STATEMENT OF JOSEPH W. BARR, CHAIRMAN, BOARD OF DIRECTORS
OF THE FEDERAL DEPOSIT INSURANCE CORPORATION
Before the
COMMITTEE ON BANKING AND CURRENCY
HOUSE OF REPRESENTATIVES
on H. R. 12267 and H. R. 12268

August 12, 1964

Mr. Chairman: Today I am appearing in support of H.R. 12267 and H.R. 12268, identical bills, introduced by Chairman Patman and Congressman Widnall. These bills are designed to provide for notice of change in control or management of insured banks.

This proposed legislation would require the president or other chief executive officer of any insured bank to report to the appropriate Federal banking agency the facts surrounding changes which occur in the outstanding voting stock of the bank which will result in a change in the control of the institution. The term "control" would be defined to mean the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the bank. National banks would be required to report such a change in control to the Comptroller of the Currency, State banks which are members of the Federal Reserve System would report to the Board of Governors, and insured State banks which are not members of the Federal Reserve System would report to the Federal Deposit Insurance Corporation.

Under the proposed legislation a report would also be required in cases where a loan or loans are made by any insured bank which are secured by twenty-five percent or more of the shares of the voting stock of any insured bank. In the case of such a loan the report would be made to the appropriate Federal banking agency of the bank whose stock secures the loan. An exception would apply to loans in the case of stock of a newly organized bank prior to its opening or where the applicant or borrower has been the owner of record of the stock for more than one year. Provision is also made that when there has been a change in control, each insured bank would be required to report promptly to the appropriate Federal banking agency any changes or replacements of the chief executive officer or directors that occur within twelve months after the change in control. The proposed bill sets forth the information which must be contained in the reports of changes in control, loans and executive officers and directors.

When I assumed my responsibilities as Chairman of the Federal Deposit Insurance Corporation, in January of this year, I was impressed with the thorough and painstaking investigations that precede the granting of insurance to newly chartered banks. In these investigations, particular emphasis is placed on the character and ability of the management and board of directors. A very complete report is submitted on every director and every chief executive officer of each bank applying for insurance. However, I was surprised to discover that when the control of a bank shifted or when a bank obtained new management, we had no such comparable reports to review. As a matter of fact, I learned that between examinations we usually found out about changes of control or management only through rumor.

Since 1934 it has become apparent that the vast majority of bank failures could be attributed to the business cycle, to bad judgment, to embezzlement or to a combination of these factors. Up until about 1955, shifts of control or management seemed to have relatively little to do with bank failures. Consequently, in January of this year, while I was surprised at this apparent gap, I was not unusually perturbed. I was not prepared to do anything about it.

But since March of this year, we have had five bank failures. The first occurred in Marlin, Texas, the second in Minden City, Michigan, the third in Dell City, Texas, the fourth in Belleview, Missouri, and the fifth in Covelo, California. All of these failures had this in common -- they were preceded by a recent change in control or management, sometimes both, and a rather sudden deterioration in the character of their assets. After the fourth failure, in Belleview, Missouri, my colleague, Director K. A. Randall, and I decided that we should try to plug up this hole in our authority. We announced our intention to ask for legislation much along the lines of the bill which you have before you today. Within a week after our announcement, the fifth failure occurred in Covelo, California, and it fell into precisely the same pattern as the four previous failures.

For those of you who are interested in reading the details of recent bank failures, you will find them spelled out in Appendix "A", which is attached to this statement. We have purposely not identified the banks in Appendix "A" because some of these matters are currently in litigation before the courts.

My purpose here today is to explain what this proposed legislation will do and why we have requested it. It is not my purpose to explain to you what it will not do. However, I do want to make it abundantly clear that we are not asking in this legislation for the authority to control or veto changes of ownership or management.

Mr. Chairman, in conclusion, it is my opinion that the enactment of this legislation will give the Federal Deposit Insurance Corporation, and the other Federal banking agencies, a useful tool to meet their obligations and responsibilities to individual depositors as well as to the American commercial banking system. The Corporation intends to transmit the information which it received, pertaining to State banks, to the state bank supervisors of the various states. I can say flatly that we intend to transmit this information immediately. Working in cooperation with the supervisors of the various states, and armed with this information, I believe that we can keep new managements or new owners under scrutiny until we are assured of their character and their ability.

The Bureau of the Budget has advised me that this proposed legislation is consistent with the Administration's objectives.

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APPENDIX "A"

CASE HISTORIES: RECENT BANK FAILURES

Between May 1963 and July 1964 seven insured banks have failed. In each instance, the cause of failure was a change of ownership of the particular bank followed by the assumption or making of bad loans which in some instances were fraudulent. The seven banks varied in amount of assets from about $1,224,000 to $19,132,000. In the aggregate their total assets amounted to approximately $36,302,000. The estimated loss to the Federal Deposit Insurance Corporation in these seven cases is approximately $2,500,000. What is not realized generally is that similar circumstances have been responsible for the closing of one-third of the last 18 insured banks to be placed in receivership prior to May 1963. It is important to discuss these earlier cases briefly before going into more detail regarding our last seven bank failures.

In 1955 a young man with only a high school education and no experience in banking put on a better demonstration of how to buy a bank with its own money and wreck it than more experienced people have done before or since. He located two banks only 40 miles apart in a rural area where the controlling stockholder in each instance desired to sell at substantially above book value and had therefore been unable to locate purchasers. He and his associates made an unsecured loan in the first bank to purchase stock control of the second bank and thereafter, after taking over the second bank, borrowed enough on an unsecured basis to go back and purchase the first bank. After installing himself and his friends as officers and directors in each of the banks, he then proceeded to make a series of unsecured loans to a number of out-of-state individuals with no credit worthiness, pocketing a great portion of the proceeds of such loans himself. This resulted in the closing of both banks and secured for the new owner of the two banks involved a ticket to the penitentiary.

Two more cases occurred in 1958 where, after changes of ownership, risky loans made by the new owners resulted in the closing of the banks. In one of these cases the new owner had control of some 15 corporations that were for the most part mere shells. Promptly following his acquisition of the bank, each of the corporations borrowed the maximum amount the bank could lend unsecured. All of these loans proved to be loss items and rendered the bank insolvent. This new owner and two of his associates went to the penitentiary.

Another such case occurred in 1959 where the new owner, after purchasing control of the bank, put his inexperienced son in the bank as chief executive officer. The son promptly rendered the bank insolvent due to risky loans which appear to have been made largely because of his lack of experience.

One case occurred in 1960 where the owner of an insolvent insurance company and his associate purchased a bank with some $750,000 of its funds and proceeded in the same transaction to attempt to rehabilitate the life insurance company, resulting in a loss to the bank of approximately $1,500,000. The bank was forced to close and these two individuals have since been convicted.

We turn now to our seven most recent failures which have occurred between May of 1963 and the present. We will also refer to two instances where checking out rumors of a change in control helped prevent insolvency.

A $7 million bank that had been operated in an ultra-conservative manner with enough of its funds in cash, due from banks and bonds to pay all of its deposits, was purchased by two individuals with no banking experience. In a period of five weeks they placed more than $1,200,000 in bad loans with a large percentage of this paper exceeding the limitations prescribed by applicable State law. Their actions resulted in the closing of the bank and indictments.

Our next case involves a bank considerably larger where several individuals, inexperienced in banking, by devious methods improperly used approximately $900,000 of the bank's own funds as part payment for stock control. They promptly selected a new executive officer of their own choosing and were principally responsible for the granting of a large volume of simulated loans with the proceeds of a large number of such loans eventually being used for their own benefit. The bank's loan volume increased $5 million within 120 days after the change of ownership of the bank. Further, some $1,600,000 in the bank's funds were placed in dormant noninterest-bearing deposit accounts with three other banks, for the sole benefit of the new owners, as a partial consideration for a $750,000 loan. Their actions resulted in the bank being placed in receivership and most of the principals involved are now under indictment.

In another case, two individuals with criminal records and inexperienced in banking, through a newly created corporate entity and a front man, or agent, acting for them as undisclosed principals, purchased the controlling stock interests in a $2.5 million bank. In a few weeks, because of the bank's lack of liquidity and by means of the payment of a bounty of 1%, they caused $1 million in cash to be placed in the bank. They in turn used this to purchase approximately $970,000 in mortgage notes (worth fifty cents on the dollar) which they bought at a 23% discount and placed in the bank at slightly less than their face value. During the few months the bank remained open after the change in stock control, they also are accused of having agreed to purchase approximately $900,000 more in mortgage notes worth from thirty to forty cents on the dollar. However, this transaction was not consummated inasmuch as the first mortgage note transaction described above resulted in the bank's insolvency, and its liquidation is now in progress.

And recently, approximately two years after purchasing stock control in an insured bank, an individual inexperienced in banking commenced paying checks of certain favored customers, including checks drawn by his sole proprietorship and two of his corporate interests. This series of paid but uncharged checks in substantial amounts were eliminated by substituting eight expertly forged notes. He then solicited $100,000 in the form of $10,000 certificates of deposit through a money broker by paying a 1% bounty above the maximum 4% interest allowable. Upon obtaining these funds he only entered four of the $10,000 items on the bank's books as deposit liabilities. The remaining $60,000 was misapplied to eliminate from the bank's books additional loss items that had arisen as a result of loans to his corporate interests. This course of action rendered the bank insolvent and resulted in the Corporation being appointed receiver. His conduct also resulted in a nineteen count Grand Jury indictment involving misapplication of funds and false entries.

Next, we have another bank that had encountered no unusual difficulties until mid-1963, when an individual from out of the State first became associated as a minority stockholder. This minority stockholder assumed dominating control of the bank in mid-1963, but did not actually consummate purchase of majority stock ownership until April 11, 1964. By the end of that month, April 1964, the bank's loans had more than doubled to a completely unrealistic 81% of total deposits. These loans included five bad notes in the aggregate of $45,000 signed by the new owner. Due to the bank's extreme lack of liquidity by mid-May 1964, the new owner had caused outstanding certificates of deposit to increase to an aggregate of $430,000, all of which represented out-of-territory money, except for approximately $27,750. On approximately $330,000 of these total outstanding certificates of deposit additional interest or bounties of from 1% to 2% were paid to cause the funds to be placed in the bank. The new controlling stockholder resigned as President in June and the bank was closed for liquidation by action of its own Board in early July, 1964.

In another case the new owners of a small country bank purchased control over three years ago. They proceeded to use the bank to assist their other enterprises. They augmented the funds of the bank by bringing in out-of-territory money through money brokers and issued certificates of deposit therefor. In order to generate income rapidly they substantially increased the number and dollar amount of out-of-territory high risk loans. Their operations endangered the bank and necessitated a change in ownership early this year. The new owners continued enlarging the bank and providing liquidity with the aid of the money brokers. They restored the capital funds of the bank by purchasing about $200,000 of criticized assets shortly after taking over. However, their operations were unsuccessful and the bank was closed for liquidation.

And again, stock control of a bank changed in June of 1963. The new owner placed large credits in the bank over the objection of other directors. In early 1964, he, in turn, sold stock control to an out-of-State farmer and cattle raiser who lost no time in placing large credits in the bank of his own and various out-of-territory interests. Preliminary reports concerning $316,000 in questionable loans caused the State banking authority to visit the bank in mid-July of 1964 to determine whether its solvency might be impaired. The bank was ordered to remove the loss loans on July 10, 1964, and when this was not accomplished the bank was closed by the State authority on July 20, 1964. The new controlling stockholder in this most recent case is the brother-in-law of a new controlling stockholder in one of our cases described previously and the next case described below wherein the bank involved was saved from insolvency.

In this case the bank, due to fortuitous circumstances was saved from insolvency. A situation arose in mid-1963 where two individuals, one of whom is the brother-in-law of the new owner described in the case immediately above, attempted to buy controlling interest in the bank for $211,000 through fraudulent manipulations (issuance of cashier's checks and a bank draft totaling $178,000). Inasmuch as the checks had not cleared at the time our examiners arrived for a regular routine examination of the bank, the cashier's checks were not paid and the scheme was thwarted before consummation and the bank suffered no loss. The brother-in-law has been indicted for his actions in this case.

Our last case involves another bank that has thus far been saved from insolvency after having been recently purchased by two new owners. They are the same two individuals who were the new controlling owners in one of the cases described above where a bank was rendered insolvent in early 1964. In this instance, control was purchased early in 1963. Here again, they caused the bank to obtain funds in the form of fifty-seven certificates of deposit issued to savings and loan associations throughout the country in the aggregate of $2,715,000. There is a strong indication that acquisition fees may have been involved. There is evidence of a $5,000 loan commission. New extensions of credit were granted, in the form of borrowings, by the new owners of the bank to concerns controlled by them in the aggregate of approximately $950,000, with approximately half of this aggregate classified "Loss." While under pressure to rehabilitate the bank, the new owners sold their stock interests under an arrangement whereby the purchase price is held in escrow for the purpose of taking care of losses on the bad paper placed in the bank by the sellers. This bank remains an operating insured bank due to early knowledge of the situation by the State banking authority and the Federal Deposit Insurance Corporation and the supervisory techniques employed.

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NAME	ASSETS	ESTIMATED TOTAL LOSS
Frontier Bank Covelo, California	$ 2,666,000	
Chatham Bank of Chicago Chicago, Illinois	19,132,000	
The First State Bank of Westmont, Illinois Westmont, Illinois	7,014,000	
The State Savings Bank of Minden City Minden City, Michigan	1,314,000	
Belleview Valley Bank Belleview, Missouri	1,286,000	
First State Bank Dell City, Texas	1,224,000	
The First National Bank of Marlin Marlin, Texas	3,666,000	
TOTAL	$36,302,000	About $2 1/2 million