

AUG 21 1989

FEDERAL DEPOSIT INSURANCE CORPORATION
SUMMARY OF STATEMENT OF JOHN L. DOUGLAS, GENERAL COUNSEL
FEDERAL DEPOSIT INSURANCE CORPORATION
BEFORE THE SUBCOMMITTEE ON CRIME OF THE HOUSE JUDICIARY COMMITTEE

July 20, 1989

The FDIC's experience has been that fraud, criminal conduct and insider abuse is present in approximately one-third of commercial banks that have failed during the past five years. In addition, the FDIC has found evidence of fraud, criminal conduct and insider abuse in approximately fifty percent of the savings and loan associations that the FDIC is managing in its conservatorship and receivership program. Thus, the RICO statute can be an important instrument to deter such improper behavior and to facilitate recovery of lost funds.

While the FDIC's use of RICO has been very restrained and limited, it has been proven to be an effective tool in deserving situations. While the Corporation does not foresee a great number of RICO claims, it is anticipated that it will be used prudently and judiciously in order to recover funds for the receivership estates of failed institutions and to preserve and protect the deposit insurance fund.

With respect to H.R. 1046, the FDIC offers the following comments:

-- The legislation should clarify the FDIC's right to sue for treble damages when suing either in its corporate or receivership capacities;

-- The legislation should also preserve the right of the FDIC to assert RICO claims in either federal or state courts;

-- The procedural affirmative defense of "good faith reliance" on regulatory decisions prior to the initiation of discovery may effectively preclude the ability to pursue appropriate claims promptly and effectively;

-- Suggest a six year statute of limitations be incorporated in the legislation;

-- Support efforts to limit treble damages to true criminal conduct.

TESTIMONY OF JOHN L. DOUGLAS, GENERAL COUNSEL

FEDERAL DEPOSIT INSURANCE CORPORATION

BEFORE THE SUBCOMMITTEE ON CRIME OF THE
HOUSE JUDICIARY COMMITTEE

JULY 20, 1989

TESTIMONY OF JOHN L. DOUGLAS

We welcome the opportunity to testify before the Subcommittee on Crime of the House Judiciary Committee on the RICO Reform Act of 1989 (H.R. 1046). The Federal Deposit Insurance Corporation has a keen interest in RICO in its capacity as insurer and regulator of our nation's banks, and we support efforts to refine its scope and to help it achieve its intended purpose.

The FDIC

The FDIC is a government controlled corporation, established in 1934 to provide insurance for depositors in commercial banks. This insurance was designed in part to bring stability to the nation's banking system. Currently, deposits are insured up to \$100,000 per depositor. Banks pay premiums to the FDIC for this insurance protection. The FDIC insurance fund currently exceeds \$14 billion.

As insurer, the FDIC has direct obligations and responsibility whenever a bank fails. In such capacity, the FDIC must assure that depositors receive their deposits up to the amount of deposit insurance. In fulfilling such obligation, the FDIC becomes subrogated to the depositors' claims against the estate of the failed bank. In addition, whenever an insured bank fails, the FDIC must also be appointed receiver of the failed bank. As receiver

it "steps into the shoes" of the failed bank, undertaking the obligation to marshal the assets of the bank in order to satisfy the bank's liabilities.

As receiver, the FDIC will liquidate the assets of the bank, as well as pursue other claims that the bank may have against officers, directors, third parties, bonding companies and others. In pursuing these collection efforts, the FDIC minimizes the costs of the failure and preserves the value of the FDIC insurance fund.

In addition to its role as insurer, the FDIC is also the direct federal regulator and supervisor of approximately 8,000 state chartered commercial banks that are not members of the Federal Reserve System. As insurer and regulator, the FDIC has a keen interest in the health and vitality of commercial banks and the commercial banking system.

Pending legislation (H.R. 1278 and S. 774) would expand the role of the FDIC. The FDIC, through a separate insurance fund, would also become the insurer of the nation's savings and loan associations. Further, by assuming responsibilities of the Federal Savings and Loan Insurance Corporation, and through its expected relationship with a newly created Resolution Trust Corporation, the FDIC will be charged with the liquidation and receivership activities of failed savings and loan associations.

It is the combination of these various roles as insurer, regulator and receiver that gives the FDIC an interest in RICO.

Recent Bank and Thrift Failures

It is safe to say that the past few years have been among the most turbulent time for commercial banks and savings and loan associations. In 1986, 1987 and 1988, an average of over 200 commercial banks each year either failed or required FDIC assistance to prevent imminent failure. Over 200 savings and loan associations were "resolved" through assistance provided by the FSLIC in 1988. The current level of bank failures in 1989 equals the pace of 1988, and currently approximately 240 savings and loan associations are operating in conservatorships and receiverships under the management of the FDIC, awaiting liquidation or resolution pending receipt of funds from the legislation now pending in Congress.

We do not attribute the high level of bank and thrift failures directly to fraud and criminal conduct. However, our experience has been that fraud, criminal conduct and insider abuse is present in approximately one-third of commercial banks that have failed during the past five years. We have found evidence of fraud, criminal conduct and insider abuse in approximately 50 percent of the savings and loan associations that the FDIC is managing in its conservatorship and receivership program. And according to the FBI, more than \$4½ billion has been lost to bank and thrift institutions over the past four years.

These are sobering statistics. It is in the interest of the FDIC to deter this illegal and improper behavior. It is also in the interest of the FDIC

to use every appropriate tool to recover funds lost as a result of this illegal conduct. The RICO statute can be an important instrument to deter such improper behavior and to facilitate recovery of lost funds.

The FDIC's Use of RICO

Consistent with the role and function of the FDIC, the FDIC's use of RICO has been very restrained and limited. As receiver, the FDIC's goal is to recover funds for the receivership estate. Asserting a RICO claim may be an appropriate means of recovering funds, and it has been so used by the FDIC. In determining whether or not to initiate a RICO claim, the FDIC evaluates the strength of the claim, the damages incurred, the likelihood of success, the type and nature of defenses to be asserted, the anticipated recovery date, and the probable resources available to satisfy any judgment. A RICO claim can only be brought with the concurrence of the head of the Division of Liquidation, the General Counsel and the Chairman of the Board of Directors of the FDIC.

Although the use of RICO has been very restrained, RICO has proven to be an effective tool in deserving situations. In FDIC v. Renda, the RICO was used in a case involving a nationwide scheme to defraud banks through a practice known as "linked financing," as well as the largest union pension fund fraud ever prosecuted by the Justice Department's Organized Crime Strike

Force. In FDIC v. Antonio, millions of dollars of fraudulent loans were siphoned from a Denver bank to known members of organized crime on the east coast under the pretext of a gold purchase project.

We note, however, that such cases are difficult to investigate and prosecute, they often result in very vigorous and aggressive defenses, and the prospect for recovery is uncertain. However, we do believe that RICO can be an important tool in the arsenal of the FDIC.

We anticipate that in our role as liquidator for insolvent savings and loan associations, there will be other instances where the use of RICO will be appropriate. While we do not anticipate a great number of RICO claims, we can anticipate that it will be used prudently and judiciously in order to recover funds for the receivership estates of failed institutions and to preserve and protect the deposit insurance funds.

Comments on H.R. 1046

With respect to specific provisions of H.R. 1046, we offer the following comments:

It is important that the legislation acknowledge the FDIC's right to assert a RICO claim for treble damages as a "governmental entity" even when acting as receiver for a failed institution. Since, as receiver, the FDIC steps

into the shoes of the failed institution, it should be made clear that the legislation provides the FDIC the right to assert a treble damage claim under RICO. Thus, we suggest that the legislation clarify the FDIC's right to sue for treble damages when suing either in its corporate or receivership capacities.

The legislation should also preserve the right of the FDIC to assert RICO claims in either federal or state courts. Congress has granted the FDIC this flexibility in dealing with failing financial institutions. The FDIC should have the option to choose the most appropriate form to assert its interests.

We are concerned about a provision in the legislation that would create a procedural affirmative defense of "good faith reliance" on regulatory decisions prior to the initiation of discovery. We are troubled that this affirmative defense may effectively preclude the ability to pursue appropriate claims promptly and may complicate the ability to prosecute the claim effectively because of inherent delay. We believe that such an affirmative defense can be effectively and properly adjudicated in the context of the trial on the merits without giving defendants a procedural right to delay discovery. This delay can permit ill-intentioned defendants to destroy documents, cover up illegal operations, complicate the tracing of funds, or otherwise impede the future discovery of wrongful acts.

We think it appropriate that a fairly long statute of limitations be incorporated in the legislation. A six year statute of limitations is a fair recognition of the difficulties in investigating and assembling appropriate lawsuits with a limited staff. Such an extended statute of limitations is not unfairly long to perpetrators of organized crime.

Finally, we support efforts to limit the treble damage provisions of RICO to true criminal conduct. We are troubled by converting legitimate business disputes into racketeering claims with the potential for treble damages, and support efforts to assure that RICO accomplishes only its intended purpose.

Conclusion

In conclusion, we support efforts to refine the RICO legislation. RICO is and should continue to be one tool to deter misconduct in our nation's commercial banks and to facilitate the recovery of funds by the FDIC following bank failures. It has been used sparingly by the FDIC, under strict controls and supervision to assure that its use is consistent with the statutory mission of the agency. We believe that it can continue to be a useful tool, and hope that the Committee will preserve its usefulness to the FDIC.