-day transactions, 101% for 60-day transactions. 101.5% for 90-day transactions and 102% for 120-day transactions. Normally, reverse repurchase transactions do not have terms in excess of six months. Also, the percentage of collateralization is based on the market value of the securities at the time the transaction is consummated, not the face value.

In all cases involving GNMA securities with collateralization in excess of 110% of the market value and U.S. Government obligations with collateralization in excess of 105% of market value, examiners will include in the examination report comments the terms and conditions of the transaction(s). Depending on the volume of reverse repurchase transactions and the financial condition of the institution, it may be appropriate to comment on collateralization levels below these amounts but which are in excess of those normally required in the marketplace (see examples in the previous paragraph).

Any comment on repurchase transactions should indicate whether or not the board of directors was specifically aware of the transaction and the extent of over-collateralization prior to consummation. In addition, the comment should address the extent to which the board of directors investigated the financial condition and practices of the broker-dealer involved. (An institution's board of directors should be especially wary of a low capital position and over-leverage of securities in the broker-dealer's portfolio.)

Supervisory Agents should seek out corrective action if collateralization on reverse repurchase agreements exceeds levels adequate for specific transactions and/or subjects the institution to unnecessary risk.

L. David Taylor
Director

Distribution to state supervisory authorities to be made by District Directors-Examinations.

D. MEMO FROM AMERICAN SAVINGS & LOAN OFFICIAL TO FHLBB CONCERNING THE "UNWINDING AGREEMENT" WITH ESM, DATED MARCH 23, 1985

AUDIT MEMORANDUM

AMERICAN SAVINGS
AND LOAN ASSOCIATION OF FLORIDA

TO: Robert Gall,
Assistant District Director/FHLBB

DATE: March 23, 1985

FRC: Walter Young

SUBJECT: Visit to Alexander Grant Regarding ESM Confirmation Work On Thursday, October 4, 1984.

On October 3rd, I was asked by Ed Mahoney and Bill Cooper to participate in the discussions that were to take place the following day regarding the ESM leveraged arbitrage transaction. I had joined ASLA on August 27th and spent most of my time until that point familiarizing myself with ASLA and my own department. At that time, I had very little knowledge of the leveraged arbitrage transaction other than that the State and Federal Home Loan Bank Examiners were reviewing it closely as part of their regular examination procedure.

The afternoon of Thursday, October 4, 1984, Messrs. Cooper, Luther, and I met at the Ft. Lauderdale office of Alexander Grant & Co. with Alan Novick of ESM and Jose Gomez, partner of Alexander Grant in charge of the ESM relationship. Also at the meeting at ASLA's invitation were Messrs. S. Moss and M. Luttinger of the New York City office of Oppenheim, Appel, Dixon.

During the meeting, Messrs Luther, Cooper, Moss, and Luttinger relayed ASLA's concerns, the highlights of which are, as best I can recall, listed below:

1. That the transaction was not as described to senior management in that;

   a) Confirms indicated gaps of up to several weeks in funding the other side of the repo;

   b) The repo purchasers (and presumably the holders of our securities) were not, as promised, all municipalities and pension funds of unquestionable credit quality. A number of the largest holders of our securities appeared to be relatively unknown, and possibly weakly capitalized companies;

   c) ESM's advices disclosed that they had acted as principal. The question of whether ESM was acting as principal or agent was discussed as an item that still needed clarification;

   d) We still did not have current audited financials or unaudited interim financials as had been requested for ESM and related companies (other than the 12/31/83 Alexander Grant audited statement for ESM Government Securities).

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2. We did not understand, and therefore asked Mr. Novick to explain the economics of the transaction. Why could ESM arrange for repo funding of approximately $900MM at a repo rate of less than the T Bill rate when the providers of funds could obtain the Bill rate by direct investment in no risk government securities on the open market.

3. We asked how, given the favorable spread to ASLA, was ESM able to make a reasonable profit on the transaction?

4. We expressed dissatisfaction with the results of the Alexander Grant confirmation work. It appeared they were given information by ESM without independent verification that it was reliable and complete. They did not confirm either the repo balance with the purchasers, nor did they confirm the repo rate, or that it was a fixed rate and not in some manner variable. They did not perform complete follow-up procedures on non-response confirms (direct telephone contact with the repo purchasers).

Mr. Novick indicated in essence that we (including our experts from Oppenheim, Appel, Dixon) did not understand this complex business and that the basic reason for their success in structuring our deal on a profitable basis was that they were extremely successful at operating profitably in a highly specialized type of financing that no one else, including the major houses was competent at. Mr. Novick denied any knowledge of the internal discussions or presentations made to ASLA; however, he indicated a willingness to cooperate in settling the transactions if we were unhappy as well as in giving us a greater feeling of confidence by substituting more acceptable repo purchasers at the other end and providing appropriate parent company guarantees.

When we approached the subject of additional work by Oppenheim, Appel, Dixon or Alexander Grant to provide us with a greater level of confidence as well as audit assurance as to the location and safety of our securities, Messrs. Novick and Gomez raised issues of confidentiality of client records and were generally unwilling to provide us with any more information than we had already been provided. They even went so far as to ask Oppenheim, Appel, Dixon to provide a guarantee from their corporate counsel that they would indemnify ESM for any losses sustained because of any breach of client confidentiality or loss of trade secrets by ESM as a result of their assistance to ASLA in reviewing and understanding ESM's records.

Throughout the entire meeting Mr. Gomez gave repeated assurances as to the soundness of ESM and his absolute confidence in the integrity of the personnel and the records of his client.

After the meeting concluded, we left with the understanding that Alexander Grant would, in a timely manner, provide us with a new engagement letter which would specifically detail the scope of their additional audit work, including re-confirmation of positions directly with the repo purchasers

as of a more recent date (after ESM had switched purchasers at our request to provide others of more acceptable credit quality). Mr. Gomez promised to contact Mr. Luther as soon as possible on the engagement as we were most anxious to receive the results of their additional audit work on our behalf.

Walter Young

WY:lt

E. LETTER FROM MARVIN L. WARNER TO FHLBB REGARDING EXAM OF AMERICAN, DATED NOVEMBER 1, 1984

MARVIN L. WARNER
3577 BRADBURY ROAD
CINCINNATI, OHIO 45248
(513) 752-3735

1 November 1984

Assistant District Director
Federal Home Loan Bank Board
1053 Maitland Center Commons, Suite 102
Maitland, Florida 32751

Re: American Savings and Loan Examination Comments

Gentlemen:

I read with interest your field examiner's preliminary comments pertaining to the recently concluded joint examination of American Savings and Loan Association of Florida.

In that certain of the preliminary comments (under the captions "Management" and "Leveraged Arbitrage Transactions") either refer to me personally or to matters in which I believe I have personal knowledge, I feel compelled to write this letter setting forth my reactions to those specific comments.

Under the caption entitled "Management" a number of general points were included and I restrict my response only to those directed at myself which, in summary, question my compensation and expenses incurred relative to some peer group comparisons and, further, the examiner notes that I am seldom in the Association's offices and that serving as chief executive officer while living in Ohio is a "...difficult, impractical and ineffective way to function..." I must take exception to the conclusions reached and I believe that a review of the record speaks adequately in my behalf. During August, 1982, a time when American Savings was reporting significant operating losses (i.e., a net loss of $13 million was reported for the fiscal year 1982) and net worth less than the minimum required by regulation (i.e., net worth totaled $39 million at fiscal year end 1982, or $2 million less than the minimum regulatory net worth requirement and 1.98 percent of deposits), I committed to invest substantially of my time and approximately $20 million of my resources in the Association I served in any and every way that I was called upon during the nineteen months prior to my being elected chairman and WITHOUT compensation of any kind. During that period I was involved in the decision process for many proposed transactions for the Association, including review and negotiations for the acquisitions of equity interests in Corporation, The Corporation, & Co., Inc., and the common stock and other investments in Corporation, Ltd.

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As of today, American Savings and Loan has reserves of $159,734,000 or 6.88% of net worth & as of 9/30/84 reported after tax gain of $18,390,000. I certainly was not solely responsible for this turn around but I believe that my investment and my efforts had something to do with it.

Since accepting the position of chairman and chief executive officer on March 22, 1984, I naturally became involved in directing the operations of American Savings - directly and through the Association's senior management officials. My first management decision was to employ a professional banking staff. I hired a new president and authorized and directed proper staffing - executives capable of competing in today's tough banking environment. Basically, my modus operandi is to work through trained professionals - deciding upon appropriate actions through staff meetings and establishing clearly defined goals and objectives for managers to implement and then tracking their progress through reporting. As part of my direction and examples thereof, enclosed are copies of staff meeting minutes in which I presided, indicating the direction of the Association.

Although most major accomplishments within an organization of the size and complexity as American Savings are result of team efforts, and I would not want to minimize that here, there have been a number of major accomplishments since I accepted the chief executive position in which I have played a significant role. These would include the following:

*Purchase and sale of a common stock investment in , a New York Stock Exchange security, resulting in gain upon sale of the investment together with dividends received of $490 thousand.

*Purchase of a significant common stock investment in another New York Stock Exchange company which the Association continues to hold, and in addition to dividend income (which, based upon current payout would exceed $2 million annually), has an unrealized profit of approximately $3 million.

*Negotiation and approval of a major real estate loan that, in addition to an attractive interest rate, has resulted in fees of $427 thousand and, depending upon future events, an additional $427 thousand, under its terms, in the near future.

Perhaps even more significant in the progress of American Savings has been the efforts to increase the level and standard of performance throughout the Association, given the size of the institution. New programs designed to either (a) reduce operating expenses, (b) expand producuts and services,

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(c) increase fee income and (d) reduce the Association's exposure to interest-rate risk are being implemented simultaneously with an equal measure of care and dispatch. Some gratifying results are already surfacing as, for example, we have succeeeded in reducing our operating staff by approximately 155 persons, net of new hires, since I became chief executive in March, 1984, resulting in annualized savings of in excess of $3 million.

In recent months a difference of opinion has developed between myself and the Broad family who are participants with me in a voting trust. This difference of opinion, I feel, has undermined my authority and impeded my effectiveness. Accordingly I have served notice of intent to buy or sell in accordance with the voting trust wherein the Broads will either buy my stock or I will buy theirs.

Regarding the examiner's comments as to operating expenses, use of my private airplane and documentation for expense reimbursement, I offer the following comments:

*Experience has shown that the best way to effectively deal with my business commitments is through maintaining my own airplane, something I have done for the last thirteen years. Corporate aircraft is a way of life in business today. It saves time. Time is money. My owning the aircraft and charging the corporation only when it is used for corporate purposes is more economical than the company owning the aircraft. Activities referred to herein above & results achieved were facilitated to a large extent by the speed and convenience of private jet travel - to Houston, Toronto, New York, Washington, Miami and other places and frequently. Enclosed herewith is a schedule of additional documentation regarding travel reimbursement which has also been provided to the Assocation.

Another matter raised by the examiner deals with my having negotiated a contract with Home State Financial Services, Inc. in connection with a proposed investment in Freedom Savings and Loan Assocation and an indication that this action is considered a conflict of interests, particularly since the board of directors had not authorized or approved my action. Although no formal indication is set forth in board of directors' minutes nor was there a specific discussion regarding this matter at a board meeting, I can assure you that I proceeded with the advice and concurrence of a sufficient number of the directors to be comfortable that I was acting with their support and in my opinion had the definite approval of the executive committee. Obviously, there was some retraction of that support level or the contract would not, as the examiner notes, have been disapproved. In this connection, it should be noted that the terms and conditions offered Home State were identical to

those included in contracts that were approved by the board and the transaction remains, in my opinion, a sound business opportunity for the Association.

The final point of the examiner's comments I propose addressing is those remarks dealing with the leveraged arbitrage transaction. In this connection, I have taken the liberty of sharing the examiner's comments with Mr. Ronnie Ewton, a director and member of the executive committee, and asked that he comment directly to your office on these comments.

In conclusion, I feel we have made good progress on many fronts since my association with the company and today the Institution is in a position of financial strength unparalleled in its history.

Returned herewith is the handwritten report, and initialed by me. I appreciate the opportunity of submitting this response.

Sincerely,

Marvin L. Warner

MLW:rc

enclosures: (1) initialed examination
(2) management meetings status report
(3) expense sheet
(4) sample of staff meeting minutes

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F. LETTER FROM RONNIE R. EWTON TO FHLBB REGARDING EXAM OF AMERICAN, DATED NOVEMBER 21, 1984

RONNIE R. EWTON

799 Osprey Point Circle
Boca Raton, FL 33431

November 21, 1984

Assistant District Director
Federal Home Loan Bank Board
1053 Maitland Center Commons, Suite 102
Maitland, FL 32751

Re: American Savings and Loan Examination Comments

Gentlemen:

Ambassador Marvin L. Warner shared with me those informal comments of your field examiner in connection with the recently concluded examination of American Savings and Loan Association of Florida as they pertain to certain leveraged arbitrage transactions. Further, he has requested that I respond directly to your office regarding those comments as I have devoted much of my professional career to the securities industry and am knowledgeable in this type of repurchase transaction. In addition to serving as a member of the board of directors and executive committee of American Savings, I am majority shareholder of E.S.M. Group, Inc., the parent of E.S.M. Government Securities, Inc., although I am not an officer of that Company nor am I involved in their day-to-day operations.

Leveraged repurchase/arbitrage transactions, such as those arranged through E.S.M. are not, as you are aware, novel or otherwise peculiar to American Savings or E.S.M. E.S.M. Government Securities, Inc. has arranged similar transactions for a number of clients, including banks and savings and loan associations, and I am familiar with similar contracts arranged by other securities firms.

In the opinion of American Savings' executive committee, those transactions offered (as well as continue to provide) some excellent advantages. For example, the Association has a very strong capital position whereby it can readily support substantial, additional leverage and remain totally in compliance with regulations and principles of prudent balance sheet management. A leveraged arbitrage with U.S. Treasury Bills provides, among other things, a matched maturity of asset and borrowing, thereby not exacerbating the Association's large negative gap position and simultaneously provides no risks as to credit quality with an investment in Bills. The transaction is structured to protect the Association against margin calls and is designed to add almost $5.6 million to net income over a twelve-month period.

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s examiner specifically notes that, among other things, (a) my personal
rolvement raises questions as to a possible conflict of interest, (b) the
nsaction structure provides for over-collateralization and (c) the
sociation was precluded from screening or otherwise evaluating the lenders.
reactions to these comments are as follows:

- Regarding the approval of the transaction(s), it should be noted that the executive committee approved entering into these arbitrage transactions at a meeting where I was not present. I did not comment upon or vote on the proposal. I am advised that the quorum present unanimously approved entering into these transactions in amounts of up to $1 billion. My letter dated June 4 referred to above, was in response to a specific request by the executive committee.

- It is my understanding that the Association's staff was specifically requested by the executive committee to seek out competitive bids and that they, in fact, did so in connection with these arbitrage transactions; therefore, I assume the transactions were placed with E.S.M. because of their competitive pricing.

- Regarding the question of over-collateralization, you should note that the transactions are structured so as to preclude margin calls, regardless of the value of the collateral on a mark-to-market basis, over the term of the contracts. This feature, coupled with the fact that the repurchase transactions were structured as leveraged arbitrage/repurchase transactions for a one-year term, fully justifies the slight over-collateralization. I do not believe the transaction could have been structured more advantageously from American's point of view as it insulates them from fluctuation in the interest rate market. This fact is contemplated and commented on in the last half of paragraph 2 in United States League Federal Guide R6-2 which I quote, "Since the risk to the purchaser generally increases in a longer term transaction, there is justification for more extensive collateralization for longer term instruments. Also, the type of collateral transferred and the likelihood of its market value fluctuating during the course of the reverse repurchase agreement's term normally will affect the extent of collateralization permissible for a given transaction."

- In connection with comments regarding the Association's staff being precluded from reviewing or selecting lenders in the arbitrage transactions, I can only advise that it has not been my experience that repurchase transactions are arranged or structured in that manner. I can assure

you that E.S.M. has endeavored to provide quality service and satisfaction to American Savings, as they would to any customer. In this connection, it should be noted that American Savings has expressed dissatisfaction with certain of the lenders and there has been substantial realignment of the lender group in an attempt to accommodate their wishes. This has been done even though E.S.M. had no obligation to provide other lenders. In addition, approximately 30 percent of the total arbitrage transactions have been "unwound" and terminated as of this date, at the request of Shepard Broad and Bill Cooper. I must add that I believe their request is not in the best interest of American and will reduce earnings without enhancing safety or soundness.

I believe that E.S.M. has provided a valuable service to American and that the lack of sophistication of certain directors and officers of American, coupled with the obvious disagreement between the Broads and Mr. Warner, has caused concern where none is warranted.

I sincerely hope that the above information is helpful to you in concluding the examination report. In the event of questions, or if I can otherwise be of service, please do not hesitate to contact me.

Sincerely,

Ronnie R. Lewton

RRE/sb

B/C: Ambassador Marvin L. Warner
Stephen W. Arky, Esquire

APPENDIX 9.—FDIC DOCUMENTS

A. LETTER AND ATTACHMENTS FROM WILLIAM M. ISAAC, CHAIRMAN, FDIC, TO HON. DOUG BARNARD, JR., CONCERNING THE OHIO THRIFT CRISIS AND ESM, DATED APRIL 1, 1985

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

OFFICE OF THE CHAIRMAN

April 1, 1985

Honorable Doug Barnard, Jr.
Chairman
Commerce, Consumer, and Monetary
Affairs Sub committee
Committee on Government Operations
House of Representatives
Rayburn House Office Building, Room B-377
Washington, D. C., 20515

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COMMERCE, CONSUMER AND
MONETARY AFFAIRS SUBCOMMITTEE

Dear Mr. Chairman:

This is in response to your letter of March 26, 1985, requesting certain information from the Federal Deposit Insurance Corporation relative to the recent financial difficulties of the non-federally insured thrift institutions in Ohio. Our specific replies to the six categories included in your request are enclosed.

We trust this information is responsive to your request and we will be happy to provide any additional available information which would be of assistance in the hearings of the Commerce, Consumer, and Monetary Affairs Subcommittee.

Sincerely,

William M. Isaac
Chairman

Enclosure

1. Set forth, as comprehensively as possible and in chronological order, the role played and actions taken by the FDIC with respect to failure of Home State Savings and the subsequent thrift crisis in Ohio. In this regard, on what date and by whom was the FDIC first made aware of Home State's financial difficulties (including its dealings with ESM) and their likely impact on the Ohio Deposit Guarantee Fund.

The FDIC participated in the Ohio thrift crisis to the extent requested, but our role was quite limited. Our first knowledge that Home State Savings ("Home") had incurred a possible substantial loss from the failure of ESM was from press reports on or about March 6, 1985. At that time we had no knowledge of Home's financial condition or the effect the loss would have on it.

Subsequently, we were advised by our Columbus Regional Office of a "run" on Home and were kept advised of developments leading to its failure on March 8, 1985. During this period the Columbus Office also provided us with general information on the financial condition of the Ohio Deposit Guarantee Fund ("ODGF").

Our Columbus Regional Office, beginning March 8, 1985, and continuing through the weekend, was in contact with officials of the Office of the Comptroller of the Currency and the State of Ohio and a potential in-state bank acquiror for Home. The Washington Office was advised of the possible acquisition and was prepared to act on an application on an emergency basis; however, the negotiations were not successful and were subsequently terminated.

During the week of March 11, the Washington Office staff was kept informed by our Columbus Regional Office of the worsening situation facing some of the ODGF insured institutions. Senior staff of the Division of Bank Supervision also were contacted by Federal Reserve officials about our possibly providing technical assistance to the State of Ohio for the handling of failures. We indicated our willingness to do so.

On March 15 and 16, after Governor Celeste's order closing the institutions, our Columbus Regional Director attended several meetings at the Federal Reserve Bank of Cleveland where a number of financial institutions attempted to work out a solution.

On March 15, examiners in our Columbus, Boston, New York, Philadelphia and Chicago Regions were alerted for possible duty in Ohio; however, only those from the Columbus and Philadelphia Regions were actually required.

Also on March 15, Chairman Isaac indicated to both Chairman Volcker of the Federal Reserve and Governor Celeste that the FDIC would be willing to consider bringing all of the state-insured institutions under FDIC coverage, without the necessity of examinations, if the State of Ohio would provide a satisfactory indemnity to the FDIC against losses.

On Saturday and Sunday, March 16 and 17, FDIC examiners, along with examiners from the Federal Reserve and the State of Ohio, visited all of the closed institutions, with the exception of Home, to see whether they desired federal deposit insurance. Senior staff in both the Washington Office and the Columbus Office were in their offices all weekend to coordinate activities.

If an institution was not interested in insurance, our examiners left. If interest was expressed an examination was commenced. When a quick review indicated a capital deficiency, capital requirements were discussed with management to see whether they could develop a plan that would raise sufficient capital to qualify for insurance.

For those institutions which were interested in insurance and showed some indication of ability to meet the capital standards, the examination continued. This latter group totaled 15 institutions and each was provided with an application for deposit insurance. Examinations have been completed at 13 of these institutions and a number of applications have been received. One application, that of Scioto Bank, has already been approved by our Board of Directors.

In those institutions where an examination was started but the institution subsequently indicated a desire to be insured by the Federal Savings and Loan Insurance Corporation ("FSLIC"), the information gathered by FDIC personnel was made available to the other regulatory agencies.

Six FDIC insured banks have requested applications for merger-type transactions with ODGF institutions.

2. (a) Please describe fully the normal procedures followed and the operating condition required of thrift institutions that convert to bank status for the purpose of seeking FDIC insurance of their accounts. Please provide copies of relevant regulations, statements of policy, or written guidelines applicable to the standards for granting insurance coverage.

The procedures followed in evaluating the applications of thrift institutions desiring to convert to bank status for the purpose of seeking deposit insurance are the same procedures used to evaluate any other application for deposit insurance.

Normally, after receipt of a completed application, the institution is examined to determine its overall financial condition, its capital adequacy and future earnings prospects, and to assess its management. The Regional Office staff then prepares a recommendation to the Board of Directors of the Corporation as to the suitability of the institution for deposit insurance. The recommendation is forwarded to the Washington Office for review, with the Board of Directors ultimately making the decision to grant or deny deposit insurance. The Ohio situation has required that we combine and compress several of the usual procedures to deal with the emergency. We have not, however, altered the standards to be applied.

4. (a) Since 1980, did any FDIC-insured institution have funds loaned to or invested with ESM? What is the total dollar value of any such funds? What is the current FDIC estimate as to the likely loss to any FDIC-insured institutions from these loans and/or investments?

(b) Please provide the dates of the two most recent FDIC examinations of each FDIC-insured institution, if any, that conducted business with ESM? Did any of the reports of these examinations criticize or mention in any way the dealings between these institutions and ESM? Please be specific. If so, were any formal or informal supervisory actions taken against these institutions? Please enumerate.

Our available records do not contain complete information on whether any FDIC-insured institution has engaged in a particular repurchase-type transaction since 1980. It is possible that some insured institutions may have engaged in transactions with ESM, but if the transactions had been successfully concluded we would have no occasion to comment on them. Likewise, if a transaction were properly secured and in reasonable amount it would not be subject to criticism and we would be unlikely to have a record of it.

We are aware of several FDIC-insured institutions that had outstanding transactions with ESM at the time of its failure. While some of these institutions could sustain losses as a result of their transactions with ESM, none of the losses are expected to be serious.

We are not aware of any supervisory actions against any of these institutions which are related to their dealings with ESM.

5. Does the FDIC have any safety and soundness policies, practices or procedures that relate specifically to financial transactions between FDIC-insured institutions and non-registered government securities dealers like ESM? What does the Corporation's examination experiences suggest about the nature and extent of such transactions?

The examination of an insured institution's securities portfolio and related securities activities constitutes a significant part of the FDIC examination program. While the FDIC does not have examination procedures specifically earmarked for transactions with non-registered government securities dealers, Corporation examiners are required to perform certain audit procedures designed to help them recognize improper or unusual investment or lending arrangements with any securities dealer.

The FDIC Washington Office maintains files on various securities dealers, especially those where complaints or enforcement actions have been registered. Examiners have been instructed to contact the Washington Office whenever questions arise regarding the operating practices of a particular securities dealer. In this way the FDIC is able to identify potential problems at an early stage.

With regard to the Corporation's experience with these transactions, we have made a concerted effort to discourage banks from transacting business with non-registered or "out of area" dealers. There is, however, no law or regulation that prohibits an institution from transacting business with non-registered dealers so long as it is done in a prudent manner. Moreover, there is no examination policy or procedure that can ensure against fraudulent acts. The FDIC's role is to identify the risks involved and encourage the institution to take reasonable steps to reduce or eliminate those risks.

6. Based on its experience to date with the Ohio crisis, does FDIC have any recommendations to Congress regarding the need for strengthening or modifying state/private deposit insurance funds? For example, is there a need to put in place a permanent "standby" rescue plan for state/private deposit insurance funds that may experience extreme difficulty? Any other recommendations?

With regard to the need to strengthen or modify state/private insurance funds, the FDIC has advocated for some time that Congress restrict private insurance of depository institutions. We believe that institutions holding themselves out to the public as "banks" should be required to be FDIC-insured and regulated. Short of a federally mandated conversion to the federal insurance system, we believe the Congress should give immediate and serious consideration to the problems posed by an often ill-informed and confused public when dealing with noninsured or privately insured institutions, e.g., the recent failure of institutions in Iowa, Nebraska, Tennessee and Ohio. It is our impression that many (if not most) of the depositors of these institutions do not fully appreciate the nature and extent of the private insurance protection afforded their deposits. To address this problem and to obviate any complaints that may arise after the fact of loss, Congress should consider the imposition of disclosure and other requirements on uninsured and privately insured institutions.

We believe the operations and adequacy of the various private insurance systems should be reviewed by Congress. The FDIC would be more than willing to participate in such a study. Our staff has already done some work in this area and we are enclosing a copy for your information.

Additional information on state and private insurance systems is contained in our study, Deposit Insurance in a Changing Environment, submitted to Congress in 1983.

This procedure is implemented as prescribed in Section 5 of the FDI Act which states, in part, that "...any State nonmember bank, upon application to and examination by the Corporation and approval by the Board of Directors, may become an insured bank." In evaluating the application for deposit insurance, the Board of Directors must also give consideration to the factors enumerated in Section 6 of the FDI Act. These factors are the financial history and condition of the bank, the adequacy of its capital structure, its future earnings prospects, the general character of its management, the convenience and needs of the community to be served by the bank, and whether or not its corporate powers are consistent with the purposes of the FDI Act.

Copies of Sections 5 and 6 of the FDI Act and the FDIC Statement of Policy relating to applications for deposit insurance are attached.

2. (b) How many of Ohio's non-federally insured thrifts have applied to date for FDIC admission? How many do you expect to apply?

While FDIC deposit insurance applications initially were furnished to 50 non-federally insured institutions, a number of these have subsequently decided they would prefer FSLIC insurance. We anticipate receiving between 12 and 15 applications for FDIC insurance or for acquisitions by FDIC-insured institutions.

2. (c) Has it been or will it be the FDIC's policy to expedite the application process or to modify in any way the substantive operating condition or performance requirements necessary for membership in FDIC. If so, how?

The FDIC is prepared to give priority treatment to deposit insurance applications or to merger or purchase and assumption applications, but will not be changing its standards for approval of these transactions in the absence of a satisfactory indemnity against losses.

3. To what extent have the Home Loan Bank Board, Federal Reserve System and FDIC coordinated their responses to the Ohio situation? Please provide specific information on the dates and the substance of communications among the agencies.

After the closings, our Regional Director in Columbus was placed in regular contact with the Federal Reserve Bank of Cleveland and attended a number of meetings at the Federal Reserve Bank. The plan to examine ODGF insured institutions was developed in coordination with the Federal Reserve Bank of Cleveland, the Federal Home Loan Bank of Cincinnati and the State of Ohio Division of Banks. Information developed by FDIC examiners from these examinations was made available to the FHLBB and FSLIC for their use in making decisions relative to insuring the ODGF institutions.

LETTER AND ATTACHMENTS FROM ROBERT V. SHUMWAY, DIRECTOR, DIVISION OF BANK SUPERVISION, FDIC, TO HON. DOUG BARNARD, JR., CONCERNING ESM, DATED MAY 9, 1985

May 9, 1985

Honorable Doug Barnard, Jr.
Chairman
Commerce, Consumer, and Monetary
Affairs Subcommittee
Committee on Government Operations
House of Representatives
Rayburn House Office Building, Room B-377
Washington, D.C. 20515

Dear Mr. Chairman:

This responds to your letter of April 24, 1985 requesting certain follow-up information relative to our letter of April 1 and matters arising from the ESM/Ohio thrift crisis. Our specific replies to the five categories included in your request are enclosed. Responses to questions related to the Bevill, Bresler and Schulman collapse will be provided at the May 15 hearing.

We trust this information is responsive to your request and we will be happy to provide any additional available information that may be useful to the Subcommittee in its investigation.

Sincerely,

Robert V. Shumway
Director

Enclosures

1. On page four of your letter of April 1, you indicated that you were aware of "several" FDIC-insured institutions that had outstanding government securities transactions with ESM at the time of the firm's failure on March 4. For each such institution, please indicate (a) the size of the institution (b) the nature, terms, and face amount of the securities, (c) the net dollar exposure of the institution, (d) the anticipated loss by the institution, (e) the dates of the two most recent FDIC examinations of the institution prior to ESM's failure, and (f) whether either of these exams criticized or mentioned in any way the dealings between the institution and ESM. Please explain.

We are aware of six FDIC insured banks which had transactions with ESM at the time it failed. All six of those institutions are either national or state member banks.

We understand that the information you requested for those six banks will be provided by the OCC and the Federal Reserve.

2. You also indicate that the FDIC Washington office "maintains files on various securities dealers, especially those where complaints or enforcement actions have been registered."

a. Please describe the contents of these files and the manner in which they are utilized for supervisory purposes. Is the information in these files shared regularly with other federal banking agencies and the SEC?

2(a) Securities firms that have been publicly charged for securities law violations, have filed bankruptcy, are subjects of apparent criminal referrals, or are otherwise implicated with unscrupulous activity are included in the FDIC's Bank and Proposed Bank Irregularity Records System. The system is maintained by the Special Activities Section. Its purpose is to identify individuals and organizations who pose a threat to the integrity of the banking industry.

The purpose is achieved by maintaining a system of records accessible by the name of an individual or organization. Input to the system is represented by (1) Reports of Apparent Criminal Irregularity generated by the FDIC Regional Offices, (2) Confidential Reports of Investigation prepared by the FBI, (3) Miscellaneous internal FDIC documents, (4) Notices of Charges, indictments, arrest records and other such items, and (5) newspaper clippings. Individuals covered by the system are directors, officers and employees of FDIC-insured banks and proposed banks, customers of such banks, and other individuals and companies who have been involved in irregularities perpetrated against banks. The records are subject to the Privacy Act of 1974 and are maintained on index cards. The system contains approximately 50,000 entries. Records are systematically checked for individuals proposing to organize new insured banks or giving notice of their intent to purchase control of a state nonmember bank, and at other times when specifically requested.

Information is routinely provided to the FDIC from the FBI and Secret Service concerning criminal investigations involving insured banks. The information maintained in the Special Activities Section is primarily used for internal purposes but is exchanged with other Federal regulators and investigating agencies in appropriate instances. Requests for information on individuals from other than the specified routine users (12 CFR 310) are subject to the restrictions of the Privacy Act of 1974.

2(b) Prior to March 4, 1985, did the FDIC maintain any file on ESM Government Securities or on any of the principals associated with the firm? If so, please provide copies of all relevant documents.

An entry to the FDIC's Bank and Proposed Bank Irregularity Records System was made on June 7, 1977. Any subsequent inquiry to the system about ESM would reveal the existance and nature of the SEC's enforcement action under Rule 10b-5. The entry indicated that the SEC had subpoenaed records of 29 customers including three State nonmember banks. The copy of the SEC's complaint has since been destroyed in accordance with our records retention policy. If further information was desired, the Washington staff would contact the SEC or put the inquirer in touch with someone at that agency.

2(c) Please describe the FDIC's policies and procedures for processing and utilizing complaints about government securities dealers. Approximately how many complaints have been received by the agency since January 1, 1980?

The Division of Bank Supervision does not maintain records of informal complaints about securities dealers, however, any information from any source indicating illegal or unsafe and unsound activity coming to our attention would be pursued; possibly leading to a referral to the United States Attorney or appropriate securities regulator. As stated previously, entries to the records system are made for individuals and organizations who are subjects of reports of apparent criminal activity. They are subsequently retrieved by the name of the individual or organization.

We have not searched all such entries to answer your question. However, based on our best effort to recall the securities firms entered in the system, we have identified over 30 entries arising from internal memos, newspaper articles and other such communications and more than 20 referrals to U.S. attorneys and/or the SEC since January 1, 1980.

2(d) In each instance since January 1, 1980, where the FDIC has taken enforcement action against an insured institution based upon its dealings in government securities, please provide a brief description of the nature of the transactions involved and the date and type of enforcement action taken.

To the best of our knowledge the FDIC has not taken any formal enforcement action against an insured nonmember bank based on its government securities activities since January 1, 1980.

3. In your April 1, letter, you further indicate that the FDIC has made "a concerted effort to discourage banks from transacting business with non-registered or 'out of area' dealers." Please provide copies of all written directives issued to FDIC examiners or to insured institutions containing such admonitions.

From time to time the FDIC is made aware of improper or unusual investment practices. When those activities are uncovered, either through the examination process or through other means, the normal procedure is to issue a directive to our examiners. Such a directive will generally (a) describe the improper activity, (b) outline recommended examination procedures that will help in recognizing the activity, and (c) describe appropriate supervisory action. After six months, the contents of that directive is incorporated into our examination manual.

We have enclosed selected pages from our examination manual which describe various improper or questionable investment activities that have become known to us over the years. This reference generally explains various aspects of securities operations and indicates those areas about which examiners should be concerned. The manual also details certain operating characteristics, such as a bank dealing with small, out of area securities dealers, that frequently are indicators of improper securities activities. The only written directive issued to insured institutions regarding these types of activities is a 1980 policy statement concerning interest rate futures contracts, forward contracts and standby contracts. A copy of that statement is enclosed.

In addition, the general topic of securities, secondary reserves and securities trading is addressed at various FDIC training schools. We have enclosed a handout used in one of these schools which provides examiners with some background and insight into the repo related failure of Drysdale Securities and materials used to explain other aspects of the repo market.

4. Testimony at the subcommittee's April 3 hearing revealed that upon its discovery of a national bank's unsafe dealings with ESM in 1977, the Comptroller of the Currency entered into agreements with six national bank subsidiaries of American Bancshares, Inc., a Florida bank holding company, prohibiting the banks from dealing with ESM or any of its principals.

a. What communications did the FDIC receive from the OCC concerning ESM's connection with American Bancshares? When did they occur?

b. What was the FDIC's response to this information? Specifically, did the FDIC take similar steps to limit ESM's dealings with any FDIC-insured institutions? Please provide details and copies of all relevant documents.

c. Subsequent to the OCC's actions against ESM in 1977, did any of the FDIC-insured Florida banks controlled by Marvin Warner (e.g. state nonmember bank subsidiaries of American Bancshares, Inc. or ComBanks Corp.) engage in government securities transactions with ESM? If so, please provide details of

such transactions, including any mention or criticism of such transactions contained in the FDIC examinations of such institutions.

We are presently in the process of retrieving all relevant files and examination reports from the Washington National Records Center. As soon as those records become available we will respond to your questions.

5. At the April 3 hearing, H. Joe Selby, Chief Deputy Comptroller of the Currency, testified that he thought the banking agencies now share information on unsafe and unsound practices in government securities trading. How would you describe the current exchange of information among the agencies? Do you think it is adequate? If not, how should it be improved? Please provide copies of all interagency communications which the FDIC has sent to, or received from, the other federal banking agencies since 1980 that deal with government securities investment.

The exchanges of information practices utilized by the FDIC and OCC for most of the specified period can best be described as informal. When examiners encounter unfamiliar and/or out-of-territory securities firms doing business with State nonmember banks, they are instructed to contact the regional office. At this point the regional staff may inquire about the securities firm with OCC's regional staff or state securities regulators. They may contact FDIC's Special Activities Section in Washington. The Washington staff routinely checks with the OCC concerning the firm's involvement with national banks and with the SEC to ascertain any disciplinary history of the firm and its brokers. In the past, copies of referrals concerning securities firms were sent to the OCC if national banks were somehow implicated or involved. Under the FFIEC's current policy, criminal referrals of amounts in excess of $100,000 which involve bank insiders or employees are shared among the bank and savings and loan regulators. We see no reason why criminal referrals involving securities firms shouldn't also be exchanged among the agencies. Nonetheless, the informal system has been effective. A fool-proof information system could not be devised even if substantial resources were dedicated to that objective as long as fraud, deception and poor judgement exist in relationships between bank officers and securities salesman.

Repo Arbitrage

A repo is defined as the instance where a holder of securities sells these instruments to an investor with an agreement to repurchase them at a fixed price on a fixed date. The repo may be further defined as a collateralized loan.

As the repo transaction has been deemed virtually risk-less, arbitrages with freed repo money may also be thought of in that same vein. Suppose a dealer does a term repo for three months. He then turns around and invests that same amount in a money market instrument of equal maturity. There is no maturity mismatch and a positive spread is earned. Summed up, the rates are established, the maturities matched and a risk-free, profitable arbitrage has been executed.

However, this may not be the case. As maturities and rates may be firmly established, the credit risk inherent in the invested securities is not. Consider investment in instruments such as term Fed funds, Euro CD's, or commercial paper. Clearly, the risk in Fed funds is greater than that of a repo agreement. This is illustrated by the comparison between the rate on a repo versus the Fed funds rate. The repo rate always lies below the Fed fund rate because of:

1) the inability for many investors to directly sell Fed funds and, more importantly,
2) the fact that a repo is a secured loan and the sale of Fed funds is unsecured -- a credit risk.

The risk relative to Euro CD's must also be considered. Investors demand a rate premium for domestic CD's versus Euro CD's. This stems from the following:

1) Euro CD's are less liquid than domestic CD's and of more relevance to this analysis; and
2) Euro CD's are considered a riskier investment either because there is worry over the loans that the London branches of U.S. banks have granted, or because of the concern over the possibility that the British might act against the Euro operations of London banks. (It should be noted that any Euro CD issued by the London branch of a U.S. bank is a direct obligation of that bank, the credit is thus that of the parent.)

While these risks are not of great magnitude, they must still be a consideration.

Investment in commercial paper also entails a definite credit risk. Credit exposure in the commercial paper market is evaluated by competent, respected rating agencies. And while the default record on commercial paper has been excellent, it must still be viewed as it is defined -- an unsecured promissory note.

In the final analysis, all of the described money market instruments have some credit exposure. While that exposure might be negligible, it still outweighs that exposure inherent in a repo transaction. Consequently, a repo transaction that is turned into what might appear to be a seemingly riskless arbitrage, is in fact not.

Repurchase Agreements (Repos)

Repos:

A repo is a transaction where the holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date.

The security "buyer" in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate him for this. Dealers use repos extensively to finance their positions. (Exception: When the Fed is said to be doing a repo, it is lending money that is increasing bank reserves.)

The essence of the transaction is most typically that the buyer of the securities is making a secured loan to the seller -- the securities sold serving in effect as collateral for that loan.

The legal status of a repo, whether it should be classified as a loan or a sale, is still being litigated in the courts.

Repo Market:

Estimating the size of the repo market is difficult because borrowings by banks in the repo market are lumped with purchases of Fed funds for reporting purposes. In addition, repo borrowings of other institutions (government securities dealers excepted) are not tracked by the Fed.

Over the last twenty years, the repo market has grown dramatically due to:

1) the 1969 Fed amendment to Regulation D stating that all repos done by banks against governments were borrowings exempt from reserve requirements;
2) the 1974 Treasury decision to shift their TT&L accounts at commercial banks to accounts at the Fed. This freed billions of dollars worth of governments and agencies that the banks had been holding as collateral against Treasury deposits.
3) the opportunity costs for corporations of holding idle balances as interest rates soared; and
4) the use of the repo market by state and local governments and their agencies. Many state and local governments are permitted to invest excess cash in repos collateralized by governments and agencies.

Repos are a major source of dealer financing. Much of this repo financing is done on an overnight basis with investors.

Overnight loans in the repo market offer several attractive features to an investor:

1) By rolling overnight repos, an investor can keep surplus funds invested without losing liquidity or incurring price risk.
2) Because repo transactions are secured by top-quality paper, an investor exposes himself to little credit risk.

Term Repo:

Term repo borrowings are for a period longer than overnight and may be as long as 30, 60, or even 90 days.

Often an investor will take a speculative position he intends to hold for some time. He might then do a term repo, for 30 days or longer. As term repos force investors to sacrifice some liquidity, the rate on a repo transaction is generally higher the longer the term for which funds are lent.

Risk in Term Repos:

Assume the amount borrowed equals the market value of securities (including accrued coupon interest), then collateral equals 100% of the loan extended.

Borrower -- From the vantage point of the borrower, if interest rates fall, the value of the securities will rise. In this instance, if the lender goes bankrupt, the borrower will be left with an amount of money which is less than the value of the securities sold. Therefore, the risk inherent in this transaction is one of credit.

Lender -- From the lender's point of view, if interest rates rise, the value of the securities will fall. If the borrower goes bankrupt, the lender will be stuck with securities that are worth less than what he had lent. Again, there is an exposure to credit risk.

Margin:

Pricing of a repo is a function of two variables:

1) length of transaction; and
2) current maturity of securities repoed.

Either side of a repo transaction can reduce his exposure t credit risk through margin.

Borrower -- May protect himself through reverse margin. In other words, ask the lender to buy securities at price greater than the current market value.

Lender -- May project himself by lending an amount less than the value of the securities. The difference between the market value and that value used in the repo agreement is referred to as the "haircut". The lender also reserves the right to reprice the instrument. This is an informal right, but an understood part of the agreement. There is no set time period for repricing; it can be done at any point in the life of the repo.

Reverse Repurchase Agreements (Resales):

Most typically a repo initiated by the lender of funds. (Exception: when the Fed is said to be doing reverses, it is borrowing money, that is, absorbing reserves.)

In essence, a repo and reverse are identical transactions. What a given transaction is called depends on who initiates it (or which side you are viewing the transaction from): typically if a dealer hunting money does, its a repo; if a dealer hunting securities does, its a reverse.

A dealer who is bearish on the market, will short the market, that is, sell securities he does not own. Since the dealer has to deliver any securities he sells whether he owns them or not, a dealer who shorts has to borrow securities one way or another. A most common technique for borrowing securities is to do a reverse repo, or more simply a reverse. To obtain securities through a reverse, a dealer finds an investor holding the required securities; he then buys these securities from the investor under an agreement that he will resell the same securities to the investor at a fixed price on some future date. Here, the dealer, besides obtaining the required securities, is extending a loan to an investor for which he is paid some rate of interest.

"Institution" owns an 8% GNMA certificate, Pool No. 12345, purchased at 100 (face amount) during November, 1977. On January 15, 1980 it agrees to sell this security with a face amount of $987,436 at its market value (80) and

concurrently agrees to repurchase four months later on May 13, 1980 at a price of 80 27/32.

Reverse Repurchase Agreemet to Maturity

Some portfolio managers are reluctant to sell high-coupon securities that are trading at a premium and recommit their funds to another instrument, because if they sell these securities, they will reduce the interest income they are booking. An alternative is to put these securities out on repo until maturity, book the interest income on them, and use the cash he has generated to invest in some other attractive instrument. This is what is known as a "reverse to maturity"

The reverse market is only a fraction of the size of the repo market but is expanding rapidly. The trend is likely to continue as smaller banks and S&L's become more sophisticated in their use of the reverse market.

"The Interest Game"
The Chase/Drysdale Debacle

The interest game arises from a quirk in the pricing of repo transactions. When used for repurchase (RP) deals, T-notes and bonds, though they carry coupons, are typically priced "flat". In other words, the contract price does not take into account interest that has already accrued on the security since the last semiannual coupon payment. Flat pricing was originated by the Fed in its repo dealings during the days when interest rates were much lower and figuring in accrued interest did not seem worth the effort. This is no longer the case.

To play the interest game, one does a reverse repo and obtains for cash some securities with, say, five months' worth of accrued interest. Then one sells the securities. The sale yields a higher price because when a security is sold outright, the proceeds consist of the quoted market price plus the accrued interest. Subtracting the cash that had to be put up to do the reverse plus the going RP rate from the proceeds of the sale, one discovers some useful, additional pocket money that can be temporarily put to use until the short sale must be converted by unwinding the reverse. If new reverses can be arranged to make up for expiring reverses, then the temporary cash enhancement can acquire an even more useful element of performance.

When most traders are asked about the interest gain, they tend to discuss it derisively. Yet almost everyone trading governments plays the interest game, just as almost everyone with a checking account engages in some innocent Kiting from time to time. As of September, 1982, the amount of what some refer to as "artificial working capital" that is generated in the government market is estimated at $1 billion.

The Drysdale Debacle

Like other traders, David Heuwetter, Drysdale's chief trader, played with borrowed money. But few traders ever borrowed as much - and lost as much - as he did. Heuwetter financed most of his trading through what has previously been described as the "interest game".

*Note: The Fed and primary dealers are now including accrued interest in the pricing of repo deals.

At Heuwetter's request, Chase Manhattan Bank and some other institutions would obtain, through RPs from dealers and other sources, securities on which a substantial amount of interest had accumulated. Heuwetter would have these securities repoed to him and then sell them in the cash market. Because of the pricing difference, the money he received from the sale would be larger than the amount of money he had to give Chase to obtain the securities. Over time, this arrangement produced a cash out-flow (in accrued interest) from Chase to Heuwetter of more than $240 million, which amounted to an unsecured loan. Heuwetter used loans obtained in this manner not only to leverage up his portfolio*, but to stay alive when he began losing money.

Why did Heuwetter start to lose money?

In the first place, Heuwetter assumed interest rates would rise. To take advantage of the anticipated rise in rates, Heuwetter shorted governments; to make delivery, the borrowed securities primarily from Chase under its securities lending program and also from other banks in smaller amounts.

During the period Heuwetter was actively shorting the government market and covering by reversing in securities, the transactions generated, because of the interest game, a goodly bit of cash flow for Drysdale. Had interest rates gone up, as Heuwetter believed they would, the firm would have made a big profit on short sales. Instead, rates fell. As previously stated, Heuwetter did not bank the cash flow generated from the short sale of securities which it had reversed in. Instead, the money was used to keep him alive.

*In leveraging a portfolio, a dealer will "repo out" securities, use the cash proceeds to obtain more securities through a reverse, put the new securities out on another repo and so on almost indefinitely. As one trader puts it:

> "In a way, I have no portfolio. Anything I buy, I finance. Anything I sell, I borrow. Anything I take in, I lend out. My investments are just numbers."

Each month Heuwetter's net capital position tended to become less and less real and more and more artificial. At some point, it probably became completely artificial. To unwind reverses when they came due, to forward interest when it was paid to the ultimate owners of the securities in reverses that remained open, as he was required to do and to cover his growing losses, he kept having to arrange an even larger series of reverses and short sales to generate new infusions of artificial capital. To protect himself from a dangerous exposure on the short side, he had to balance his portfolio with very large long positions consisting of small accrued interest securities purchased from dealers and at Treasury auctions that he would then put out on repo.

Playing the interest game in ever-larger size put a new cast on Heuwetter's trading. As one trader states -- "When you are trying to raise cash this way, your trading becomes inherently uneconomic. It is not performance related with a view towards where the market is going. You are buying and selling certain issues because you have to do it. You are knocking issues of the yield curve and it can cost you a fortune." In trying to generate cash to cover existing deficits, Heuwetter was generating still more deficits.

The dealer community was fattening itself at Heuwetter's expense. If a guy is desperate to do a certain kind of business, says one dealer, "you know he will pay an extra half a point. There was alot of money to be made off that guy."

In mid-May, dealers know Heuwetter would face a severe cash crunch. He owed $160 million to Chase to cover coupon payments due on securities he had borrowed from the bank. Dealers decided to make it "very sticky for him". They demanded securities back (that had been repoed to him). Now, Heuwetter had to not only cope with the coupon, but somehow replace a major portion of his portfolio. On May 17th, Heuwetter knew he was finished and called Chase to announce he would be unable to make coupon payment.

Source: Institutional Investor.

Chase

To make delivery on shorted governments, Drysdale borrowed securities primarily from Chase. Chase's securities lending program involved lending:

1) securities held by its customers on a prearranged fee basis; and
2) securities reversed in from other institutions through repo brokers.

Drysdale had to pay only principal on the securities it reversed in from Chase, but it sold these same securities for principal plus accrued interest whenever it made a short sale.

In mid-May, Drysdale was unable to come up with $160 million it owed Chase to cover coupon payments due on securities it had borrowed then. Chase was obligated to pass these payments on to the investors on whose behalf it had lent these securities.

On the transactions in question, Chase was acting as an agent. This is indicated by the fact that tickets for these transactions were written not with Chase Bank as principal but for the XYZ stock loan account at Chase.

It is a street convention that when an investor lends securities through a bank that is acting as an agent, the borrower of the securities will collect the coupon and turn the proceeds over the agent who will, in turn, pass them on to the lender of the securities.

Large, savvy investors who lend securities through a bank that is acting as an agent for an investor ask the agent for a letter that says that, while the bank is acting on behalf of a customer, it is for all intents and purposes, and in particular with respect to the payment of accrued interest on coupon dates, acting as principal. This is another street convention and since not everyone is familiar with this convention, not everyone asks for such a letter.

The presumption is that fees for acting as an agent (1/2% or in this case, $2 million on a $4 billion position) represent payment not just for writing tickets, but for providing anonymity to one or both parties and for assuming any inherent credit risk in the transaction.

Whey Drysdale failed, Chase found itself being asked by the institutions whose securities it had lent to ante up $160 million of coupon, interest that was due them. At first, Chase refused to pay saying that, in its capacity as

agent, it was not legally bound to do so. Chase was put under a lot of pressure (from a wide range of market participants) to pay up, and realized that if it failed to pay the interest due, its action might trigger the failure of other firms, which in turn might cause the whole dealer market in governments to collapse. At any rate, Chase finally agreed to pay the $160 million of accrued interest due while reserving the right to pursue claims against third parties.

Implications to Chase

1) Chase got into trouble only because it lacked or failed to implement proper credit controls. The drawing up and enforcement of strict credit controls is fundamental to the operation of any financial institution.
2) In addition, deciding to run a big securities lending operation was a strategic decision made by Chase. This decision should have been made only on the basis of a careful evaluation of the risks, as well as possible rewards, associated with the new venture.

All banks today are looking for a way to raise ROA. This means banks are all scrambling for service business that will bring them fee income without ballooning their balance sheets. Running a securities lending operation, because it has no impact on the balance sheet of the institution running it, is a natural for banks wanting to raise ROA. The catch is that, if all big banks and dealers are scrambling for the same business, they can all build bigger books only by dealing with less and less creditworthy customers. In other words, competition will tend to erode the initially attractive fee offered on this service because entry of many institutions into the provision of this service will raise the notional, but nonetheless real, credit risk associated with it. This, in turn, will lower the true spread earned on it.

STATEMENT OF POLICY CONCERNING INTEREST RATE FUTURES CONTRACTS, FORWARD CONTRACTS AND STANDBY CONTRACTS

The following is a Board of Directors policy statement relating to insured State nonmember bank participation in the futures and forward contract markets to purchase and sell U.S. government and agency securities as well as in the futures contract market to purchase and sell certificates of deposit issued by domestic banks ("bank C/D's"). Information contained below is applicable specifically to activities of commercial and mutual savings banks. An additional statement of policy applicable to trust department activities of State nonmember banks may be issued at a later time.

The staff of the Treasury Department and the Board of Governors of the Federal Reserve System recently completed a study of the markets for Treasury futures. In part, the study notes that there is evidence that financial futures can be used by banks effectively to hedge portions of their portfolios against interest rate risk. However, the study also cautions that improper use of interest rate futures contracts will increase rather than decrease interest rate risk. In addition, various participants have advised that certain salespersons are attempting to suggest inappropriate futures transactions for banks, such as taking futures positions to speculate on futures interest rate movements. Furthermore, some banks and other financial institutions have recently issued standby contracts (giving the contra party the option to deliver securities to the bank at a predetermined price) that were extremely large given their ability to absorb interest rate risk. In so doing, these institutions have been exposed to potentially large losses that could (and sometimes did) significantly affect their financial condition.

Banks that engage in futures,[1] forward[2] and standby[3] contracts should only do so in accordance with safe and sound banking practices. Levels of activity should be reasonably related to the bank's business needs and capacity to fulfill its obligations under these contracts. In managing their investment portfolios, banks should evaluate the interest rate risk exposure resulting from their overall activities to ensure that the positions they take in futures, forward and standby contract markets will reduce their risk exposure and policy objectives should be formulated in light of the bank's entire asset and liability mix. The following are minimal guidelines to be followed by banks eligible under State law to participate in these markets.

1. Prior to engaging in these transactions, a bank should consult its State banking authority or obtain an opinion of bank counsel concerning the legality of these activities under State law.

2. The board of directors should consider any plan to engage in these activities and should endorse specific written policies in authorizing these activities. Policy objectives must be specific enough to outline permissible contract strategies and their relationship to other banking activities. Record keeping systems must be sufficiently detailed to permit internal auditors and examiners to determine whether operating personnel have acted in accordance with authorized objectives. Bank personnel are expected to be able to describe

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[1] *Futures Contracts:* These are standardized contracts traded on organized exchanges to purchase or sell a specified security or a bank C/D on a future date at a specified price. Futures contracts on GNMA mortgage-backed securities and Treasury bills were the first interest rate futures contracts. Several other interest rate futures contracts have been developed, and it is anticipated that new and similar interest rate futures contracts will continue to be proposed and adopted for trading on various exchanges.

[2] *Forward Contracts:* These are over-the-counter contracts for forward placement or delayed delivery of securities in which one party agrees to purchase and another to sell a specified security at a specified price for future delivery. Contracts specifying settlement in excess of 30 days following trade date shall be deemed to be forward contracts. Forward contracts are not traded on organized exchanges, generally have no required margin payments, and can only be terminated by agreement of both parties to the transaction.

[3] *Standby Contracts:* These are optional delivery forward contracts on U.S. government and agency securities arranged between securities dealers and customers and do not currently involve trading on organized exchanges. The buyer of a standby contract (put option) acquires, upon paying a fee, the right to sell securities to the other party at a stated price at a future time. The seller of a standby (the issuer) receives the fee, and must stand ready to buy the securities at the other party's option.

and document in detail how the positions they have taken in futures, forward and standby contracts contribute to the attainment of the bank's stated objectives.

3. The board of directors should establish limitations applicable to futures, forward and standby contract positions; and the board of directors, a duly authorized committee thereof, or the bank's internal auditors should review periodically (at least monthly) contract positions to ascertain conformance with such limits.

4. The bank should maintain general ledger memorandum accounts or commitment registers to adequately identify and control all commitments to make or take delivery of securities. Such registers and supporting journals should at a minimum include:

(a) The type, nature of position (long or short) and amount of each contract,
(b) The maturity date of each contract,
(c) The current market price and cost of each contract, and
(d) The amount of money held in margin accounts.

5. With the exception of contracts described in guideline 6, all open positions should be reviewed and market values determined at least monthly (or more often, depending on volume and magnitude of positions), regardless of whether the bank is required to deposit margin in connection with a given contract.[4] All futures and forward contracts should be valued on the basis of either market or the lower of cost or market, at the option of the bank.[5] Standby contracts should be valued on the basis of the lower of cost or market.[6] Market basis for forward and standby contracts should be based on the market value of the underlying security, except where publicly quoted forward contract price quotations are available. All losses resulting from monthly contract valuation should be recognized as a current expense item; those banks that value contracts on a market basis would recognize gains as current income items. In the event the above described futures and forward contracts result in the acquisition of securities, such securities should be recorded on a basis consistent with that applied to the contracts (market or lower of cost or market). Acquisition of securities arising from standby contracts should be recorded on the basis of lower of adjusted cost (see item 7(c)) or market.

6. Futures or forward contracts associated with bonafide hedging of mortgage banking operations, i.e., the origination and purchase of mortgage loans for resale to investors or the issuance of mortgage-backed securities, may be accounted for in accordance with generally accepted accounting principles applicable to such activity.

7. Fee income received by a bank in connection with a standby contract should be deferred at initiation of the contract and accounted for as follows:

(a) Upon expiration of an unexercised contract, the deferred amount should be reported as income;

(b) Upon a negotiated settlement of the contract prior to maturity, the deferred amount should be accounted for as an adjustment to the expense of such settlement, and the net amount should be transferred to the income account; or

(c) Upon exercise of the contract, the deferred amount should be accounted for as an adjustment to the basis of the acquired securities. Such adjusted cost basis should be compared to market value of securities acquired. See guideline 5.

8. Bank financial reports should disclose in an explanatory note any futures, forward and standby contract activity that materially affects the bank's financial condition.

9. To ensure that banks minimize credit risk associated with forward and standby contract activity, banks should implement a system for monitoring credit risk exposure associated with the customers and dealers with whom operating personnel are authorized to transact business.

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[4] Underlying security commitments relating to open futures and forward contracts should not be reported on the balance sheet. Margin deposits and any unrealized losses (and in certain instances, unrealized gains) are usually the only entries to be recorded on the books. See "General Instructions" to the Reports of Condition and Income for additional details.

[5] Futures and forward contracts executed for trading account purposes should be valued on a basis consistent with other trading positions.

[6] Losses on standby contracts need be computed only in the case of the party committed to purchase under the contract, and only where the market value of the security is below the contract price adjusted for deferred fee income.

10. To assure adherence to bank policy and prevent unauthorized trading and other abuses, banks should establish other internal controls including periodic reports to management, segregation of duties, and internal audit programs.

The issuance of long-term standby contracts, *i.e.*, those for 150 days, which give the other party to the contract the option to deliver securities to the bank will ordinarily be viewed as an inappropriate practice. In almost all instances where standby contracts specified settlement in excess of 150 days, regulatory authorities have found that such contracts were related not to the investment or business needs of the institution, but primarily to the earning of fee income or to speculating on future interest rate movements. Accordingly, the Board of Directors concludes that insured State nonmember banks should not issue standby contracts specifying delivery in excess of 150 days, unless special circumstances warrant.

The Board of Directors intends to monitor closely insured State nonmember bank transactions in futures, forward and standby contracts to ensure that any such activity is conducted in accordance with safe and sound banking practices. In light of that continuing review, it may be found desirable to establish position limits applicable to insured State nonmember banks. This policy statement is issued pursuant to the Financial Institutions Supervisory Act, 12 U.S.C. 1818, and the supervisory authority of the Federal Deposit Insurance Corporation with respect to nonmember insured banks.

By order of the Board of Directors, March 12, 1980.

[Source: 44 Fed. Reg. 66673, November 20, 1979, effective January 1, 1980; as amended at 45 Fed. Reg. 18116, March 20, 1980; 46 Fed. Reg. 51302, October 19, 1981]

ed trading account will necessitate examiner recommendations to control and possibly register those activities and implement the accounting procedures described above. If the bank lacks the financial condition and degree of expertise required, such activities should be discontinued.

Securities Purchased or Sold Under Repurchase Agreement or Similar Transactions

Securities held by a bank under a repurchase or similar agreement should not be included in a bank's investment or trading account, for such holdings are in reality a form of loan and should be reflected in reports of examination under the caption "Federal Funds Sold & Repos." Similarly, securities sold under such agreements should be reflected in reports of examination under the caption "Federal Funds Purchased & Repos." Such transactions do not require entries to the securities account of either bank. The selling (or borrowing) bank continues to carry the securities in its investment account, collect all interest thereon and make the necessary income adjustments for amortization or accretion, as the case may be. Transactions of this nature which disguise the real intent of the transaction are discussed under Improper Investment Practices.

XI. AUDIT

It is the Corporation's Policy to encourage an adequate audit program for every insured bank and that subject, including fraud detection, is discussed under the Internal Routine and Controls Section of this Manual. However, when examining the securities account and in fulfilling the responsibility of appraising the adequacy of internal and external controls in that area, the examiner must perform certain audit procedures (expanding when necessary) and be alert to possible improper investment practices. Two required procedures are reviewing security invoices and security purchases and sales since last examination. Time and manpower constraints may restrict complete reviews but the examiner must be reasonably assured that the bank's investment practices are proper.

Invoices

Invoices for bonds sold or purchased by a bank and supplied by dealers or correspondent banks should be retained by the bank in its files. Examiners will scrutinize invoices to arrive at a basis to establish book value and to determine possible misrepresentation. Corporation policy is predicated on the appraisal of investment quality bonds in examination reports at the lower of cost or book value, less any necessary amortization of bond premiums and with allowance for any proper accretion of discount. This obviously assumes that invoice figures represent true costs, not fictitious amounts, and management is properly adjusting bank records.

Invoice reviews can also determine whether or not: (1) The bank engages one securities dealer or salesperson for virtually all transactions; (2) the bank engages "out of territory" dealers or salespeople to an unreasonable extent; (3) investment account securities have been purchased from or sold to the bank's own trading account or trust department; (4) the bank is engaging in futures, forwards and standby contracts; (5) there is an unusual volume of trading activity in the investment portfolio; and (6) any other activities are conducted which appear to be outside of the legitimate needs of the bank.

Any of these practices will obviously necessitate thorough discussion with management, comparison of purchase and sales prices to independently established prices as of trade date and possibly cross referencing descriptive details on investment records and purchase confirmations to the actual bonds or safekeeping receipts.

Purchases and Sales

At a minimum, examiner methods of analyzing investment account activity since the previous examination will involve a review of purchases and sales. The bank's records of original entry and supporting schedules will be reviewed to determine: Actual costs; original carrying value; proper accountability for the proceeds of sales; and whether gains or losses on securities have been handled correctly.

These techniques are to be used to determine satisfactorily that the bank is receiving the total benefit from its investment transactions.

XII. IMPROPER INVESTMENT PRACTICES

Examiners must be alert to recognize improper investment practices. Potential causes for these practices are: Inadequate supervision by the bank's board of directors; undue reliance on one bank employee or broker who may lack the knowledge or character to properly conduct the bank's investment affairs; or an income prejudice on the part of management. Improper transactions may be suggested by prior reports of examination or the levels and trends of selected UBPR ratios; however, the on-site examination gives the examiner the opportunity (and obligation) to investigate and assess individual practices. Examiners are assisted in this area of their responsibilities by Corporation-issued statements regarding certain practices which in substance mandate accurate or desirable methods of reporting the earnings and condition of banks. Included below are prac-

tices which have warranted supervisory attention and concern, and should prove helpful in recognizing and correcting improper activities.

Overtrading

The term "overtrading" refers to excessive turnover in the bank's investment portfolio inconsistent with the bank's stated investment objectives or legitimate needs. Portfolio objectives generally include an intent to hold securities for interest income and liquidity, and purchases and sales should therefore improve the character of the portfolio. Purchase and sale activity motivated by the intent of taking profits from short-term price movements is only appropriate in a designated trading account. The volume of purchases and sales and the length of time securities have been held are the primary considerations in determining whether a bank is "churning the account" and should establish a trading account. If a bank is effectively conducting a trading account, it follows that it should be subject to the same market and accounting discipline, otherwise unprofitable speculative investments can be held in, and "backstopped" by, the investment portfolio. Overtrading in the securities portfolio should be criticized and the directorate requested to immediately discontinue the practice.

Overtrading may involve "adjusted trading" or "bond swapping." These terms involve selling a security to a broker at a price substantially above the prevailing market value and simultaneously purchasing and booking a different security, frequently a lower grade issue, at a price greater than its market value. Thus, the broker is reimbursed for loss on the purchase from the bank and ensured a profit margin. Such transactions defer accounting for losses on the security eliminated and establish an excessive book value for the newly acquired security. The carrying value of the investment portfolio and the bank's income accounts are distorted. When encountered, the carrying value of such transactions should be written down to independently established market value as of the date of acquisition and a Report of Apparent Criminal Irregularity (ACI) forwarded to the Regional Office. Independent pricings are obtainable through the Division's Securities Analysis Unit or from other reliable sources.

In this; as well as other types of suspected improper transactions, examiners are advised to carefully assimilate the relevant facts. One or a few instances of apparent improper pricing may be due to pricing limitation in the municipal bond market. The significance and pattern of such transactions will establish intent and possible culpability. In determining Loss classifications or supporting ACI reports, examiners should allow banks to obtain independent pricing for comparative purposes.

Trading at prices other than market normally involves collusion between the bank and a securities dealer and may be for the purpose of concealing trading losses from management or examiners; unauthorized purchases and sales of securities, futures, forwards; and benefits accruing to a bank employee.

Coupon Stripping

Coupon stripping involves detaching unmatured coupons from securities and selling either the coupons or the ex-coupon securities. Such transactions are often motivated by the need for increased cash flow or by tax considerations. This practice can significantly diminish the worth, marketability, and liquidity of a security and is generally considered inappropriate except on a limited, legitimate scale.

U.S. Government obligations are the most common type of securities used for this activity. Corporate or municipal issues may be used but are not viewed as attractive alternatives because of credit risk and early redemption features.

The Internal Revenue Service has ruled that proceeds from the sale of unmatured coupons constitute ordinary income and are to be included in the taxable income for the year in which the sale occurred. An institution can increase current period taxable income to utilize a prior year's tax loss carry-forward by selling all or a portion of the unmatured coupons of its securities. Similarly, ex-coupon securities may be sold at discounted value. The difference between the sale proceeds and the cost basis of the securities is recognized as a current period tax loss. As none of the tax basis of the securities is allocated to the sold coupons, the sale of ex-coupon securities is typically transacted to generate tax losses. A limited number of dealer banks have become active in the wholesale and retail trading and reoffering of detached coupons and ex-coupon securities. Due to the limited marketability and impaired practical liquidity during periods of moving interest rates, the disruption of an orderly securities market, and the uncertain suitability for customer purchase, it is generally considered inappropriate for banks to deal in, lend, borrow, buy, or sell ex-coupon securities or coupons under agreement to resell or repurchase unless there is adequate customer disclosure and consent.

Ex-coupon securities and detached coupons are distinctly different from securities that have all the unmatured coupons attached. Ex-coupon securities have a diminished and uncertain market

value and, because they are not considered "good delivery" items by security dealers, there is an impairment of their practical liquidity. National banks may not pledge ex-coupon securities as collateral for their own trust deposits and State banking authorities should be contacted for relevant requirements for State chartered institutions. Such securities require physical custody transfer and cannot be wire transferred on the Federal Reserve Communications Systems.

Management should also realize that it is not the general practice of the Federal Reserve System to accept ex-coupon securities as collateral for U.S. Government deposits or borrowings from its banks. However, each Reserve Bank has the statutory discretion to determine what collateral is acceptable and, under certain circumstances, some Reserve Banks will accept ex-coupon securities but with restrictions that render the practice impractical.

If an institution has engaged or elects to engage in such transactions, they must be appropriately reported. The original purchase price must be allocated between the principal portion and the coupons at the time the security is divided. This allocation will be based upon the yield to maturity of that security at the time it was purchased by the institution. The profit or loss on the portion sold must be recognized during the period in which the sale occurred as "other income" or "other expense." It will be the difference between that portion of the original purchase price, allocated as above to the portion sold, and the actual selling price of that portion. The portion retained will be carried on the books of the institution at its allocated portion of the original purchase price. Any discount (or premium) must be amortized (or accreted) to maturity. Detached coupons or principal portions held by a bank, either as a result of purchase or of mutilating securities, for its own account will be reported as "Other notes, bonds and debentures," and not as "U.S. Treasury securities," "Obligations of other U.S. Government agencies and corporations," or "Obligations of States and Political subdivisions in the United States."

Fast Pay GNMA Pools of Securities"

Among the undesirable practices sometimes associated with Government National Mortgage Association (GNMA's) pass-through, mortgage backed certificates is the activity of acquiring and paying significantly more for such securities on the assumption they will mature in a shorter period of time than the industry standard. Again, the quality of the security is not questioned; rather it is the speculative nature of the transaction (assumptions regarding turnover rates and the factors affecting them) that can involve significant risks and overpayment by the bank. Pass-through certificates have stated maturities equal to those of the underlying mortgages which range from twelve to forty years and the security holder receives a monthly payment as determined by a pool authorization schedule, plus a proportionate share of prepayments. Due to prepayments and to achieve uniformity in pricing methods, representatives of large national security firms price GNMA's on a twelve year average life calculation, however, some smaller regional firms do not adhere to that convention. Most firms actively involved with GNMA's keep records of historical cash flow yields of the various pools and make investment decisions on these records employing the twelve-year standard for pricing purposes. The Division of Bank Supervision has taken the position that as long as the industry pricing standard remains status quo, examiners should request that method of valuation for uniformity in bank examination.

"Buy-Backs," "Pair-Offs," "Free Riding"

These terms have been applied to practices wherein the prospective purchaser receives the verbal assurance of the broker that the security will not have to be accepted for delivery. The commitment requires no investment on the part of the purchaser because the purchased security is to be sold and settled before settlement date. In a rising market it can generally be sold at a profit; in a declining market banks can become liable for the purchase of considerable amounts of securities at prices substantially in excess of prevailing market at settlement date. In the latter instance, the portfolio can become a dumping ground with sizable built-in losses. The banker is enamored of the leverage and short-term profits involved while the unscrupulous security dealer is gaining discretion over the security account. Such activities have led to an unscrupulous dealer or salesperson exercising complete authority over the investment portfolio with predictable results.

"Unsuitable Investments"

As the name implies, this terminology encompasses all improper activities discussed herein and generally refers to transactions inconsistent with the bank's financial background, tax status, investment objectives, or any other similar circumstances. Bankers as well as securities dealers are expected to be parties to "suitable" transactions only and supervisory authorities in both areas have imposed legal, accounting, and examination procedure requirements to eliminate abuses. The examiner must review transactions as they relate to the total investment portfolio and the total bank. When transactions are improperly motivated, the examiner will approach each situa-

tion in a manner consistent with the Corporation's directives.

Open Contractual Commitments to Purchase or Sell Securities

These commitments include transactions in "When Issued" securities, forward placement contracts, standby contracts, and financial futures contracts, which can be objectionable if improperly motivated and not for legitimate purposes, such as hedging a bank's interest rate risk. Forwards, futures, and standbys are defined elsewhere but the most common type of open contractual commitment to purchase or sell securities encountered by examiners is a "When Issued" or "When and If Issued" (WI) security transaction. Such securities are new issues that have been awarded to a buyer but have not yet been paid for or delivered. A (WI) period may last several weeks or more than a month. During that period, the buyer usually pays nothing but has all ownership rights to the underlying security. These securities, enjoying wide market distribution, usually begin to trade in the secondary market during the (WI) period and a bank may therefore sell its rights to the security prior to paying for it.

Outstanding contractual commitments to purchase securities should be reviewed and priced to determine their impact on liquidity, earnings and risk diversification. Purchase and sale activity between examinations should be reviewed to determine if the volume is consistent with policy objectives and does not result in the sale of profitable positions and retention of unprofitable investments at an inflated carrying value.

Resale and Repurchase Agreements

In this situation, money market instruments are purchased for the bank's own account or acquired under an agreement to resell and then sold under an agreement to repurchase. Such transactions can be proper but examiners must be alert for attempts to improve profits by using the proceeds of completed transactions to finance an inventory of assets to be used in further repurchase arrangements or increase the earnings yields of the instruments employed by lowering quality or lengthening maturity. Risks should be controlled by policy guidelines that: Establish account limits; require approximately matched asset and liability maturities; subject the underlying securities of a resale agreement to periodic market valuation, in order to determine market exposure; mandate credit approvals for parties providing securities acquired under agreements to resell; and insist that characteristics of the money market instruments be compatible with the bank's own investment standards.

Adjusted Price Forward Placement Trades

This practice (a derivation of "adjusted trading") is used when the value of the security underlying a bank's forward position to buy has decreased and the bank will have to recognize a loss because of the required revaluation at time of settlement. To avoid accounting for losses, the dealer agrees to buy back the bank's forward position at cost (rather than market) and the banker agrees to pay in excess of market for a new forward position to compensate the dealer for his market loss.

Repositioning Repos

Repositioning repos are often used to fund a bank's acquisition of depreciated "When Issued" or forward placement positions. In cases where the bank has taken a large position not expecting to fund it, the dealer may have to provide financing to complete the trade when market value becomes less than cost. The dealer finances the transaction by offering to repurchase the security under an agreement to resell (repo). Repositioning repos encourage speculation and avoidance of loss, therefore securities funded through them are generally regarded as trading account securities and marked to market or the lower of cost or market. A financial institution usually will not enter into a simultaneous purchase and repositioning repo transaction unless the underlying security is depreciated. In addition, such arrangments have negative funding implications and often result in an unhealthy banker-dealer relationship.

Repo to Maturity and Dollar Repos

These transactions are often used in a rising or high interest rate environment when bond prices are depressed. A securities dealer offers to purchase depreciated securities from a bank in a manner which avoids the recognition of the loss normally occurring if the transaction is accounted for as a sale of a bank asset. The intent of either transaction is to permanently dispose of an asset but the manner in which it is done differs. In a repo to maturity, the bank and dealer agree to continue the arrangement until the repoed bond matures which is normally long-term. In a dollar repo, the security dealer buys at present market a depreciated security under agreement to resell, generally within a period of time shorter than maturity. At the time of the dollar repo transaction, the bank enters into a forward placement contract with the same or another securities dealer to take delivery of a similar security (to replace the one sold) at the same price as the repo price. In both instances the security sold by the bank is sold by the dealer with no "cost-of-carry" or market risk. The dealer receives adequate remuneration in the repo to maturity situation since the arrangement

(including rate) is only made provided the bank uses the proceeds to purchase additional bonds which may be inflated in price or otherwise undesirable for the dealer to hold. The dollar repo may help generate additional security transactions and the security underlying the forward contract sold to the bank provides a dealer profit. In both repo forms the bank is recording and reporting as an asset items which do not exist as assets of the bank.

Banks traditionally lend securities to brokers (generally to cover delivery of short sales) and supervisory authorities do not take issue with such practices. Examiners must therefore be careful not to confuse legitimate activities with improper ones. Such activity is acceptable if: The transaction is the same as or (as in the subject discussed) essentially an extension of the traditional version of lending securities to a broker which is in writing and calls for the broker's payment of interest in return for use of the borrowed securities; the broker provides collateral in the form of cash, or identical or substantially similar securities; the bank analyzes the creditworthiness and financial capacity of the broker with whom the transaction is consummated; at the maturity of the agreement the bank will receive identical or substantially similar securities; the borrowing period, economic benefits, planning and safeguards indicate the substance of the transaction is not to permanently dispose of an asset; and the accounting and reporting procedures are not misleading and present fairly, through reclassification of assets and income if necessary, the substance of the transaction.

When legitimate, repo type transactions are shown as either loans or borrowings. When improper, they require appropriate entries to the securities and income accounts of the bank.

XIII. SECURITIES SCHEDULES

Situations will arise when it will be advisable for examining personnel to insert supplementary schedules in the report to present significant information concerning the securities account, such as: The nature of speculative activity between examinations; the marginal quality and/or long maturities evident in purchases made since last examination; a depreciation schedule with a breakdown as to classes and maturity; depreciation schedule of pledged securities; securities which can be sold without loss to alleviate a liquidity problem; and substantial deviations from stated investment policy.

Examiners should not hesitate to draw appropriate attention to these schedules in preparation of the Examiner's Comments and Conclusions schedule. Securities deemed to be of subinvestment quality or otherwise deserving of special management attention will be listed in the appropriate report schedules with sufficient descriptive and substantive comments to support the examiner's reason for listing.

XIV. SECURITIES DEALER ACTIVITIES

A bank operates as a securities dealer when it underwrites, trades or deals in securities. A bank functions as an underwriter when it pays an agreed price to a securities issuer and attempts to profit from resale to investors at higher prices. A bank trades when it is considered to be "in the business" of buying and selling securities for its own account in an attempt to profit from market price movements or bank initiated mark-ups on sales to dealers or to customers. The legalities, accounting procedures, tax rules, registration requirements and examination procedures vary with the extent of such activities. An established trading account and bank registration as a municipal securities dealer are normally associated with underwriting, trading or dealing and such activities are usually administered in a separate trading department. However, absence of a trading department does not preclude a bank's involvement in dealer activities.

Commercial banks may engage in securities trading and underwriting to the extent permitted by Federal and State regulation. In general terms the exceptions "carved out by Congress" allow banks to deal in, underwrite, purchase and sell for their own account, without limitation, obligations of the United States, general obligations of any State of the United States or any political subdivision thereof and other obligations listed in Paragraph Seven of 12 U.S.C. 24. Subject to a 10% of capital and surplus limitation, a bank may deal in, underwrite, purchase and sell for its own account obligations of the International Bank for Reconstruction and Development, The Inter-American Development Bank, the Asian Development Bank and the Tennessee Valley Authority, or obligations issued by any State or political subdivision or any agency of a State or a political subdivision for housing, university or dormitory purposes. Each of the above types of investments requires consideration of the resources and obligations of the obligor and a determination that the obligor possesses resources sufficient to provide for all required payments in connection with the obligation. State laws may impose additional restrictions on such activities.

The Federal Deposit Insurance Corporation has general supervisory jurisdiction over all insured, State nonmember bank securities dealer activities and ordinarily fulfills that responsibility through

marily backed by unused bank credit lines sufficient to repay the liability. Major commercial paper issuers are rated by Moody's, Standard and Poor's and other services.

Commercial paper may be issued as an interest-bearing instrument or at a discount. Market trades are priced at a current yield, net of accrued interest due the seller or, if the commercial paper was issued at a discount, at a discount figured for the actual number of days to maturity based on a 360-day year. The sale of commercial paper issued by bank affiliates must be conducted in a manner which conforms to legal restrictions and avoids conflicts of interest.

U.S. Government Loans - Banks also engage in the purchase and sale of U.S. Government guaranteed loan programs which provide lenders with a partial guarantee of principal and interest and allow for the separate sale of the guaranteed portions of loans to third parties. An FDIC Statement of Policy in this regard may be found in the Prentice-Hall volumes.

Certificates of Deposit and Eurodollar Certificates of Deposit - Negotiable CD's issued by money center banks are actively traded in denominations of $100,000 or more. Interest is generally calculated on a 360-day year and paid at maturity. Secondary market prices are computed based on current yield, net of accrued interest due the seller. Eurodollar CD's trade like domestic CD's except their yields are usually higher and their maturities often longer.

Eurodollar placements pose similar credit risks to those found in Federal funds transactions or any other loan to a bank. As such, bank management should be encouraged to implement policies on such activity. The policy should include consideration of the aggregate amount of funds to be placed at any one time, the maximum amount placed with any one institution (individual bank limits), a list of acceptable depository institutions, and the terms of the placement as to rate and maturity. Individual bank limits should be established by credit officers, particularly during periods of money market uncertainty or rapidly changing economic and political conditions.

Eurodollar placements can expose a nonmember institution to possible adverse affects due to actions taken by the government where the foreign branch of the U.S. bank or the foreign bank is situated. Actions of this nature include exchange controls or nationalization of banks within the country. In either case, the foreign government might attempt to seize the assets of banks within its jurisdiction and block the repayment of liabilities or restrict transactions. There are both legal and practical considerations attendant to these matters which require the examiner to exercise judgment before levying criticism. The examiner should determine that these matters were considered by bank management and a well-reasoned decision was made to move ahead with the investment.

Probably the most often encountered bank dealer activities are resale and repurchase agreements. In these activities, money market instruments or securities, usually U.S. Government securities, are purchased under an agreement to resell, "reverse repo", or sold under an agreement to repurchase, "repo."

Banks purchase "reverse repos" to finance the U.S. Government securities inventory of other dealers or mortgage bankers who have originated pools of mortgages to back Federal housing agency securities. Repos are sold to bank customers in lieu of certificates of deposit. An FDIC Statement of Policy in this regard can be found in the Prentice-Hall volumes. Banks employ repos of Government securities as borrowing substitutes because they are not subject to interest rate limitations and reserve requirements. Repos are generally a less expensive method of acquiring source funds because maturities are relatively short and the customer's funds may be collateralized by the security underlying the repurchase transaction. Profits are based on the spread between interest earned and interest paid.

Trading and Underwriting of Municipal Bonds

Trading and underwriting is a very specialized subject that is treated in detail in the Corporation's handbook covering municipal securities dealer (MSD) activities. The following comments are presented because they relate to the general informational needs of the commercial examiner. More specific informational needs will necessitate reference to the MSD handbook and/or the Regional Office.

Amendments to the Securities Exchange Act of 1934 extended Federal regulation to the municipal securities dealer activities of insured nonmember banks. All banks (or separately identifiable departments or divisions of banks) engaging in sales or underwriting of municipal securities must register with the Securities and Exchange Commission (SEC) as municipal securities dealers. The Municipal Securities Rulemaking Board (MSRB), an industry self-regulatory organization, was created and given broad authority for proposing, adopting and interpreting rules governing municipal securities dealers. The municipal securities dealer activities of registered dealer banks are examined by the FDIC at least once every 24 months. The FDIC is also responsible for enforcement of the MSRB Rules. The

conditions prompting increased Federal regulation of the municipal securities industry included: Increased involvement of individual investors in the municipal securities market; abusive sales tactics by a limited group of individuals and firms; and industry support for a self-regulatory organization to establish professional qualification standards and just and equitable principles of trade.

Registration with the Securities and Exchange Commission

Banks which conduct municipal securities dealer activities must register with the SEC pursuant to Section 15B(a)(1) of the Securities Exchange Act of 1934. In order to properly register, a bank must file a registration form (Form MSD) with the Securities and Exchange Commission, Washington, D.C. A manually signed copy of the application must also be filed with the FDIC's Washington Office.

SEC guidelines require registration as a municipal securities dealer if a bank or department is involved in: Underwriting or participating in a syndicate or joint account for the purpose of purchasing securities; maintaining a trading account or carrying dealer inventory (bank regulatory agencies have generally defined "trading account securities" as a portfolio of securities, separate from the bank's investment account, which are held for resale either to other banks or to the public); or advertising or listing itself as a dealer in trade publications or otherwise holding itself out to other dealers or investors as a dealer.

The nature of municipal securities activities, rather than the volume of transactions, determines whether a bank must register as a municipal securities dealer. The following activities do not require registration: Buying and selling municipal securities solely for investment for the bank's own accounts or for accounts for which the bank acts in a fiduciary capacity, even though such purchases and sales are made frequently; or reselling municipal securities purchased directly from issuers provided such sales are to registered dealers acting as principals and the bank does not provide financial advisory services to the issuer from whom it purchases the municipal securities.

Treatment in Examination Reports

If the examiner determines that a bank is acting as a municipal securities dealer but has not registered with the SEC, the Regional Office should be consulted. An apparent violation of Section 15B(a)(1) of the Securities Exchange Act of 1934 should be scheduled under Group B on the violations page. If the examiner is conducting an independent Compliance or Trust Examination, the circumstances should be outlined in a separate memorandum to the Regional Director.

Section 15B(a)(1) of the Securities Exchange Act of 1934 prescribes that: "It shall be unlawful for any municipal securities dealer . . . to make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of any municipal security unless such municipal securities dealer is registered . . ." in accord with Section 15B(a)(2) of the same law.

If the facts of the case do not clearly support registration, or bank management does not agree that registration is required, the Regional Director may ask the bank to contact the SEC in writing for an opinion whether the bank's municipal securities activities require registration. However, if a violation of Section 15B(a)(1) is evident, the bank should be notified to cease all municipal securities activity until it has properly registered with the SEC and has employed persons qualified to conduct municipal securities business in accordance with Federal securities laws and MSRB Rules.

Safety and Soundness Considerations

All bank dealer activities (registered or not) must be evaluated in terms of safety and soundness. The same principles of sound banking discussed throughout this Manual (and the MSD handbook) are generally applicable to bank dealer activities. However, some principles and precautions relate more specifically to bank dealer activities and should be restated. (1) The market and credit risk inherent in all activities should be controlled by bank policy. Standards should be clearly established to limit the amount and type of bank holdings, including commitments to purchase, and exposure on arbitrage and/or short sales. (2) Deceiving or failure to adequately inform customers or the investing public could be considered a violation of the anti-fraud provisions of the Federal securities laws or other related laws. (3) The bank should make a qualitative analysis of the issuer of instruments in which it deals. Credit approvals should be obtained prior to trading in a corporation's commercial paper or in another bank's certificates of deposit, acceptances or Federal funds and reviews should be made regularly. (4) The aggregate amount of "reverse repo" and "repo" accounts should be limited and acceptable amounts of funds for unmatched maturity transactions and minimally acceptable interest rate spreads for various maturity agreements should be determined. (5) "Reverse repo" agreements are merely another form of secured lending. Therefore, the bank should limit the amount extended to one or more related firms, subject them to normal credit

reviews and control collateral coverage as they would on any other secured loan. (6) Banks should be aware that dealer activities or programs must be structured to conform with Federal banking and securities laws. Institutions are expected to secure the opinion of competent counsel as to the applicability of Federal and State banking laws and the registration requirements of Federal and State securities laws before proceeding. (7) Bank officers should have, and operate within, established operating guidelines. (8) The scope of internal and/or external audit programs should include bank dealer activities. (9) Trading accounts have an income producing purpose (as well as certain required and prohibited practices) but must also be evaluated for credit quality and marketability.

It is the examiner's job to determine if policies, practices, procedures and internal controls regarding bank dealer activities are adequate and when deficient or in violation of law, rulings or regulations, to initiate appropriate corrective action. The dimension of that responsibility is easily appreciated when one realizes that the volume of dealer type activities (over a relatively short period of time) can far exceed a bank's total resources, and credit, market and litigation losses resulting from poor management can quickly dissipate bank capital and earnings. Commercial banking's increased pursuit of fee income will only increase that responsibility.

APPENDIX 10.—MISCELLANEOUS DOCUMENTS

A. LETTER FROM HON. DOUG BARNARD, JR., TO STEVEN J. ARKY, DATED MARCH 27, 1985

NINETY-NINTH CONGRESS

Congress of the United States

House of Representatives

COMMERCE, CONSUMER, AND MONETARY AFFAIRS
SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
RAYBURN HOUSE OFFICE BUILDING, ROOM B-377
WASHINGTON, DC 20515

March 27, 1985

Steven Arky, Esq.
Arky, Freed, Stearns, Watson,
Greer, Weaver & Harris, P.A.
1 Biscayne Tower
2 South Biscayne Blvd.
Miami, Florida 33131

Dear Mr. Arky:

This will confirm your appearance before the Commerce, Consumer, and Monetary Affairs Subcommittee on Wednesday, April 3, 1985, in connection with the subcommittee's examination of the collapse of ESM Government Securities, Inc., and its impact on Ohio thrift institutions. You will be appearing before the subcommittee on Wednesday afternoon. We will advise you soon of the specific time of your appearance.

The subcommittee's purpose in holding the hearing is to establish a comprehensive record that Congress can use to develop a more effective program for supervising government securities markets and assuring the safety and soundness of the nation's financial institutions. Our country's financial markets can ill-afford a repetition of the Ohio crisis and the events which precipitated it.

Your testimony should discuss, as specifically as possible, your dealings with ESM and your knowledge of its activities and methods of operation, particularly as they impacted financial institutions and municipalities. We would also appreciate your views on what lessons Congress should have learned from the ESM/Ohio experience; and your recommendations on how federal and state supervisory agencies can better protect financial institutions and municipalities who do business with nonregistered government securities dealers like ESM. If you have any questions, please call the subcommittee staff director, Peter S. Barash.

Sincerely,

Doug Barnard, Jr.

Doug Barnard, Jr.
Chairman

DB:psb:b

B. LETTER FROM DANNY O. CREW, ASSISTANT CITY MANAGER, CITY OF POMPANO BEACH, FL, TO HON. DOUG BARNARD, JR., DATED APRIL 2, 1985

City of Pompano Beach Florida

April 2, 1985

Honorable Doug Bernard, Jr., Chairman
Subcommittee of Commerce
Consumer and Monetary Affairs
Committee on Government Operations
U.S. House of Representatives
Rayburn House Office Bldg., Rm B-377
Washington, D.C. 20515

Dear Representative Bernard:

I am the Assistant City Manager of the City of Pompano Beach, Florida, one of the cities which had a large investment in ESM Government Securities. I know that my Finance Director testified at a recent subcommittee hearing, but I would also like to take a minute to offer my suggestions for appropriate regulations.

I understand the reluctance of many Federal agencies to regulate the government securities market. However, there are a few very simple actions that could be taken that would not place any drastic restrictions on the market, yet would offer a measure of security for the investor.

1) License all government securities dealers.
2) As part of the license requirement, require that they meet a certain assets test.
3) Also, as part of the license process, require that they carry appropriate liability insurance against illegal acts.
4) Finally, as part of the license process, that all trust contracts for securities safekeeping be submitted for review.
5) At least once or twice a year, the appropriate Federal oversite agency conduct a limited audit of the companies to determine their compliance to the assets test and to insure that pledged collateral is actually segregated in the name of the investor at a safekeeping institution.

These simple and non-onerous regulations would ensure that ESM-type dealers are operating within the law. It would also give individuals and organizations using repurchase agreements a sense of security, thus protecting this important investment instrument.

Thank you for your time and consulation.

Sincerely,

Danny O. Crew, Ph.D
Assistant City Manager/Administration

An Equal Opportunity Employer

C. LETTER FROM HON. GERALD LEWIS, COMPTROLLER OF THE STATE OF FLORIDA, TO HON. DOUG BARNARD, JR., DATED MAY 15, 1985

OFFICE OF COMPTROLLER
DEPARTMENT OF BANKING AND FINANCE
STATE OF FLORIDA
TALLAHASSEE
32301

GERALD LEWIS
COMPTROLLER OF FLORIDA

May 15, 1985

The Honorable Doug Barnard, Jr., Chairman
Commerce, Consumer and Monetary Affairs Subcommittee
Committee on Government Operations
United States House of Representatives
Washington, D.C. 20514

Dear Chairman Barnard:

I am writing this letter in response to the March 29, 1985 testimony of H. Joe Selby, Senior Deputy Comptroller for Bank Supervision, Office of the Comptroller of the Currency. Mr. Selby was responding to your request for information concerning national bank involvement with E.S.M. Government Securities, Inc., Ft. Lauderdale, Florida.

The impression given by Mr. Selby's testimony and documents provided by him to your committee is somewhat misleading.

Mr. Selby's letter indicates that information on the dealings between E.S.M. and a certain national bank was first communicated to this office in a letter dated February 16, 1977. Mr. Selby's letter then goes on to say that during this same period of time Robert Seneca and Ronnie Ewton, two of the principals of E.S.M. Government Securities, Inc. acquired a controlling interest in a bank holding company, American Bancshares, Inc. Mr. Selby states that, although Ewton and Seneca's involvement with American Bancshares had no connection with problems encountered in another national bank, the Office of the Comptroller of the Currency deemed it appropriate to enter into written agreements with ABI's six national bank subsidiaries to preclude any business dealings between ABI's subsidiary national banks and E.S.M. Securities, Inc., and its affiliates and principals.

Mr. Selby then states that Messrs. Ewton and Seneca attempted to subvert these agreements, apparently without success, and that later the national bank subsidiaries converted to state charter and Messrs. Seneca and Ewton eventually sold their interest in the holding company to Marvin Warner. This chronology is incorrect. Mr. Selby indicates that prior to the conversion of the national banks to state charter, this office was informed of the outstanding agreements between the OCC and the national banks.

Mr. Selby further provided to your committee a memo authored by Mr. Lou Frank, Deputy Regional Administrator of National Banks for the Atlanta Region. Mr. Frank's memorandum which was apparently prepared in response to a request to investigate Messrs. Ewton and Seneca in connection with their proposed acquisition of American Bancshares, Inc. describes highly questionable transactions arranged by E.S.M. and includes the highly publicized reference to Messrs. Ewton and Seneca as "suede show types, slickers, high-pressure salesmen," and as "Memphis-bond bandits".

I am greatly concerned that the impression created by Mr. Selby's letter is that this office was aware of questionable dealings by E.S.M. that may have been a threat to the solvency of the banks controlled by Ewton and Seneca and that we nevertheless, approved the conversion of those six national banks to state charters thereby enabling them to avoid the restrictions of the written agreements previously entered into with the OCC. A careful review of the circumstances surrounding the written agreements and the sequence of events which led to the conversion of the banks to state charters will make it clear that the impression created by Mr. Selby's letter is greatly different from the events that actually occurred.

To begin with, the conclusions of Mr. Frank's investigation of Messrs. Ewton and Seneca together with the problems involving E.S.M. that had arisen at another national bank might well have indicated that Ewton and Seneca should not have been approved to acquire control of American Bancshares, Inc. Nevertheless, it appears that OCC did not communicate this information to the Federal Reserve Board, nor to this office, and that agency then approved the acquisition. Although American Bancshares owned three state-chartered bank subsidiaries, the interest acquired by Ewton and Seneca was less than the amount which would have required approval by this office, and consequently, this office was not called on to approve the acquisition as was the Federal Reserve Board.

To repeat this point, the information about E.S.M. that had been acquired by OCC was not communicated to this office. The only matter which was brought to our attention by the OCC was the fact that E.S.M. had apparently effected certain transactions on a date which was about three weeks prior to the time when it was authorized by this office to transact business in Florida. Absent any allegation of fraud in the transactions and not having any complaint regarding these transactions, this infraction would have amounted only to a technical violation of the law which, by the time we were notified of it, would have been cured. Neither Mr. Frank's conclusions based on his investigation nor any information concerning the transactions with the other national bank, were shared with this office.

Moreover, the written agreements between the OCC and the six national banks which were entered into in anticipation of the acquisition of control by Ewton and Seneca, reflect no concern for any potential of fraudulent dealing on the part of E.S.M. Rather, the restriction against making loans or extending credit from the banks to E.S.M. and its principals and affiliates, suggests a concern with potential insider transactions and perhaps a concern over potential violations of the Glass-Stegall Act. And yet these agreements were entered into at least a week after Mr. Frank's memorandum.

Although, as far as I am aware, there has been no suggestion that the banks did not comply with the terms of the written agreements, Mr. Selby's letter indicates that Ewton and Seneca attempted to subvert the agreements. But in a letter dated September 30, 1977, Mr. Selby himself indicated to Ewton and Seneca that OCC "neither intended nor anticipated that the agreements would remain effective in perpetuity." In fact, Selby invited the boards of directors of the affected banks to request modification or termination of the agreements at any time if they proved to be unduly burdensome or otherwise appropriate.

At any rate, in July of 1978, Ewton and Seneca sold their interest in American Bancshares to ComBanks, Inc., which was controlled by Marvin Warner. It was not until three months after Ewton and Seneca were no longer directly involved with American Bancshares that the six national banks applied to convert to state charters. From information found in our files, it appears that the banks attempted to negotiate revisions to the written agreements which would have deleted references to Ewton and Seneca, presumably since they were no longer involved with the banks. Instead, OCC deemed it necessary to issue and serve upon the banks notices and charges alleging certain unsafe and unsound lending practices and seeking permanent cease and desist orders against those practices. It was in this setting, then, that the banks applied to convert to state charters.

The implication, therefore, created in Mr. Selby's letter is wrong on two counts. First of all, Ewton and Seneca did not apply to convert the charters of the banks to escape the written agreements, because they were no longer involved with the holding company at the time the applications were filed. Furthermore, the provision in the written agreements restricting transactions with E.S.M., would seem to have been no longer applicable after the time Ewton and Seneca had sold their interest in the holding company, and therefore there would have been no threat of insider transactions or potential Glass-Stegall violations.

In considering the applications for conversion, representatives of this office met with OCC's staff in Atlanta to discuss the condition of the national banks. From these discussions, it appeared that, additional

capital had been provided to the banks by the holding company and that sweeping management changes had been made at the banks. As a result, by the time the conversion applications were approved on December 28th, the written agreements dated 22 months earlier would seem not to have been necessary. This office, therefore, issued its approval order authorizing conversion of the six national banks to state charters without requiring that the written agreements be extended or that the cease and desist action be pursued.

Thus, Mr. Selby's implication that Ewton and Seneca converted the banks in order to escape restrictions imposed by OCC, is simply erroneous. Moreover, at the time of the conversions, this office had no information which would have suggested that Ewton and Seneca were undesirable persons and that the conversion should have been denied.

I am concerned that OCC, or at least Mr. Selby, would communicate information to you and members of the subcommittee which implies that this office was used by Ewton and Seneca to avoid the restrictions that had been placed on them by OCC. I trust that this information will set the record straight and will dispel any notion that we may have overlooked information which had allegedly been furnished to us and which would have had a material bearing on an evaluation of the character of Messrs. Ewton and Seneca.

We in Florida have perhaps more reason than anyone else to work for the establishment of regulatory procedures which will minimize the chance of a recurrence of an event like the failure of E.S.M. We hope that other regulatory agencies will see fit to contribute to that effort instead of looking about to shift the blame for a failure such as this to other agencies.

Sincerely,

Gerald Lewis

GERALD LEWIS

GL:jmm

D. DOCUMENTS RELATING TO COMBANKS' INVESTMENTS WITH ESM, 1981

E.S.M. GOVERNMENT SECURITIES, INC.

June 15, 1981

Mr. Stephen Arky
Arky, Freed, Stearns, Watson & Greer
One Biscayne Tower, Suite 1820
Miami, Florida 33131

Dear Steve:

I am enclosing a copy of Burt Bongard's memorandum to Bob Weeder and Chris Tomczak, a copy of Bob Weeder's memorandum to Burt Bongard, and copies of the transactions we proposed to Combanks and Great American Banks.

In addition, I would like to point out the following:

1. Combanks would be purchasing and holding the securities, in this case, U.S. Treasury Bills, as a replacement for the securities that would be repo'd with us. We would loan them the funds and purchase the new securities.

2. These two small transactions would increase their annual earnings by $327,000.

3. This is no different and much less risky than taking collateral from a bank customer and loaning them money on the collateral. If the securities go down in value, and they can't pay off the loan, the bank would be at risk for interest and principal. This trade, the securities would mature at par in a year or less and the only risk would be loss of earnings if we went out of business.

I am not familiar with the State of Florida's Banking regulations, but I can tell you, that we have done this with other financial institutions. Conservatively, I feel that this would increase the earnings of Great American Banks and Combanks by a minimum of $1,000,000 per year.

If you have any questions that I can answer, please call me.

Very truly yours,

ORIGINAL 003528

Alan R. Novick
Vice President

ARN/br

Colee Hammock Executive Plaza
1512 East Broward Boulevard, Suite 100, Fort Lauderdale, Florida 33301 • 305/ 764-2600

cc: Burt Bongard

4/17/85 bds

EXHIBIT 90 4-18-85 4/8/85

E.S.M. GOVERNMENT SECURITIES, INC.

COMBANKS

Settlement Date:	06/10/81
Purchase:	$9,000,000 U.S. Treasury Bills due 05/20/82 (339 days)
Investment:	Repo $9,500,000 Notes 7.0% 05/15/82 @ 83 1/8 = $7,896,000
Cost @ 12.95:	$7,886,300.00
Maturity Value:	$9,000,000.00
Cost of Bills:	7,886,300.00
Discount Income:	$1,113,700.00
Cost:	$7,896,000 x 13.00 ÷ 360 x 339 = $966,602.00
Discount Income:	$1,113,700.00
Repo Expense	966,602.00
Net Income	$ 147,098.00

$$\frac{\frac{\$147,098.00}{339} \times 360}{\$7,896,000.00} = 1.978$$

006162

Subject to market at time of execution

003529

ORIGINAL

Colee Hammock Executive Plaza
1512 East Broward Boulevard, Suite 100, Fort Lauderdale, Florida 33301 • 305/764-2600

E.S.M. GOVERNMENT SECURITIES, INC.

COMBANKS

Settlement Date:	06/18/81
Purchase:	$10,900,000.00 U.S. Treasury Bills due 06/17/82 (364 days)
Investment:	Repo $5.5mm Notes 7 1/4% 02/01/84 @ 76 = 4,180,000 $5.6mm Notes 8.0% 08/15/86 @ 70½ = 3,948,000 $2,0mm FNMA 7.45% 09/01/85 @ 68 = 1,360,000 9,488,000
Cost @ 12.95:	$9,472,766.11
Maturity Value:	$10,900,000.00
Cost of Bills:	9,472,766.11
Discount Income:	$ 1,427,233.89
Cost:	$9,488,000 x 13.00 - 360 x 364 = $1,247,144.89
Discount Income:	$1,427,233.89
Repo Expense:	1,247,144.89
Net Income:	$ 180,089.00

$$\frac{\frac{\$180,089.00}{364} \times 360}{\$9,488,000.00} = 1.877\%$$

Subject to market at time of execution

$06163

003530

ORIGINAL

Colee Hammock Executive Plaza
1512 East Broward Boulevard, Suite 100, Fort Lauderdale, Florida 33301 • 305/764-2600

Bob Weeder
Chris Tomczak 6/9/81

Burt Bongard

Leverage Transactions

During the past two days the three of us have had conversations in reference to improving your yields on existing government securities.

Chris, I have asked you this date to get a formal opinion in reference to a leverage purchase defined as the following: ComBanks sells securities under a repurchase agreement for 1 year or less at a fixed rate. Obviously, the securities will be benched with the lendor. The lendor will provide $9 1/2 million on the $13 million of pledged securities. ComBanks then buys $10.9 million of one year Treasury Notes. The $10.9 million is physically delivered to ComBanks and held by ComBanks. This transaction improves interest income by $180,000.

How is this different from a customer REPO? Your position is that a customer REPO is short term. That the above is 1 year and based on interpretation of the regulations, falls in the 50% borrowing category, etc.

Once and for all, we want to know what we can or cannot do in reference to yield improvements through the repurchase of securities and/or leverage of securities.

I do not want to do anything that is not within the code of regulations governing the banks.

It is unfair for us to send our information to ESM, have them work on it, and then never be able to complete a transaction. This creates hostility and I want it to stop as of this date. I want to know whether we can or cannot under the law do these transactions and I want a formal opinion and I want it now.

B. M. B.

BMB:npb

cc: Marvin L. Warner

bcc: Alan Novick ✓

MEMORANDUM

June 9, 1981

TO: Burt Bongard

FROM: Bob Weeder

SUBJECT: Are Leverage Transactions Allowable Under the Florida Banking Code?

As we discussed today and also mentioned in your memo dated June 9, 1981 concerning leverage transactions, I contacted Bruce Berger, Chief of the Bureau of Bank Examinations for the State of Florida for a ruling on this type of investment. His comment was that he thought there would be a problem with both sides of the transaction. He had his doubts as to this being an allowable investment and felt that the liability side would fall under the borrowing limitations (100% of capital stock and 50% of surplus). He said that he would investigate this and give me a written opinion as soon as possible.

RJW/dw

cc: Marvin L. Warner
Allen Novick
Chris Tomczak

banker law

check the law

- restrictions on liability ?

- what asset do you have?

306165

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ORIGINAL

ComBank/Winter Park

June 10, 1981

Mr. Bruce E. Berger
Chief, Bureau of Bank Examinations
Division of Banking Personnel, State of Florida
Capitol Building
Tallahassee FL 32304

Dear Mr. Berger:

As per your conversation of June 9, 1981, with Bob Weeder, Treasurer of ComBanks Corporation, I am submitting for your review the pro forma details of a transaction that has been suggested to us as a means of increasing our return on a fixed term investment. Stated briefly, the trade involves purchasing $18 million of U.S. Treasury Bills with a cost of $15.6 million. These bills would be financed by selling the entire $18 million Treasury Bills under repurchase agreement to generate $12.6 million in available funds. The remaining $3 million would be contributed from the banks available funds. Since the borrowing cost on the securities sold under repurchase agreement is less than the return on the Treasury Bills this maneuver should result in increasing the yield on invested funds to over 26%. This proposed trade is detailed on the attachment.

There has been some disagreement among ourselves as to whether a trade of this type violates the State Banking regulations, consequently, we are submitting these details to you for your review and opinion. In studying this information, please direct your attention to the effects of this leveraging on both the asset and liability side of the balance sheet as we have questions in each regard.

If any further information is required please contact me at your convenience. I anxiously await your reply.

Sincerely,

Michael Martin
Vice President

MM:pt.
cc: B. Weeder
B. Klingler

ORIGINAL

003533

750 South Orlando Avenue • Winter Park, Florida 32789 • (305) 645-8100

ComBank/Winter Park

Mariann Hurd

July 1, 1981

Arky, Freed, Stearns, Watson & Greer
Attention: Ms. Allyson Miller
One Biscayne Tower
Two South Biscayne Blvd.
Miami, Florida 33131

Dear Allyson:

Bob Weeder requested that I forward to you copies of the attached correspondence for your review. It pertains to the leveraged arbitrage proposal that you are studying. If you have any questions regarding this material please contact me at your convenience.

Sincerely,

Mike

Michael Martin,
Vice President

MM:cb

Enclosures

006168

003535

PAGINA

750 South Orlando Avenue • Winter Park, Florida 32789 • (305) 646-6100

PROPOSED BILL ARBITRAGE

Settlement Date:	6-9-81
Purchase:	$18,000,000 U.S. Treasury Bills due 5-20-82 (345 days)
Investment:	$3,000,000
Cost @ 13.50 (87.0625):	$15,671,250.00
Maturity Value:	$18,000,000.00
Cost of Bills:	$15,671,250.00
Discount Income:	$ 2,328,750.00

Cost:	$15,671,250.00
Investment:	3,000,000.00
	$12,671,250.00 X 13.0 ÷ 360 X 345 = $1,578,626.56

Discount Income:	$ 2,328,750.00
Repo Expense:	1,578,626.56
Net Income:	$ 750,123.44

$$\frac{\$\ 750{,}123.44}{\$\ 3{,}000{,}000} \times \frac{360}{345} = 26.091$$

006167

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GINAL

GERALD A. LEWIS
COMPTROLLER OF FLORIDA

OFFICE OF COMPTROLLER
STATE OF FLORIDA

TALLAHASSEE
32301

June 23, 1981

Mr. Michael Martin
Vice President
ComBank/Winter Park
750 South Orlando Avenue
Winter Park, Florida 32789

Dear Mr. Martin:

Reference is made to your letter of June 10, 1981, regarding the purchase of U. S. Treasury securities and subsequent sale under repurchase agreements.

So long as the repurchase agreements are structured to avoid statutory borrowing limitations, the proposed transaction does not appear to violate state law.

We would urge you however, to contact your appropriate federal regulator as the proposed transaction is receiving a great deal of federal attention, especially required disclosure relating to federal securities laws and the absence of deposit insurance, and the requirement that repurchase agreements of less than $100,000 may be limited to an eighty-nine day maturity. In some interest rate markets this could be a problem if the primary security was purchased with a substantially longer maturity.

If we can provide further information, please let me know.

Sincerely,

Bruce E. Berger, Chief
Bureau of Bank Examinations
Division of Banking
Suite 1301, The Capitol

BEB:dn

cc: Area Supervisor - Orlando

E. LETTER FROM ARKY, FREED TO ALEXANDER GRANT & CO., REGARDING ESM, DATED JANUARY 31, 1985

LAW OFFICES

ARKY, FREED, STEARNS, WATSON, GREER, WEAVER & HARRIS, P.A.

[illegible] BISCAYNE TOWER

MIAMI, FLORIDA 33131

(305) 374-4900

TELEX 51-3592

TAMPA OFFICE
SUITE 3300
ONE TAMPA CITY CENTER
POST OFFICE BOX 3399
TAMPA, FLORIDA 33601

(813) 223-4800

ORLANDO OFFICE
SUITE 900 BARNETT PLAZA
201 SOUTH ORANGE AVENUE
ORLANDO, FLORIDA 32801

(305) 422-4800

OF COUNSEL
ALFREDO G. DUHAN

January 31, 1985

Alexander Grant & Company
Certified Public Accountants
1900 One Financial Plaza
Fort Lauderdale, Florida 33394

RE: E.S.M. Securities, Inc., E.S.M. Government Securities, Inc. and E.S.M. Group, Inc., (the "Companies")

To Whom It May Concern:

We have been requested by George G. Mead, Vice President of E.S.M. Government Securities, Inc., to furnish you with certain information in connection with your audit of the Companies.

This letter and the information contained herein is being submitted to you in connection with the preparation of financial statements as of December 31, 1984. You are not authorized to use this letter for any other purpose or to provide copies of this letter to any other person or governmental agency without the express written consent of this firm.

While this firm represents the Companies on a regular basis, our engagement has been limited to specific matters as to which we were consulted by the Companies. Subject to the foregoing and to the last paragraph of this letter, we advise you that for the period ended December 31, 1984, and as of the date hereof, we have not been engaged to give substantive attention to or represent the Companies in connection with any material loss contingencies coming within the scope of Paragraph 5 of the Statement of Policy referred to in the last paragraph of this letter, except as follows:

United States of America v. One 1981 Rockwell International Commander 690C/840, Serial Number 11627, Civil Number 82-A2-66; United States District Court - North Dakota.

E.S.M. Aviation, Inc. ("E.S.M. Aviation") is a wholly-owned subsidiary of E.S.M. Group. E.S.M. Aviation is the owner of a 1981 Rockwell International Commander 690C/840, Serial Number 11627. On December 20, 1981, the Rockwell aircraft was seized by agents of the federal government pursuant to 21 U.S.C. § 881 for facilitating the transportation of controlled substances. On the flight in question, E.S.M. Aviation had leased the aircraft to Cav Air, Inc., a licensed air carrier. Cav Air, in turn, had chartered the plane and provided a pilot to three individuals who were arrested in Fargo, North Dakota, indicted and convicted for federal narcotics violations. No employee of E.S.M. Aviation or Cav Air has been implicated in any wrongdoing.

On May 10, 1982, the United States of America commenced judicial forfeiture proceedings against the subject aircraft, seeking to extinguish E.S.M. Aviation's ownership interest in the aircraft. On June 9, 1982, E.S.M. Aviation answered the complaint for forfeiture and counterclaimed for damages against the United States. On August 3, 1983, E.S.M. Aviation moved for summary judgment, arguing that the airplane is not subject to forfeiture because it was being used as a common carrier, and neither the captain nor the crew was acting in concert or privity with the persons transporting controlled substances. In the alternative, E.S.M. Aviation argued that the airplane is not subject to forfeiture because the owners did everything reasonably possible to avoid the airplane being used in an unlawful fashion. On September 6, 1983, the Court agreed in part with E.S.M. Aviation's position. The Court ruled that the flight in question was conducted as a common carrier aand the burden therefore shifted to the government to demonstrate that the owner or operator was privy to or consented to the illegal transportation of contraband. A trial on this sole issue commenced February 21, 1984. On February 24, a jury returned a verdict in favor of E.S.M. Aviation and on February 27 judgment was entered directing that the aircraft be immediately returned to E.S.M. Aviation.

On March 8, 1984, the government moved for reconsideration of the trial court's September 6, 1983 ruling that the flight in question was conducted as a common carrier. Over E.S.M.'s objection, on June 29, 1984, the trial court reversed its earlier ruling, entered a directed verdict and final judgment in favor of the government and ordered forfeiture of the aircraft. On July 9, 1984, E.S.M. appealed the trial court's ruling. On December 12, 1984, the appellate court heard argument and, on February 8, 1985, the appellate court reversed the trial court's forfeiture of the aircraft. The appellate court reinstated the jury verdict and directed that the aircraft be returned to E.S.M. Aviation.

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As of December 31, 1984, the Companies had no outstanding balance for services rendered by this firm.

This response is limited by and in accordance with the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (December, 1975). Without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response (Paragraphs 2 and 7) are specifically incorporated herein by reference and any description herein of any "loss contingencies" is qualified in its entirety by Paragraph 5 of the Statement and the accompanying Commentary (which is an integral part of the Statement). Consistent with the last sentence of Paragraph 6 of the ABA Statement of Policy and pursuant to the Companies' request, this will confirm as correct that whenever, in the course of performing legal services for the Companies with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, we have formed a professional conclusion that the Companies must disclose or consider disclosure concerning such possible claim or assessment, we, as a matter of professional responsibility to the Companies, will so advise the Companies and will consult with the Companies concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5.

Very truly yours,

ARKY, FREED, STEARNS, WATSON,
GREER, WEAVER & HARRIS, P.A.

Arky Freed Stearns Watson Greer
Weaver & Harris, P.A.

MTW:tee
cc: E.S.M. Securities, Inc.
E.S.M. Government Securities, Inc.
E.S.M. Group, Inc.
c/o E.S.M. Government Securities, Inc.

ORIGINAL

006503

APPENDIX 11.—PRESS MATERIALS

A. "MIAMI BANK INDICTED ON CHARGES OF LAUNDERING ILLICIT DRUG MONEY", THE NEW YORK TIMES, DECEMBER 14, 1982

THE NEW YORK TIMES, TUESDAY, DECEMBER 14, 1982

Miami Bank Indicted on Charges Of Laundering Illicit Drug Money

Special to The New York Times

MIAMI, Dec. 13 — A Federal grand jury has indicted 16 individuals and companies, including a bank based in Miami, in connection with currency transaction reports involving about $96 million in what the Government says was illegal drug money.

The four indictments stemmed from a two-year Federal investigation involving the Great American Bank of Dade County and money laundering. Money is "laundered" by people involved in illicit activities to camouflage its origin or its owner by moving it through various financial institutions.

The first indictment, returned by the grand jury Friday, accuses the bank of failing to file accurate currency transaction reports with the Internal Revenue Service for about 400 transactions between January 1980 and Feb. 27, 1981.

The bank, two former officers and a former teller are also charged with conspiracy to defraud the United States by obstructing the collections of reports of currency transactions for use in criminal tax and regulatory investigations and with conspiracy to willfully fail to file and falsely file required reports.

According to the United States Customs Service, Great American is the first bank in the area to be indicted on money laundering charges, and the second in the United States.

Named in the indictment were Lionel Paytuvi, former vice president for installment loans; Carlos Nunez, former head teller and assistant loan officer and Elaine Kemp, a former teller.

Mr. Paytuvi and Mr. Nunez were suspended with pay last year after Federal agents raided the bank. Neither was charged with any crime at that time.

Three other indictments naming 12 other defendants, including two Miami-based corporations, were returned.

One named Isaac Kattan, a convicted drug trafficker, and four other people on charges of conspiracy to defraud the United States on reports of currency transactions and making false statements regarding the currency transactions. The indictment covers about 30 transactions for a total of $6 million.

Another indictment named two Florida corporations, Interfil Inc. and Latina Export and Import Inc., and four employees. They are said to have conspired with Great American Bank and its employees to fail to file or to falsify reports to the Treasury Department, concealing currency transactions totaling $68 million.

The fourth indictment charged Carlos Octavio Piedrahita, also known as Luis Rondon, with failure to file or falsely filing currency transaction reports involving $9.7 million. The indictment alleges that he derived the money from selling controlled substances and that traffickers delivered money to him for deposit to the bank.

According to The Miami Review, a business newspaper, Great American Bank ranked 22 out of 63 banks in Miami in total deposits, as of Dec. 31, 1981.

The extent of money laundering is difficult to measure because of the lack of reliable data. Treasury Department officials say, however, that the problem is severe enough to distort the economies of south Florida and other regions.

Bank Says It Was Victim

MIAMI, Dec. 13 (AP) — Great American Bank's attorney, Michael J. Madigan, said the indictment was unwarranted. "The truth of the matter is that the bank was a victim," Mr. Madigan said, and no senior officials knew about the transactions.

B. "MARVIN WARNER: HORSE TRADER IN FLORIDA BANKS", FLORIDA TREND, MARCH 1983

Marvin Warner: Horse Trader in Florida Banks

The former ambassador to Switzerland may not really want to be your banker. He's more interested in making money — lots of money — swapping bank stocks.

By Otis White

When Marvin L. Warner was building homes for the masses in Cincinnati in the 1950s, he developed a mystique that rankled many in the city's downtown business establishment. It was hard to describe the mystique, but it was as if Warner, a young, plain-featured Southerner from Birmingham, Alabama, constantly dealt with people on two leveis — and got away with it.

On the outside, he was a pleasant, deferential young man. He had a habit of asking visitors what they thought of his blossoming housing developments, most of which were aimed at the lower middle class. When they offered rambling observations, he listened seriously to what they said. And when reporters visited him, he seemed genuinely grateful for their attention.

But beneath his soft Southern accent and polite manners, Warner was fast gaining a reputation as a bare-knuckles negotiator, a developer whom even Cincinnati's tough building trades/unions/respected. And there were stories floating around that Warner routinely bargained contractors down to the barest profit margin — and then whittled another quarter-cent or half-cent a square foot off that price.

"He was the sine of gut realis George Lockwood, one of his closest business associates in the 1950s, "who could pat you on the back and kick you in the ass at the same time and make you go away feeling good." Lockwood says that with admiration. Many in Cincinnati's polite business circles weren't so happy with Warner in those days.

Twenty-five years after he roiled the home-building waters of Cincinnati with his combination of grace and grit, Marvin Warner is making even bigger waves in the polite circles of Florida finance. There are some differences between the Warner of the 1950s and the Warner of 1983. At age 63, he now counts his money by the scores of millions. He doesn't ask visitors for their opinions of his businesses anymore. And he is reluctant now to be interviewed at any length by reporters, saying he's had enough publicity and adding that, since Watergate, reporters hunt too often for scandal. On the other hand, he still has that Southern charm about him that belies his rabbit-punch style of business. And he still gets away with it.

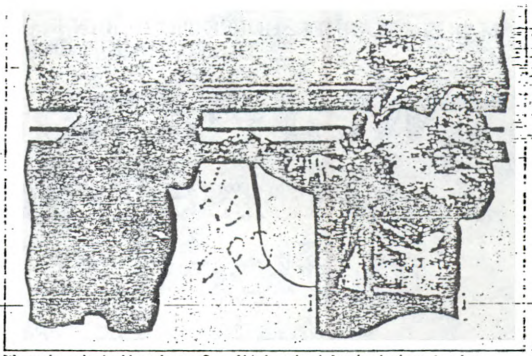
Warner first attracted the attention of Florida bankers in 1976, when he and attorney Hugh Culverhouse, owner of the Tampa Bay Buccaneers, bought controlling interest in ComBanks Corp. of Orlando, a mid-sized Central Florida bank holding company. (A few years later, Culverhouse sold his interest to Warner.)

In the six and a half years since, Warner has been all over the state's banking map, floating a bid for Florida National Banks of Jacksonville, taking control of Great American Banks of North Miami, winning a bidding contest in Tampa for the failed Metropolitan Bank's assets, lighting the skies with a spectacular losing effort to take over Fort Lauderdale's Century Banks.

In the process, Warner has played Florida bank stocks so shrewdly he reminds some people of the late Ed Ball, the legendary Jacksonville financier who had an uncanny knack for spotting undervalued properties. And he has negotiated every deal as if it would make him his first million — or cost him his last. Even when he lost, as he did in his struggle with Sun Banks for control of Century Banks, he walked away with a satchel full of money.

Joel R. Wells Jr., president and CEO of Sun Banks, sat across a table from Warner in late 1981 and early 1982 as the two men bargained for Century Banks. Says Wells today: "What makes for toughness in negotiation is the ability to have the stre-

FILES



Warner is used to backing winners. One of his favorites is Lombardi, above. Another Warner horse, Stalwart, was an early favorite in last year's Kentucky Derby.

...side to show you're prepared to carry out whatever position you have staked out." Warner had threatened to tie up the Sun-Century merger indefinitely with a swarm of lawsuits. Wells believed him. "I recognized," says the Sun Banks president, "he had the capability to do that if he wanted to."

Warner's hang-tough position netted him $5 million in cash from Sun Banks to call off his lawyers, plus an estimated $12.5 million cash profit on the sale of his Century stock. As a proviso to their agreement, Wells had Warner swear in writing he would not buy more than 1% of Sun Banks' stock for at least 15 years. By then, Warner will be 77. Wells will be 68.

That proviso may have been needless. Just as suddenly as he first stormed into Florida banking, Warner is pulling out. In a series of moves last summer that caught nearly everyone by surprise, Warner started shucking his bank holdings like wool sweaters in a hot room. In quick order, he cancelled plans to merge two of his holdings, Great American and ComBanks, and negotiated the sale of Great American to Barnett Banks and ComBanks to Freedom Savings & Loan Association of Tampa.

And, just as unexpectedly, he began buying savings and loan stocks. Inside a month he had picked up nearly 18% of troubled American Savings & Loan Association of Miami and, in a move that raised a lot of eyebrows, he bought about 8% of Freedom Savings' stock.

That move came on the eve of Freedom stockholders' final vote on whether to purchase Warner's ComBanks. Twice, stockholders had refused to approve the purchase by the necessary two-thirds margin, even though management threatened to go ahead with the merger anyway by buying up all of ComBanks' assets. On the day before the third stockholders' vote, Warner quietly purchased 200,000 shares of Freedom Savings stock from one of the dissident shareholders. With management's proxies and other sympathetic stockholders, Warner voted through the purchase of his own bank. (All federal and state regulators were at press time reviewing the transaction to see if it merits a full-scale investigation.

It was a typical Warner move — quick, quiet and without a lot of concern about how it would look afterwards.

Warner's transactions all have an air of intrigue about them because the man has remained, at best, a vague figure in Florida, calling most of his shots from his 600-acre horse farm in Ohio, occasionally jetting to his condo in Bal Harbour or appearing suddenly in Tampa or Orlando. Although he held his ComBanks stock for six and a half years, the image that has emerged from his lightning-like investments and his hardball style of negotiation is that of a corporate raider, someone on the order of fellow Cincinnatian Carl Lindner of American Financial Corp. Warner's reluctance to talk at any length with the press, like Lindner's, has only heightened that image.

But just over a month ago, Warner finally consented to a long interview with FLORIDA TREND at his farm, tucked away in the lush hills of Clermont County, Ohio, just east of Cincinnati. Over the course of the expansive, 3½-hour interview, Warner — a trim, gray-haired man — said that he has taken a totally new tack in his investments. He is getting out of the banking business, he says, because he sees an end to the golden days of bank investment in Florida. And he is getting into savings and loans, he adds, because he believes S&Ls' fortunes are on the rise again.

He adamantly denies, however, he has any grand plan for a fresh round of Florida investments. "I wish I could give you something to stir your juices, to say this is my master design," he said at one point in his soft Southern drawl. "But the truth is, I don't have any master design."

Not many who watch Florida financial stocks believe that. The generally accepted theory among bank analysts is that Warner is carefully assembling a statewide chain of S&Ls. He now has the dominant ownership voice in American Savings, the state's third-largest S&L whose offices are spread throughout Southeast Florida. And they assume he is preparing to take over Freedom Savings, which has a significant presence in Central and Southwest Florida. With the addition of a third S&L — say, one in the Jacksonville area — Warner can, at relatively little cost, put together a statewide financial institution. Then all he need do, analysts say, is wait for the big Northern banks to begin flooding into Florida after interstate banking bans are dropped and sell his cross-state assemblage of S&Ls for a New York-sized price. "He's trying to build the biggest financial empire with the least amount of money," Ronald W. Gold, analyst for Allen C. Ewing & Co., says. Says another ana-

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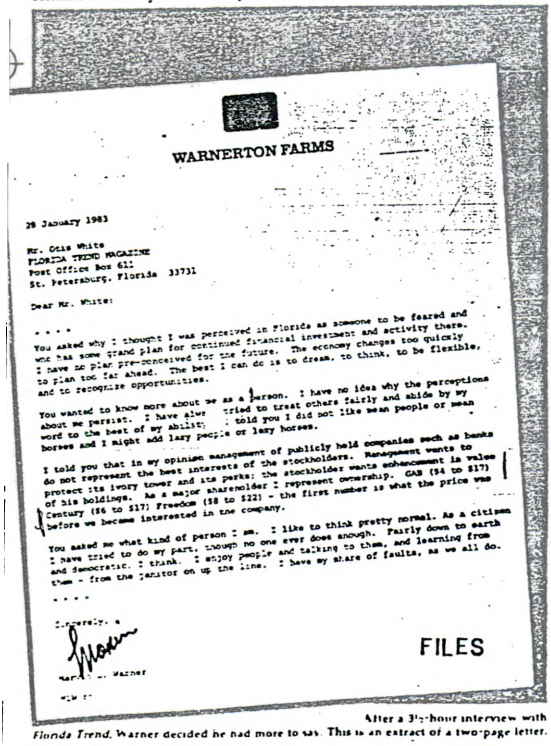
admiringly: "If anything at all, he man is a very shrewd opportunist."

All this speculation has many bankers biting their knuckles over what Warner may do next. With a war chest of at least $50 million to finance his investments, Warner can afford to have his way with their companies if he wishes.

Warner simply shakes his head when he is asked about the analysts' guesswork. "If anybody knows what I'm going to do, he knows more than I do," he says. He maintains he has no plans — at the moment, at least — to take over Freedom. (Freedom officials also deny there is any deal in the making with Warner.) And he says his American Savings investment and his dealings with Freedom have nothing to do with one another. Does he think the two should merge someday? Warner shrugs. "I don't want to be presumptuous," he says, pointing out he is not involved in managing either institution.

If anybody knows what I'm going to do, he knows more than I do," says Warner.



WARNERTON FARMS

20 January 1983

Mr. Otis White
FLORIDA TREND MAGAZINE
Post Office Box 611
St. Petersburg, Florida 33731

Dear Mr. White:

. . . .

You asked why I thought I was perceived in Florida as someone to be feared and one has some grand plan for continued financial investment and activity there. I have no plan pre-conceived for the future. The economy changes too quickly to plan too far ahead. The best I can do is to dream, to think, to be flexible, and to recognize opportunities.

You wanted to know more about me as a person. I have no idea why the perceptions about me persist. I have always tried to treat others fairly and abide by my word to the best of my ability; I told you I did not like mean people or mean horses and I might add lazy people or lazy horses.

I told you that in my opinion management of publicly held companies such as banks do not represent the best interests of the stockholders. Management wants to protect its ivory tower and its perks; the stockholder wants enhancement in value of his holdings. As a major shareholder I represent ownership. GAB ($4 to $17) Century ($6 to $17) Freedom ($8 to $22) - the first number is what the price was before we became interested in the company.

You asked me what kind of person I am. I like to think pretty normal. As a citizen I have tried to do my part, though no one ever does enough. Fairly down to earth and democratic. I think. I enjoy people and talking to them, and learning from them - from the janitor on up the line. I have my share of faults, as we all do.

. . . .

Sincerely,

Marvin L. Warner

mlw:rr

FILES

After a 3½-hour interview with *Florida Trend*, Warner decided he had more to say. This is an extract of a two-page letter.

If Warner is being disingenuous about his short-term strategy, he is much more forthcoming about his view of the investment horizon in Florida. He thinks the window of opportunity for investing in bank stocks is shutting and the one for S&L stocks is opening. Thus, he sold off ComBanks and Great American — at tremendous profit. He made about 4½ times his original investment in the ComBanks deal and about four times his investment in the Great American transaction.

Explains Warner: "The basic reason I decided to sell (ComBanks and Great American) is because I felt the pattern of the industry was going to be one where the big banks squeeze out the smaller ones with electronic gadgets and so on, and the big ones will be able to do a lot the smaller ones couldn't do." He adds that he wouldn't own stock today in any Florida bank with less than $2 billion in assets — "and that is low."

In fact, Warner has disdain for bankers in general, big-time or small. He considers them a timid, conformist lot. And he thinks much of the fear that he's engendered in Florida is a sign of bankers' insecurity. "My style might intimidate a guy who punches a clock at 9 and at 5 and keeps putting a bolt on the axle every day," he philosophizes. But, he adds, it shouldn't bother a man or woman with ambition and drive.

Still, it bothers him somewhat that Century Banks' management resisted his takeover attempt two years ago. When Warner announced he would try to buy control of Century, the bank company's management frantically searched for a merger partner to head off Warner. It attracted Sun Banks, which eventually outbid Warner for the $1.1 billion bank. Says Warner today: "I think, frankly, they (Century's management) would have been better off in my organization than in a larger organization. I think I give people more flexibility. My management procedure is to hold a meeting once a month and to set forth some objectives, and then let them do it."

That's considerably different from the Marvin Warner management style of the 1950s. Then he watched his Midwestern housing

developments so closely, he always kept a pair of galoshes in his car so he could jump out at any work site and tramp around with the construction workers. The floor mats in his Cadillac were constantly caked with yellow mud.

But the Warner empire of the 1980s is quite different from its counterpart back then, although it retains a few remnants of the early days. As the accompanying chart shows, Warner's empire a year ago was largely a collection of banks, a single S&L and several insurance companies. He has since sold off one of his insurance companies, Tampa-based Founders Financial Corp. (for an estimated $1.85 million profit on his four-year investment), and he is in the process of selling his banking

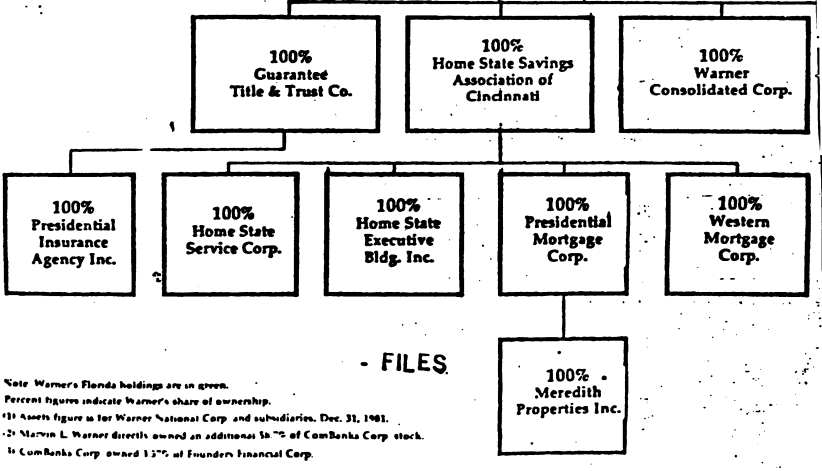
How Marvin Warner's Empire Looked a Year Ago

Marvin Warner's empire a little over a year ago stretched from insurance and real estate to Florida banks and a company that bought accounts receivable from doctors.

In the past year, Warner has been rearranging his portfolios by selling his stake in Founders Financial Corp. of Tampa and agreeing to sell ComBanks Corp. and Great American Banks. He's added blocks of stock in American Savings and Freedom Savings.

The advantage of owning a candy store as completely as Warner owns his is he can run it as he sees fit. (Warner National is a privately held company, although it is still required to make some filings with the SEC.)

One thing Warner does that might raise eyebrows at a publicly traded company is put a fair number of relatives on the payroll. Daugher Marlin Arky and son Marvin Warner Jr., for instance, were members of the board of ComBanks in 1981. Son-in-law Stephen W. A[illegible] sat on the Great American Banks and Founders Financial boards. In addition, Arky's Miami law firm was paid $448,758 in legal fees by ComBanks and Great American in 1981. Warner's other son-in-law, Cincinnati insurance agent Herbert R. Kuppin Jr., wrote policies for the two bank companies that totaled $215,437 in annual premiums that year.



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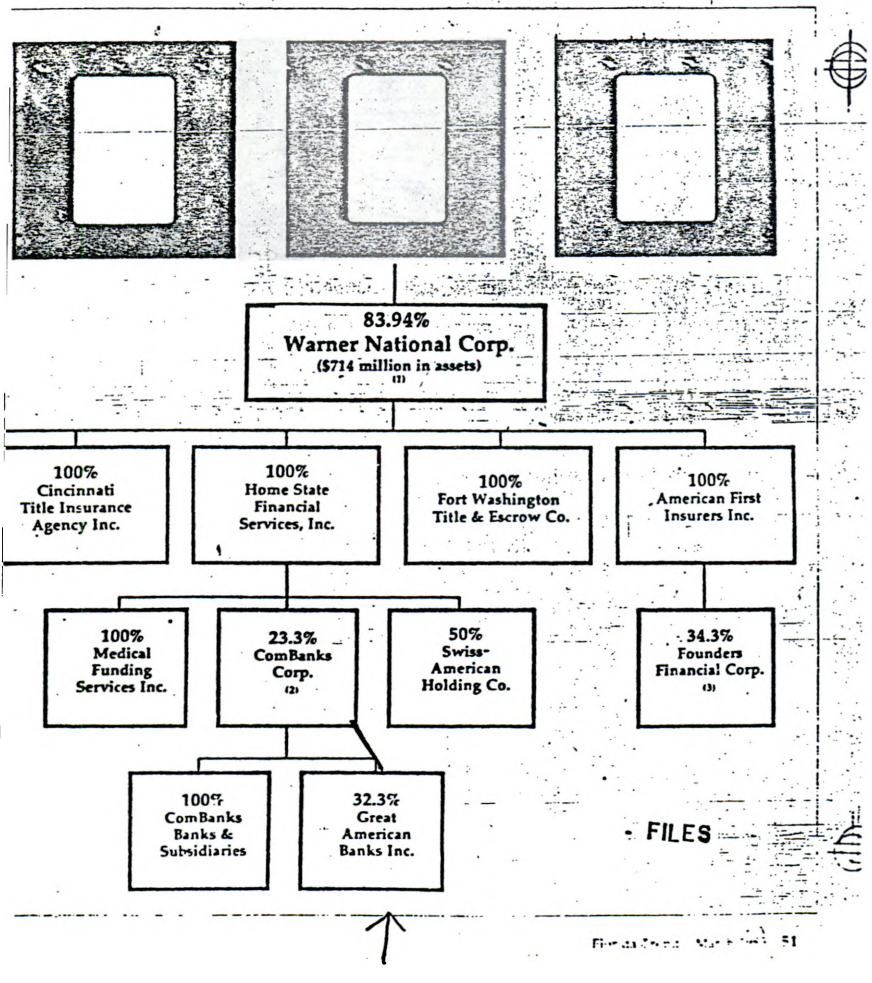
Note: Warner's Florida holdings are in green.
Percent figures indicate Warner's share of ownership.
(1) Assets figure is for Warner National Corp. and subsidiaries, Dec. 31, 1981.
(2) Marvin L. Warner directly owned an additional 5.7% of ComBanks Corp. stock.
(3) ComBanks Corp. owned 13.5% of Founders Financial Corp.

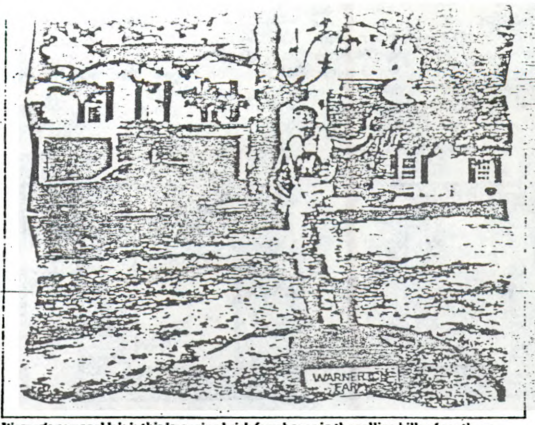
50 Florida Trend: March 1982

interests. ComBanks and Great American. Added to the Warner empire are shares of American Savings and Freedom Savings, which were purchased through Home State Financial Services, a Warner subsidiary.

How much is Warner worth? Guesses from friends and associates range from $50 million to more than $100 million. A good benchmark is $75 million, which, incidentally, was the net worth of Ed Ball when he died two years ago.

Warner's dramatic retreat from banking is not the first time he has drastically shifted his investment strategy. Until the early 1970s, Warner was still primarily a developer. Then he started selling off his real estate holdings. Why? "He thought





Warner's personal lair is this imposing brick farmhouse in the rolling hills of southern Ohio. Part of the house dates to 1804.

"The bloom was off the rose," says Oliver W. Birckhead, chairman of Cincinnati's Central Trust Co., which has been Warner's primary bank since the early 1950s. Warner himself says the housing business had become simply too burdensome. "We got more zoning restrictions, more environmental restrictions, more problems with finance, more problems with utilities," he says.

While he was involved in it, though, there was still plenty of bloom on housing's rose. The son of a baker, Warner grew up in Birmingham during the hardscrabble days of the late 1920s and early 1930s in a family of modest means. He worked his way through the University of Alabama, earning degrees in business and law, before joining in the Army.

His idea was to be a lawyer, but that notion was dashed when one of Birmingham's most prestigious law firms offered Warner, freshly discharged from the Army in 1946, a job at the miserly salary of $150 a month. He went to work, instead, for an uncle, selling real estate and insurance for $250 a month, plus commissions. He hated the insurance business. "Every time you said hello to someone you knew, they thought you were saying that to sell them some insurance," Warner recalls. He laughs. "And it was probably true."

But the real estate part appealed to him, enough to venture some of his own money to build a 10-unit bungalow-style apartment house in Birmingham. He and his wife moved into one of the units and rented out the other nine. He called it the Saipan Apartments, after one of his billets in the Army.

In those housing-scarce days following World War II, Warner quickly recognized the potential for profit from home building, particularly in the construction of suburban houses of modest cost. He and Joseph H. Kanter, another young man from Birmingham fairly brimming with ambition, pooled their meager assets and went into business together, scouring the country for cities that needed modest-priced housing. They discovered Cincinnati early on. Eventually, their business in the Cincinnati area grew so fast Warner packed up and moved there.

Over the next few years, Warner's insight into the potential for housing paid off in spades. The Warner-Kanter Co., fueled by Warner's boundless energy, his flattering manner and his steely determination, grew into one of Cincinnati's premier home builders, a vertically integrated operation that, by the mid-1950s, included its own facilities for designing, engineering, construction and maintenance of its multiplying projects. Thanks to Warner's shrewd purchase of a local savings and loan association, Warner-Kanter even had its own mortgage lending facility.

But even as the company grew, the relationship between Marvin Warner and Joe Kanter deteriorated. By 1959, their personal enmity had grown so great, the two could no longer work together. They divided the company in half, Kanter keeping the Cincinnati-area properties, Warner taking the out-of-state holdings, including properties in St. Louis, Washington and Florida. Kanter today lives in Miami, where he is chairman of National Banking Corp., a one-bank holding company.)

Warner stuck mostly to real estate during the 1960s and early 1970s, investing in a range of projects with another friend from his days in Birmingham, lawyer Hugh Culverhouse, who lived in Jacksonville at the time. Culverhouse, who enjoys a reputation of his own as a master deal-maker, says today of Warner: "He is about as intelligent a businessman as I've ever met."

The Culverhouse connection is what drew Warner into the world of Florida banking. So close were the two men in the mid-1970s that when Warner spotted the opportunity to buy ComBanks in 1976, he automatically turned to Culverhouse with an offer to let him in on the action. Culverhouse accepted. Earlier, when Culverhouse had won the Tampa Bay Buccaneers franchise, he let his friend Marvin Warner buy 48% of the franchise. (By 1979, the business relationship between Warner and Culverhouse had cooled a bit. Warner sold his portion of the Bucs back to Culverhouse, and Culverhouse sold Warner his shares of ComBanks stock. Both men deny there are any hard feelings between them, but they are involved today in only one joint project, an apartment house in Fort Wayne, Indiana.)

Culverhouse wasn't Warner's only well-placed friend, though. Another was George Steinbrenner, who at the time ran his American Shipbuilding Co. from Cleveland. Steinbrenner now lives in Tampa. The two men met when they served on the Ohio Board of Regents, which

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...University System. They became close enough that, in 1974, Steinbrenner let Warner buy 10% of his New York Yankees baseball team. Three years later, Warner sold his share back to Steinbrenner.

Warner got the Board of Regents appointment through his lavish campaign contributions to Ohio Democrats. In addition to business and racehorses, politics is a passion for Warner. He indulges that passion by writing checks for Democrats he likes. For at least the past 10 years, Warner has been the largest single contributor to the Ohio Democratic Party. During the Democrats' dog days, from 1975 to 1977, he and his family pumped nearly $70,000 into various federal races and, by tapping his rich friends, raised many thousands more. (His only known contribution to Florida politics was a fund-raiser he hosted in Orlando last October for Gov. Bob Graham, which netted the governor's re-election campaign $14,714. Graham says he's known Warner since Warner was part owner of the Bucs.)

All Warner's behind-the-scenes financial assistance paid off in 1977, when President Jimmy Carter, at the behest of Democratic Sens. John Glenn and Howard Metzenbaum of Ohio, appointed him the U.S. ambassador to Switzerland. He spent three mildly controversial years at the embassy in Bern — mildly controversial because he insisted on using his post to arrange business deals between Swiss interests and American companies. One incident that caused some clucking in sedate diplomatic circles occurred when Warner parked 24 new American cars on the driveway and lawn of the American Embassy and invited 800 or so Swiss government officials and procurement officers to drop by and look them over. Like the businessmen of Cincinnati in the 1950s and the bankers in Florida these days, the professional diplomatic community never knew quite what to make of Marvin Warner the ambassador. For his part, Warner relishes the memory and, even today, his staff refers to him as Ambassador Warner.

Indeed Warner loved...as a public servant enough to serve a second...

likes the game and the challenge. He likes competition and action."

...sider running for governor of Ohio last year. He commissioned a public opinion survey and started knitting together some political commitments before he finally decided the public scrutiny of running for political office wasn't worth the effort. Says he: "Ever since Watergate, these people in the public eye lose so much of their privacy that it's a real question whether going from the private sector to the public sector is justified."

Perhaps. But it is widely believed in Ohio political circles that Warner has his eye on at least one public-sector job: senator from Ohio. Since he is averse to running for office, Warner's road to the Senate would open only if Sen. John Glenn were elected president or vice president in 1984. That would leave Ohio Gov. Richard Celeste, a Democrat, with a vacancy to fill. Warner was one of Celeste's most important supporters during last year's election, and many think Warner would be first in line for the appointment. As for Warner, he acts nonchalant when asked whether he would accept an appointment to the Senate. "It would depend on a lot of different factors," he shrugs. "Where I'm living, what I'm doing."

Where Warner, twice divorced, lives now is in an intimate, white-brick farmhouse whose main part dates to 1804. From his second-story office window, he can look out on the snow-covered hills of Clermont County. If he tires of the view, he can always jet off to his Florida apartment, his pied-a-terre in Switzerland or his place in Aspen. But for the most part, he sleeps in Ohio, running his business empire from a cordovan leather reclining chair, an impressive array of communications devices within reach. In his bookshelves behind him are some political bestsellers and a book by Ezer Weizman the former Israeli defense minister. There is also a copy of the Florida Banking Annual.

On his farm in Ohio and another farm in Kentucky — both called Warnerton Farms — Warner runs one of America's premier horse-breeding operations. He has 200 horses, 30 currently on the racing circuit. Warnerton is currently ranked 13th in the nation in producing stakes-winners. The horse closest to his heart at the moment is a three-year-old bay colt named Stalwart. Last year, Stalwart was an early favorite in the Kentucky Derby before injury removed him from the running.

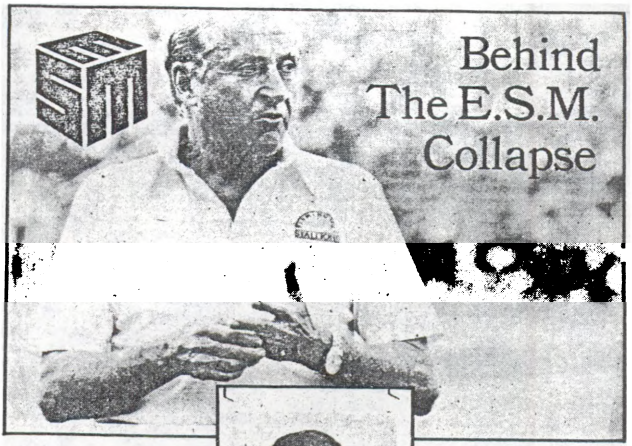
Warner is intense about all his interests — business, politics and horses — and he maintains an exhausting schedule as he shuttles among them. Recently, he added a fourth interest when he bought a franchise in the new U.S. Football League. Perhaps for sentimental reasons, he selected the Birmingham franchise. To no one's surprise, he named his team the Birmingham Stallions.

At this point in life, having far more money than he could ever have imagined as a young man in Birmingham, Warner still wheels and deals with the same fervor that seemed so off-putting when he hit his stride in Cincinnati 25 years ago. Why does he keep it up? Oliver Birckhead, Warner's banker, offered some observations. "I don't think the money is all that important to him. It's not the dominant force in his life," said Birckhead, a large, formal man whose patrician accent underscores his private-school upbringing. Birckhead looked out his office window at downtown Cincinnati. "He likes to win. He likes the game and likes the challenge. He likes the competition and the action."

Warner himself appears puzzled when he's asked about his motivation. "If you don't continue the excitement of day-to-day life, you lose the thing that makes accomplishment interesting," he answers in a rambling fashion. He goes on for a few moments and then adds, "I hope to be involved as long as I live."

If so, perhaps Sun Banks made a mistake when it made Warner promise he wouldn't buy the bank's stock for 15 years. Maybe it should have held out for 30.

C. "BEHIND THE ESM COLLAPSE", THE NEW YORK TIMES, MARCH 14, 1985



Behind The E.S.M. Collapse

Mike Clemmer

Marvin L. Warner, top, who owns the Birmingham Stallions football team, last June on the playing field. Ronald Ewton, former chairman of E.S.M. Government Securities Inc. of Fort Lauderdale, Fla.

Tangled Web Of Finances

By JAMES STERNGOLD

Special to The New York Times

MIAMI, March 13 — It took the investigators looking into the collapse of E.S.M. Government Securities Inc. less than hour to discover that, for nearly a decade, the firm had hidden hundreds of millions of dollars in losses in an affiliated dummy company. But trying to determine precisely how the money was lost — and how E.S.M. operated — has led the investigators into a complex tangle of records providing no clear answers.

But one persistent, puzzling question is how Marvin L. Warner, an experienced and successful entrepreneur, could have been caught up in the E.S.M. web. Throughout the firm's nine-year history, there are strong and continuing links between Mr. Warner and Ronald Ewton, the 42-year-old founder of E.S.M.

Marvin Warner is a politically influential man who is prominent in Florida and Ohio, as well as in his native Alabama.

Mr. Warner made a fortune in home building, and then ventured into banking and professional sports. (Once a part owner of the New York Yankees, he now owns the Birmingham Stallions football team.) A Democrat who supported his party financially, Mr. Warner was President Carter's Ambassador to Switzerland from 1977 to 1979.

E.S.M., the defunct firm, did a lot of business with three thrift institutions and a commodities broker that Mr. Warner owned or dominated. E.S.M.'s collapse left two of the thrift units with huge losses, and one of them, the Home State Savings Bank in Cincinnati, failed over the weekend, a casualty of its dealings with the Fort Lauderdale firm.

Mr. Warner, 65, has generally declined to discuss E.S.M.

"Obviously, I cannot comment on E.S.M. at this time, except it appears that I am one of the biggest victims," he said in a brief telephone interview today. "The facts are not yet in. My attorneys and others are trying to get the facts. After they get them, we will determine a course of action."

Indeed, Mr. Warner and his son-in-law, Stephen Arky, a Miami attorney, were among a handful of individuals who had personal accounts at E.S.M., which dealt mainly with government entities and financial institutions. According to court records, at the end of last year Mr. Warner's account

Continued on Page D11

THURSDAY, MARCH 14, 1985

Business Day

Tangled Web Behind Collapse of E.S.M.

Continued From First Business Page

amounted to $37 million; Mr. Arky's, $2 million.

It remains unclear how great Mr. Warner's losses were, however. Both Mr. Warner and his son-in-law closed out their accounts well before E.S.M.'s abrupt demise. According to an associate, Mr. Ewton called Mr. Arky in December and suggested he close his account. Mr. Arky did so on Jan. 11, and Mr. Warner did so, too, the same day. And government investigators say that although Home State was wiped out by its big losses, Mr. Warner's equity in the institution was less than $3 million.

Sorting Through the Rubble

Investigators sorting through E.S.M.'s rubble cannot fathom how the securities dealer managed to keep going for years while it was losing many millions of dollars. By one theory, the business that E.S.M. did with thrift institutions controlled by Mr. Warner was critical in keeping it afloat. The accounts that these thrift units held may have provided E.S.M. with government securities that it desperately needed to keep going. It could sustain a flow of cash by selling, repurchasing and reselling them.

It also appears that a thrift institution when Mr. Warner shared control was instrumental in bringing E.S.M. to an end. Over his objections, the board of the American Savings and Loan Association in Miami decided to undo its substantial dealings with the securities dealer and reclaim $108 million in government securities that it had put up. E.S.M. was unable to make good.

A Profit in 1976

E.S.M. Government Securities was closed by a court order obtained by the Securities and Exchange Commission, after evidence of problems surfaced. In its complaint, the S.E.C. alleged a pattern of fraud extending over the life of the company. E.S.M. was founded in 1976, the only year it showed a profit.

Mr. Ewton, through his attorney, James J. Hogan, has declined to comment. "I can't allow him to have an interview," Mr. Hogan said. "The only time he'll talk is in court."

While over the years customers were shown a healthy balance sheet — duly certified by Alexander Grant & Company of Chicago — the S.E.C. charged that E.S.M. had concealed some $196.5 million in accumulated losses. And it can be determined, its collapse is likely to saddle its customers, mostly small municipalities across the country, with more than $300 million in losses. This week American Savings put its losses at $55 million.

Business associates describe Mr. Warner as difficult and demanding, but as an investor with a keen sense for value and an ability to get what he wants out of a deal. "A tough, shrewd, aggressive entrepreneur," said Robert M. Klingler, the chief executive of Freedom Savings and Loan in Tampa, Fla., which is 7 percent owned by Mr. Warner.

"He is extremely tough to work for," said Mr. Klingler, whom Mr. Warner had brought from Ohio to head Combanks, a bank holding company Mr. Warner controlled before it was bought by Freedom Savings. "I got five years' worth of experience in three years working for him, but it took 10 years from my life."

Mr. Warner first knew Mr. Ewton through his son-in-law, Mr. Arky, who had served with Mr. Ewton in the National Guard in 1971, according to Eugene Stearns, Mr. Arky's law partner and spokesman. When Mr. Ewton and two other men set up E.S.M. in 1976, Mr. Arky did the legal work, Mr. Stearns said.

The following year, Mr. Ewton began to buy control of American Bancshares, an ailing bank-holding company in Miami. Mr. Warner's Ohio thrift unit, Home State Savings, financed the acquisition and received warrants to buy stock in American Bancshares, Mr. Stearns said. And according to a former employee familiar with E.S.M.'s records, Home State has been an active investor with E.S.M. at least since 1979. (Home State has not returned telephone calls seeking its comments.)

By this time, Mr. Warner controlled Combanks, based in Winter Park, Fla. Combanks invested in American Bancshares in 1977 and took control the following year in a swap of shares. Mr. Ewton emerged with a 15 percent interest in Combanks, according to Mr. Klingler, who was then its chief executive.

After that deal, Combanks became an investor with E.S.M. Mr. Klingler says the investments worried him, and he eventually ended them because of a "documentation" problem.

'Really an Unsecured Loan'

"What we were doing was called a government securities deal, but it was really an unsecured loan to E.S.M. the way it was structured," Mr. Klingler said. Mr. Warner and Mr. Ewton had pushed Combanks to make the investments, he said.

E.S.M. was dealing in government securities in sophisticated transactions known as repurchase agreements. Though structured as sales and resales, the "repos" are a form of short-term borrowing. A municipality with idle cash can "buy" a packet of securities, which the seller agrees to buy back at a later date. The seller gets the cash, the municipality has the securities — in effect, its collateral — and the repurchase price is set high enough to pay the municipality for the use of its money.

In addition to selling securities in repo agreements, E.S.M. engaged in reverse repurchase agreements. In a reverse repo, the customer (typically a financial institution) puts up the securities and borrows against them. It can use the loan proceeds for unrelated purposes, or it can use them as a down payment in making an even larger investment in securities.

According to court records, E.S.M. endured a critical year in 1980, when it suffered losses amounting to $92.8 million. Losses of that magnitude should have wiped it out, since its net worth was only a little more than $30 million. Apparently it kept its head above water by borrowing large amounts of securities through reverse repos, and then lending them out on repos. The repos kept enough cash coming in to meet obligations.

This race could go on only as long as there were institutions willing to engage in large reverse repos and put up large batches of securities. "They were running in front of a tidal wave," is how Charles Harper, an S.E.C. official, described the effort.

According to Thomas Tew, the Miami attorney serving as E.S.M.'s receiver, E.S.M.'s chief financial officer kept "all the balls in the air." This officer, Alan Novick, died last Nov. 23 of a heart attack, just as E.S.M.'s problems were mounting.

In 1980, the Unity Savings Association of Chicago was a key in building up the reverse repos that E.S.M. needed. Unity suffered serious problems in 1981 and was forced by regulators to merge with another savings and loan in early 1982.

As Unity closed, a group including Howard Bass of Unity, Mr. Ewton and Mr. Novick of E.S.M., and Burton Bongard, then chief executive of Home State Savings, formed Midland Commodities Inc., in Chicago. Midland's common stock is 50 percent owned by Home State, according to public records, and Home States owns all of its preferred stock.

Midland then became a substantial customer of E.S.M., and it also managed to close out nearly all of its positions just before E.S.M. collapsed. According to court records, Midland had reverse repos valued at nearly $9 million as of Dec. 31, but was able to reduce this to $1.8 million. Midland closed its doors today, the National Futures Association said.

Most Notable Link

Mr. Warner's most notable link to E.M.S. was through American Savings and Loan of Florida, based in Miami. Mr. Warner bought about 25 percent of American Savings in 1983, at a time when American needed capital. Mr. Warner put his shareholdings in a trust with the Broad Family, whose patriarch, 78-year-old Shepard Broad, founded American Savings in 1950. Mr. Warner was named chairman, and Mr. Ewton was elected to its board.

Immediately afterward, Mr. Broad said, Mr. Ewton and Mr. Warner pushed to have American Savings do reverse repos with E.S.M. Mr. Broad commented: "Marvin told me that the best partner he ever had was Ron Ewton. He spoke very highly of him." The board agreed to the transaction, and in May and June American Savings put up $108 million in Treasury securities to build up a position worth about $1 billion.

Mr. Broad recalled that he grew concerned about the transactions and had an attorney and an accountant examine them. He says he pressed the matter on the board and eventually forced an agreement to withdraw from the transactions.

Overruled by Board

At the same time, Mr. Warner and the Broads clashed over his plan to acquire Freedom Savings. Mr. Warner lost when, at Mr. Broad's urging, the board overruled him.

This clash split Mr. Warner and the Broad family, which finally bought Mr. Warner's stake from him in January for $26 million, producing a hefty profit for Mr. Warner.

When American Savings instructed E.S.M. to undo its huge reverse repo positions and return the securities it had put up, it was the beginning of the end. The securities had been lent to other E.S.M. customers in repurchase agreements for cash. E.S.M. was able to return only $42 million of securities, which it did last September. The remainder of the securities were lost when E.S.M. closed.

In November, Mr. Novick, who was under intense pressure, suffered his fatal heart attack. In January, Mr. Warner and some of his associates closed out their positions with E.S.M. That same month Mr. Ewton retained one of Miami's top criminal attorneys, Mr. Hogan, and he resigned from what was left of E.S.M. Feb.11.

Associated Press

Examining papers at the desk of Ronald Ewton, the former chairman of E.S.M. Government Securities Inc., are, clockwise from lower left; Thomas Tew, receiver appointed by the Federal Court; Richard H. Critchlow, law partner of Mr. Tew; Laurie S. Holtz, accountant brought in by the receiver, and Jack Goldstrich, a partner of Mr. Holtz.

Warner Resignation

Special to The New York Times

CHICAGO, March 13 — Gov. Richard F. Celeste of Ohio said late today that he had accepted Marvin L. Warner's resignation as chairman of the Ohio Building Authority, a five-member board that oversees the construction of state buildings.

Mr. Warner has been a fund-raiser for the Governor. An aide to the Governor, who asked not to be named, said Mr. Warner "would be tied up with his financial problems for a while, and the Ohio Building Authority job is a demanding one."

Ohio Legislature Passes Savings Unit Fund Bill

Special to The New York Times

CHICAGO, March 13 — In the wake of the failure of the Home State Savings Bank of Cincinnati, an emergency measure to shore up Ohio's 70 other state-chartered savings institutions has moved quickly through the State Legislature.

Late this afternoon, both houses of the Ohio Legislature passed a bill to set up a $50 million emergency insurance fund for the savings institutions.

Brian T. Usher, press secretary for Gov. Richard F. Celeste of Ohio, said the Governor would sign the measure as soon as it could be brought before him.

Mr. Usher also said that negotiations continued with "both in-state and out-of-state banks" for the purchase of Home State Savings.

The measure would create a fund consisting of a $50 million state loan and $40 million more obtained from assessments on the state-chartered institutions.

Today's action took place amid rumors of panic-inspired withdrawals at savings units in the Cincinnati area. The crisis at Home State Savings followed a severe depletion of its funds last week by depositors after news came out of its involvement with a failed securities firm, E.S.M. Government Securities of Fort Lauderdale, Fla.

Legislative action has been taken in Ohio because the private Ohio Deposit Guarantee Fund, which insures the state-chartered savings institutions, has $136 million in assets and there is concern that the losses at Home State Savings will swallow at least that much.

Meanwhile, Ohio officials and a conservator appointed Sunday continued their efforts to find a prospective purchaser for Home State Savings. State officials expressed optimism earlier in the week that a buyer could quickly be found and Home State Savings reopened. It closed for business last Saturday.

A spokesman for the Ohio Deposit said he had heard of "brisker-than-usual business" at other such savings institutions in the Cincinnati area, but "no around-the-corner" lines of wary depositors.

An amendment in the proposed law would proscribe any funds going to an institution operated by a conservator, an apparent move to restrict a tapping of the fund by Home State Savings or another severely troubled institution.

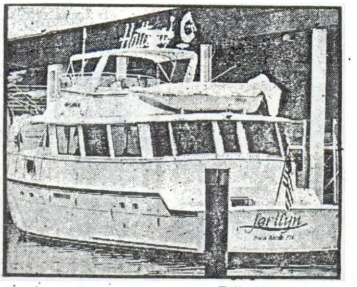
Monday, officials of the the private guarantee fund said in a statement that its other 70 member institutions "are not in any way involved in the transactions giving rise to Home State's failures."

Meanwhile, officials at Moody's Investors Service in New York said that "information gathering" by the ratings agency was continuing on municipalities that had invested in the underregulated government securities market through E.S.M.

Robert W. Stanley, an assistant vice president with Moody's, said that about 10 communities still had "investment relationships" with E.S.M. when the Florida firm failed.

Toledo, Ohio; Beaumont, Tex., and Pompano Beach, Fla., are among the communities left without securities in hand as collateral following E.S.M.'s failure.

In Toledo, one of the hardest-hit communities, Mayor Donna Owens said the city would file a lawsuit "within a week to 10 days" seeking to recover its $19 million investment with E.S.M.



The New York Times/Terry Renna

The 70-foot yacht "Jerilyn," docked at Hatteras Yachts in Fort Lauderdale, Fla., owned by Ronald Ewton and named for his wife.

Despite Huge Losses, E.S.M. Paid Well

Special to The New York Times

MIAMI, March 13 — While E.S.M. Government Securities Inc. was losing nearly $200 million since 1976, its senior officers enjoyed large loans from the company, generous salaries and bonuses. They also drove luxury cars at company expense.

According to company records, E.S.M.'s chairman, Ronald Ewton, paid himself a salary of $400,000 in 1984 — down from $500,000 in 1983. E.S.M.'s three other top officers — George Mead, Nicholas Wallace and Charles Streicher — were paid salaries of $300,000 in 1984. The four also enjoyed year-end bonuses last year of $250,000 each.

According to Thomas Tew, a Miami attorney who is E.S.M.'s court-appointed receiver, Mr. Ewton owed E.S.M. nearly $30 million; the other officers had borrowed about $1 million each.

"With the company never earning anything, you have to call what they were taking looting," Mr. Tew said.

There were never any payments on the loans, Mr. Tew added, with accrued interest totaling about $11 million. The company also owned two aircraft. Former employees say that Mr. Ewton flew in them regularly.

Just before his departure from the company in Februrary, Mr. Ewton took out a payment of $710,000. The day before the firm closed up, there was also a $1.6 million payment to the estate of Alan Novick, the chief financial officer who died last Nov. 23.

Mr. Ewton and Mr. Novick were fond of horses. Mr. Novick owned a horse farm in Kentucky and, according to estate documents in County Court, owed at least $5 million to Kentucky banks secured with his interest in the farm and thoroughbred horses.

Mr. Ewton is a polo enthusiast. A magazine put out by The Royal Palm Polo/Sport Club, described him as "a gentleman with a 'all-out-to-win' reputation," noting his substantial progress in the game after picking it up only two years before. In addition, Mr. Ewton had recently purchased a 70-foot yacht, which he named after his wife, Jerilyn.

Mr. Ewton was also a previous partner in the Tampa Bay Bandits, a professional football team in which Stephen Arky, the son-in-law of the investor Marvin L. Warner, is a principal owner. But a club official said that Mr. Ewton had recently sold his interest.

Mr. Tew, said he has frozen $23 million in E.S.M.-related assets, including the planes, the yacht, 12 polo ponies and other "toys of the rich." But he said that was far short of an estimated $320 million in losses engendered by the firm's collapse.

D. "THE SEC IS PROBING ALEXANDER GRANT AUDITS OF COLLAPSED ESM'S BOOKS, SOURCES SAY", THE WALL STREET JOURNAL, MARCH 15, 1985

3/15/85

SEC Is Probing Alexander Grant Audits Of Collapsed ESM's Books, Sources Say

By Lee Berton
Staff Reporter of The Wall Street Journal

NEW YORK—The Securities and Exchange Commission is investigating the performance of Alexander Grant & Co., a Chicago-based accounting firm, in auditing the collapsed E.S.M. Government Securities Inc., accounting industry sources said.

Both Grant and the SEC declined to comment on the report.

Meanwhile, an accountant working for the court-appointed receiver of E.S.M. Government Securities asserted it should have been obvious to Grant that E.S.M. Government Securities and its parent, E.S.M. Group Inc., were keeping two sets of books that "don't agree."

Jack Goldstrich, a partner with Holtz & Co., a Miami accounting firm, said E.S.M. Government Securities kept its books clean by making only brief journal entries for itself and "booking the real activities for the parent company."

Avoiding Losses

Thomas Tew, the court-appointed receiver for E.S.M. Government Securities, explained that the subsidiary thus was able to avoid showing losses in dealing in repurchase agreements backed by government securities. In effect, this means that the parent rather than the subsidiary took all the risk and that the subsidiary's assets allotted to its repurchase-agreement business remained frozen since 1983, Mr. Tew said.

In dealing with customers, E.S.M. Government Securities typically put up government securities as collateral for cash loans from customers, with the agreement to buy the securities back from the customers later at a higher price. In a "reverse repurchase agreement," the customer, often a brokerage firm, borrowed money from E.S.M., using government securities as collateral; the customer agreed to buy the securities back later at a higher price.

Borrowers of cash under such arrangements bet that the price of the government securities will rise while lenders hope that the securities' price will fall.

'Mirror-Image' Transactions

Mr. Tew asserted that E.S.M. Government Securities was able to avoid showing losses in these dealings by "booking mirror-image" transactions with the parent. For example, if the subsidiary did a repurchase agreement with a customer for $1 million, it would book a $1 million reverse agreement with its parent. Thus, the unit would appear to have no chance for a loss or gain, and any risk would fall on the parent.

But, according to Mr. Tew and Mr. Goldstrich, the parent passed off any losses to an affiliated company, E.S.M. Financial Group Inc., and created the illusion that the parent had made profitable trades.

Mr. Tew said he didn't understand how Grant, E.S.M. Government Securities' outside auditor, could miss the significance of the mirror transactions. Grant has been the subsidiary's auditor for several years, but only prepared the annual tax returns of E.S.M. Group and E.S.M. Financial Group, Mr. Goldstrich noted.

The parent and E.S.M. Financial Group didn't have outside auditors, Mr. Goldstrich added.

Robert A. Kleckner, Grant's executive partner, declined to comment on the likelihood of any SEC action. "It would be inappropriate for me to comment on matters involving a client at this time," he said.

Accounting Parallels

Accountants said they see parallels in the E.S.M. collapse with auditing failures at Continental Vending Corp. in the late 1960s, Equity Funding Corp. of America in 1973 and Drysdale Securities Corp. in 1982. At Continental Vending and Equity Funding, parents and subsidiaries had separate auditors, while Drysdale allegedly passed off losses in government securities to a unit set up for that purpose.

"The government securities business is volatile, and an auditor looking at it should make sure that he understands all transactions" among parents, units and affiliates, said Allan Ackerman, a partner of KMG Main Hurdman, a New York-based accounting firm.

Douglas Carmichael, an accounting professor at Baruch College here and former director of auditing standards for the American Institute of Certified Public Accountants, said that an accounting firm auditing a subsidiary whose parent it doesn't audit is "put in a difficult position." Auditing rules require the subsidiary's auditor to understand the purpose of transactions with the parent. The auditor must examine business documents behind such transactions, the rules also say.

"If there's any suspicion of covering up problems," the auditor should examine all dealings between parent and subsidiary, Mr. Carmichael said. Mr. Goldstrich of Holtz & Co. said that in looking through E.S.M.'s books, he didn't see any indication that Grant did this. Grant declined to comment on this aspect as well.

E. "HOME STATE CHIEF PUT ASSETS TO WORK", CLEVELAND PLAIN-DEALER, MARCH 17, 1985

Home State chief put assets to work

He made large loans to self, family

A-1 3/17/85

By THOMAS SUDDES
PD BUREAU

COLUMBUS — For Cincinnati financier Marvin L. Warner, banking has been both an interesting and an opportune career.

Warner, a power in the state and national Democratic Party, former ambassador to Switzerland and former chairman of the Ohio Building Authority, owns 96% of Home State Financial Inc., parent firm of the troubled Home State Savings Bank. Warner's personal fortune is estimated at more than $100 million, and he has been generous in his support of Democratic candidates.

Documents filed with federal and state regulators by Financial — as it's known to distinguish it from Home State — paint a fascinating picture of Warner's dealings.

Among other morsels, the records recount bargain-rate loans extended to Warner, to his family and to Financial executives, hefty legal fees paid to a son-in-law's law firm, an insurance deal with another son-in-law, Financial's joint interest with a Swiss bank in a tax-free "offshore" bank in the West Indies, and payments by Financial for a helicopter.

As part of a loan-participation it bought into last year, Financial held a 32% share of two mortgages totaling about $1.4 million, most of which was secured by a cemetery in Puerto Rico.

Warner's son-in-law Stephen W. Arky is a partner in the Miami law firm of Arky Freed Stearns Watson Greer Weaver & Harris.

Financial reported it paid the firm $88,000 in 1983 and $501,000 for the first six months of 1984 "for legal services performed in behalf of (Financial) and its subsidiaries."

Warner's company agreed in 1983 that its wholly owned subsidiary, Presidential Insurance Agency Inc., would place its insurance business with the Herbert R. Kuppin Jr. Insurance Agency Inc. in return for sharing commissions 50-50, less $30,000 annually for expenses.

Financial said it paid the Kuppin agency $26,400 for the year ended

CONTINUED ON PAGE 16-A

Dec. 31, 1983. Kuppin is married to Warner's daughter Alyson.

Beginning in 1981, Financial leased the Kuppin agency 6,200 square feet of space in Financial's headquarters at a base annual rent of $49,400 for five years — about $7.97 a square foot.

Financial reported that in 1983, it made aircraft rental payments of $21,200 to a company owned by Warner.

Presidential Services Corp., which is 100% owned by Financial through intermediate subsidiaries, "was formed in 1982 for the purpose of owning and operating a helicopter utilized by Home State Savings and its affiliates," according to Financial's Form 10-K, filed with the Securities and Exchange Commission.

It's unclear whether the 10-K's helicopter entry refers to the 1983 aircraft rental, but Warner sometimes zoomed to meetings of the Ohio Building Authority aboard a chopper that landed on the helicopter pad atop the 40-story State Office Tower across from the Statehouse in Columbus.

Financial extended loans to "certain directors, officers and related parties ... at interest rates more favorable than would have been made to unrelated third parties," the company reported last year.

Among those loans were several to Warner himself.

Other loans were extended to his daughter Alyson Warner, a director of Financial; David J. Schiebel, a director and officer of both Financial and Home State Savings; to Arky; and to Cincinnati TV personality Bob Braun, a director of both Financial and Home State Savings.

For the 18 months after Jan. 1, 1983, Financial's largest single "inside" borrower appeared to be Warner himself.

His two largest borrowings, according to Financial's reports, both from Home State Savings, both arranged in June 1983, were for $2.6 million each.

One was listed as a "passbook loan," and was made to him in June 1983 at an interest rate of 1% over the passbook rate.

Warner also arranged a $2.6 million secured line of credit with Home State due to be repaid by last July 1 with interest based on the prime rate plus 1%, Financial reported.

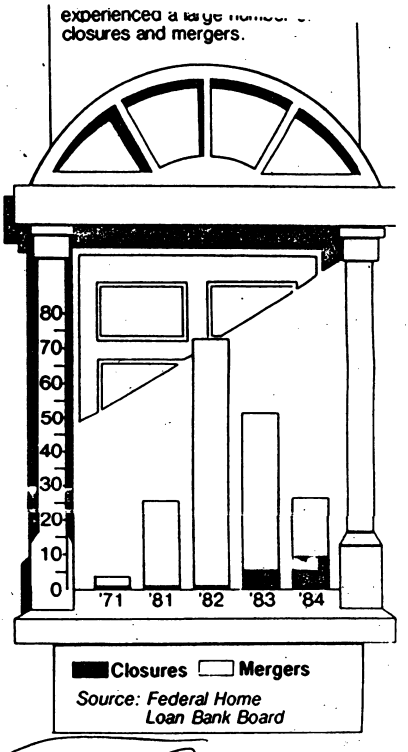
All told, including the two large loans, the largest amount due Home State during 1983 from various loans to Warner totaled $7.8 million, Financial reported.

The largest single amount due Home State from Alyson Warner during the period, Financial reported, was a $607,831 mortgage extended to her in May 1983, with interest based on the prime rate plus 1%.

Counting that loan, the largest overall amount due Home State during 1983 from Alyson Warner was about $1.8 million, Financial reported. The interest rates on her loans ranged from 8% for a residential mortgage, which could vary "at the discretion of the company," to a variable prime rate with a floor of 16.5%.

The largest amount due to Home State from Arky in 1983 was $302,167 for a residential mortgage extended in 1979, Financial reported, with interest based on a rate of 8%, which could vary at the discretion of the company.

For unspecified reasons, Financial invested $200,000 in 1981 for a 50% interest in the Swiss American Holding Co., S.A., a Panamanian company



formed to own 100% interest in an offshore bank and a trust company in Antigua.

Antigua, a former British colony independent since 1981, is a 171-square-mile island nation of 80,000 people in the eastern Caribbean.

In 1982, Financial invested an additional $800,000 in Swiss American, Financial reported last year.

Financial's partner in Swiss American is the Inter-Maritime Bank, a Swiss bank, according to the SEC 10-K.

The two offshore entities Swiss American holds are the Swiss American National Bank of Antigua (SANBANK) and the Antigua International Trust Ltd. (TRUSTCO). The government of Antigua has granted a 20-year "tax holiday" to both SANBANK and TRUSTCO, but also has an option to purchase up to 15% of SANBANK from Swiss American for a five-year period that appears to end in 1986.

The documents also reveal that, as of mid-1984 at least, Financial's two savings associations — Home State and Home State Dayton — were prohibited from paying common-stock dividends to Financial because they did not meet the Ohio Deposit Guarantee Fund's dividend-paying requirements.

The two associations, which are insured by ODGF, also failed to meet the dividend-paying requirements in 1981, 1982 and 1983, according to the reports, because their statutory net worth was less than 5% of their deposits. The shortfall in the amount needed by the associations to permit payment of dividends ranged from $10.4 million in 1982 to $12.9 million (last June 30).

As has been suggested in other reports on Home State's troubles, the documents confirm that Financial's subsidiary, Home State Savings entered into baroque dealings in government securities to hedge against volatile interest rates.

Those dealings, and the closure of the securities firm with which Home State dealt, led to last week's closing of Home State after its Cincinnati area depositors stampeded the bank, prompting — indirectly or directly — the temporary closure Friday of Ohio's 71 other privately insured savings associations.

F. "CLOSING OF OHIO S&L'S AFTER RUN ON DEPOSITS IS ONE FOR THE BOOKS", THE WALL STREET JOURNAL, MARCH 18, 1985

Thrift Crisis

Closing of Ohio S&Ls After Run on Deposits Is One for the Books

U.S., State Officials Scramble To Fix Gaps in Insurance; Gov. Celeste on the Hook

Fallout From ESM's Failure

A WALL STREET JOURNAL News Roundup

"I've gone from kindergarten to first grade in learning about banking," says Ohio Gov. Richard Celeste, who on Friday ordered 71 state-chartered savings and loan institutions closed for at least three days. "Ten days ago," he adds, "I couldn't have told you the difference" between federal and state-sponsored insurance funds.

The governor isn't the only one befuddled about how to handle the depositor runs at some of the state's thrift institutions.

"I've got manuals here on how to manage a savings and loan, but there's nothing written about this," complains William Garman, vice president of Jefferson Building & Savings Bank of Steubenville, Ohio. The thrift institution hesitated, opened briefly on Friday in defiance of the governor's order but then closed early after learning that banks weren't honoring its checks.

The Democratic governor ordered the closings after a surge of withdrawals at a number of Ohio thrift institutions in the wake of the failure of Home State Savings Bank of Cincinnati, which had depositor insurance through the state-sponsored but private Ohio Deposit Guarantee Fund and didn't have federal insurance. Home State was closed earlier and put up for sale after runs stemming from heavy losses in its dealings with the failed E.S.M. Government Securities Inc., of Fort Lauderdale, Fla.

Ohio's governor will ask legislators to require 71 thrifts to apply for federal insurance (see page 7). In Washington, officials are at sea over how to bring order to the chaotic government-securities market (see page 7). For a chronology of how E.S.M.'s collapse led to the Ohio thrifts' closings, see page 6. The situation sent jitters through Friday's credit markets (see page 49).

Mr. Celeste today will ask the state legislature to pass a bill requiring the 71 thrifts to apply for federal insurance before they can reopen.

Scenes From 1930s

The temporary closings in Ohio are believed to be the most extensive such action affecting financial institutions since the Great Depression. And they were preceded by scenes that looked right out of the 1930s.

Outside Molitor Loan & Building Co. in the Cincinnati suburb of Delhi, more than 100 people waited in line all Thursday night. Boistered by thermos bottles, sleeping bags, kerosene heaters and portable television sets, they waited for the thrift to open Friday and to get their money out.

"Ohio Deposit Guarantee Fund: All Savings Guaranteed in Full," said the sign over Molitor's glass door. But 35-year-old Christine Wright, unconvinced, had driven 90 miles from her home in Greenville, Ohio, to wait in line for her mother.

Her mother, Ms. Wright said, had been hit by a "double whammy." The mother had had $5,000 in cash in Home State Savings, but she had been lucky enough to get it out in time. Then, she had turned around and put the money in Molitor, which, though financially sound, was being hit by a run of its own. Ms. Wright said her mother has little other income except a minimum Social Security check. She added: "I wasn't even aware there were two different kinds (of deposit insurance)—state and federal."

Ms. Wright and the others waited in vain. Molitor didn't open Friday morning.

Psychological Crisis

However worrisome to the depositors at the closed Ohio thrifts, the overall damage inflicted by the S&L crisis was more psychological than economic. The combined assets of the closed institutions was about $5.3 billion, only slightly more than 10% of the total S&L assets in the state and less than the assets of many medium-sized banks.

But the E.S.M. collapse had far wider repercussions. The losses incurred by those dealing with the government-securities firm are estimated at $315 million. In addition to Home State's loss, which could total $150 million, American Savings & Loan Association of Florida, in Miami, estimated its net loss at $55.3 million; the city of Toledo, Ohio, said $19 million invested through E.S.M. is in jeopardy; Beaumont, Texas, may be out $20 million, and a number of other cities and investors may suffer losses.

Moreover, the psychological damage may be heavy. The failure of E.S.M. and Home State makes clear that, although the economy is expanding vigorously for a third consecutive year, the nation's financial system remains vulnerable to disquieting strains. It is being shocked repeatedly by the problems of shaky foreign loans, overextended farmers, a high rate of bank and thrift-institution failures, depletion of deposit-insurance funds and banking scandals.

The fallout from the E.S.M. collapse also has exposed the naivete of many thrift executives and municipal-finance officers, serious gaps in one state's system of deposit insurance, and the failure of federal and state regulatory officials to move quickly to stem the crisis.

And it illustrates the continuing dangers in the vast, largely unregulated market for government securities. The current debacle is the fifth in eight years to strike that market—a market that once was a model of stability and conservatism but has become an arena of high-stakes speculation. Although the earlier disasters at Winters Government Securities Inc. in 1977, Drysdale Government Securities Inc. in 1982, Lombard-Wall Inc. in 1982 and Lion Capital Group last year provoked some proposals for more extensive regulation, little was done.

And now, for the first time, the troubles at a government-securities firm have spilled out of the marketplace and disrupted the lives of thousands of ordinary citizens. In Ohio, moreover, it was ordinary citizens who were draining the thrift institutions' deposits—in contrast to the problem at Continental Illinois Corp., a federally insured institution where a slew of bad loans sparked a run by big money managers last year.

In view of the financial jitters stemming from the crisis in Ohio, the Federal Reserve System is generally believed to be unlikely now to go forward with a widely expected tightening of its monetary policy. "The Fed can't afford to rock the boat" by tightening its credit reins, says David H. Resler, vice president and chief financial economist at First National Bank of Chicago. He adds that the central bank may even have to "take action to calm depositors' anxieties about the safety of Ohio thrift institutions."

In fact, the Fed already has acted to ease the crisis, making emergency loans to some Ohio thrifts and saying that the Fed stands ready to extend additional loans as needed. "We have begun taking appropriate steps to work with these institutions to inform them of collateral and other requirements for this assistance," says Karen Horn, the president of the Federal Reserve Bank of Cleveland.

Leonard Santow of Griggs & Santow Inc., a financial consulting firm, predicts that the "problem will be over in a short period of time." He called it an "isolated situation" that won't spread to other areas.

Adds Raymond Garea, executive vice president of Cates Consulting Analysts in New York: "The implications for federally insured institutions are zero."

The damage already done by the collapse of E.S.M. is sparking calls from political leaders and others for stricter regulation, however, and the Federal Reserve Bank of New York stepped up its surveillance of the government-securities market after Drysdale failed. The New York Fed says that since then it has lengthened the list of government-securities dealers making voluntary financial reports to the Fed, tightened some accounting standards and shortened the time for trading in securities that haven't been issued yet. Last month, the New York Fed proposed voluntary standards of capital adequacy for the dealers.

However, officials conceded that most of the Fed's surveillance is still directed at 36 major dealers, known as primary dealers, who report daily to the Fed on their securities positions. None of them have failed. The problems have involved "fringe people," notes Ralph F. Peters, the chairman of Discount Corp. of New York, a primary dealer. And none of the steps taken by the New York Fed would have prevented the E.S.M. collapse.

In a general comment, a spokesman for the New York Fed remarks, "No matter what any regulator does, no one can prevent fraud."

But other observers complain that only lip service has been paid to regulation. Felix Rohatyn, a general partner of Lazard Freres & Co., says, "When Drysdale came up, we said we had to do something. Then there was Lombard-Wall. Now this. When is enough?" He warns that the financial markets have "turned into a huge casino," and he adds, "At least in a casino, you know you're gambling."

Celeste's Decision

The problems at the thrifts in Ohio built up quickly.

At 8 a.m. last Friday, the telephone rang at the Cincinnati home of Laird Lazelle, executive vice president of Charter Oak Savings Association. The caller was Gov. Celeste, who had been calling thrift executives around Ohio since midnight. He wanted to know what Charter Oak was going to do.

"I'm concerned about some of the other companies [thrifts]," the governor said, as Mr. Lazelle recalls it. Mr. Celeste told the executive that some of the other thrifts insured by the Ohio insurance fund were asking for a bank holiday, but that he hadn't yet decided.

Mr. Lazelle told the governor that Charter planned to keep open. He reminded Mr. Celeste that the Fed's "idea is to keep the doors open, and that's how you break a panic." But he also gave the governor some alternatives. One was to keep the thrifts, including Home State, open, but to limit individual withdrawals. Another was for the state to put its full faith and credit behind the thrifts. "I can't do that," Gov. Celeste replied.

At 5 a.m., two hours after calling Mr. Lazelle, Gov. Celeste decided to close the 71 thrifts insured by the Ohio fund.

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The move was stunning. The time-honored way to deal with a bank run is to throw money at it. Institutions liquidate assets, borrow to the hilt from the Fed's discount window and do all they can to meet their customers' withdrawal demands, thus letting the run play itself out and restoring confidence.

Some state-insured thrifts were preparing to do just that.

Lining Up Help

Anchor Savings Association of Hillsboro, Ohio, had contacted the discount window at the Fed and also a team set up by Merrill Lynch & Co. to help the threatened thrifts liquidate assets.

"We were mobilizing the resources to create a lot of liquidity if we needed it," says George McGuire, president.

And all week long, the Cleveland Fed had been publicly stating it would lend money to institutions seeking liquidity at the bargain 8% discount rate, "under normal conditions."

That phrase may be key. "Normal conditions" means putting up the required collateral. State officials worried that some of the state-insured thrifts mightn't have been able to do it, at least not quickly. Because the Fed didn't regulate this group of thrifts, it didn't have data on their finances, though Fed staffers had been working around the clock since Home State's collapse to collect it.

"One option was to let the run continue, let it run out," Gov. Celeste says. "When you're close to a weekend, that's a tempting thing to do. But it was clear that several [thrifts] didn't feel they could open [Friday] or make it through the day." The governor considered closing just the thrifts in jeopardy but rejected that idea. "There was no good place to amputate," Gov. Celeste says, "without raising serious questions about the others."

Most of the thrifts closed without question, and some with genuine relief. But, like Jefferson Building & Savings—which Mr. Garman described as "solid" and "safe"—Buckeye Savings & Loan Co. of Bellaire was defiant. Buckeye opened, as usual, at 8:30 a.m., despite an 8 a.m. call that "supposedly came from the governor's office," says George Hazlett, the thrift's chairman. He and other officials didn't consider the call a valid order.

Implied Threat

Around noon, though, Mr. Hazlett got a second call. It came from an official at the state Department of Commerce, who implied that state police might close Buckeye by force. The thrift locked its doors a few minutes later. Mr. Hazlett complains, "What the governor did was incite people into being nervous."

Gov. Celeste, meanwhile, had flown to Cincinnati to give the first of several news conferences in various Ohio cities that day. The "severe and spreading lack of confidence" made the bank holiday necessary, he said at a Cleveland news conference, adding that his goal was "restructuring these institutions as soon as possible in a viable way."

Asked by a reporter what kind of restructuring would occur, Mr. Celeste replied, "If I could explain it, we wouldn't need to take [time] to do it." At his side was Mrs. Horn of the Federal Reserve Bank of Cleveland.

"We have delivered a lot of cash in the last several days" to Ohio thrifts by lending them money through the discount window, Mrs. Horn said. "And we aren't the only one in that business. A lot of commercial banks were really on the front lines in delivering the cash [loans]." But she added that the problem wasn't "a run on cash as much as a run on confidence."

How ESM's Collapse Led to Ohio's S&L Crisis

October, 1976
Bond dealers Ronnie R. Ewton, Robert Seneca and George Mead found E.S.M. Group Inc. and its E.S.M. Government Securities Inc. subsidiary.

Late 1977
E.S.M.'s losses begin. They will continue and expand into early 1985.

September 1984
Miami-based American Savings & Loan Association of Florida asks E.S.M. to return $108 million of government securities. The holding has been the "downpayment" on about $1 billion of government securities being used as what amounts to collateral on loans to E.S.M. by other customers.

December 31, 1984
The billion dollar American Savings position has been winnowed down to $562.2 million. But E.S.M. owes $1.62 billion to a group of 38 customers and having only $1.32 billion of securities on hand as collateral.

March 4, 1985
E.S.M. is forced into receivership under a court order obtained by the Securities and Exchange Commission.

March 7-8
Depositors withdraw $90 million from Cincinnati-based, Home State Savings Bank, whose expected heavy losses from its dealings with E.S.M. have been publicized.

March 9-10
Home State closes, citing the run, and a conservator is appointed to try to sell the ailing thrift, whose E.S.M. losses are now estimated by banking sources at $150 million or more.

March 11
Thomas Tew, E.S.M.'s court-appointed receiver, estimates that, as of Feb. 28, some 13 local government and five thrift institution customers of E.S.M. face losses totalling $315 million.

March 13
Ohio legislators authorize a new $90 million fund to augment the $136 million privately financed deposit insurance fund for state-chartered thrifts. Home State, whose losses alone may wipe out the regular fund, won't get access to the new $90 million, but the 71 thrifts insured by the fund will.

March 14
Depositors, still worried about the adequacy of insurance, begin massive withdrawals from some state-chartered thrifts, especially in the Cincinnati area. State banking officials hold an evening press conference in Cincinnati to urge calm.

March 15
Following all-night meetings with banking regulators, Ohio Governor Richard Celeste invokes emergency powers to close the 71 thrifts for "at least" three days.

March 16-17
Efforts continue in Ohio on various ways to shore up and reopen the thrifts.

Fed Role Unknown

Mrs. Horn's role in Mr. Celeste's decision isn't known, but her view might have been influenced by the Fed's experience with Home State. The Cleveland Fed was an active, though secured, lender to Home State in the days before it collapsed—but its loans weren't enough to stop the run and end the Ohio thrifts' crisis there.

After that midmorning news conference, Mr. Celeste and Mrs. Horn adjourned to the Cleveland Fed to huddle with aides and with officials of Ohio banks and thrifts to figure out what to do.

Throughout the weekend, Mr. Celeste shuttled among Cleveland, Cincinnati and Columbus, holding news conferences and meetings. All the while his entourage was growing. The state added another airplane to accommodate the growing crowd of reporters who wanted to follow the governor.

How the Panic Began

Throughout the week of March 4, the public became increasingly aware of Home State's involvement with, and losses from, E.S.M.

Late in the week, a full-scale run developed. Depositors withdrew more than $90 million. A secured loan from the Federal Reserve Bank helped, but not enough. Around 10 p.m. on Sunday, March 10, Gov. Celeste's office announced that the state had appointed a conservator to take control of Home State and to try to sell it to a healthy financial institution. Home State was shut down, and people who still had money on deposit there couldn't get to it.

Their deposits were insured by the Ohio Deposit Guarantee Fund, which had been established in 1955 mainly for the hundreds of small neighborhood thrifts in Cincinnati that didn't want to deal with the intricacies of federal deposit insurance. Though the fund was sponsored by the state, it was financed by member institutions, which were assessed 2% of their deposits to belong. And unlike the Federal Savings and Loan Insurance Corp., which insures thrift deposits up to $100,000, the Ohio fund insured deposits up to *any* amount. Many of its members advertised that pledge.

But there was a catch. The Ohio fund had assets of $136 million, and it soon became clear that Home State's losses probably exceeded that and might wipe out the fund.

The Ohio legislature started to rush through a bill creating a new $90 million fund, which Home State wouldn't be allowed to touch. It was a prudent move, but it also prompted lots of news stories about the weakness of the state-sponsored deposit insurance. Those stories were read by many Cincinnatians, including Bill Cunningham.

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Mr. Cunningham is the host of a talk show on radio station WLW in Cincinnati. In the days before Home State's collapse, he had been talking to state officials and discussing their reassurances on the air. "I had spent a week of shows telling people not to panic, the money is safe," Mr. Cunningham recalls. "I bought it hook, line and sinker."

But no more. Last Wednesday and Thursday, Mr. Cunningham went on the air with a different tune. "I said it was time [for state officials and banking executives] to panic," he says. "I told them [his listeners] there was going to be a disaster" because the Ohio fund had been exhausted.

Soothing Talk

Mr. Cunningham's Wednesday show also featured Mr. Lazelle of Charter Oak Savings. As withdrawals mounted that day, Mr. Lazelle had called Mr. Cunningham and volunteered to go on the air that night to reassure depositors. Mr. Cunningham said he warned Mr. Lazelle that the tactic might backfire, but Mr. Lazelle said he would take the risk.

He did. But the show apparently only focused the spotlight on Charter Oak, which had been solidly profitable for three consecutive years, and on Molitor Loan & Building.

All state-insured thrifts in the area had heavy withdrawals Thursday, but Charter and Molitor had the heaviest. Mr. Lazelle phoned Mr. Cunningham and said, "Bill, it didn't work."

The state decided to step in. Kenneth Cox, the recently named director of the Commerce Department, which oversees the Division of Savings and Loans, called an 8 p.m. news conference to reassure the public.

But Mr. Cox was hardly reassuring. He said that depositors should have confidence in thrifts insured by the Ohio fund and that the state is "pursuing every means conceivable" to make sure Home State depositors get their money. But he ducked questions on whether the state unconditionally insured Home State depositors.

At one point, a woman got up and told the hushed group that she and her husband had recently moved to Cincinnati from Nebraska, and had deposited all their money in Home State in hopes of buying a house. "They said your money is guaranteed," said the woman, who didn't give her name. "What am I to think now?"

All this played on the local 11 p.m. news, along with pictures of huge overnight lines forming outside many thrifts.

Ticking Time Bomb

Home State was clearly a ticking time bomb, and the detonator was its relationship with E.S.M. Government Securities. And indications are that Ohio regulators knew perhaps as early as 1983 that the timer was ticking.

Home State engaged in different types of transactions with E.S.M. Between the end of 1982 and Sept. 30, 1984, SEC filings show, Home State nearly doubled its assets, mainly through transactions with E.S.M. The transactions included Home State's purchase of $300 million of Government National Mortgage Association certificates and $410 million of U.S. Treasury bills from E.S.M.

Home State financed most of the purchase by selling securities back to E.S.M. and agreeing to repurchase them about a year later. Home State had $94.4 million of its own cash involved in the transaction last Sept. 30 and also had pledged $16 million of U.S. Treasury bonds and notes as collateral. The upshot was that Home State would be vulnerable if anything happened to the securities, especially if it did lots of business with E.S.M.

All this worried key people for some time. "I know that the Ohio Deposit Guarantee Fund knew about the concentrations of Home State's [investments] with E.S.M. early in the game," says Steven Farrar, the treasurer of the North Carolina deposit insurance fund, who visited Ohio fund officials last week. "They tried to do something, but lacked the power."

Fund's Trustees

The reason, Mr. Farrar suggests, is that the trustees of Ohio's fund, unlike North Carolina's, come from member institutions. "You don't want the fox watching the henhouse," Mr. Farrar says. Roger Yurchuk, the Ohio fund's counsel, concedes that the fund can't issue orders to members, but he adds: "You can tell someone not to do it, and if they keep doing it you throw them out."

But that didn't happen, and apparently state savings and loan regulators weren't much more forceful. "They worked to tell Home State how threatening the situation was," one observer says. But the intent was to allow Home State to gradually unwind itself from E.S.M. However, Home State did "substantially all" of its repurchase agreements with E.S.M., the thrift said last year in a filing with the Securities and Exchange Commission.

Home State officials aren't commenting on the events that led up to the closing.

"This isn't an appropriate time to comment," David J. Schiebel, Home State's chairman and chief executive, said yesterday. "I'd like to but I can't." After further questions, he said in a trailing voice, "I have been advised by the conservator, Ario Smith, not to comment on anything."

Impact on Cities

For Toledo, the E.S.M. debacle has put more than the $19 million it invested in jeopardy. It has split the city administration along party lines, and the political squabbles and finger pointing have shaken the confidence of the business community at a time the city is trying to revitalize itself. City leaders think Toledo's plan to participate in the construction of a convention center by issuing bonds might be at stake.

"I was absolutely floored that anything like this could happen," says Chester Devenon, the chief executive officer of Sheller-Globe Corp. in Toledo. "There is no question that a great deal of confidence (in the city administration) has been lost; we have to overcome this fiasco."

Toledo began investing through E.S.M. in June 1984 and its investment totaled about $220 million, but at the time E.S.M. collapsed the city had a $18 million exposure. The city may not get the money back because it has discovered that city officials didn't take physical possession of the E.S.M. securities apparently pledged against the loans. It isn't clear how the city came to select E.S.M. for investment, and some documents released by the city suggest that Toledo officials lent money to E.S.M. without taking counter bids.

Scott Searle, one of the Toledo officials involved in placing city funds, declined to comment whether he or others in similar positions took competitive bids. "I don't want to get into that," he says.

Similarly hard hit by the E.S.M. collapse is Beaumont, Texas. The depressed port city on the Texas Gulf Coast faces a $20 million loss from the government securities it purchased from E.S.M. The $20 million represents one-fifth of Beaumont's annual $100 million budget.

"The impact of the loss on the short-term operations of the city is devastating," says Hugh Earnest, assistant city manager. "We had planned on using that money for day-to-day operating expenses as well as badly needed capital improvements."

As a result, late last week Beaumont had to cancel a $32 million municipal bond offering to finance large water and sewage projects and a $1 million purchase of new trucks and other equipment. It also froze all hiring and pay increases. City Manager Karl Nollenberger has tried to set an example for the city's "austerity program" by slashing his $72,000-a-year salary 20%. Robert Nachlinger, the city's finance director who was responsible for placing the city's money with E.S.M., has resigned over the scandal. Mr. Nachlinger couldn't be reached for comment.

In Florida, the city of Tamarac is facing a $7 million loss on its E.S.M. investments. "We're not going to be investing in repurchase agreements at all," says Stephen Wood, the director of finance. "Until there's some more regulation of this whole industry, the only safe place for money is in your hand or in your mattress."

The city had been planning to sell $8 million in bonds for a new police station and city hall, but now it has decided to postpone the bond issue for 30 to 60 days, Mr. Wood said.

Lures to Cities

There were two financial incentives that apparently encouraged local governments not to take possession of the government securities that were collateral for their loans to E.S.M.

E.S.M., like other government-securities dealers, offered a higher interest rate on repurchase agreements in which the customer didn't take possession of the collateral. And to take possession of the securities, E.S.M. customers had to have an expensive government-securities account set up at a major bank.

The additional interest, of as much as one-quarter of a percentage point, wasn't enough incentive for big institutions that already had bank accounts to handle government securities. The accounts are necessary because ownership of Treasury securities is transferred electronically, by changing computer-account entries.

But the cost of setting up such an account was prohibitive for a small player in the market. Helen Cunneen, a vice president at Irving Trust Co. in New York, says the minimum charge to set up such an account would be more than $1,000, plus charges for each transaction. "It wouldn't be terribly practical to set up an account for less than $10 million that did less than one trade a month," she said. Of 27 governments or government agencies that were doing business with E.S.M. as of last Dec. 31, all but one had lent less than $15 million, according to court papers filed by the SEC, and eight lent $1 million or less.

Securities-industry executives expressed amazement at the way some municipalities dealt with E.S.M., particularly in light of the losses suffered last year in Lion Capital's collapse. "It seems inconceivable to me that you could get in a position where you don't have either the money or the computer blip," said the president of one firm with a large government-securities business. "That's just crazy."

Adds Ms. Cunneen: "I don't know of any major institution that would even consider doing a repurchase agreement without having a [unquestioned security] interest in the collateral."

Last June, E.S.M. tried to drum up business among credit unions but was blocked by the National Credit Union Association, which insures and regulates more than 15,000 credit unions.

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"It was very difficult to understand exactly what they were offering," says Robert Fenner, deputy general counsel of the association. "We suspected at the time, and were later proved right, that they made it hazy on purpose." The E.S.M. officials, he adds, "represented that what they were offering was an absolutely risk-free method for a credit union to increase the yield on its government securities" two to three percentage points.

The credit union association saw two problems with E.S.M.'s proposal, Mr. Fenner says. E.S.M. couldn't provide a "paper trail" showing that the Treasury bills to be used in a deal would be placed in safekeeping with a third party, which Mr. Fenner says was "necessary for the security of the credit union if E.S.M. failed." The other problem, he says, was that it appeared that the only way E.S.M. could promise such an interest rate spread was to mismatch maturities by borrowing money at short-term rates while lending at long-term rates. If interest rates went up, E.S.M. would lose money.

Other State Funds

The crisis at the Ohio Deposit Guarantee Fund illustrates the risks facing these state-chartered but industry-owned entities: Large losses at one or more of the insured institutions can deplete a fund's resources and undermine confidence in other fund-insured institutions.

Nonetheless, officials of thrift insurance funds in Pennsylvania, Massachusetts, Maryland and North Carolina—the other states that have them—said the problems in Ohio were unique and sought to dispel any concern that the troubles could spread to their states. They said they haven't seen any spillover from the events in Ohio so far, and although there are certain to be inquiries from nervous consumers, they don't expect significant deposit withdrawals. These officials contended that their insurance is as safe or safer than that of the Federal Deposit Insurance Corp. and the Federal Savings and Loan Insurance Corp., which insure the vast majority of deposits at commercial banks and savings institutions.

For one thing, the fund officials said their reserves are larger in comparison to insured deposits than are those of the federal agencies. They insure about $27 billion in deposits at 485 thrift institutions, with fund resources of about $829 million. The aggregate 3% ratio of fund assets to insured deposits compares with coverage ratios around 1% at the FDIC and FSLIC. However, the FDIC and FSLIC are implicitly backed by the U.S. government.

G. "REGULATORY FAILURE ON ESM", THE NEW YORK TIMES, MARCH 30, 1985

Regulatory Failure on E.S.M.

NYTimes - 3/30/85

Lax Scrutiny A Key Factor

By JAMES STERNGOLD

Steven Bisker, assistant general counsel of the National Credit Union Administration, received two visitors one day last June at his Washington office: George Mead, a senior officer of E.S.M. Government Securities Inc., and Ronald Pellerito, an E.S.M. salesman. The two were promoting what they promised would be a "risk-less" investment designed to add two or three extra percentage points of income on securities portfolios.

But Mr. Bisker worried about the safety of the collateral that the credit unions were being asked to put up. When he asked for the legal documentation E.S.M. would provide, he said, "They just gave me some mumbo jumbo, but they didn't really answer me."

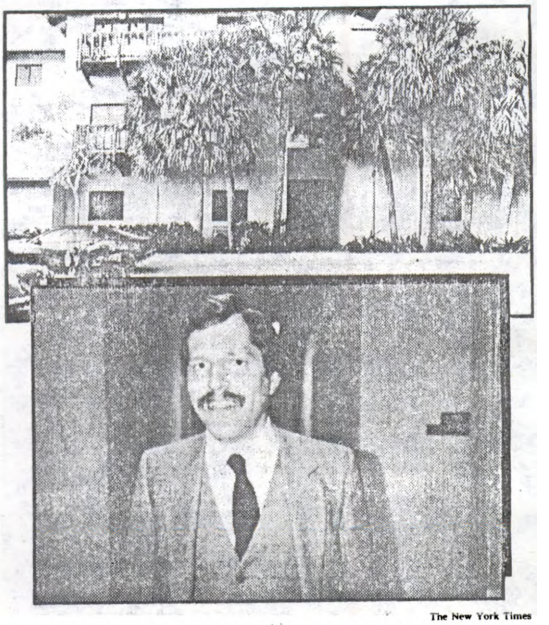
The result was that Federal credit unions were advised against dealing with E.S.M. — and they were spared from the more than $300 million in losses that the company's collapse is likely to cause its customers.

The question now being asked by legislators, as well as by E.S.M.'s customers, involves where the other regulators were. How did E.S.M.'s problems escape detection for so long, particularly when its activities did, in fact, come under repeated scrutiny?

One answer is that E.S.M. slipped through the regulatory cracks. The principal protection that the public has against securities market irregularities, the Securities and Exchange Commission, does not extend to the government securities market. The commission can only investigate such a firm when it has specific reason to believe there has been a fraud. And, when the S.E.C. did make an attempt to review E.S.M., the firm successfully resisted. Congress is now exploring legislation to put this market more directly under the commission's purview.

"If E.S.M. had known that the regulators could walk in its doors at any time and look over its records, ask yourself if they would have been able to do what they did for that period of time," said Michael Wolensky, regional administrator for the commission in Atlanta.

Another answer to the question of how E.S.M.'s problems remained undetected is that, even when regulators did have suspicions, they did not pursue E.S.M. aggressively. Some state regulators did have direct power to examine its affairs. And those with concerns did not communicate them to other regulatory agencies that might have had an interest in E.S.M.



The New York Times

The E.S.M. Government Securities Inc. office in Fort Lauderdale, Fla., and, inset, Steven Bisker of National Credit Union Administration. His concern about E.S.M. led to credit unions being advised against investing in it.

In addition, the S.E.C. has charged that E.S.M.'s outside auditor — another important layer of independent protection for investors — provided fraudulent financial statements that hid its critical problems from customers. The accounting firm, Alexander Grant & Company, and the accountant working with E.S.M., José Gomez, have been named in an S.E.C. suit.

The regulatory trail began before E.S.M. opened for business in 1976. Two of its principals, Ronald Ewton and Mr. Mead, were fresh from jobs

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Regulatory Failure In E.S.M. Episode

Continued From First Business Page

with other securities firms that had regulatory problems of their own.

Mr. Ewton had worked as a salesman for Winters & Company in Florida and for Hibbard, O'Connor & Weeks. Both firms, which like E.S.M. were government securities dealers, were the subject of charges by regulators. When Winters was closed in 1977, it was being investigated by the Federal Reserve and the National Association of Securities Dealers and was charged with fraud by the S.E.C.

Mr. Mead and another prinipal, Nicholas B. Wallace, had also spent several years with Hibbard, which was charged, along with a number of its officials, with a range of securities laws violations by the commission in 1976.

E.S.M. itself first came under regulatory scrutiny in 1977. An investigation had been initiated by the S.E.C., according to Mr. Wolensky, after it received complaints about unfair markups on securities transactions.

Bitter Legal Quarrel

The investigation, though, turned into a bitter legal quarrel. E.S.M. sued the commission, challenging its subpoena on the ground that a commission investigator had used deception to gain access to the company's records. The investigator, Floyd Young, had reportedly said that he was there only to learn about the complicated government securities business, to help in the S.E.C.'s investigation of Winters. In fact, the suit said, he was examining E.S.M. but did not disclose this.

The suit reached a Federal appeals court in 1981, where the judge indicated that the subpoena should be upheld, but he ordered another hearing to determine whether the commission had knowingly misled E.S.M., and whether this deception resulted in the subpoena. But the hearing was never held. The S.E.C. dropped its investigation.

"The decision was made that it was not worth all the resources at that point we needed to throw at the case to pursue it," Mr. Wolensky said of the commission's action. "We were also talking about offenses said to have happened back in 1977."

Florida regulators also examined E.S.M. but failed to detect its problems. The state's securities department received a complaint about E.S.M. in 1983 and performed a special examination at its offices in August. But that did not result in any actions, said William Quattlebaum, an aide in the office of Florida's Comptroller.

"Our reviewers don't go behind the transactions of the company," he explained. "They just check to see that the records are in order." Even though examiners subsequently determined that E.S.M.'s records were misleading, that was not uncovered by the Florida investigators.

Ohio Regulators Worried

State banking regulators in Ohio also scrutinized some of E.S.M.'s dealings in 1982, in connection with its extensive transactions with the Home State Savings Bank of Cincinnati, a state-regulated thrift institution. They came away deeply worried.

They concluded that Home State had committed too large a portion of its assets to the tiny, unknown Florida securities broker, according to Clark Wideman, the state's supervisor of savings and loans until 1983. He added that Home State was heavily overcollateralized: that it had put up far more securities in the transactions, called repurchase agreements, than the state thought prudent.

However, according to Mr. Wideman and other Ohio regulators, Home State persuaded the state that, if it were to close out the positions with E.S.M. too quickly, it would incur huge losses that could jeopardize not only the thrift institution but also seriously deplete the state's private depositor insurance fund. Thus, the regulators said, they allowed Home State to put off a deadline to close out the transactions — until Home State was caught when E.S.M. closed.

Home State did belatedly acknowledge last September just how much risk its huge investment with E.S.M. faced — as Mr. Bisker had seen. "Recovery of the company's equity would be subject to the same risks to which unsecured creditors of a bankrupt are generally subject," it said in a public filing.

"There was no right way to turn," Mr. Wideman said. Even knowing about the potential problems, the state never prepared contingency plans in case their fears were realized.

In 1981, the Federal Home Loan Bank in Chicago also encountered some E.S.M. transactions that it considered troublesome, when it studied the Unity Savings Association. The Federal agency had similar fears to the Ohio regulators, but in this case did order Unity to end its repurchase agreements with E.S.M.

The Federal agency, however, did not notify any other banks or other agencies. This is a sore point for Ohio regulators, who assert that such communication could have spurred them into tougher action against Home State.

Asked why it did not inform other banks about this concern, John J. Battaglia, a supervisory agent with the Federal agency in Chicago, said: "We were not aware that any other banks had dealings with E.S.M. Anyway, there isn't a good vehicle for exchanging that kind of information." He added that "in my view, any responsible supervisor would have stopped that kind of thing; the over-collateralization problem was right there."

Whether such problems that seem so evident now can be avoided in the future through better communication — or increased regulation — remains to be seen. For now, most regulators are eager to put the responsibility for the crisis elsewhere. But those looking into the circumstances — in Congress and in Ohio — will be looking both at whether new regulations are needed and at whether the rules already in the books were adequately enforced.

H. "FOUNDERS OF ESM LIVED HIGH", MIAMI HERALD, MARCH 31, 1985

SHERI GAYNOR FEINBERG / Miami Herald

In 1976, Robert Seneca bought this $375,000 house at 3999 Bayview Drive, Fort Lauderdale. He no longer lives there.

3 ESM founders lived high life of sports cars, Rolexes, jewelry

Founders of ESM lived high

Wealth brought houses, jewelry

By PETER CARY
And SUSAN SACHS
Herald Staff Writers

In the good old days, when ESM Government Securities Inc. soared toward the stratosphere of high finance, the Mr. E and the Mr. S and the Mr. M called each other "the mouth," "the brains" and "the muscle."

The information comes from a messy divorce case. From that lawsuit, as well as from a few other folks, now emerges a revealing portrait of the founders of ESM, a firm that is taking its place among the nation's classic financial disasters.

As long ago as 1976, court records show, ESM had its troubles. Robert Seneca, "the brains," lived a life of exuberant spending, whirlwind vacations and cocaine parties, his ex-wife said.

"They used to call the company the brains, the mouth and the muscle," June Seneca testified in 1978. "My husband is the brains because the company could not go on without my husband. And Ronnie Ewton is the mouth because he gets drunk. And the muscle, because he is strong, is [George] Mead."

Robert Seneca, 40, once a pool hustler from South Philadelphia, Ronnie Ewton, 42, a charismatic motivator of men, and George Mead, 51, a quiet, hard-working nice guy, began ESM with $75,000 nine years ago.

They founded an empire that claimed assets of $1.6 billion. Executives drove Mercedes-Benzes, owned thoroughbreds and polo ponies and knocked down $500,000 salaries.

When it crashed a few weeks ago, amid allegations of fraud and a bribed auditor, investors may have lost $300 million. In Ohio, 70 savings and loan associations closed for a week and the dollar plunged 8 percent on the world market.

The portraits of the three men are not yet in complete focus. For one thing, they aren't posing. Their lawyers don't want to say much. Neither does the Justice Department. And a ton of litiga-

Please turn to ESM / 30A

ESM / from 1A

tion is certain to bury them in the courts for years to come.

Here, though, is a glimpse of some of the shaky beginnings of ESM and its luminaries.

★ ★ ★

Robert Seneca was born Oct. 13, 1944, and he grew up poor in South Philadelphia.

According to one of his ex-wives, he put himself through college shooting pool — two years at Spring Garden Institute of Technology and two years at the Philadelphia College of Textile and Science.

Seneca graduated in January 1966 and married wife No. 1, Cheri, that summer. After a three-year stint in the Army, never overseas, he was honorably discharged as a captain in 1970.

In six years he had six jobs, selling securities in New York, Stamford, Conn., and Fort Lauderdale.

He barely made a living. In 1972 he made $9,790. In 1973 it was $3,300. He claimed he lost money those two years because of expenses. Wife Cheri made more than he did. She brought home $20,406 from a fur store.

In 1974 Seneca listed his income at $8,853. Then, in December 1974, Seneca joined Winters and Co. in Fort Lauderdale, and he struck it rich selling government bonds to big institutions.

To the IRS, he reported an income of $231,614 in 1975. But he also told the IRS he lost $307,732 in a mining investment that year.

The next year he married wife No. 2, Frances June Bellas Sims, an English hairdresser and part-time actress. Sometimes she modeled bikinis.

Their marriage didn't last. Seneca sued her for divorce Jan. 6, 1978. The lawsuit lasted longer than the marriage. In 13 volumes, June testified about everything from lipstick on his shirts to pool hustling.

"I think he was a gambler at heart, and that [shooting pool] is how he paid for his education," she said. "He had his own stick and he went to all the clubs."

It was at Winters and Co., she testified, that Seneca discovered "a scheme of how to make money . . . he always talked in millions to me."

He also told her something else, she said. "He said to me they have one set of books for the government and one set of books for the company."

June Seneca said it was her husband who brought together Ewton and Mead and started ESM. Seneca put in $40,000, Ewton $30,000 and Mead $5,000. They agreed to divide the stock: 40 percent each to Seneca and Ewton, and 20 percent to Mead.

Mead wanted to work on commission. Ewton and Seneca agreed to take small salaries. By year's end each was drawing $100,000.

In a deposition, Seneca explained that the salaries were based on "needing more money."

"If you're spending 50 and making 60, you have an agreement you should be making 70. If you spend 70 and make 80, you take 90 out. That's how it gets up there," Seneca testified.

The romance of Robert and June Seneca began with a drink in the Regency Hotel in Manhattan and swept the East Coast in a grandiose spree of carefree spending.

"He bought me shoes from Maria Valentino. He took me to expensive restaurants. He bought me clothes at Bloomingdale's, he opened a bank account for me. He gave me money and everything."

"My husband always picked up the tab in every restaurant we went to, for all his friends, for everybody. It was too generous," June said.

He bought a 1953 Bentley. They traveled in chauffeured limousines. They slept at the Waldorf Astoria. Her mink cape with the hood cost $12,000.

He gave her cash, only cash, $500 to $700 a week, and it was always in $100 bills, she said.

"Every time I went to the store, it would be a hundred dollar bill and they would say to me, 'You've got to go down to the cashier. We can't change it.' "

Seneca borrowed $30,000 from ESM and he and June romped on Paradise Island for a week. In August 1976, he borrowed $50,000 from the company and bought a $375,000 house at 3999 Bayview Drive, Fort Lauderdale.

They were married first in the home, then again in the Vatican the next month.

June said that her husband forged a document to keep the church from knowing that he had been married before. "I saw that myself," she said.

"I said, 'What have you done?' and he said, 'Don't worry about it. Everything is going to be all right.' "

She said she also believed he bribed the priest.

From the beginning, June said, Seneca used cocaine. She said he used it the first night they met in New York, and after that virtually daily.

"He doesn't stop. I've never seen as much . . . my whole life," she testified. She said "lots of people" who worked with Seneca used it; also, but, after her husband, the next most frequent user was Ewton.

June said her husband told her he was dealing in drugs "quite a bit."

After a whirlwind year of marriage, with a trip to the Kentucky Derby and dinners at the swank Le Club International, Seneca walked out on June and their infant son.

On Jan. 6, 1978, Seneca sued June for divorce, claiming she suffered from "psychological and emotional disorders" and lacked the capacity "to distinguish between right and wrong."

He retained heavyweight legal representation, Arky Freed Stearns Watson & Greer.

In protracted litigation, attorney Eugene Stearns produced June's live-in boyfriend, Frank DiRado, 23.

The boyfriend testified that June picked him up at a tea dance at the Marlin Beach Hotel on Fort Lauderdale beach, did cocaine every day and slept with a family friend for $100.

By June 21, 1978, Seneca, "the brains," had left ESM forever. As a comet across the financial skies, ESM was just beginning to blaze.

"The whole board wanted me out," Seneca said. "I was no longer producing income and had caused the company considerable loss and was a financial drain."

Attorney Stearns said Seneca didn't dispute June's tales of big spending, but that his client emphatically denied any use or sale of drugs. "That woman had zero credibility," said Stearns. Her allegations were "all false, all nonsense."

The divorce dragged on. In 1981, Seneca returned from Sacramento, Calif., and said he was broke, owed his attorneys $150,000, owed the IRS maybe $50,000 and was driving a 5-year-old Datsun that belonged to a friend. He said he had a job selling securities. It paid him $239 that month.

★ ★ ★

If Ronald Ewton was "the mouth" of ESM, the label could have come from his splendid talent for oratory.

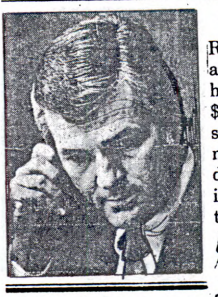
"Ewton was a guy who could get up in front of a group of people and talk to them and leave them absolutely spellbound," said a competitor who knew him well. "He could really motivate people."

"He likes to flash," said another. "The kind of thing like, if you've got six gold rings, wear all six of them."

Ewton bought a $575,000 house for his first wife, Darla, and a $470,000 house for his second wife and former secretary, Jerilyn, drove a new Cadillac, and dressed conservatively in the daytime and to the hilt at night. So did his wives.

"It was like Joan Collins going into the Academy Awards — all glitter, spangle, tremendous jewelry, the competitor said.

Inventory of his wife Darla's jewelry resembled a Tiffany showcase: a 56-bead gold necklace, a gold choker with three diamonds and two sapphires, a 20-diamond necklace, a bangle with two horse-heads with ruby eyes, a spinning ring with 29 diamonds, a Piaget watch with 32 diamonds and a Tiffany ring with a ruby and diamonds.



Ronnie Restine Ewton was born May 23, 1942, in Nashville, Tenn. He said he went to Castle Heights Military Academy in Lebanon, Tenn., and got through two years of Georgetown College in Georgetown, Ky.

He sold life insurance in Jefferson City, Mo., and securities in Little Rock, Ark. His first job in Fort Lauderdale was in 1969 at a securities brokerage firm. He ran the local Hibbard O'Connor and Weeks office.

That's where a man with an unusual name, Melvin Bogus, met him. Bogus used to sell government securities. The SEC once suspended his license for 15 days. Now he is under federal indictment, accused in a tax-shelter fraud. These days he sells cars for a living.

"Ronnie was exceptional on the phone," Bogus said. "He loved expensive cars. He loved airplanes."

Bogus said that Ewton lost a power struggle over control of the company when he locked horns with the man who ran the Houston office of the same firm, John Mark Lee Osborne. Bogus worked in Houston for a while. Business was good. "There were nine Rolls-Royces parked in the lot. It was Rolex Heaven."

Bogus said he never learned the substance of the battle, but a big corporate meeting was held and Ewton lost and the company shut down its Fort Lauderdale office.

The departure didn't slow him down. He worked for three different securities firms in 1975, then founded ESM.

That was a time of the so-called "bond daddies," a trade takeoff on "sugar daddies." Bogus called it a "kind of a term of endearment."

"This is the guy who used to sell corrugated boxes or something and somehow got into the securities business. He didn't have much training, but they'd stick him on a telephone."

"He had Rolex watches, he'd drive a Ferrari, but you were lucky if he could spell his name."

Ewton prospered. But his marriage of 12 years broke up in 1979 and it cost him dearly.

He agreed to pay $3,000 a month in alimony and child support and another $1,000 a month so that his 10-year-old daughter could keep her ponies and take riding lessons.

ESM

Ronnie Ewton bought a $575,000 house for his first wife and a $470,000 house for his second wife, drove a new Cadillac, and dressed conservatively in the daytime and to the hilt at night.

E/S/M

M B Mead

George G. (Mead), "the muscle" of the early days of ESM, was born in Pensacola on Oct. 20, 1933. He went to high school in Jacksonville Beach, put in three years at the University of Florida and got out of Florida Southern College in Lakeland in 1956.

He began as an insurance salesman, switched to pharmaceuticals, then went into securities in 1971 at Hibbard, O'Connor and Weeks in Fort Lauderdale. He bounced around three more brokerage firms until settling in at ESM in 1976.

Bogus portrayed him as a tall, good looking, blond ladies' man. "He was a very good salesman," said Bogus.

In the view of a security salesman, Mead qualified as "a very quiet individual, not a go-out type of guy. A very hard worker."

"He is a sweetheart. It's inconceivable to people who know George that he could have known about anything," said the salesman.

Said another dealer, "He was a good, conscientious salesman." His salesmanship made him $107,000 in 1976, his first year at ESM, and $242,000 the next.

His first wife, Zelmarie, divorced in 1970, took note of his success and filed for more alimony and child support in 1978. She got it. He upped it to $1,600 a month.

By then Mead owned a 2-year-old ocean racing boat, a Wellcraft Scarab, worth $27,000. His Olds was four years old.

Only "the muscle" survived the full nine years of ESM's existence. Ewton, paying himself a $710,000 bonus, bailed out Feb. 11.

Ewton's lawyer, Lawrence R. Heller, said neither he nor his client could discuss any of the allegations, personal or otherwise. "It is not appropriate," he said.

Seneca's divorce lawyer of the 1970s, Eugene Stearns, does not represent Seneca anymore. Seneca finally got his divorce in California, not Florida. Charles Farrar, a Miami lawyer, said he may soon represent Seneca, but not yet. He said Seneca is visiting in South Florida, but he didn't know where. Friday he couldn't find Seneca's phone number and was waiting for a call.

Mead's lawyer is Samuel I. Burstyn. His client, he said, is "a good guy" who "works, works, works, works." Suddenly, a few months ago, Mead got the opportunity to run the company and "his nightmare begins," said attorney Burstyn.

"Any story has to have a patsy, and George was the patsy," he said.

I. "ESM DOUBTS LED TO FIRING, EX-BANKER SAID", CLEVELAND PLAIN-DEALER, APRIL 19, 1985

CLEVELAND PLAIN-DEALER
4-19-85

ESM doubts led to firing, ex-banker said

'85 PD FR1
1A

By W. STEVENS RICKS
STAFF WRITER

TALLAHASSEE, Fla. — A former investments officer of ComBanks Corp., a defunct Florida holding company owned by Cincinnati financier Marvin L. Warner, said he was fired from his job in April 1980 for questioning the institution's investments with ESM Government Securities Inc.

William J. Dugan, former vice president for investments of ComBanks, said he aroused the ire of Warner and other bank executives by resisting their pressure to increase ComBanks' involvement with ESM. He said he was reluctant to invest further with the securities dealer because of its risky financial state.

Dugan's comments came in sworn testimony before a 1981 Florida comptroller's office hearing called to determine whether Warner was competent to acquire control of Century Bank of Fort Lauderdale.

Warner sold ComBanks to Freedom Savings & Loan Association of Tampa in 1982, but two other banks he controlled were devastated by ESM's collapse March 4.

Dugan described Warner's banking style as that of a "bull in a china shop." He said that Warner "shot from the hip, made very abrupt decisions, literally scared everybody to death."

Dugan said he was hired by ComBanks in 1978, while Warner was U.S. ambassador to Switzerland, to manage the banking group's $100 million investment portfolio.

He said that three-quarters of that portfolio consisted of securities deals with ESM. At the time, ESM Chair-

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ESM

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man Ronnie R. Ewton owned 14% of ComBanks' stock.

Dugan said he had never heard of ESM and called the securities dealer to obtain a financial statement in late 1978. ESM officers refused to provide the information.

Four months later, Dugan testified, ESM did provide the financial data. An internal auditor for ComBanks determined from that data that ESM was seriously overextended and the company's failure could cost ComBanks $1.6 million.

But instead of retreating from their involvement with ESM, ComBanks officials urged Dugan to push forward with more deals, he testified.

Dugan said he received a personal call directly from the ambassador in Switzerland. "Jay," he quoted Warner as saying. "'Ronnie (Ewton) has told me that you have not been communicating well, and I want you to know that he is a stockholder of ComBanks and I would like you to do business with him.'"

Nevertheless, Dugan said he was uncomfortable about ESM and gave them business only on the few occasions that they offered deals that were competitive with other brokers.

Despite those incidents, however, Dugan said the bank holding company operated smoothly until Warner resigned his ambassadorship and returned to the United States in 1979.

Then the trouble began, he said.

"He (Warner) ran the bank as a corporation ... he had little regard for banking statutes and everything was run as an iron-fisted corporation."

Five senior bank officials resigned during Warner's first four months back in the United States and ComBanks employees took to derisively calling Warner "the king" behind his back, according to Dugan.

"'Are you making me money?'" Dugan quoted Warner as repeating during bank visits. "'Are you making me money? I want to make a lot of money.'"

In April 1980, Dugan said he was called into the office of Robert Klingler, then president of ComBanks, and dismissed.

"He called me into the office and mentioned to me that he felt that the investment philosophy that I had was greatly different than what Marvin Warner and ESM had," Dugan testified. "He didn't think there was going to be a meeting of the minds and that I would have to leave."

Dugan could not be reached for comment yesterday.

Eugene E. Stearns, the Miami lawyer who represented Warner during the Century Bank hearings, called Dugan "a nasty, flaky guy who was mad about being fired."

Stearns said the former ComBanks vice president's testimony was not credible.

Frank Markiewicz, Warner's Washington spokesman, did not return phone calls to The Plain Dealer yesterday.

J. "WARNER, PALS UNDID LIFE'S WORK, ANGRY MIAMI S&L FOUNDER SAYS", CLEVELAND PLAIN-DEALER, APRIL 21, 1985

Shepard Broad
Founder of S&L in Miami left holding the bag.

Warner, pals undid life's work, angry Miami S&L founder says

By W. STEVENS RICKS 41
STAFF WRITER

MIAMI — It took Shepard Broad 35 years to build his $7,500 initial investment into American Savings & Loan, with $4 billion in assets.

But it took his erstwhile business partner, Marvin L. Warner, less than a year to put the thrift on the brink of disaster.

It was Broad, 78, who had to face family, friends and longtime employees last month and tell them that the collapse of ESM Government Securities Inc. meant an estimated loss of $55 million for American.

By then, Warner was long gone. He had tried a power play the previous October by exercising a buy-sell agreement with the Broad family that he hoped would put him in sole control of American.

Instead the Broads bought Warner out, preserving the business they had nurtured since 1950.

Warner, however, left behind the brunt of $1 billion in securities transactions with ESM he had helped negotiate for American.

To Broad, they were the commercial equivalent of a foundling left at the door of a monastery — the unwanted fruit of a tawdry liaison.

As it turned out, the two lawyer-financiers were never meant to be partners.

"I just do not do business that way," Broad lamented during a recent conversation.

Broad came to this country in a roundabout way from his native city

See **WARNER, PAGE 11-A**

Home State depositors are angry and despairing, as getting their money seems no closer, Page 16-A.

Home State Savings apparently had other financial problems, Page 17-A.

Warner

■ FROM PAGE 1-A

of Pinsk in Russia. In 1920, he landed at Montreal after a solitary steamship passage financed by the uncle from whom he took his anglicized name.

Later, he settled in New York City, where he learned finance by working for years in banks and brokerage houses. He went to law school at night.

In 1940, he moved to Miami to practice law. He founded American a decade later with a meager stake and the support of friends and family.

By 1982, when Broad took Warner into his business, he had developed a reputation for fiscal conservatism. Much of his business came through friends.

But it was a low point, financially, for savings and loans throughout the United States, and American needed capital.

One of Broad's friends was a young, aggressive Miami lawyer by the name of Stephen W. Arky. Arky suggested that Broad get to know his father-in-law, Warner.

By November 1983, Warner controlled the votes of more than 2.8 million shares of American stock. Broad and Warner formed a voting trust of their shares and Warner became chairman of American in March 1984. Then the trouble started.

As one of his seven appointees to the American board of directors, Warner brought in Ronnie R. Ewton, the "E" in ESM.

"I did not seek out Mr. Ewton," Broad recalled. "He was delivered to me."

Once delivered, Ewton began working with Warner to build board support for securities transactions with ESM.

In March 1984, the board approved a reverse-repurchase securities agreement with ESM through which American borrowed $62.9 million from ESM by purchasing discounted, short-term U.S. Treasury bills with a face value of $40 million.

The agreement works like this: A financial institution borrows money from a firm such as ESM, putting up government securities as collateral. The value of securities often exceeds the value of the loan.

American used longer-term Treasury notes as collateral.

Two months later, American acquired $500 million more in T-bills from ESM. Although Broad was concerned about the transaction, he said he didn't push the point because of assurances from Ewton.

"It was represented as a riskless investment," said Broad, echoing the much-repeated line of ESM victims. "You don't shoot Santa Claus."

Broad's restraint evaporated in June, however, when the board indulged in another $500 million transaction with ESM. Broad said the deal was cut while he was out of town.

"I wouldn't do a billion-dollar deal with the biggest bank in America," Broad complained of the transaction that increased American's involvement with ESM to the equivalent of a fourth of American's assets. Federal regulators said they shared Broad's concerns after a routine August examination.

To pacify Broad and his directors, Ewton produced a special financial statement on ESM by the accounting firm of Alexander Grant & Co. The statement, prepared by the firm's managing partner in Miami, Jose Gomez, was a fraud, according to ESM receiver Thomas Tew.

After the ESM collapse, the Securities and Exchange Commission charged that Gomez's statements kept ESM afloat long after it was hopelessly insolvent. In return, Gomez received more than $100,000 in payment from ESM officers, the SEC said.

Broad, whose suspicions were aroused, brought in the accounting firm of Oppenheim, Appel & Dixon to probe further. But Oppenheim's efforts were frustrated by the ESM insiders. The firm never produced a substantive report before the collapse, Broad said.

Meanwhile, Broad said, he had convinced the American board members — with the exception of Warner and Ewton — that they had overextended with ESM.

On Sept. 28, American began to unwind the complicated securities transactions that had begun six months earlier.

The Warner-Broad rift continued to widen as the Cincinnati financier tried to push a merger between American and Freedom Savings & Loan of Tampa.

Warner wanted to acquire 37% of Freedom as the first step in the merger. The tender was to be shares and options of American stock.

"It would have been a less-than-friendly takeover," Broad recalled. "We didn't want that. I, personally, don't do business that way."

The same month he won the ESM battle, Broad gained board support to block Warner's Freedom move. A month later, on Oct. 27, Warner announced his intention to execute his buy-sell option.

Although the split was portrayed at the time as being amicable, Broad recently admitted to hard feelings toward Warner and Ewton. In November, Ewton wrote the Federal Home Loan Bank Board to defend American's ESM transactions and criticize the "lack of sophistication" displayed by Broad and the other directors.

Warner, according to the lawyers in his son-in-law's firm, assumed that the aging Broad was ready to get out of the thrift business.

But Broad's 49-year-old son, Morris, was prepared to step in, so the family bought out Warner's 26% share and sent Warner and Ewton packing.

The displaced pair, however, left behind most of the ESM entanglement. By the time ESM was closed last month, the Broads had managed to get back only $50 million of the money American had tied up with the securities dealer.

Tew, the ESM receiver, filed suit this week against American to recover $45 million the S&L withdrew during the six months before the SEC shut down the securities dealer.

"American, Warner and Ewton, conspiring together, developed an unlawful device, scheme or artifice, to mitigate American's losses at the expense of ESM's other knowing creditors," the suit charges.

Tew charged that American received preferential treatment from ESM when it set up the reverse-repurchase agreement and was favorably treated when it decided to close out that deal.

"There is no basis for, nor any merit to, any claim of preferential transfer," said Morris Broad.

Shepard Broad scoffed at any insistence that American, finally rid of Warner and Ewton, could be considered an ESM insider.

"It is the most ridiculous thing I have ever heard," he said.

Broad's law firm, which is general counsel for American, has gone on the offensive. Last week, the firm convinced a federal judge in Fort Lauderdale, Fla., that Tew's law firm should not be allowed to serve as general counsel for the ESM receivership.

The firm accepted, then returned, a $500,000 retainer from two ESM officials to conduct the special investigation that led to the securities dealer's closure.

The Broads are gearing up for a long battle. "We're prepared to defend ourselves aggressively," Shepard Broad said. "We're not going to be victimized by excessive claims."

K. "STATE CAN'T KEEP UP WITH SECURITIES", MIAMI HERALD, APRIL 28, 1985

Fair, Mild
Details on 2A

The Miami Herald

Final Edition
F-2

446 pages | Sunday, April 28, 1985 | 75 cents

State can't keep up with securities

Unsavory brokers slipping through big administrative holes

ESM warnings ignored / 12A

First in a two-part series
By SUSAN SACHS
Herald Staff Writer

Florida's freewheeling government securities industry, one of the biggest and most disaster-prone in the country, is regulated by a tiny state office that rarely inspects the companies for financial stability and sometimes licenses past lawbreakers.

State Comptroller Gerald Lewis's 22-person Division of Securities is overwhelmed simply by the 50 new license applications from securities dealers and salespeople that arrive every working day.

Meanwhile, the guts of Florida's rules to protect investors — seeking to keep out brokers of bad repute, assure that securities companies maintain a minimal level of net capital, and examine annual financial statements — are only haphazardly enforced.

"I'm aware that we need more help over there," Lewis said in an interview two weeks ago. He since has revised his new budget request to ask the Legislature for 50 new staff positions.

Lewis conceded that unsavory dealers "slip through the cracks" and that "we haven't been doing anything" to inspect government securities dealers once they are licensed.

A series of incidents from just last month confirm his view:

● Following the collapse of ESM Government Securities in March, federal bank regulators claimed they had warned Lewis eight years ago that the firm began operations before it had a state license.

Lewis said he doesn't know what happened to that letter. He also said he never inquired why the U.S. Comptroller of the Currency in 1977 forbade six national banks in Florida from doing business with

Please turn to LEWIS / 12A

Gerald Lewis: 'I'm aware we need more help.'

1375

State can't keep up with deluge of securities firms

LEWIS / from 1A

ESM.

● Three weeks ago, Lewis moved to suspend the license of Tampa-based GIC Government Securities, Inc., in part because the company allegedly failed to inform its customers of past disciplinary actions in seven states dating back to 1981.

Yet Lewis' office routinely licensed the same company in 1982 and 1984.

"We screwed up," said securities division director Chris Anderson. "The persons who handled the file have been reprimanded for not being as thorough as they should have been."

● Collins & Associates Government Securities Inc., in Boca Raton, was routinely licensed in March, although its principal, David Collins, reported on his application a record of violations in other states. The application wasn't shown to a supervisor in the securities division.

"Someone on the staff determined they had ... rehabilitated themselves, and it was not in the public interest to deny the license," Anderson said.

Arkansas authorities said that Collins' parent firm in Little Rock went out of business two weeks ago, the latest in a string of failures in the nation's $60 billion-a-day government securities industry.

Many of those failures had Florida ties. They include Winters & Co. in Fort Lauderdale; ESM in Fort Lauderdale; and Bevill, Bresler & Schulman and Comark — both with offices in Florida.

Of the estimated 100 companies that specialize in marketing bonds and notes issued by the U.S. government, 11 — with 75,000 registered dealers and salespeople — called Florida home before ESM and Collins collapsed.

States' domain

Although each failure brings a renewed call for federal regulation, government securities dealers remain the only stocks or bond dealers that are regulated only — if at all — by states. Other dealers in corporate stocks and bonds are regulated by the Securities and Exchange Commission and by one of several self-policing industry associations.

"It's the easiest business to go into," said Charles Harper, head of the SEC's Miami office. "You pay $2.50 for some paperwork, get a light bulb and screw it into the ceiling and hang out your shingle."

Indeed, government dealers in Florida must do little more than pass a basic 100-question test and pay a $100 fee. Each firm must maintain $25,000 in net capital. The only other tool of the trade is a telephone.

The business is open to virtually anyone. Some government securities salespeople in Florida once sold used cars and insurance, for example. Others are former car hops, car mechanics, former professional football players, and plumbers.

Tips for Investors

No amount of government regulation can protect an imprudent investor.

Here are some precautions you can take if you buy government securities from dealers that sell to individuals:

KNOW WHAT YOU'RE BUYING

Individuals buy government securities backed by pools of mortgages. They are called Ginnie Maes, Fannie Maes and Freddie Macs and there are differences between them. Ginnie Maes, for example, are backed by the full faith and credit of the U.S. government. Freddie Macs are not.

It may sound silly, but some South Florida investors have found they were sold one kind of security when they thought they were buying another.

UNDERSTAND WHAT YOU'RE BUYING

Ginnie Mae securities have 30-year maturities and are backed by home mortgages. Beware of a sales pitch that tries to convince you that a particular Ginnie Mae is guaranteed to be paid off before its 30-year maturity date.

There's no way any securities dealer can say with absolute certainty when all the mortgages that serve as collateral for your Ginnie Mae will be paid off.

SHOP FOR THE BEST DEAL

Securities dealers make money on the markup — the difference between the price they pay for a security and the price they charge their customers. The markup is hidden in the price of the security, just as the markup on a dress is hidden in the retail price.

Find out what a dealer will charge for a particular security carrying a particular interest rate. Then call other dealers to compare prices.

BE CAREFUL WHEN YOU'RE DEALING WITH YIELDS

Some experts warn against buying a government security based on a stated 'yield to maturity' instead of the interest rate and price. Because many factors affect the pay-down rate of Ginnie Maes, "there's a lot of room for flimflam in calculating yield," says Joseph Cooney, senior vice president of Southeast Bank.

THINK ABOUT HOLDING YOUR SECURITY

Many people don't want to be bothered with holding the bond they buy and so rely on banks and brokerage firms to keep the securities. But if you're not absolutely confident in the financial stability of your bank or brokerage, take physical possession of your security.

Few applications are denied, although the state may refuse to license "unworthy" companies or individuals. In Florida, even people disciplined repeatedly in other states get licensed. The unworthiness standard is rarely used, or, as in the case of GIC Securities Inc., it's applied after the fact.

Three-month delay

GIC and its Memphis-born president, Lonnie Kilpatrick, applied for a securities dealer's license in late 1983. Anderson said his staff didn't tell him, until nearly three months had passed, about GIC's history of censures and cease-and-desist orders from other states.

He denied the application, citing the company's "unworthiness."

GIC protested the denial, and in August, the company and Kilpatrick signed a consent agreement promising not to apply for registration as securities dealers in Florida for 12 months.

Yet one month before the agreement was signed, in July, Anderson's office authorized Kilpatrick to serve as the principal for a sister company, GIC Government Securities Inc., which had opened 11 Florida offices.

Anderson said he also was embarrassed to discover that the government securities affiliate had been licensed in Florida since 1982, despite then-pending charges against it in Tennessee, Missouri and Wisconsin. By late 1984, the GIC affiliates had been rejected for registration by six states and charged with operating illegally in four states, according to division documents.

"It does occur on occasion that persons who have had disciplinary histories re-affiliate with a different firm and are able to continue in business," Anderson said. "Some slip through. When we become aware of it, we try to monitor the person and the firm to see if they've rehabilitated themselves."

Infrequent contact

Once a firm or a broker is registered in Florida, though, contact with Lewis' office is infrequent. Companies are required to file audited financial statements

each year. But four months ago, the state auditor general found the office lacked such statements from 40 percent of the companies.

Anderson admitted his division doesn't know how many dealers comply with the law because it doesn't keep track of when or if the reports are filed.

Worse, no one reads them.

"Some probably have not filed the reports in a couple of years," said Anderson, who instituted a computer program to track compliance with the rule in January. "It hasn't been something we've been able to devote much time to."

In financial statements that are filed, the formats vary widely. Anderson has no interest in seeing a uniform-reporting program such as California's.

"There's no sense requiring them to submit all this paper to us if I don't have the time or the staff to look at them," he said.

The state may examine securities dealers' books and trading activity, but the occasional inspection is superficial, limited to ensuring that a dealer's license is displayed and that a complaint file is kept.

ESM, for example, was examined and pronounced healthy in 1981 and 1983, years in which it was hiding millions of dollars in losses from its government securities business.

'You pay $2.50 for some paperwork, get a light bulb and screw it into the ceiling and hang out your shingle.'

SEC's Charles Harper

Election contributions

In 1982, wives of two ESM officers and of ESM's attorney, Stephen Arky, contributed $4,000 to Lewis' re-election campaign. Arky's Miami law firm, with its roster of bank clients, contributed $3,000.

Lewis said he wasn't aware of the contributions but makes no apology for accepting them, despite his pledge not to accept money from those he regulates. That promise was "a hassle" to keep, he said.

Few state regulators of banks and securities have his problem. Most don't run for election.

Arkansas' 7,900 registered brokers and salespeople, for example, report to an appointed commissioner and must meet tough standards for financial solvency and protection of customer funds. Arkansas' examiners sometimes go over the books of an out-of-state applicant before licensing it. They make regular, surprise inspections of securities firms.

And Arkansas does it all with a staff of three: an accountant; a former federal auditor; and a certified public accountant.

"We feel an obligation to the rest of the world for the firms in our backyard," said assistant securities commissioner Nancy Jones.

Coming Monday: Once again, there's talk in Washington about clamping down on securities dealers.

Regulator ignored ESM warning signals

By SUSAN SACHS
Herald Staff Writer

Eight years ago, a federal investigator in Atlanta determined that ESM Government Securities Inc., a new company out of Fort Lauderdale, made a "sucker" out of a Hialeah bank president.

Lou Frank, then deputy regional administrator of national banks for the U.S. Comptroller of the Currency, told his boss of "unsafe and unsound" bond transactions between ESM and the National Bank of South Florida.

Frank also told the Securities and Exchange Commission in Miami.

Both of the agencies took the allegations seriously enough to investigate and, in one case, forbid a group of Florida banks from dealing with ESM or its officers.

But the agency legally responsible for regulating government securities dealers like ESM — the office of Florida Comptroller Gerald Lewis — did nothing, despite warning signals from Frank and others.

Securities Regulation By States

Florida is one of few states with an elected securities industry regulator. It ranks third behind New York and California in the number of dealers licensed in the state, yet has one of the smallest regulatory staffs. Here is a comparison of Florida's securities division and those of several other states:

State	Top Regulator	Staff Size	On-site Examinations	Registered Dealers And Sales Personnel	Increase From 1983
Florida	Elected	22*	Rare	73,000	12,000
Arkansas	Appointed	3*	Routine	7,900	1,500
Georgia	Elected	22**	None	19,000	3,500
Texas	Appointed	62**	Special	54,000	25,000
California	Appointed	150**	Routine	78,000	25,000

* Does not include staff handling banking and securities fraud enforcement.
** Includes enforcement staffs dedicated soley to securities laws.

$300 million short

ESM was shut down last month by the SEC when it discovered the securities dealer owed more than $300 million more than it had. It was the most spectacular failure of a government securities dealer in recent history.

The ESM collapse also focused attention on Lewis, who regulates both banks and securities firms and is a second cousin of Cincinnati financier Marvin Warner. ESM and its officers had strong social and business ties to Warner, who has been the most active individual bank purchaser in Florida.

In a recent interview, Lewis defended his handling of ESM and said his relationship with Warner is friendly but not close. "My decisions have never been affected by a relation," he said.

In the case of ESM, "we now have a great advantage of hindsight," Lewis added. He is "irritated" by the Comptroller of the Currency's recent disclosure of Lou Frank's memo and the implication that he disregarded warnings about ESM.

'Easy to say'

"Eight years later, it's pretty easy for them to say we knew about it," Lewis complained.

Neither the Comptroller of the Currency nor the SEC brought fraud charges against ESM or its officers in connection with their investigations. And it's not clear that Lewis could have averted ESM's failure last month, even if he had acted in 1977.

Yet as Florida's top financial regulator, Lewis had several opportunities to learn of federal concerns about ESM and its officers.

The first was in February 1977, following Frank's investigation of the National Bank of South Florida's dealings with ESM.

In a memo to the regional administrator of national banks in Atlanta, Frank said he informed Lewis' office by telephone that ESM had violated Florida securities law. He followed up the conversation with a letter.

Today, Lewis said, no one in his office can even recall seeing Frank's letter, which was sent to Tim Rigsby, then the state's director of banking.

The letter remains in the files of the Comptroller of the Currency, though. It advised Rigsby that ESM engaged in securities transactions with the Hialeah bank on Dec. 1 and 2, 1976.

'Unauthorized'

Because ESM wasn't registered to do securities business in Florida until Dec. 23, the transactions were "unauthorized and prohibited" by Florida law, he said.

Neither Rigsby nor former state securities director Don Rett, both now in private law practice, remember Frank's letter. A search through the securities division's files didn't turn up the letter either, present director Chris Anderson said.

Frank sent to the SEC — but not to state officials — his more detailed memo about ESM's "unscrupulous" bond transactions and unfair markups. The SEC enforces anti-fraud laws, although it doesn't routinely regulate government securities dealers. It ordered an investigation.

ESM's officers cooperated with the SEC for a few days, then balked. Their lawyer, Stephen Arky, went to talk to the SEC. At a meeting in the agency's Miami office, the Frank memo was discussed, according to the SEC's Charles Harper.

Arky has refused to comment on his representation of ESM.

After the meeting, though, his firm sued to block the SEC. Lawsuits in the bitter battle even accused the SEC investigator of trespass.

Four-year lull

The litigation staved off the SEC for four years.

By 1981, the SEC decided not to pursue its investigation of what were, by then, dated transactions at a government securities dealer regulated by the state.

But that prolonged fight between ESM and the SEC apparently went unnoticed by Lewis. He said he wasn't aware of the case.

Meanwhile, the Frank memo was causing the securities dealers trouble on another front.

In 1977, ESM founders Ronnie Ewton and Robert Seneca applied to federal bank regulators for permission to acquire American Bancshares Inc., a Florida holding company that controlled six nationally chartered banks and three state-chartered banks.

The Comptroller of the Currency was alarmed at the prospect "because of our experiences with ESM," a senior official told a congressional subcommittee last month.

As a result, American Bancshares's national banks were required to sign a tough, five-page binding agreement that forbade them any dealings with ESM Securities Inc., any of its affiliates or officers, and any relative or company associated with ESM officers.

Ewton and Seneca ultimately bought the bank holding company. As required, they notified Lewis's office of the change of ownership on the three state-chartered banks.

'Good people'

Lewis said the change caused him no concern because the Federal Reserve Board already had approved Ewton and Seneca's takeover of the bank holding company.

"I'm assuming the Fed thought they were good people," he said. He claimed he was unaware at that time of the binding agreement on the national banks.

In early 1978, Ewton and Seneca sold their interest in American Bancshares to Warner, who was involved with Ewton in several bank deals.

A few months later, Warner converted the six national American Bancshares banks to state charters, bringing them under Lewis' oversight and removing them from the unfriendly jurisdiction of the Comptroller of the Currency.

For the first time, Lewis said, his office became aware of the year-old binding agreement prohibiting those banks from dealings with ESM.

Simply a vestige

Lewis said he "assumed" that the agreement was simply a vestige from the time that Ewton and Seneca owned the banks. It "seemed to be" a reminder that federal law prevented banks from being in the securities business and a warning to the securities dealers not to engage in self-dealing through their banks.

Although he is the chief regulator of securities firms like ESM, Lewis said he didn't check any further into the reasons for the agreement. Nor did he feel it necessary to continue the restrictions once the former American Bancshares institutions got their state charters.

As it turned out, when ESM collapsed this year, banks were the biggest losers.

Home State Savings in Ohio, controlled by Marvin Warner, said it was owed more than $144 million it had invested with ESM. American Savings & Loan Association in Miami, where Ewton and Warner once sat on the board, said it lost $57 million.

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M. "HOW MANY HATS CAN STEVE ARKY WEAR?", THE AMERICAN LAWYER, MAY 1985

How Many Hats Can Steve Arky Wear?

BY JAMES LYONS

"Florida Securities Firm Ends Operations; SEC Appoints Receiver." This headline might have appeared eight years ago. But, thanks largely to the deft work of Miami lawyer Stephen Arky, the Securities and Exchange Commission's attempt in 1977 to take a closer look at E.S.M. Government Securities, Inc., was thwarted. And it wasn't until March 1985 that the headline finally made it into print—too late to prevent E.S.M. customers from losing up to $300 million and too late to prevent a run on Ohio savings and loans, one of which had invested with E.S.M.

According to a former SEC lawyer familiar with the aborted 1977 investigation, the SEC would have uncovered the apparent fraud right from the start if its efforts hadn't been blocked. "If you had been there at the time," says the SEC source, "all of this was foreseeable. This is an 'I told you so' situation."

The story of E.S.M.—how it was formed, how Ohio financier Marvin Warner became a major customer, how the firm stayed out of trouble with the law for so long, and how its affairs will be handled under the direction of court-appointed receiver Thomas Tew of the Miami office of Finley, Kumble, Wagner, Heine, Underberg, Manley & Casey—can't be told without repeatedly coming back to Arky, 41, a founding partner of the Miami firm of Arky, Freed, Stearns, Watson, Greer, Weaver & Harris.

During the course of the story, Arky plays many roles: incorporator of E.S.M. Securities; defense lawyer for E.S.M.; securities lawyer for E.S.M.; customer of E.S.M.; lawyer to E.S.M. customer Marvin Warner, who is also his father-in-law; and investment banker setting up a deal with an E.S.M. partner, in competition with Warner. Even Arky's activities as an SEC lawyer in the early 1970s come into the E.S.M. story.

There is no evidence that Arky violated any law or ran afoul of the Code of Professional Responsibility. Nonetheless, his many roles brought him at least to the edge of conflicts of interest. And his tenacious efforts to shield E.S.M. from scrutiny even as customers were losing millions—and his own and his father-in-law's money was in jeopardy—raise questions about how many interests a lawyer can properly serve at one time.

Arky's response is a simple one: He didn't know anything was amiss at E.S.M., he says, until February 1985. And, he adds, he perceived no conflict in his complex relationships with E.S.M., E.S.M. partners, and Marvin Warner.

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For Stephen Arky the E.S.M. connection began in 1969, when he was a 26-year-old specialist fourth class in the National Guard. Ronnie Ewton, then 27 and a securities dealer for the Fort Lauderdale office of Hibbard, O'Connor & Weeks, was Arky's commanding officer. "I liked Ronnie right away," says Arky. "I thought he was smart, and he was the only guy to show up at [National Guard] meetings in a new Cadillac."

Arky, a graduate of St Louis's Washington University law school, was then an attorney for the SEC's division of trading and markets, which was later renamed the division of enforcement. He had recently been granted a transfer from the commission's Washington, D.C., office to Miami, which he hoped would be a better place to raise a family.

Arky says he became friendly with Ewton but had no business dealings with him until 1974, three years after Arky had left the SEC and joined Miami's Pettigrew & Bailey. Ewton at that time asked Arky to assist in setting up a securities trading company. Arky says the deal didn't gel.

In October 1975, however, Arky did incorporate a securities trading company for Ewton and his partners, George Mead and Robert Seneca. Mead worked with Ewton at Hibbard, O'Connor & Weeks, and Seneca was a securities salesman from New York. Arky says he didn't discuss with Ewton the nature of his securities operations. "I don't know a repo from a giraffe," he insists, referring to repurchase agreements, one of the financial transactions E.S.M. engaged in. The new firm was named E.S.M. Securities, Inc., after its three founding partners. Before the first board meeting, Arky was listed as the company's sole director; he resigned when the directors were named at the meeting.

E.S.M. Securities was Ewton, Seneca, and Mead's second business venture. The first, a government securities trading company that was later named E.S.M. Government Securities, Inc., had been incorporated a month earlier by Delray Beach, Florida, solo practitioner Thomas Griffith, who then had his office in Fort Lauderdale. (Eventually there were to be four more E.S.M. companies: E.S.M. Financial Group, Inc., an affiliate owned by Ewton, was incorporated by Thomas Clark of Fort Lauderdale's Watson & Clark in February 1976. E.S.M. Group, Inc., the parent company, and E.S.M. Avia-

tion, Inc., a subsidiary, were both incorporated in 1977 by Arky, Freed partner Robert Hudson, Jr. And E.S.M. International, Inc., was incorporated in 1977 by Fort Lauderdale lawyer Kenneth Tworoger; Arky was the company's statutory agent, according to records in the Florida secretary of state's office.)

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Shortly after he set up E.S.M. Securities, Arky became involved in a start-up of his own. In 1976 a dispute broke out at Pettigrew & Bailey over partnership takes, and Arky seized the opportunity to take partners Owen Freed, Eugene Stearns, Marc Watson, and Bruce Greer to a new firm, Arky, Freed was blessed with a combination of talents: hard-driving litigators Stearns and Greer; entrepreneurial dealmaker Arky; and Freed, who had studied political science and law in Uruguay and Honduras and had good business contacts in Latin America.

Two of the firm's most notorious clients were high-rolling financiers Marvin Warner and Victor Posner. By comparison, E.S.M. was a small account: Arky, Freed was to receive a modest retainer—first $3,000 and later $5,000 a month—to handle routine regulatory work for E.S.M. Securities, the E.S.M. subsidiary that traded in regulated securities.

The storm clouds began to gather over E.S.M. when the first of the companies, E.S.M. Government Securities, had been in business a little more than a year. In 1977, during a routine examination of the books of the National Bank of South Florida, a regional office of the comptroller of the currency uncovered curious transactions involving E.S.M. Government Securities, and called them to the attention of the SEC's Miami office. According to an internal SEC memo, the comptroller of the currency reported that an E.S.M. salesman had approached the chairman of the bank's board with a proposal for short-term trading of Government National Mortgage Association [GNMA] securities. The bank would commit to purchase securities that would be issued later—in essence, the bank would be buying futures—and then would sell those securities, presumably at a profit, before the settlement date, when the bank would actually have to pay for them. The E.S.M. salesman promised $150,000 a year in profits for a limited stake, the amount of which was not specified in the SEC memorandum.

But the deal had turned out to be a bomb. According to the SEC memo, the value of the securities the National Bank had committed to purchase dropped, threatening the bank with a $50,000 loss. Moreover, E.S.M. was unable to resell the GNMA futures contracts before the settlement date, and the bank was forced to take delivery of $930,000 in securities.

The National Bank did not have $930,000. So, in an apparent effort to bail out the bank, E.S.M. entered into a "repo" with it: E.S.M. loaned the bank the money to pay for the securities, with the securities themselves serving as collateral for the loan.

Coincidentally, in April 1977—at about the same time the SEC was hearing rumors about E.S.M. Government Securities from the comptroller of the currency—SEC investigator Floyd Young, a tenacious 20-year veteran at the commission, made a routine inspection of the books and records of E.S.M. Securities. Unlike E.S.M. Government Securities, which dealt in an unregulated market, E.S.M. Securities dealt in registered securities and its books were subject to SEC inspection at any time.

According to an affidavit filed by Young in later litigation, "I noted that E.S.M. Government Securities, Inc., and E.S.M. Securities, Inc., were operated by the same individuals and used the same facilities; in fact, it was difficult to see where one operation left off and the other began. . . . During that visit, Ron Ewton, the Chairman of the Board of E.S.M. Government Securities, Inc., volunteered to allow me, or other Commission representatives, to inspect the books and records of E.S.M. Government Securities, Inc. at any time."

Meanwhile William Nortman, SEC regional administrator, and Charles Harper, who was then an SEC staff attorney and now heads the commission's Miami office, concluded on the basis of the report from the comptroller of the currency that E.S.M. might be engaging in a fraud and that a formal investigation should be ordered. According to a memorandum Harper wrote in May 1977, "The staff believes that it may have uncovered the tip of an iceberg involving the fraudulent trading of GNMAs, and other securities issued by the United States and its agencies."

Harper continued: ". . . [I]t seems that Fort Lauderdale, Florida, may have among its other attributes, the distinction of being the hot bed of speculative trading in GNMA delayed delivery contracts. This situation has been spawned by the large sums of money that can be made, and

ILLUSTRATION BY DAVID JOHNSON

the fact that this type of security trading does not impose any margin requirements. What appears to be a common thread . . . is the fact that dealers in United States government securities have a relatively large and aggressive sales force that prey[s] on relatively small financial institutions. These small financial institutions were coaxed into . . . invest[ing] in a highly speculative transaction with promises of no risk and the allure of large profits."

The memo included a colorful description from the comptroller's report of E.S.M.'s salesmen as "suede shoe types, slickers, and high pressure salesmen."

Harper's 1977 characterization of E.S.M.'s activities has a familiar ring. Since its collapse earlier this year, investigators have hypothesized that E.S.M. took advantage of small financial institutions and municipalities in a similar fashion. As the receiver's report describes the scheme, some customers borrowed cash from E.S.M. and handed over securities as collateral. Other customers loaned money to E.S.M., which pledged securities in return. Investigators claim that E.S.M. may have pledged the same securities in more than one transaction. "The Receiver can only speculate," says the report, "as to what techniques were used to lure customers to a small, relatively unknown, unregulated government securities firm in Fort Lauderdale, Florida, over a period . . . in excess of seven years."

The purpose of Harper's May 1977 memorandum was to persuade the SEC to issue a formal order of investigation allowing commission staffers to subpoena the financial records of E.S.M. Government Securities and two other Miami-area securities firms. The SEC granted the request in June.

Armed with the formal order of investigation, SEC investigator Young returned to E.S.M.'s offices in November. But, according to Young's affidavit, although he had been authorized to issue a subpoena, he decided not to do so because Ewton had already offered to show him the books of E.S.M. Government Securities. "We already had a subpoena drafted up," says SEC lawyer Harper, "but [Young] said these guys are entirely cooperative. He thought, why be heavy-handed with guys who would be forthright? . . . [There is] no sense in using a compulsory process when you have cooperation."

Young and Joseph Karten, a newly hired SEC staff attorney, visited E.S.M. three times in November 1977. According to an affidavit later filed by Karten, the November examination uncovered "at least 16 transactions with six customers, [in which] E.S.M. made a profit which greatly exceeded the profits made by its customers in those transactions." Karten's affidavit notes a transaction in which E.S.M. made $66,000 on a $2-million GNMA trade that netted its customer, an Illinois savings and loan, only $2,500.

On the investigators' third visit, on November 15, Ewton suddenly balked. According to later court papers, Karten and Young were told they were being denied access to E.S.M.'s records. Young replied that a formal order of investigation had been issued and that he could subpoena the documents. The subpoena was issued the following day.

Arky, Freed immediately challenged the subpoena. According to papers filed by the firm, by not telling E.S.M. that a formal order of investigation had been issued, the SEC staffers had used "fraud, trickery, or deceit" in order to gain access to the company's records. Further, the law firm argued, the SEC investigators had tricked E.S.M. by telling Ewton that they were only visiting the offices to gain an "education" about the government securities business in connection with another investigation. "Only when [Karten and Young] went so far as to demand Xerox copies of all of [E.S.M.'s] salesmen's commissions did Ron Ewton . . . realize that the 'education' they desired had nothing to do with another investigation," claimed Arky. Freed in its motion to quash the subpoena.

Five days after the subpoena was issued, Arky went to the SEC's Miami office to meet with Karten, Young, Harper, and Nortman. "Arky gave us this whole story about how he met Ewton in the National Guard and how he had a personal knowledge about the guy," Harper recalls. "He said he was a fine sort of man."

According to SEC documents, at the meeting Arky accused the SEC of engaging in a "witch-hunt" and a "fishing expedition," gathering evidence to convince Congress to permit the SEC to regulate the government securities business. The same sources say Arky also accused the agency of conspiring with the comp-

ACTION MEMORANDUM

File Nos.: A-914
A-915
A-918

Date: May 13, 1977

TO : Division of Enforcement
Attn: James A. Clarkson, III
Assistant Director

FROM : Atlanta Regional Office
William Nortman
Associate Regional Administrator
Miami Branch Office

PREPARED BY : William Nortman 305/350-4851
Charles B. Fearlman 350-4857
Charles C. Harper/fg 350-4852
Floyd E. Young 350-5765

SUBJECTS : [illegible]
ESM Government Securities, Inc.

RECOMMENDATION : That the Commission enter three [illegible] Orders of Investigation.

As the staff pointed out in a prior memoranda 1/ it seems that Ft. Lauderdale, Florida may have among its other attributes, the distinction of being the hot bed of speculative trading in GNMA delayed delivery contracts. This situation has been spawned by the large sums of money that can be made, and the fact that this type of security trading does not impose any margin requirements. What appears to be a common thread in the Winters Government Securities Corporation, (A-904) and the three situations discussed below, is the fact that dealers in United States government securities have a relatively large and aggressive sales force that prey on relatively small financial institutions. These small financial institutions were coaxed into transactions where they invested in a highly speculative transaction with promises of no risk and the allure of large profits. As with every other bubble, the eldorado portrayed by the salesmen burst when interest rates declined and clients were obligated on losses on transactions which, in some cases, were not authorized and certainly were not fully [illegible].

16/ The receptionist tape records [illegible] purchasers response.

17/ The information in the report came to light in connection with an examination of the National Bank of South Florida, which is located in Hialeah, Florida. In his report the Deputy Regional Administrator characterized ESM's bond salesmen as "suede shoe types, slickers and high pressure salesmen".

[illegible]rency's staff theorizes that [illegible]s allowed to make [illegible] supervision of the sales[illegible] of its salesmen.

Conclusion and Recommendation

The staff believes that it may have uncovered the tip of an iceberg involving the fraudulent trading of GNMA's, and other securities issued by the United States and its agencies. The staff is requesting a Formal Order of Investigation in order to subpoena the records from the Banks, as well as the Dealers 26/ in GNMA delayed delivery or forward contracts.

A 1977 memo from the Miami office of the SEC convinced the agency to order an investigation of E.S.M. Government Securities. Arky and his firm mounted a vigorous—and effective—defense.

troller of the currency to "get" E.S.M. Harper's affidavit states. "Counsel said he was concerned that his client's business [records] would be presented to a congressional committee and [that] reports of it would be presented to the newspapers."

Arky was engaging in a bit of paranoia," says a former SEC staffer familiar with the discussions. "He was really giving us too much credit. He started making all these connections that we didn't even consider. As far as the commission conducting an investigation to gather information to present to Congress, I don't think that was in anyone's mind at the staff level. . . . Around the office, we used to say that Arky had a Napoleonic complex."

Asked in a recent interview if he had used such language as "witch-hunt" and "fishing expedition" in his meeting with the SEC, Arky replies, "I don't recall exactly, but I could have used pretty strong language with them." At the time, he maintains, he believed the SEC's only concern was that E.S.M. was taking too large a share of the profit. Even if the accusation were true, says Arky, it would not have meant E.S.M. was doing anything illegal, since it was operating in an unregulated arena.

According to Harper's affidavit, Arky also alleged at the meeting that the SEC was harassing E.S.M. because Ewton and Seneca ". . . [h]ad recently purchased an interest in [American Bancshares], and had encountered difficulties with personnel from the Comptroller [of the currency's] office."

Arky was acutely aware of the American Bancshares transaction because he was involved in the deal—as an investment banker. According to Arky, a broker for American Bancshares had contacted him in 1977 with a proposal to sell the holding company to his father-in-law, Marvin Warner. "I called Marvin," says Arky, "and there were some meetings, but they wanted a fast closing. Marvin eventually backed out of the deal," Arky continues, "and then I contacted Ewton and Seneca. . . . They acquired control; they bought somewhere around thirty percent of the bank."

Arky recalls that his fee for acting as both lawyer and investment banker for the transaction was $35,000. "I sat down with Ronnie and George and told them what I thought my fee ought to be," he says, "and they were happy to pay it. To be honest, I thought what they paid me was a tremendous amount of money in those days."

Arky was clearly cementing his ties with Ewton and Seneca, and it wasn't long before he introduced them to Warner. "Just as I am guilty of being Marvin Warner's son-in-law, I am also guilty of introducing Marvin Warner to Ewton and Seneca," Arky says sardonically. The 1977 meeting took place over lunch, and Ewton and Seneca suggested to Warner that he become an E.S.M. customer. Warner and companies he controlled eventually had securities positions of more than $600 million with E.S.M.

Although Arky was adamant in his contention that the SEC was out to "get" Ewton and Seneca as a result of the American Bancshares deal, he says his partner Bruce Greer negotiated a compromise deal with the commission. The compromise, according to SEC documents, would allow its investigators to view, but not copy or remove, some documents from E.S.M.'s office.

Nonetheless, according to SEC investigator Young's affidavit, when he and Karten returned to E.S.M. on December 1, Alan Novick, treasurer of E.S.M. Group and vice-president of E.S.M. Government Securities, disputed the SEC's understanding of the terms of the agreement and refused to cooperate. (Novick died in November 1984.) According to the Young affidavit, "Mr. Novick left and returned in a few minutes and told us that their counsel, Mr. Arky, had advised them not to let us examine any more records. We left the offices of E.S.M. Government Securities at that time."

A few days later, say three sources then with the SEC, Arky had another conversation with the SEC's Miami staff, insisting that his client would not cooperate with the subpoena because the commission did not have jurisdiction over E.S.M. Government Securities, Inc., since it dealt in unregistered securities. Further, Arky said, one of the requests in the subpoena—for documents relating to excessive markup and markdown policies—exceeded the scope of the SEC's order of investigation. Markups and markdowns are essentially commissions earned in trading government securities.

Because government securities dealers are not registered, E.S.M. would not ordinarily be obligated to tell its customers the actual trading prices of securities being bought or sold for the customers' accounts. Sources close to the SEC investigation contend, however, that the prices E.S.M. was quoting to its customers were so greatly at variance with the actual market price that they constituted retusnon of a material fact, one of the theoretical underpinnings of securities fraud. Under such circumstances, the SEC asserts, it has authority to investigate possible instances of securities fraud.

Arky, Freed's argument that the SEC's request for information on markups and markdowns was outside the scope of its investigation led the SEC to amend its order to include specific reference to the markups and markdowns. Based on the new order, a second subpoena was served on E.S.M. on January 18, 1978.

Unlike the subpoena issued to E.S.M. the previous November, which had not named customers whose accounts would be subject to review, the new subpoena requested documents relating to the transactions of 28 E.S.M. customers. According to papers filed by the SEC, those customers were named because Karten and Young ". . . had inspected records which indicated that E.S.M. made a profit which greatly exceeded the profits made by its customers in certain transactions." Included in this list were three companies controlled by Arky's father-in-law/client Marvin Warner: Home State Savings Association, Home State Financial Services, and Warner Management.

The SEC's decision to question transactions involving Warner companies' investments in E.S.M. would seem to have put Arky in a difficult position. On the one hand, if Warner's investment in E.S.M. was in jeopardy—or even if E.S.M. was simply taking more of the profit than it should, as the SEC investigation seemed to suggest—it would seem to have been Arky's responsibility as Warner's lawyer to stand aside and let the SEC investigate. On the other hand, as counsel to E.S.M. he was obliged to try to block the SEC investigation.

Arky first met E.S.M's Ronnie Ewton in 1969, when both were in the National Guard. "I liked Ronnie right away," Arky recalls. "He was the only guy to come to meetings in a new Cadillac."

Arky says he did not recognize a conflict. "It wouldn't be a conflict unless there was a determination of unfairness [on the part of E.S.M.] at the time," he asserts. Arky points out that he did not have access to the SEC memoranda and says he had no sense that there was any substance to the SEC's concerns about E.S.M. He claims he can't remember if he read the second subpoena, in which the 28 customers, including Warner Management, were listed. (In a later interview with *The American Lawyer*, Arky, Freed litigator Greer asserted that Arky, after discussing the matter with him, remembered calling Home State about the SEC's interest in E.S.M. Greer told *The American Lawyer* that he had not asked Arky with whom he spoke at Home State. Asked whether the question of possible conflict had arisen in Arky's conversation with Home State and whether Home State had given its consent for Arky to continue representing E.S.M., Greer replied that such consent was "implicit." Arky declined to make himself available for further interviews.)

Arky, Freed name partner Eugene Stearns, who is acting as Arky's lawyer and his firm's spokesman in matters relating to the E.S.M. collapse, claims that there was no conflict of interest because E.S.M.'s conflict was with the government, not with its customers. "What you're engaging in is a very fine-line analysis with the benefit of hindsight," Stearns says. "None of the customers were complaining."

E.S.M.'s response to the SEC's second subpoena was short and to the point—a one-sentence letter from Arky, Freed's Greer, dated January 27, 1978, saying, "Pursuant to our earlier advice on a number of occasions regarding the impropriety of your actions, we are compelled to advise our client, E.S.M. Government Securities, Inc., to refuse to produce any documents as requested. . . ."

Why not advise E.S.M. to cooperate? The main reason E.S.M. was so concerned about the investigation, explains Arky, Freed spokesman Stearns, was that it didn't want the SEC to contact customers and give them the impression that the company was in trouble. That, says Stearns, would have been bad for E.S.M.'s business. Adds Arky: "There's no question the hand of the government can be a very heavy hand."

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For the next three years, Arky, Freed's Greer waged an intense court fight with the SEC. "Arky, Freed put up what can only be described as a ferocious defense," says SEC attorney Harper. "Frankly, in our minds, the lengths to which they were going to defend was out of proportion to the probe. . . . There are a lot of lawyers in Miami who put up excellent defenses, but this seemed a little much."

In typically aggressive Arky, Freed style, the firm augmented its defense of E.S.M. with an offensive blow: It brought suit against SEC investigator Floyd Young, charging him with violating E.S.M.'s constitutional rights, trespass, and conversion—essentially using E.S.M. property for improper purposes. Young, who retired in 1982 after 25 years with the SEC and now lives in the Florida Keys, says of the suit: "I thought they were trying to rattle me, and it seemed like it was part of the smokescreen they were throwing up to prevent the investigation of E.S.M. from going any further."

While the battle was in progress, Arky became an E.S.M. customer. Thus he was simultaneously investing at E.S.M., advising E.S.M. customer Warner, and defending E.S.M. against an investigation that might prove both his and his father-in-law's money to be in jeopardy. Asked about this period, Arky again emphasizes that he had no idea the money might be in danger. "Would you have put your money into E.S.M. if you had any idea what was going on?" he asks persuasively.

In April 1979 federal district judge Norman Roettger, Jr., ordered E.S.M. to comply with the subpoena. In his ruling, Roettger found that Young and Karten had not exceeded the scope of the SEC's first order of investigation when they had inquired about E.S.M.'s markups and markdowns. "The court can find no authority for the proposition, as advanced by E.S.M., that the SEC binds itself in its investigations to only those areas mentioned in orders issued by the Commission," Roettger wrote.

The judge also rejected E.S.M.'s arguments that the SEC had used "fraud, trickery, or deceit" to gain access to its books and that the searches had been unreasonable. The SEC had had no obligation to inform E.S.M. that it was a target of an investigation, he wrote, adding that E.S.M. had hardly been duped into cooperating with the investigators: "Considering the circumstances of this case, the court notes that E.S.M.

personnel are sophisticated businessmen who operate in a complex and highly regulated industry."

Arky, Freed appealed to the Fifth Circuit, which reversed and remanded Roettger's decision in May 1981, a little less than four years after the SEC had issued its first formal order of investigation.

The purpose of the Fifth Circuit's remand was to allow the district court to decide three questions: "First, did the SEC intentionally or knowingly mislead E.S.M. about the purposes of its review of E.S.M.'s files? Second, was E.S.M., in fact, misled? Third, is the subpoena the result of the SEC's allegedly improper access to E.S.M.'s records?"

However, the district court never got the opportunity to answer those questions. A few months after the remand decision, the SEC dropped its investigation of E.S.M. and decided not to reargue the case before Roettger. In return, E.S.M. promptly ended its suit against investigator Young. David Sirignano, one of the SEC lawyers who handled the appeal, says, "We dropped the investigation of E.S.M. because of the age of the case. By the time we would have gotten a chance to look at the documents it would have already been a stale case." Arky, Freed had succeeded in protecting E.S.M., at least for the time being.

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In addition to incorporating the company and fighting the SEC investigation, Arky, Freed was handling a number of other matters for E.S.M. in the late seventies and early eighties. It had, for example, its retainer to do routine broker-dealer registrations for the company's regulated subsidiary, E.S.M. Securities. Arky, Freed spokesman Stearns says the firm received $35,000 in January 1985 for the preceding seven months of its broker-dealer work for E.S.M. Securities. (In his report, receiver Tew says he believes E.S.M. Securities has been inactive since 1981.)

But Arky, Freed was also involved in solving less routine problems, including the divorce of one of the E.S.M. partners and a drug-related case. In late 1981 a Rockwell Commander airplane, which the E.S.M. Aviation subsidiary had purchased for close to $1 million, was seized by the Drug Enforcement Administration. The plane had allegedly been used to ferry cocaine from Florida to Fargo, North Dakota, and three suspects, who were not E.S.M. employees, were accused of selling 18 ounces of cocaine to a DEA agent. E.S.M. claimed it had leased out the plane and did not know how it was being used.

When the DEA attempted to take possession of the plane in May 1982, Arky, Freed won a jury verdict, which was overturned by the judge. Arky, Freed appealed and won in the Eighth Circuit. The DEA's request for a rehearing en banc was under consideration when E.S.M. collapsed.

Stearns says his firm is still owed between $60,000 and $75,000 for its work on the case. "We may be part of the creditors who will go after E.S.M.'s money," he adds.

Although Arky and Stearns acknowledge having done various kinds of work for E.S.M., they vehemently deny newspaper reports that the firm was E.S.M.'s general counsel. "I don't know who, if anyone, was their general counsel," says Arky. "It was clear that [E.S.M. Group treasurer] Novicl: saw me as Ron Ewton's lawyer and friend, not necessarily E.S.M.'s lawyer."

According to Finley, Kumble partner Richard Critchlow, lead counsel to receiver Tew, "I don't believe there was a general counsel for any of the E.S.M. companies, and the corporate minute books don't reflect it."

Several Florida firms worked for E.S.M. Gilbert Haddad of Miami's Haddad, Josephs & Jack handled an E.S.M. suit against the accounting firm of Peat, Marwick, Mitchell, challenging an audit of a restaurant chain owned by a company in which E.S.M. bought a 40 percent interest. E.S.M. recovered $4.9 million in the suit last year. Fort Lauderdale's Watson & Clark, which incorporated E.S.M. Financial, also did real estate work for E.S.M.

In 1980 Arky invested $200,000 with E.S.M., and made a profit of $170,000 in just 13 days. However, he says, his second venture as an E.S.M. customer was a disaster—a loss of nearly $130,000.

Nonetheless, it was Arky, Freed alone that handled the one piece of legal work most crucial to E.S.M.'s survival: its defense against the 1977 SEC investigation. "We wanted to find out what E.S.M. was charging as markups," says the SEC's Harper. "It's really hard to say where the investigation would have gone." According to SEC lawyers, whenever the agency finds any irregularity in books it is reviewing, it is permitted to broaden its investigation and look at all of the company's documents.

According to a consolidated profit-and-loss sheet prepared in 1985 for the SEC's permanent injunction against E.S.M., the E.S.M. companies were starting to run up staggering losses during the period when Arky and his firm were shielding its government securities trading subsidiary from the SEC. The accounts prepared for the SEC show that the only year in which E.S.M. Group and its affiliate, E.S.M. Financial, showed a profit—a modest $737,000—was 1976. Otherwise the SEC accounts record a string of losses: In 1977, the year in which Floyd Young visited E.S.M. Securities for the first time, the E.S.M. companies lost about $450,000. In 1978, when Arky, Freed began waging its court fight with the SEC, the E.S.M. companies had losses of $7.8 million. In 1979, when the district court ruled in favor of the SEC, the E.S.M. companies lost a total of $14.4 million. In 1980, while the case was on appeal to the Fifth Circuit, the E.S.M. companies had losses totaling $92.7 million. And in 1981, when the Fifth Circuit made its ruling, the E.S.M. companies racked up losses of $20.6 million. The combined losses for the E.S.M. companies from 1977, when the SEC investigation began, to 1981, when the probe was dropped, total more than $135 million.

Arky says he was not aware of these losses. And, in fact, receiver Thomas Tew alleges that E.S.M. Government Securities hid its losses by transferring them to its holding company, E.S.M. Group, which covered those losses by listing accounts receivable from E.S.M. Financial.

During the same time that Arky was fighting the first SEC investigation of E.S.M., he was also working as an investment banker and lawyer for Marvin Warner and other investors in bids to purchase banks. In one of these deals, Arky steered perilously close to another potential conflict with Warner.

Warner had begun his involvement in Florida banking in 1976, when he and Tampa lawyer Hugh Culverhouse bought a controlling interest in ComBanks Corporation of Orlando, a midsized bank holding company. Culverhouse later sold his interest in ComBanks to Warner. Arky was involved in Warner's original purchase, although not in his purchase of Culverhouse's interest. Arky's wife, Martin, together with E.S.M.'s Ewton, served on the ComBanks board of directors.

As Warner continued to parlay his first fortune, from homebuilding, into a second by buying and selling banks, Arky represented him in his 1981 hostile takeover attempt of Century Banks, Inc. Under pressure from Warner, Century fled to the arms of white knight Sun Banks of Florida, Inc.—and Warner walked away with an estimated $12.5-million profit. More recently, Arky represented Warner during his battle with banker-lawyer Shepard Broad over the Miami-based American Savings and Loan Association of Florida. Early this year, Broad bought out Warner's position in American Savings for more than $26 million—giving Warner a profit of about $13 million on a three-year investment.

Warner's most spectacular Florida banking deal was his 1982 sale of ComBanks to Freedom Savings and Loan of Tampa for $57.5 million—the first instance of a savings and loan purchasing a bank. Initially Arky was not involved in the Freedom deal. Then the Federal Deposit Insurance Corporation required Freedom to raise $25 million in new capital by the end of 1983. Freedom's need for capital, its increased size as a result of the ComBanks deal, and its dominance of the thrift market in Tampa made the bank attractive to bidders.

Enter Stephen Arky. In August 1983, he decided to put together an investor group to acquire Freedom. "I knew Freedom had been shopped and shopped and there were no takers," says Arky. "I was acting as investment banker in trying to put the deal together, and I didn't hide that fact. . . . I didn't know who the investors were going to be."

When he acts as an investment banker, Arky says, he maintains a mental list of clients and acquaintances who may be interested in certain deals. In the case of Freedom, he put together a list of possible investors that included John Bassett, with whom he co-owns the USFL Tampa Bay Bandits; Juan Vicente Perez Sandoval, a wealthy Venezuelan for whom Arky had previously done legal work; and E.S.M.'s Ewton. According to sources on both sides of the transaction, Perez was to be the key investor, putting up most of the $26 million to acquire about 32 percent of Freedom's stock.

But Warner, too, had designs on Freedom. His Home State Financial Services Corporation, which then owned about 6 percent of Freedom's stock, protested Perez's proposed acquisition, saying that he was unfit to run the bank because of questions that had been raised about his financial status in the wake of a family scandal in Venezuela. Home State alleged in a complaint to Florida state comptroller Gerald Lewis—who is Warner's second cousin—that Home State's interest would be adversely affected if Perez took control.

According to three sources close to the deal, Warner was furious at Arky for attempting to try to buy Freedom on someone else's behalf. Says one source close to Freedom: "Steve [Arky] called up to tell me about Home State's action and said, 'Can you believe my own father-in-law sued me?' Arky was real surprised that Marvin would do something like that to him." (Warner did not return phone calls.) Arky says he did not know of Warner's intentions to buy Freedom at the time the Perez deal was announced, and declines comment on whether Warner was angry with him.

The Perez deal—for which Arky says his firm would have collected a fee between $500,000 and $1 million—was never completed. According to Arky, Perez decided not to try to raise the necessary capital because of the sudden devaluation of the Venezuelan bolivar.

Although the transaction was not completed, Arky's initial willingness to act as investment banker in the kind of deal in which his client/father-in-law Warner has been an extremely active investor appears to have created at least the potential for an Arky-Warner conflict.

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Arky conducted his multifaceted relationships with Warner and Ewton in relative privacy until early in March 1985, when the E.S.M. story burst into the headlines and Tew revealed that, according to his initial examination of E.S.M. books, Arky had a $2-million securities position with the company as of December 31, 1984.

Arky says he closed out his account in early January, two months before the collapse. He adds that he first became an E.S.M. customer in June 1980, at Ewton's invitation. Over a 13-day period, he says, he placed $200,000 at E.S.M.'s disposal in five separate deposits. On the thirteenth day, he closed out his account,

hich was then worth $370,000. In ss than two weeks he had earned 170,000. Arky, Freed spokesman tearns says Arky was able to realize uch large gains because of the vola- le nature of the market in govern- nent securities, adding that E.S.M. nade 30 transactions on Arky's be- alf in the 13-day period.

Arky says his second venture as an E.S.M. customer was not nearly so smooth. Based on his first experience, he says, he put another $20,000 into E.S.M. on June 23, 1980, followed by infusions of $60,000 on June 24 and $80,000 on June 30, for a total of $160,000. He claims that he soon heard from E.S.M.'s Novick that the market had turned sour, and that he could not expect any quick profits this time around.

But, Arky says, E.S.M. offered "to hedge" his investment to protect him from a large loss. Stearns explains that Arky did not ask about the mechanics of the arrangement, but understood that he might have to hold on to his securities until they matured in August 1985.

According to the receiver's report, E.S.M. loaned Arky the money to purchase securities interests at an interest rate equal to the coupon rate on the securities themselves: 9.625 percent. Thus Arky would not incur carrying charges. (Tew's report lists Arky's holdings as worth $3 million from June 1981 to December 1982, and $2 million in January 1983. Spokesman Stearns says E.S.M. sold some of the securities, but he says Arky received no cash.)

Arky didn't touch his account for four years. Then, on December 5, 1984, he says, Ewton called him and said the market was favorable enough for him to sell the securities for a profit. Arky says he checked with his accountant, tax lawyer Mitchell Yelen of the Miami accounting firm Pinchasik, Alexander & Co., who said there would be tax advantages for Arky if he did not close out his account until the new year. The account was closed on January 11, 1985. A few days later he received a check for $33,125, all that remained from his $160,000 investment.

Arky claims, both in an interview with *The American Lawyer* and in a formal response to the receiver's report, that he was puzzled by the loss and asked his accountant to visit E.S.M. and get more information about it. "Mr. Yelen was in the process of attempting to determine if E.S.M. owed additional money to Mr. Arky when E.S.M. was closed," the response says.

Interviewed by *The American Lawyer* on April 10, the day the response was issued, Yelen says that, when he went to E.S.M., "I didn't know if [Arky] made or lost money." He explains, "When the account was closed, I received a series of trade slips and I didn't understand them completely. So I went to E.S.M. and met with them for about an hour and a half on January 21. . . . I felt better, but I still didn't understand [the trade slips] completely. But I wasn't concerned that [Arky] had been cheated."

Although Arky's second E.S.M. investment seems to have been an unmitigated disaster, receiver Tew asserts that the interest rate charged Arky was unusually low. "The broker rate is usually one or two points above prime, and the interest rate charged to Arky was below that," Tew says. "He was charged the coupon rate on the T-notes." In Tew's report, he writes, "The difference between market interest and the coupon rate paid for the financing of these transactions was detrimental to [E.S.M. Government Securities, Inc.] by approximately $250,000 in the case of Arky's trade. . . ." Asked about the implications of the charge, Tew says, "I don't know if there's anything illegal. The question is at what point is the company injured and [are] others unjustly enriched—and we haven't made those determinations yet. I don't know if these are sweetheart deals or fair deals."

Stearns dismisses Tew's calculations, claiming that the difference between the market rate and the rate charged Arky amounts to no more than $20,000. He also says that E.S.M.'s collapse hurt another of Arky's investments. According to Stearns, in 1984 Arky paid $70,000 for 5,000 shares of stock in American Savings, the Miami-based savings and loan association in which his father-in-law then had a substantial interest. Shortly after the E.S.M. debacle, in which American has estimated its losses to be $55 million, the price of the stock plummeted to less than half of what Arky paid for it. "If Steve Arky knew what was up at E.S.M., why would he have bought stock in American when he knew American was an E.S.M. customer?" Stearns asks.

Arky was not the only partner from his firm to put money into E.S.M.'s hands. According to records produced by receiver Tew, Arky, Freed name partner Bruce Greer, who argued the 1977 subpoena enforcement action, had a securities position worth $4.8 million at E.S.M. at the end of 1980. Greer says he opened a $25,000 account at E.S.M. in June 1980, and closed it in January 1981, after E.S.M. told him he had lost $10,000. "I don't really remember much about it, other than getting out," he says—adding that it is "logical" to assume he received $15,000 back from his original investment, but that he does not remember the amount of the check.

A month after Arky says he closed his account with E.S.M. Government Securities, Ewton resigned from E.S.M. and retained counsel—initially Miami-based solo practitioner James Hogan and later the three name partners of Miami's Gilbride, Heller & Brown. About the same time, Arky says, his firm received information that led him to resign from representing E.S.M. Arky will not disclose the substance or source of the information, claiming lawyer-client privilege. "We received a privileged communication that caused the law firm to advise E.S.M. that we could no longer be their counsel," he says. When pressed, he adds, "Conflicts was one of the concerns."

Later, Arky says, he received a call from George Mead, E.S.M. Government's executive vice-president. "I had a conversation with George, and I said I didn't know what the facts were, but that if he wanted to tell me the facts I would have to then decide the firm's responsibility to disclose those facts. . . . I told him that E.S.M. needed to get independent counsel. . . . The purpose was so he would understand that anything he told me would not be privileged."

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Characteristically, Arky has reacted to Tew's receiver's report by taking the offensive. On April 10, he submitted a 15-page response, charging that Tew "is motivated by neither a zeal for the truth nor a concern for the best interests of E.S.M.'s creditors. . . . Tew has abused his position to aid him in a personal vendetta against Mr. Arky. . . ."

Both Arky's formal response and earlier interviews with Arky, Freed sources attribute Tew's alleged hostility to Arky to two past cases over which the two locked horns. The first began in 1971, while Arky was a staff attorney in the SEC's Miami office. He was working on a case stemming from a 1967 SEC preliminary injunction that had barred Continental Tobacco Company of South Carolina, Inc., from offering securities unless they were registered. After the injunction, Continental had filed for bankruptcy and been reorganized by Contoba Management Corporation, which was owned by Thomas Tew and his father, Conton.

The Tews wanted to recapitalize Continental by selling about $140,000 worth of its stock. They contended that the securities were part of a private offering and didn't have to be registered, and that the preliminary injunction should be lifted. The SEC objected, seeking a permanent injunction. After a six-day trial in 1971, the district court ruled against the SEC, but the Tews lost on appeal before the Eighth Circuit.

Arky and other lawyers involved in the case say he was involved in setting strategy for the district court trial. "Oh sure, Tom Tew knew who Steve Arky was," says one lawyer close to the matter. "There were only four lawyers in the office at the time. It was run like a small law firm, and everybody saw all the people who were coming and going.

"We knew Steve was at the office and there was a possibility he might have had some hand in what was going on, but he wasn't our adversary," says Jeffrey Tew. Thomas's younger brother, who represented Continental in the case. (Jeffrey Tew is now a partner at the Miami office of Kirkpatrick Lockhart.) Thomas Tew says he didn't see Arky during the course of the litigation and points out that Arky's name does not appear on the court papers.

More recently, Tew and Arky, Freed clashed over an airplane-leasing tax shelter deal that Tew originally proposed to the chairman of Key Pharmaceuticals, Phillip Frost, and the company's president, Michael Jaharis, Jr. Key Pharmaceuticals is a major Arky, Freed client. Tew says he met with Frost and Jaharis in July 1981 on behalf of ICS Diversified Services, Inc., an equipment leasing company. His law firm—he was then a partner at Tew, Critchlow, Sonberg, Traum & Friedbauer—was a partner in the deal, in which ICS and the firm would collect a fee for finding a buyer and a lessee for six turboprop airplanes.

Tew says that after his meeting with the two men, "We went back and drafted the lease and sent the papers over to Arky, Freed." Then, he claims, Arky, Freed tax partner Robert Hudson, Jr., informed him that Frost and Jaharis had decided to back out of the tax shelter. A few months later, Tew says, he found out that Frost and Jaharis had gone ahead with the deal, using the same airplane manufacturer and lessee, but cutting out ICS—and Tew.

ICS and Tew sued Frost and Jaharis for breach of contract and civil theft of Tew's work product. According to papers filed by the defendants, Tew and ICS contended they were to receive $140,000 per plane for setting up the deal; Tew's deposition puts the fee at $75,000 per plane. The suit was settled a year and a half ago for about $75,000, according to two sources familiar with the case.

When asked about the ICS incident today, Tew says Arky, Freed "just took our deal and closed it with our paperwork, right down to the typos." Asked about his feelings as a result of the dispute, he replies, "I may be disappointed with some of the people at Arky, Freed, but not Steve Arky. He is an excellent lawyer, and he has built a fine law firm. I don't have a vendetta against him. I'm just trying to do my job to recover assets for the creditors [of E.S.M.]. . . . I don't see what the hell our personalities have to do with it," he continues. "I didn't put Steve Arky in E.S.M. I think the whole thing [about a personal feud] is a smokescreen."

Arky, Freed's Stearns tells a different story. He says he and Arky met with Tew in mid-March of this year—after the E.S.M. story broke and Tew became receiver—to see if they could clear the air. According to Stearns, "Tew spent about forty-five minutes going on and on about [the ICS] case. . . . He said, 'If Marc Watson [the Arky, Freed tax partner who defended Jaharis and Frost] walked into this office, I'd throw him out the f—ing window."

A Miami lawyer (not at Arky,

Freed) who has been involved in the E.S.M. affair says, "There is tremendous animosity between Arky and Tew—and there's no doubt Tom's been vindictive toward Arky."

Whatever his feelings toward Arky, Tew's activities during the days immediately preceding the closure of E.S.M. raise questions about his appointment as receiver. Tew's critics point out that on Friday, March 1, he was counseling E.S.M. Government president Nicholas Wallace and executive vice-president Mead, and by the end of the day on Monday, March 4, he had been named receiver of E.S.M., with a duty to recover all assets of the company—an obligation, his critics charge, that could put him in opposition to the interests of his former clients, Mead and Wallace.

Tew explains his involvement this way: On Thursday, February 28, he says, he was called by Miami attorney William Cagney, III, George Mead's lawyer. Cagney told him that officials of Home State had raised serious questions about the bank's E.S.M. account. On Friday, Tew goes on, "We were retained by the officers of [E.S.M.] who were also the two remaining directors [George Mead and Nicholas Wallace], in their capacity as officers of the company." Tew adds that his firm, Finley, Kumble, received a $500,000 retainer from E.S.M. and set up a weekend audit. On Sunday, March 3, he says, he received verbal consent from Mead and Wallace to take E.S.M.'s problems to the SEC. He briefed the SEC on Monday morning, and later that day was appointed by federal district judge William Hoeveler as E.S.M. receiver at the suggestion of the SEC, and with the support of the representatives of Home State. Before accepting appointment as receiver, he says, he received written consent from Mead and Wallace. He also says his firm has returned the $500,000 retainer. (Mead is represented by Miami attorneys Cagney and Samuel Burstyn, and Wallace by Fort Lauderdale's Al Thomas.)

"The relevant question is what [Mead and Wallace] wanted to do," says Tew. "If they had any objection, I could not have served as receiver or bankruptcy trustee. . . . The fact of the matter is that my selection as receiver had no objections from anyone."

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E.S.M.'s collapse and Tew's public statements about the affair and Arky's role as an E.S.M. customer have put Arky in the national spotlight. Reporters have besieged him and his firm seeking information about his money and his motives, and the SEC has called on him to testify in its investigation—which he has done. Arky has retained Thomas Foran and Jack Carriglio of Chicago's Foran, Wiss & Schultz; Foran is a former U.S. attorney for the Northern District of Illinois. Stearns, who has also been representing Arky, says that "Foran has been retained to give independent counsel to Steve, because there is a possibility I might have to testify at some point because of my involvement in [E.S.M. partner] Seneca's divorce [proceedings]."

In late March, at the conclusion of a five-hour interview with *The American Lawyer* in which he vigorously presented his side of the E.S.M. story, Arky reflected on recent events. "What could we have done?" he asks. "What could we have known? I doubt we would have done things all that differently. . . . I don't know what Ronnie Ewton or other people at E.S.M. knew about what was going on, but if it's Ronnie, it's going to be tough for me to accept. It's hard to believe Ronnie did it." (Seven days after this interview Ewton was arrested and charged with forging the will of E.S.M. Group treasurer Alan Novick.)

Pausing for a few seconds, Arky starts speaking again, his eyes fixed on the center of a conference table. "Marvin Warner has lost more money at E.S.M. than anyone else. It's a devastating thing. And as a result, there's been a backlash at me and the firm, and that is undeserved. . . . I regret that I ever heard of E.S.M."

But Arky has, of course, heard of E.S.M. He actually helped bring it into existence. He invested his own money with it, and introduced his father-in-law to it; he decided to wage a legal war against the SEC and its investigator when the agency tried to peek into E.S.M.'s books; he refused to recognize that there might be conflicting interests or an appearance of conflict between E.S.M. and another of his clients.

Arky insists that there was no conflict because there was no SEC finding of unfairness, and that he did not know anything was amiss at E.S.M. until early in 1985. But, of course, the reason there are rules against conflicts (or for that matter, any rules or laws at all), is to deal with situations where things might turn out amiss because people are not deserving of the trust others place in them. If companies never cheated their customers there would be no need for customers to have lawyers, let alone for lawyers to worry about conflicts.

N. "THE RISE AND FALL OF MARVIN WARNER", BUSINESS WEEK, MAY 6, 1985

Finance
MONEY & BANKING

THE RISE AND FALL OF MARVIN WARNER

It's now nearly two months since the crash of Marvin L. Warner's Home State Savings Bank in Cincinnati, which triggered the first bank holiday since the Depression and caused the financial world to hold its breath. It may be many more months before investigators fully understand what happened. But a BUSINESS WEEK team has already turned up a clear pattern: Warner used financial institutions as candy stores for family and friends. Officials had plenty of warning, but the well-connected Warner managed to stay one step ahead of disaster—until the morning that panicky depositors lined up outside Home State and the doors never opened.

The tangled nature of Warner's dealings almost assures that Home State customers will have a long wait before they can touch their estimated $500 million. An examination of Home State's books by Chemical New York Corp., which has offered to buy the thrift, indicates that Ohio would have to come up with a capital infusion of some $110 million to make the deal work. Approval by the state legislature is far from certain. And the trail on which the FBI, congressional committees, banking agencies, and a special prosecutor in Ohio, among others, have started is sure to be long and shadowy.

VICTIM? What investigators have already unraveled to a large degree is how the activities of ESM Government Securities Inc., with which Warner had close ties, were the undoing of Home State. That small Fort Lauderdale (Fla.) firm provided ESM principals with a lavish lifestyle of yachts and executive aircraft but produced heavy losses for Home State. The Securities & Exchange Commission has accused the Alexander Grant & Co. auditor who verified ESM's financial statements of receiving $200,000 in improper payments from ESM's officers. ESM was "probably the most abusive corporate raping I have ever seen," says attorney Thomas Tew, ESM's court-appointed receiver.

Warner has insisted he was victimized by ESM. "I feel like a girl who's been raped and has to prove she's not a prostitute," he told BUSINESS WEEK. Warner says all he knew about ESM was in the misleading financial statements audited by Alexander Grant. But the principals of ESM were fellow investors with Warner in many of his enterprises. And a former investment officer at one of Warner's Florida banks has testified that he was fired in 1980 for not doing more business with ESM.

'I feel like a girl who's been raped and has to prove she's not a prostitute'

MARVIN L. WARNER
Financier

Warner talked to BUSINESS WEEK shortly after Home State closed and answered a list of written questions for this story. But the pattern in Warner's dealings emerged mainly from SEC filings, interviews with friends and former associates, court documents, and testimony by Warner and others before bank regulators.

From the start, Warner showed a talent for making the most of other people's money. The son of a baker, he grew up in Birmingham, Ala. After serving in World War II, he wanted to capitalize on his law degree, "but at that time lawyers weren't getting very much," he once recalled. He went, instead, into the real estate business with his Army savings and with loans from his uncle and mother. He tapped a government loan-guarantee program to put up his first apartment building and moved into one of the units himself. "It was ironic," Warner remarked. "I didn't have enough money to buy a house. But under the program, it was possible to build a 10-unit apartment."

FINANCIAL FORAYS. His real estate activities eventually led him to Cincinnati, where his forays into finance started in 1952 with the purchase of Active Savings & Loan Assn., a thrift with $200,000 in assets. Within four years, Active had grown to $20 million, and Warner had sold it off. His next investment, in 1957, was Home Main Savings Assn., with $3 million in assets. He changed the name to the now-famous Home State and took charge of the thrift personally. He even acted as its lending officer, using contacts built up through his real estate business to drum up loans.

By 1976, according to Warner, he had withdrawn from an active role in Home State to devote more time to a wide range of interests. Home State was only one subsidiary of Warner National Corp., a holding company that was 84% owned by Warner and then had a net worth of $5.1 million. Other Warner Na-

tional holdings included insurance companies, consumer finance companies, real estate, and Kinder-Care Learning Centers Inc. Warner had bought Kinder-Care stock to provide financing for Alabama friends at Kinder-Care and sold the stock back to the company in 1976.

Warner National was hardly Warner's only holding. He and Miami attorney Hugh F. Culverhouse jointly owned the Tampa Bay Buccaneers of the National Football League. And in 1976, Culverhouse went in on Warner's first purchase of a Florida financial institution, ComBanks Corp., of Winter Park. Warner also bred and raced thoroughbred horses from his Warnerton Thoroughbred Farms near Cincinnati.

Warner was also devoting more time to civic and political activities. By 1976 his chairmanship of the Ohio Board of Regents had brought him into contact with fellow board member George M. Steinbrenner III and led to Warner's purchase of a 10% stake in the New York Yankees. He had already served on the Democratic National Committee, been a member of the U. S. delegation to the U. N., and contributed heavily to Democratic campaigns. In 1976, Warner supplemented his contributions by heading a fund-raising breakfast for then-candidate Jimmy Carter.

HANDSOME SUPPORT. Carter nominated Warner to be ambassador to Switzerland in May, 1977. When Warner appeared before the Senate Foreign Relations Committee for confirmation, he was obviously among friends. His chief sponsor, Senator John H. Glenn (D-Ohio), and Senator Howard M. Metzenbaum (D-Ohio), both of whom had received contributions from Warner, were seated with him at the witness table. The committee's chairman, Democrat John J. Sparkman, from Warner's native Alabama, boasted that Warner had been "a very handsome supporter of mine." The American Foreign Service Assn. opposed the nomination on the grounds that it was a payoff for $60,000 in campaign contributions from Warner. But Sparkman was unmoved. "Thinking back over some political contributions of the past, $60,000 is not a very big one," he said. The committee quickly recommended confirmation.

As ambassador, Warner was an active booster of U. S. business interests, at one point parking a fleet of American cars on embassy property and inviting the Swiss to come by for a look. But he also ruffled feathers among the staid Swiss. Warner arrived at the Swiss federal executive's annual diplomatic reception squiring Carter's secretary, Susan S. Clough. When the Swiss noted that Clough had not been invited, both she and Warner left.

While still in Bern, he expanded his investments in Florida financial institutions—a move that led to his ties with ESM's principals. ESM, which was set up in 1975, took its name from the initials of its owners: Ronnie R. Ewton, Robert C. Seneca, and George G. Mead.

According to documents obtained by a House Government Operations subcommittee on monetary affairs, ESM first came to the attention of the regulators in late 1976. Examiners for the Comptroller of the Currency spotted some speculative transactions between the National Bank of South Florida and ESM that were "unsuitable for a national bank." The Comptroller forced the bank to unwind the transactions. A few months later, the Comptroller discovered that Ewton and Seneca were acquiring American Bankshares Inc., of Dade County. The regulators had no power to stop them, but they did have leverage over the six federally chartered bank subsidiaries of American. The Comptroller got the banks to sign agreements not to do business with ESM or its owners.

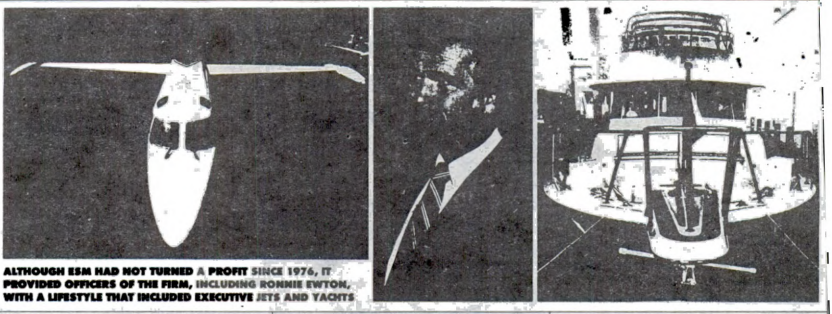
But Ewton and Seneca deftly sidestepped the Comptroller's oversight. They sold a controlling interest in American to Warner's ComBanks in 1978. As part of the deal, Warner's Home State Financial Services lent $3 million to Ewton to purchase an interest in ComBanks from Warner. Ewton became a director of ComBanks. Later that year, American converted the charters of its banks from federal to state, and the agreement with the Comptroller was no longer binding.

Since ComBanks was already state-chartered, the banks in both holding companies were doing business with ESM. But when Warner came back from Switzerland in 1979, he served notice that his banks were not dealing enough with the firm.

William J. Dugan, the former chief investment officer of ComBanks, explained why. Dugan had become concerned about ESM's financial condition in 1979, shortly after he took the job. In a 1981 hearing by the Florida State Banking Commission on one of Warner's bank takeover attempts, Dugan testified that ComBanks had been doing business with ESM without bothering to look at the firm's financial statement. And after Dugan obtained one, it showed the firm was leveraged at 245 times its capital, he said. When Warner returned from Switzerland, he called Dugan into a meeting with Ewton. Dugan says that Warner told him: "Ronnie has told me that you have not been communicating well, and I want to let you know that he is a stockholder of ComBanks, and I would like you to do business with him."

SELLING OUT. Dugan said he did some business with ESM, but only when its bids were competitive with those of other firms. Finally, he was fired by ComBanks Executive Vice-President Robert M. Klingler in early 1980. Klingler says the ESM dealings were not the reason for Dugan's firing. He attributes the firing to "good business reasons" that he declines to specify.

In 1983, Warner sold off both ComBanks and American, which were renamed Great American Banks Inc. Great American went to Barnett Banks of



ALTHOUGH ESM HAD NOT TURNED A PROFIT SINCE 1976, IT PROVIDED OFFICERS OF THE FIRM, INCLUDING RONNIE EWTON, WITH A LIFESTYLE THAT INCLUDED EXECUTIVE JETS AND YACHTS

Florida for $47 million and ComBanks to Freedom Savings & Loan Assn. for $59 million. Before the deals were closed, Warner's banks became targets of money-laundering investigations stemming from transactions that occurred while he was chief executive officer of each holding company.

'COMMON KNOWLEDGE.' Great American and three employees, including the vice-president for installment loans, pleaded guilty last year to various charges growing out of a scheme to disguise the source of cash deposited from drug operations. In an affidavit filed in the case, the vice-president, Lionel Paytuvi, said: "It was common knowledge at the bank that the money was from drugs." But Warner says he knew nothing about the transactions, and law enforcement officials say there was insufficient evidence to warrant prosecuting any higher-ups.

The records of ComBanks were subpoenaed in 1983 for a grand jury investigation into money laundering. Klingler, now the president of Freedom, says he has been advised that there will be no criminal indictments of ComBanks or its officers. But Freedom has yet to receive final word that the investigation is closed.

Home State was penalized in 1980, when it pleaded no contest to charges of defrauding customers who had paid for loan commitments from the thrift but were unable to get the loans. Warner testified in 1981 that he had been unaware of what was going on. He even praised the work of the agents who had uncovered the transactions. "It's part of our system, checks and balances," he said. "Thank God for America."

Warner became a more active investor after his return from Switzerland. He tried to take over Century Banks of Florida, and Century resisted, leading to the hearings that produced Dugan's testimony. Century eventually sold out to Sun Banks Inc. in 1981. In addition to buying Century stock from Warner and his companies for some $3.5 million more than their original investment, Century and Sun paid $5 million for Warner to end his pursuit.

FAMILY TIES. Another takeover try, however, turned out to be costly for Home State. Global Natural Resources Inc., an oil and gas exploration company based in Jersey in the Channel Islands, successfully resisted an attempt by Warner and others to take control of the company in 1982. The most recent SEC filings for Home State showed that it still owned nearly 300,000 shares of Global purchased for $3.8 million. Current value: about $1.1 million.

Global was not the only case where Warner's financial institutions provided the wherewithal for wheeling and dealing by Warner and others in his favor. The loan to Ewton to buy ComBank stock from Warner is another example. Home State also provided $10 million for Carl C. Icahn's takeover of what was then a railcar company, ACF Industries Inc. And the filings of Warner's companies reveal a steady flow of loans, commissions, and jobs for his family and associates.

ESM RECEIVER TEW: WARNER'S $4 MILLION PROFIT SHOULD HAVE BEEN ONLY $230,000

His son-in-law, Stephen Arky, did extensive legal work for Warner's companies and in 1974 was secretary of a Florida real estate partnership that borrowed from Home State to buy an apartment complex from other Warner subsidiaries. Warner's daughter, Alyson Warner Kuppin, a Home State board member, benefited from her family ties. Her husband's insurance agency got business from Warner companies and split commissions with certain Warner enterprises. In 1983, Kuppin and her husband's agency owed some $1.95 million to Warner subsidiaries. At the end of that year, "related parties" owed various Warner enterprises $6.6 million. Warner says that, to his knowledge, his companies' loans to family and friends were all "good loans, well-secured."

But while Warner's institutions were providing financing for him and those close to him, Home State itself was having a harder and harder time making money. Even though it was not federally insured or regulated, the gradual elimination of deposit ceilings at other institutions forced Home State to offer higher rates on its deposits. And this apparently led Home State to take bigger risks to get higher returns on its investments.

Home State's dealings with ESM increased substantially. Most of the transactions were reverse repurchase agreements, or repos, in which Home State lent government securities to ESM in return for cash to invest elsewhere. These repos tended to be for as long as a year. Most repos are for far shorter terms, so Home State's vulnerability to market price swings was acute.

'MIDAS TOUCH.' American Savings & Loan Association of Florida, another of Warner's interests, was engaging in similar transactions with ESM. Warner bought into American in 1982, after Arky had introduced him to American's owners, the Broad family. Because of his takeover deals with Century and other Florida banks, Warner "was considered to have a Midas touch," says Morris N. Broad. Warner bought 28% of American and became chairman. ESM's Ewton became a director.

By the spring of 1983, says Broad, American executives became concerned about their dealings with ESM and began trying to unwind the transactions. Meanwhile, state regulators in Ohio were pressing Home State to phase out its transactions with ESM, but with little success.

The growing friction between the Broads and Warner finally came to a head last year. The reason: Warner, as chairman of American, tried to take over Freedom Savings & Loan, to which he earlier had sold ComBanks. Broad found out about this only when he approached Freedom in hopes of arranging a friendly merger with American. But on finding that Warner had already launched a hostile takeover attempt, the Broads insisted that American keep its hands off Freedom. The Broads ended up buying back Warner's shares in American.

With Warner out of the picture, American began cutting its exposure to ESM even more drastically. By this time, Home State was winding down its ESM position, as the regulators had urged. As ESM receiver Tew describes the process, the withdrawal of Home State and American was crucial. The securities that they had lent to ESM often were worth a lot more than the cash they got in return for them. That margin was a major reason why ESM was still alive even though it had not turned a profit since 1976.

And as the two thrifts pulled out, Warner pulled out even faster. Tew's analysis shows that Warner's personal account at ESM had a zero balance by the beginning of this year, and by the time he closed it, Warner had taken out profits of $4.4 million. Indeed, Tew says that

Warner's profit would have been only $230,000 if Warner had paid the same rate ESM charged other customers who bought securities on credit. Tew's analysis shows Warner paid rates as much as 9.5 percentage points less than other customers. Warner says simply that Tew's analysis of the interest rate charges is not accurate.

Ultimately, of course, American and Home State were unable to get out of ESM fast enough. Home State went into the care of a conservator. American is surviving, but it is likely to lose at least $50 million. Cities and school boards across the nation have watched some $100 million of their taxpayers' money vanish behind ESM's closed doors. The state of Ohio still hasn't been able to reopen all the 71 thrifts that Governor Richard F. Celeste had closed to halt the run. And Marvin Warner spends most of his time in Florida, closeted with investigators. The man who in 1977 was honored with "Marvin Warner Day" by the city of Cincinnati is now, his friends say, afraid to set foot in Ohio.

By Dan Cook in Cincinnati and G. David Wallace in New York, with Stan Crock and Carla Anne Robbins in Washington, Pete Engardio in Tallahassee, and John Templeman in Lausanne

MARKETS & INVESTMENTS

WHY THE SHEARSON-LEHMAN HONEYMOON WAS SO SHORT

"If you really want the story of the last year, talk to my barber," says Peter A. Cohen, chief executive officer of Shearson Lehman Bros. To hear Cohen tell it, the gray hairs started sprouting on his 38-year-old head shortly after Shearson/American Express Inc. acquired Lehman Bros. Kuhn Loeb Inc., a prestigious, old-line investment bank torn by intramural warfare.

Actually, in some ways the Lehman deal has worked out suprisingly well for Cohen. Lehman's trading, money management, and retail brokerage operations were absorbed with little fuss and have generated handsome profits. But Shearson coveted Lehman Bros. mainly for its tony investment banking division. And the post-acquisition traumas in investment banking have been enough to turn anyone's hair gray.

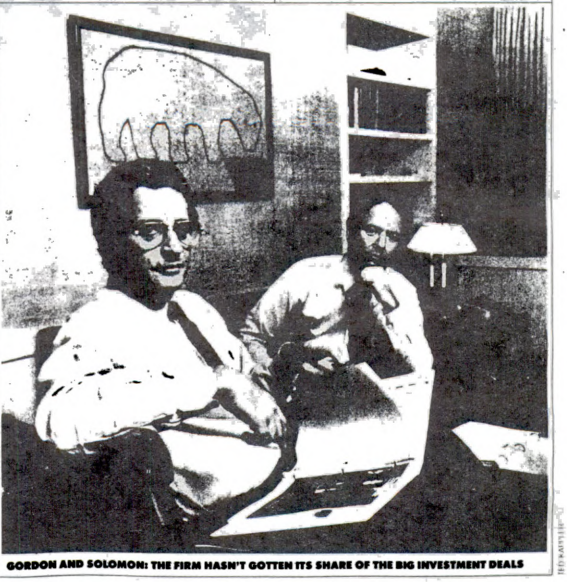
BRUTE FORCE. Although Shearson Lehman posted a seemingly impressive 25% rise in first-quarter earnings, to $31 million, top management was disappointed. "The first quarter was not anything like what we were hoping for," says Jeffrey B. Lane, chief operating officer of Shearson Lehman, a unit of American Express Co. "It's like having a Ferrari and not being able to get your foot on the gas pedal."

Investment banking was supposed to supply the acceleration. To be sure, the combined firms have muscled their way into corporate underwriting's elite "bulge bracket." Thanks to a unique combination of brute force and prestige, the six bulge-bracket underwriters receive preferential treatment in the syndicates assembled for big securities offerings. This is not the lucrative honor it once was, however. Fees have been cut to the bone as regulatory changes have transformed most underwritings into routine transactions.

The most profitable investment banks have gravitated toward businesses with higher profit margins. The most visible of these is advising on mergers and acquisitions (M&A). Shearson Lehman has worked on plenty of small and midsize deals. But in this era of rampant megamergers, it has very few billion-dollar transactions to its credit. Concedes Sheldon S. Gordon, who just stepped aside as director of investment banking: "The place we've fallen down consistently is in getting our share of the big deals."

Chase Manhattan, Continental Group, and Uniroyal are among the old Lehman clients that have taken their merger business elsewhere. But the defection that really stung was American Broadcasting Cos.' decision to hire First Boston Corp. to help negotiate its $3.5 billion sale to Capital Cities Communications Inc. Peter J. Solomon, Shearson Lehman's merger chief, who handled the ABC account himself, says he didn't learn of the Cap Cities deal until it was announced. "I'm never going to talk to those people again," Solomon fumes.

COSTLY COUP. Even before Shearson entered the picture, Lehman's whole investment banking operation was hurt by the departures of such top-flight senior bankers as former Chairman Peter G. Peterson and Eric J. Gleacher, who now runs Morgan Stanley's M&A department. Since the sale, only about 15 bankers have left voluntarily. Most Lehman partners are constrained by employment contracts that prohibit them from working



GORDON AND SOLOMON: THE FIRM HASN'T GOTTEN ITS SHARE OF THE BIG INVESTMENT DEALS

O. "BANK CRISIS FIGURE SHOOTS SELF TO DEATH", WASHINGTON POST, JULY 24, 1985

Bank Crisis Figure Shoots Self to Death

Associated Press

MIAMI, July 23—Stephen W. Arky, an attorney for the Fort Lauderdale securities company that collapsed last spring and touched off a banking crisis in Ohio, has shot himself to death, police said.

Arky, 42, said in a suicide note that he was suffering from deepening depression and that "he couldn't live any longer like that," Metro-Dade Detective John Butchko said.

"He didn't want to be committed to an institution, and that was why he was going to leave the world," Butchko said. "He told his wife [in the note] he was sorry and that he didn't do anything wrong."

Arky, son-in-law of Cincinnati financier Marvin Warner, shot himself Monday at his Coral Gables home, police said. He was part owner of the Tampa Bay Bandits of the United States Football League and founding partner of a 55-lawyer firm with three offices in Florida.

Among Arky's clients was E.S.M. Securities Inc. of Fort Lauderdale, which failed March 4. The Securities and Exchange Commission alleged that the company misled investors with false financial reports while hiding about $200 million in losses over nine years.

Home State Savings Bank of Cincinnati, controlled by Warner, closed after a run by depositors alarmed by revelations that Home State lost nearly $150 million as a result of investments with E.S.M. The loss exceeded the $130 million in the private insurance fund of which Home State and 69 other Ohio thrifts were members, and after Home State shut down, 69 other Ohio thrifts were closed temporarily to prevent runs.

Despite Arky's death, the state of Ohio will pursue a lawsuit against Arky, who with Warner and former officials of Home State are named as defendants in a $432 million suit in connection with the bank's failure, according to John Hartranft, a lawyer representing Ohio.

The Hamilton County Common Pleas Court suit claims that Warner failed to curb Home State's risky over-investment with E.S.M. and benefited from personal transactions with E.S.M. that he allegedly kept secret from state examiners and Home State officers.

It claims that Arky bought $1 million in U.S. Treasury notes from E.S.M. in January 1983 by using a $990,000 loan from E.S.M. plus the balance in cash or securities and that E.S.M. later absorbed a loss for him on the deal. Arky sold the notes in January 1984 before their August 1984 maturity date, knowing that E.S.M. was insolvent, the state's lawsuit alleges.

The federal government said E.S.M., which was not registered with the SEC, bilked more than $300 million from at least 68 investors, including 16 cities and some mid-sized banks.

A report by Thomas Tew, E.S.M.'s court-appointed receiver, said Arky closed his E.S.M. account shortly before the collapse. Arky said he did not know about E.S.M.'s financial straits at the time.