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Statement by

George A. LeMaistre, Chairman
Federal Deposit Insurance Corporation

before the

Senate Committee on Banking, Housing and Urban Affairs
United States Senate

September 26, 1977

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Oversight hearings to determine whether additional statutory or regulatory safeguards are needed to assure appropriate agency response to a wide range of abusive banking practices.

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I. INTRODUCTION

Mr. Chairman, I welcome the opportunity to testify at these oversight hearings which seek to determine whether additional statutory or regulatory safeguards are needed to assure appropriate agency response to a wide range of abusive banking practices. We at the FDIC appreciate your concern and the concern of the Committee in this regard. We view these hearings as a constructive process in which we can advise the Committee and the public on the steps which we are taking to curb abusive conduct and in which we can seek to develop further tools to deal with such conduct.

In your letters of August 31, 1977, and September 20, 1977, you requested that we focus upon abuses involving: bank stock loans; loans to favored customers; overdrafts; failure to comply with banking laws or regulations; insurance commissions and double use of collateral. In addition, you sought our views and information regarding actions that the FDIC has taken under the Financial Institutions Supervisory Act of 1966; our appraisal of the responsibilities and liabilities of bank directors; our views as to the appropriateness of legislation dealing with the transfer of control of banks; and finally, our views as to conflicts of interest involving bank examiners. We have sought in the discussion that follows to be as responsive as possible to these inquiries. Needless to say, we are anxious to work closely with the Committee in the coming months as it addresses these and related matters.

Your inquiry largely focuses on abuses by bank insiders. In that regard, I must emphasize in the strongest possible terms that the FDIC is

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deeply concerned about and responds vigorously to overreaching and abusive conduct on the part of bank insiders. Our experience over the years and our current investigations indicate that serious abuse is not widespread. At the same time, we are fully aware that the potential for the abuse of a bank is great and that serious abuses do occur.

The FDIC has a unique perspective among the banking agencies in viewing the subject of abusive insider banking practices. Not only are we responsible for supervising and regulating the more than 9,000 insured state nonmember banks, but we also serve as receiver or liquidator for those institutions which fail. As a result, we are acutely aware of the ill effect of abusive and unsound banking practices and we know all too well the ways in which an insider may abuse his or her financial institution. Moreover, because of our responsibility to protect the insurance fund, secure confidence in the banking system generally and protect the various segments of the public which have a stake in the viability of a bank, the FDIC has a further direct institutional interest in the prevention of abusive conduct.

At the outset, I should state that I am absolutely confident of the toughness of our examiners in dealing with abusive conduct. It is essential to remember during the course of these deliberations that no system of human beings and laws is perfect. People will make mistakes and some are dishonest. Laws and tools of public policy do evolve to keep up with changes in technology and innovations in abuse, often at a pace which

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frustrates us all. Similarly, our view as to what are appropriate tools and policies has evolved.

The experience of the FDIC in using its cease and desist powers is illustrative. For several years after Congress granted the agencies this power in 1966 it was not used at all. Even though banks were aware of the possibility that it might be used, the first order was not issued until June 1971. From June 1971 to May 1976 the power was used sparingly. This lack of use was interpreted by many as reflecting laxity and indifference. My perception is that this was not the case. Rather, supervisory personnel and the agency generally simply did not use a tool which they found unfamiliar and cumbersome possibly because they believed that existing tools were more effective. Since May 1976 the agency has made increasingly frequent use of this tool, and many of its most outspoken critics within the agency have become its greatest supporters.

I must also underscore that just as there are differences among the Committee as to what constitutes abusive and unsound conduct and precisely what should be done about it, there are also differences among those of us at the FDIC who are concerned about these issues. I shall in the course of my discussion attempt to illuminate rather than obscure these differences as I believe that it is appropriate for the Congress and the public to focus upon the gray areas of policy where reasonable men may differ. At the same time, I shall also emphasize that there are other areas in which the abuses are not gray but are black and white and in which there is no disagreement at the FDIC.

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In the discussion that follows, I shall describe our current perspective as to the extent of the practices that you are focusing upon and spell out in some detail the response which the FDIC has made to these practices. As this discussion will make clear, we continue to seek new policies and techniques which will minimize abusive conduct. As you know, we are in the process of developing more detailed information as to the scope of activities in some areas.

Before turning to a discussion of the questions which you have raised and our practices and policies in dealing with abusive conduct, I shall outline for you surveys and studies which we have undertaken in response to the Committee's concerns. Information and data were collected from three different sources -- the experiences of our 14 Regional Directors, a sample of 261 bank examination reports on file in the Washington office of state nonmember insured commercial banks having deposit balances due to other banks and a survey of 303 state nonmember insured commercial banks which were in the process of being examined during the period from September 6 to September 16, 1977.

Each of our Regional Directors was asked to comment on the types of abusive practices involving correspondent bank balances and the financing of bank stock purchases, the procedures followed to detect such abusive practices and the actions taken in cases where abusive practices are found to exist. The Regional Directors were also asked to provide information on overdrafts.

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Bank examination reports for state nonmember insured banks provided a second source of information and data. We assumed that banks with positive "due to bank" balances would be more likely than other banks to make bank stock loans and loans to insiders of other banks. There were approximately 2,600 insured nonmember banks with such balances as of June 30, 1977, out of a possible total of over 8,700 insured nonmember banks. From the 2,600 we selected a sample of 261 banks consisting of 31 banks with deposits of $300 million or more (large banks), 105 with deposits of $50 to $300 million (medium-sized banks) and 125 with deposits of $50 million or less (small banks). We used the latest available Report of Examination of each of the 261 banks as a source of information with respect to bank stock loans, loans to officers and directors of other banks and overdrafts.

Finally, detailed information was collected on loans secured by bank stock, loans to officers and directors of other banks, correspondent balances and overdrafts to insiders in all nonmember insured commercial banks for which an examination was in progress between September 6 and September 16, 1977. Usable information was supplied for 303 banks, including 250 small banks, 45 medium-sized banks and 8 large banks. (Information pertaining to overdrafts was collected from only 189 banks.)

In addition, at the request of this Committee, the FDIC is preparing, in conjunction with the Comptroller of the Currency and the Federal Reserve Board, a survey which will be sent to all insured commercial banks in the next few days. In this survey, banks will be asked to report as of September 30, 1977, bank stock loans, loans to officers, directors and major

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shareholders of other banks, and loans to their own officers, directors and major shareholders and their business interests. The banks will be asked to supply data about amounts outstanding, interest rates and correspondent balance relationships.

II. FDIC'S APPROACH TO INSIDER ABUSE, INCLUDING PREFERENTIAL LOANS TO INSIDERS

Generally, the bulk of the issues which you have focused upon involve the abuse by insiders of their relationship with their financial institution. However, in your letter of August 31, 1977, you seek information with respect to loans to favored customers generally and not merely insiders. Because we treat insider transactions very differently from those not involving insiders, I shall attempt to deal with the two issues separately.

It is important to note that the problem is a general one not limited to overdrafts or compensating balances or extension of credit on preferential terms. For example, over the years the FDIC has uncovered and responded to insider overreaching involving exorbitant management fees, excessive legal fees, preferential treatment in the purchase and sale of assets, favorable lease arrangements, misuse of bank assets, and other devices whereby insiders use their institutions for their personal advantage.

As I have indicated, the question of what constitutes abuse, is one which generates some disagreement. My own view, and the predominant view at the FDIC, is that insider conduct is abusive and constitutes

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an unsafe and unsound banking practice when an insider obtains a benefit which is not available to a noninsider otherwise similarly situated and when the result of the insider's obtaining that benefit is detrimental to the bank. While such a standard is easy to apply in many cases, in other instances the question is a complex and difficult one. My own views in this regard were set forth early in my term as Director at the FDIC. Speaking at the 33rd Annual Texas Bankers Conference on August 20, 1974, I stated:

> A bank is necessarily adversely affected when an insider exacts terms not available to members of the public. This is true whether the deal reflects a conscious intent to milk the bank or is merely the result of tainted judgment. In either event, the bank is harmed, since the economic benefit redounding to the insider represents a cost or loss of earnings which is borne by non-benefiting shareholders and/or in some way passes through to the bank's customers.
>
> For this reason, any transaction between a bank and an insider or his interests that is significantly more favorable to the insider than a comparable transaction with a non-insider is an unsound banking practice and should not be tolerated by a bank's board of directors. Where such conduct is tolerated by a bank's board, it should be the subject of firm supervisory action. To follow any other policy is to allow banks to subsidize the non-banking financial activity of preferred insiders at the ultimate expense of minority or non-interested shareholders, and, in the case of bank failure, at the expense of many creditors and depositors as well.

As you know, the most glaring example of the abuse of an insider relationship is the failure of U. S. National Bank in San Diego, a failure which was caused by what has been termed "a riot of self-dealing." This failure led the FDIC to reassess the effectiveness of its policy and procedures in dealing with insider abuse. The result of this appraisal was the adoption of a regulation dealing with insider transactions which

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became effective on May 1, 1976. The Corporation's reasons for adopting this regulation are stated further in the preamble to the regulation and in the notice published in the Federal Register which announced its adoption. This notice stated:

> This action is based on the experience of the Corporation which indicates that many banks have suffered loan losses, loss of revenue, excessive costs and other substantial economic detriment as a result of ill-considered transactions with insiders. The need for more rigorous supervision of such transactions by boards of directors and bank supervisory agencies is indicated by the fact that abusive self-dealing has been the primary cause or a significant contributing cause in more than half of all bank failures since 1960, including the failure of 30 nonmember insured banks. The most dramatic example of the harm which can result from abusive self-dealing is the 1973 failure of the United States National Bank, San Diego, California, for which the Corporation has had to establish a reserve of $150 million for loss to the deposit insurance fund. Review of existing and past "problem" bank cases also reveals insider overreaching as a significant source of serious difficulty. Moreover, an insider transaction that is not effected on an "arm's length" basis will lead to a diminution of earnings and an erosion of capital, even where the immediate result is not the bank's failure or its designation as a "problem" institution. It follows, therefore, that insider transactions whose terms and conditions cannot be justified when viewed in light of all the circumstances surrounding the transaction, increase the risk of loss to depositors and ultimately to the deposit insurance fund. In addition, insider transactions whose terms and conditions cannot be justified constitute a diversion to insiders of resources that properly belong to all shareholders on a pro rata basis, as well as a misallocation of a community's deposited funds.

I am confident, however, that the view set forth in this statement is not a new one at the FDIC. Our examiners have always given special scrutiny to insider transactions and have vigorously sought to achieve corrective action when abuse is found. Thus, instead of establishing new

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policy, the FDIC's regulation sought instead to highlight and reenforce a longstanding policy. Historically, this approach was enforced through two vehicles: (1) the supervisory and examination process, and (2) the applications process.

Although not well understood by those unfamiliar with bank supervision, the examination process is a potent tool of enforcement and compliance. For example, in United States v. Philadelphia National Bank, 374 U.S. 321, 329 (1965), the Supreme Court stated:

> . . . [P]erhaps the most effective weapon of federal regulation of banking is the broad visitatorial power of federal bank examiners . . . . The FDIC has an even more formidable power. If it finds "unsafe or unsound practices" in the conduct of the business of any insured bank, it may terminate the bank's insured status . . . . Such involuntary termination severs the bank's membership in the FRS, if it is a state bank, and throws it into receivership if it is a national bank . . . . As a result of the existence of the panoply of sanctions, recommendations by the agencies concerning banking practices tend to be followed by bankers without the necessity of formal compliance proceedings.

When abusive insider transactions or insider transactions involving violations of law or regulation are discovered by examination, they are enumerated and criticized in the examination report. In fact, whether abusive or not, all significant insider transactions will be reflected in the report. Correction of abuses is sought by the bank examiner or his superiors, either through discussions with management or through the bank's board of directors. Great emphasis is placed upon achieving voluntary compliance, although for the last few years the Corporation has not hesitated to institute formal corrective action if "moral suasion"

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or "jawboning" was not effective. Though not designed as such, the application process has also served as an effective tool of bank supervision. Corrective action is often achieved through denial or threat of denial of various actions for which a bank must seek prior FDIC approval. For example, the applicable statute provides that a bank must obtain the prior approval of the FDIC in order to establish or relocate a branch office and one of the factors the Corporation must consider is the general character of the bank's management. An otherwise routine application might be denied if abusive insider practices were existing and not being corrected.

The regulation dealing with insider transactions which was adopted in 1976 sought to add three elements to this approach. First of all, the regulation establishes procedures which require bank boards of directors to supervise bank insider transactions in a meaningful manner. The board of directors of each insured nonmember commercial bank is required to review each insider transaction involving assets or services greater than a specified amount which varies with the size of the bank. In addition, certain information, including a record of dissenting votes cast by members of bank boards of directors, must be kept available in order to foster effective internal controls over such transactions by the bank itself, and to facilitate examiner review and analysis. While the regulation imposes certain recordkeeping requirements, we have not required the bank to keep new records or to establish new files. It is our view that the minutes of board meetings can serve as an

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appropriate listing of all insider transactions and that the regular filing system of the bank can be the repository of information required by the regulation so long as it is readily accessible to FDIC examiners.

Most importantly, the regulation itself makes clear that formal compliance with the board of director review and approval requirements does not relieve the bank of its duty to conduct its operations in a "safe and sound" manner. Nor does it prevent the Corporation from taking whatever supervisory action is deemed necessary and appropriate. And, we have made it clear that the FDIC Board views <u>any</u> significant insider overreaching as an unsafe or unsound banking practice, and, as such, will not be tolerated.

That this is the case is reflected in the Agency's record in bringing 51 cease and desist orders since January 1, 1976. As discussion below reflects, 35 out of the 51 cease and desist actions brought during this period were aimed at least in part at correcting some insider abuse.

Particularly notable are 8(b) actions brought this summer against five related banks in which we charged former and present officers and directors with abuse of their authority by causing the banks to pay excessive expenses to companies owned by the insiders. These cases represent a significant innovation in that we sought recovery from the individuals for the first time in the history of our use of the Section 8(b) power -- bringing what is tantamount to a derivative action. By consent, the offending insiders agreed to reimburse the banks in an amount agreeable to the FDIC and the state supervisor.

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As I have indicated, our insider regulation became effective May 1, 1976. Thus, it has been in place for a little more than a year. We are now in the process of engaging in a detailed review and evaluation of its effectiveness. I anticipate that we will seek to effect certain changes in the regulation as a result of this review. It is my intention, as I will indicate below, to propose to the Board of Directors that the regulation be modified so as to provide us with the tools for dealing with abuse in the bank stock loan area.

In addition, I am prepared to propose to the Board that we amend the regulation to make more clear the standard which we expect bank boards to apply in reviewing insider transactions and which we will apply in determining whether to bring supervisory action. As the regulation now stands, Subsection (g) states:

> (g) Supervisory Action in Regard to Certain Insider Transactions. Notwithstanding compliance with the review and approval requirements of paragraph (b) of this section, the Corporation will take appropriate supervisory action against the bank, its officers or its directors or trustees when the Corporation determines that an insider transaction, alone or when aggregated with other insider transactions, is indicative of unsafe or unsound practices. Such supervisory action may involve institution of formal proceedings under section 8 of the Federal Deposit Insurance Act. Among the factors which the Corporation will consider in determining the presence of unsafe or unsound banking practices involving insider transactions are:
>
> (1) Whether, because of preferential terms and conditions, such insider transactions are likely to result in significant loan losses, excessive costs, or other significant economic detriment which would not occur in a comparable arm's length transaction with a person of comparable creditworthiness or otherwise similarly situated;

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(2) Whether transactions with an insider and all persons related to that insider are excessive in amount, either in relation to the bank's capital and reserves or in relation to the total of all transactions of the same type; or

(3) Whether, from the nature and extent of the bank's insider transactions, it appears that certain insiders are abusing their positions with the bank.

It is my belief that this provision should be modified to remove any doubt that a transaction which reflects a preference to an insider or his interest and results in a detriment to the bank is an unsafe or unsound banking practice which should not occur and will be dealt with severely by the FDIC.

Finally, we believe that additional restrictions of the type contained in Sections 103 and 107 of S. 71 as it passed the Senate would be advisable. These sections provide that existing limits under applicable federal and state law on loans to one borrower would apply to loans any officer or person holding 10 percent or more of the bank's voting stock, including loans to companies controlled by such officer or stockholder. These sections would also require that when aggregate loans to any officer, director or holder of 10 percent or more of stock exceed 25,000, advance approval of two-thirds of the bank's board of directors would be required. In addition, loans to such insiders on preferential terms would be prohibited.

III. BANK STOCK LOANS AND ABUSE OF THE CORRESPONDENT RELATIONSHIP

As you know, among the most serious abuses associated with bank stock loans are those involving the use of correspondent balances by a banker to compensate a correspondent bank for preferential loans extended to him

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or his interests. This abuse has been most prevalent in states in which there are restrictive branching policies and the loans are used to finance the purchase of control of smaller banks. It should be noted, of course, that abuses of correspondent balances are not only associated with bank stock loans but may also involve any extension of credit to someone who can exercise control over a correspondent account. Moreover, there are a variety of other abuses which may be associated with bank stock loans not involving a correspondent relationship. Often, for example, these occur when a principal has overextended himself and must overreach to meet his obligations.

A. Frequency of Bank Stock Loans and Loans Associated with a Correspondent Relationship and Extent of Possible Abuse

Our Regional Directors report that frequently loans are made by correspondent banks to the officers of a depositing bank. Some of these loans are secured by stock of the depositing bank. These banks typically are closely held institutions where control is vested in one person, a small group of individuals or a one-bank holding company and are often located in small communities.

In commenting on the extent to which correspondent balance arrangements and other potential abuses relating to bank stock loans have been problems in insured nonmember banks, our Regional Directors indicated that significant abuses existed in several regions during the late 1960's and early 1970's. They report, however, that serious abuse has diminished substantially since that time. Our Regional Directors attribute the decline

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to increased supervisory pressure, notification to banks that the Justice Department viewed such arrangements as possible violations of 18 U. S. C. 656, and referral of specific cases to Justice for investigation.

This decrease in the number of compensating balance cases is reflected by a decline in the number of referrals to the Justice Department. This strongly suggests that abuse has been curbed. There were 205 referrals in 1971, 114 in 1972, 17 in 1973, 28 in 1974, 10 in 1975, and 43 in 1976. There have been only eleven thus far this year. (We are reviewing these cases to determine what number involved the financing of bank stock; it is fair to assume that a substantial portion of them did.)

Although the financing of bank stock loans by other banks is common, relatively few insured state nonmember banks engage in such lending to any significant degree. In our survey of 261 bank examination reports, we found that 10 of the 31 large banks, 23 of the 105 medium-sized banks and 8 of the 125 small banks had bank stock loans outstanding. Insured nonmember correspondent banks that extended loans secured by the stock of their depositing banks included 7 large banks, 21 medium-sized banks and 4 small banks. In terms of percentages, 16 percent of the sample banks with "due to" accounts had bank stock loans and 75 percent of these, or 12 percent of the total, had loans secured by stock of their depositing banks.

Of the 303 insured state nonmember commercial banks that were being examined during the first part of September, 30 small banks,

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15 medium-sized banks and 3 large banks, or 16 percent of the total sample, had made loans secured by 5 percent or more of the stock of other banks (See Table 1). Only 14 of the 303 banks, approximately 5 percent, made loans secured by stock of banks for which they served as correspondent. These 14 included 5 small banks, 6 medium-sized banks and 3 large banks.

Again referring to the survey of 261 bank examination reports, loans to officers of banks were associated with correspondent relationships in 30 percent of the small banks, 43 percent of the medium-sized banks and 71 percent of the large banks in the sample. Overall, 54 percent of the sample banks with "due to" accounts had loans to officers of other banks and 40 percent had loans to officers of depositing banks. However, only 39 of the 303 banks in the examination survey, about 13 percent, extended credit to officers of depositing banks. The 39 banks included 24 small banks, 11 medium-sized banks and 4 large banks (See Table 2).

The differences in the percentages reported for the survey of examination reports and the survey of examinations in progress may be related to the more limited scope of the bank examination report survey and differences in the size distribution of banks in each sample. Specifically, the bank examination report survey included a much greater percentage of large banks. Large banks are more likely than small banks to make bank stock loans and extend credit to officers of depositing banks. In any event, the percentages indicate that loans secured by bank stock

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Table 1

LOANS SECURED BY 5 PERCENT OR MORE
OF THE SHARES OF STOCK OUTSTANDING OF OTHER BANKS

	Total Deposits in Millions			Total Number of Banks
	$0-$50	$50-$300	$300+	
Number of Banks in Sample	250	45	8	303
Number of Banks Making Stock Loans	30	15	3	48
Number of Banks Making Stock Loans with Apparent Preferential Treatment	4	3	0	7
Number of Correspondent Banks Making Loans Secured by Stock of their Depositing Banks	5	6	3	14
Number of Correspondent Banks Making Loans with Apparent Preferential Treatment Secured by Stock of their Depositing Banks	1	3	0	4
Number of Correspondent Banks where Correspondent Accounts were Opened or Increased Around the Time Stock Loan was Made	1	2	2	5
Number of Correspondent Banks Making Loans Secured by Stock of their Depositing Banks where Correspondent Accounts Appeared Large in Relation to Services Provided	1	0	2	3

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Table 2

LOANS TO OFFICERS OF OTHER BANKS

	Total Deposits in Millions			Total Number of Banks
	$0-$50	$50-$300	$300+	
Number of Banks in Sample	250	45	8	303
Number of Banks Making Loans to Officers of Other Banks	154	40	7	201
Number of Banks Making Loans with Apparent Preferential Treatment to Officers of Other Banks	11	9	2	22
Number of Correspondent Banks Making Loans to Officers of their Depositing Banks	24	11	4	39
Number of Correspondent Banks Making Loans with Apparent Preferential Treatment to Officers of Depositing Banks	3	2	1	6
Number of Correspondent Banks Making Loans to Officers of Depositing Banks where the Correspondent Account was Opened or Increased at Time Loan was Made	2	3	0	5
Number of Correspondent Banks Making Loans to Officers of Depositing Banks where the Correspondent Accounts Appeared Large in Relation to Services Provided	0	3	1	4

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are not commonly made by insured state nonmember commercial banks. A correspondent relationship with the same bank whose stock secures a loan is even less common. Moreover, extension of loans to officers of depositing banks does not appear to be a widespread practice.

In our survey of the 261 banks whose examination reports were reviewed, we found that 40 percent of the banks made loans to officers of their depositing banks and 12 percent made loans secured by stock of depositing banks. Since the abuse resulting from a misuse of correspondent balances depends upon the effect of the depositing banks, review of the correspondent's examination report alone did not enable us to evaluate the effect of the correspondent relationship on the depositing banks.

The survey of banks in the process of being examined during early September revealed that 22 of the 303 banks, or 7 percent, had extended loans to officers of other banks that apparently involved preferential treatment. Included in the 22 banks were 7 banks, or 2 percent of the total sample, that had made bank stock loans. Six of the 22 banks extending credit to officers of other banks, which had a correspondent relationship with the officer's bank, and 4 of the 7 banks making stock loans, which had a correspondent relationship with the bank whose stock secured the loan, accorded preferential treatment to these loans.

Of the 39 banks that extended loans to the officers of depositing banks, 5 involved the opening or increase of a correspondent account at the time the loan was made and 4 had correspondent accounts that appeared large in relation to services provided. The 6 banks showing

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evidence of apparent preferential treatment included 3 where the correspondent account had been opened or increased at the time the loan was made, 2 where the correspondent account appeared large in relation to services provided and 2 where the correspondent account not only had been opened or increased at the time the loan was made but also appeared to be large in relation to services provided.

Out of the 14 banks that had made loans secured by stock of depositing banks, a correspondent account was opened or increased around the time that the loan was originated in 5 and correspondent accounts appeared large in relation to services provided in 3. The 4 banks showing evidence of apparent preferential treatment included 2 where the correspondent account had been opened or increased around the date of the loan and 2 where the correspondent account not only had been opened or increased but which also appeared to be large in relation to the services provided.

In summary, apparent preferential treatment of loans to officers of depositing banks was discovered in 6 banks. Four of these had made loans secured by stock of depositing banks. While these cases may involve abuse of the depositing bank, further investigation would be required to verify this. These figures suggest that abusive practices involving correspondent balances may be an isolated phenomenon. However, because of the small size of the sample, it is possible that these figures are not representative of all insured state nonmember banks. The survey of all insured commercial banks, which will be conducted in the coming weeks, should provide better information on the extent of such practices.

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B. FDIC Policies and Practices

1. Abuse of correspondent relationships

The Corporation's procedures for dealing with abusive practices in connection with correspondent balances has been evolving over the last several years. In the late 1960's in response to potential abuses in inter-bank lending and financing of bank stock acquisitions, the three federal bank supervisory agencies developed reports on loans to officers of other banks and bank stock loans. Examiners are required to list all loans to officers of other banks, except for loans of insignificant amounts, on Form 6500/22 (Exhibit A). Loans secured by stock of other banks, which in the aggregate amount to 5 percent or more of each bank's outstanding shares, are listed on Form 6500/23 (Exhibit B).

In September 1970, after receiving a letter from the Department of Justice, stating that certain practices involving bank stock loans and correspondent accounts might constitute a breach of fiduciary duty owed by borrowing officials to their banks and that these practices might in certain circumstances warrant prosecution, the Corporation sent a letter on October 26, 1970 (Exhibit C) to all insured state nonmember banks calling attention to the Justice Department letter. This was followed by a memorandum (Exhibit D) to all the FDIC Regional Directors. At the

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same time the Justice Department's letter was incorporated in the Corporation's Manual of Examination Policies. The Corporation forwards cases involving the use of interbank deposits as compensating balances for loans to individuals connected with the depositing bank to the appropriate United States Attorney with copies to the Criminal Division of the Department of Justice in Washington, D. C.

Since December 1971, copies of the October 26, 1970 Justice Department letter have also been furnished to applicants requesting deposit insurance for a new bank.

In March 1972, further instructions were issued to Regional Directors requesting that certain factual information be included in the irregularity reports furnished to the Department of Justice (Exhibit E). In 1974, guidelines (Exhibit F) were developed to assist examiners in focusing more clearly on those cases where bank resources are used for the personal benefit of bank officials. The guidelines were developed by the Corporation's Legal Division and were designed to facilitate investigation of suspected abuses.

In addition to actions taken by the Washington Office with respect to this problem, supervisory follow-up has occurred in the Corporation's Regional Offices. For example, in the southwest area of the country where this activity was most prevalent, the Director of the Dallas Regional Office was concerned about this problem prior to 1970. Information exchanged between the three federal banking agencies indicated that certain stock loans in that part of the country bore unreasonably low interest rates.

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The Dallas Regional Director also found that such loans were generally accompanied by excessive correspondent balances maintained at the lending bank by the bank whose stock was being pledged and that this practice was having an adverse effect on many of the banks under his supervision. Accordingly, he instituted procedures to be used by examiners in detecting abusive practices and instructed them to criticize management for such practices and to seek correction during the course of examination.

Since January 1, 1971, the Corporation has referred 417 cases of apparent irregularities stemming from the misuse of correspondent balances to the Department of Justice. The result has been two prosecutions and one conviction. We would be less than candid if we did not point out that a definitive determination on the misuse of correspondent balances is often elusive. Even where clear cut, it is difficult to convince a jury beyond a reasonable doubt that the insider has willfully misapplied bank funds with intent to defraud the bank. This may explain in part the disinclination to prosecute correspondent balance cases.

Insured nonmember banks keep balances on account with larger member banks primarily to provide balances necessary for check clearing. These balances also count as reserves under the laws of some states. In exchange for these balances, correspondent banks provide a multiplicity of services including, but not limited to, check clearing, data processing safekeeping, purchase and sale of securities and excess funds, investment advice and auditing services. It is often extremely difficult to place a

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"price tag" on such services. Nevertheless, detailed investigations in accordance with the FDIC Legal Division guidelines are, as a matter of policy, carried out in cases of suspected correspondent balances abuse.

In our opinion, the decrease in abuse in this area is the result of increased examiner awareness (made possible by the issuance of specific guidelines with respect to bank stock loans) and closer supervisory surveillance and criticism of the practices. In addition, we feel the investigations conducted by the FBI as a result of the referrals made to the Department of Justice, the accompanying publicity, and the potential for criminal prosecution also have served to deter these activities. Although criminal prosecution may not have occurred as often as might have been warranted, we believe that this has not impeded our continued efforts to stop improper practices.

In addition to referrals of apparent irregularities to the Justice Department, the Corporation's Regional Directors have used various methods to effect correction of apparent abuses involving compensating balances. For example, meetings with a bank's board of directors often results in corrective action. Sometimes a letter from the Regional Director requesting corrective action is all that is necessary. If correction is not forthcoming within a reasonable period of time, a cease and desist order will be prepared. Often this is sufficient to gain compliance without the need to actually issue such an order. Our examiners also have spoken out publicly to educate bankers about the Corporation's intentions to deal vigorously with any abuses of this sort.

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2. Other abuses associated with bank stock loans

Our experience over the years has shown that potential abuses involving bank stock loans can take several forms in addition to misuse of correspondent accounts. Abuses of correspondent accounts can take the following forms:

1. Excessive lending on bank stock in relation to the value of the underlying collateral;

2. Preferential interest rates;

3. Excessive borrowings to finance stock acquired by organizers of new banks;

4. Reciprocal loan arrangements between banks involving principal officers of the banks;

5. Excessive lending to principal owners of a bank holding company and their interests by banks owned or controlled by the holding company;

6. Financing of bank stock through voting trust arrangements or syndication of shares to avoid lending limitations to one borrower; and

7. Excessive dividend payments or remuneration to key shareholders to facilitate payment of shareholder debt to other banks.

Bank stock loans which are unusually large, inadequately collateralized or apparently preferential are given stringent credit analysis. Normal examination procedure requires evaluation of credit risk, as well as obtaining bank management's justification for apparently preferential treatment. When abuse is encountered, the loan is adversely classified or otherwise strongly criticized. Management of the lending bank is

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directed to take necessary corrective action to bring the loan up to bankable credit standards. This may involve obtaining additional collateral or documentation or seeking a reduction in the principal balance. Of course, any bank with a high level of adversely classified loans, be they bank stock loans or otherwise, is a prime candidate for formal enforcement action under Section 8(b).

As mentioned above, when a bank stock loan is disclosed, the examiner prepares a form detailing the transaction which is forwarded to his superior and then to the regional office of the federal bank supervisory agency which has jurisdiction over that other bank. At the FDIC it is the practice for the forms to be reviewed as soon as received. When immediate attention is not required, the form is placed in the file of the bank whose stock has been pledged and is given closer attention at the next regular examination. This information is valuable to the examiner at that time in reviewing that bank's policies regarding earnings and capital. A bank whose stockholders have borrowed heavily against their stock is likely to have greater pressure for high dividends and a reluctance to sell new stock. Knowing about the debt, the examiner is alerted to potential problems and is given insight into managerial behavior. Similar forms are exchanged regarding loans to officers of other banks and are reviewed in similar fashion.

In addition to requiring a notice of a change of control, Section 7(j) of the FDI Act requires an insured bank which makes a loan secured by 25 percent or more of the stock of another bank, to notify the appropriate

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federal agency unless the borrower has owned the stock for over one year. The change of control or the report of a bank stock loan under Section 7(j) is reviewed carefully as soon as it is received. If there is a change of control report without a loan report, inquiries are made as to how the transfer was financed. If it is disclosed that the stock of the bank is heavily financed, supervisory attention in the future is attuned to close scrutiny of earnings and pressure for dividends. In the past this has been done largely through the examination process. However, our new computerized monitoring systems and semi-annual (quarterly for large banks) earnings statements will allow more frequent evaluation.

Excessive financing of bank stock has sometimes been a problem in new bank situations. An important part of the analysis in any new bank application is the course of the initial capital. It is axiomatic that the capital cannot come from any source which might tend to require heavy dividend payments from the new bank in its early formative years. The FDIC has a firm guideline regarding the amount of financing we will accept in a new bank's application for insurance and in many cases we have required the organizers to put up more of their own funds and borrow less money. It is our view that no one individual in a new bank should finance more than 75 percent of the purchase price of his shares and that no more than 50 percent of the bank's total capital should be borrowed. Violation of the commitments made during the application process are grounds for Section 8(b) action.

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C. Additional Safeguards

Although our experience and the results of our surveys suggest that abusive conduct associated with the use of correspondent balances to obtain bank stock loans has diminished greatly in recent years and is not now substantial, there are actions which can be taken administratively by the Corporation and by the Congress which would facilitate our dealing with the abuses I have discussed. I would recommend five.

1. Modification of the FDIC's Insider Transaction Regulation to address specifically bank stock loans

I intend to propose to the Board of Directors of the FDIC that Part 337.3 of our Rules and Regulations be amended to provide that "insiders," as defined in that regulation, be required to report to the bank's board of directors any loans obtained from or other business transactions with another bank with which the insider's bank maintains a correspondent balance, and that the terms and conditions of such loans or transactions be reflected in the bank's minutes or other records readily available to FDIC examiners. In addition, the regulation as amended would require that the board of directors periodically review the bank's various correspondent relationships in light of these transactions to assure that insiders are not benefiting from such relationships to the bank's detriment. The details of such a review should be reflected in the bank's minutes.

This approach would insure meaningful analysis of the bank's correspondent relationships by its board of directors and would thereby significantly minimize the likelihood of abuse. And more importantly,

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it would provide FDIC examiners with a better data base for use in detecting other abuses associated with bank stock loans.

2. Use of Section 8(b) Cease and Desist Powers

Heretofore, the FDIC has responded vigorously to compensating balance cases. It is our judgment that the use of supervisory tools has largely eliminated substantial abuse even in the absence of a significant number of criminal prosecutions. However, as I have indicated, the FDIC has not made use of its cease and desist authority in dealing with correspondent balance cases. We may well find the use of this tool appropriate in the future.

3. Passage of S. 71

We do not have clear and adequate authority to control improprieties as effectively as we should. Our greatest supervisory problem in trying to curb the abuse of correspondent accounts is that Section 8(b) of the Federal Deposit Insurance Act is directed to the bank. Although we have used the power to force the bank to seek restitution from self-dealing insiders, the power would be more effective if it could be employed directly against the individual. Also, under Section 8(e) of the FDI Act, which permits the FDIC to remove certain individuals from insured state nonmember banks, the FDIC must establish that the individual caused substantial financial damage to a bank or endangered the safety of a bank's deposits, and that the individual's act was one involving personal dishonesty. This burden of proof is not unlike the burden required in a criminal proceeding and is a difficult burden to carry.

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S. 71, as recently passed by the Senate, would remedy these shortcomings and generally enhance our ability to deal with abuse. For example, proposed amendments to Section 8(b) would enable the FDIC to move directly against officers, directors and persons in control of the bank, who use the bank's resources for their own gain. The amendments would also provide a monetary penalty for violation of a final cease and desist order. The penalties would be applicable to individuals as well as banks. Finally, the FDIC could remove and prohibit officers, directors and other persons from participating in a bank's affairs where their acts involved willful disregard to the safety and soundness of the bank.

4. Transfer of Control

I believe that prior scrutiny of new ownership by the regulatory authorities would assist in minimizing abuse associated with bank stock loans. As you know, Title VI of H. R. 9086, introduced by Congressman St Germain, would provide for such prior approval. I will testify in support of the thrust of that legislation.

Presently, Section 7(j) of the Federal Deposit Insurance Act (12 U. S. C. 1817(j)) requires notification of federal regulatory authorities when there is a change in control of an insured bank or when there is a loan secured by 25 percent or more of an insured bank's outstanding stock. Reports involving national banks are sent to the Comptroller of the Currency, those involving state member banks to the Federal Reserve, and those involving insured state nonmember banks to the FDIC.

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Title VI of H. R. 9086 would make two major changes in present procedures. First, all reports would go directly to the FDIC as insurer of bank deposits. Second, FDIC approval would be required before any change in control of an insured bank could occur. The FDIC could impose a civil penalty of up to $10,000 per day on any person who willfully violates the Title or any regulation issued thereunder. The bill would also require reports by <u>any person</u> making a loan secured by 25 percent or more of an insured bank's stock and would require certain additional types of information to be submitted under Section 7(j), including any relevant information required by the FDIC.

Among the grounds for disapproval of a change of control under Title VI of H. R. 9086 are findings by the agency that the financial condition of an acquiring person might jeopardize the financial stability of the bank or prejudice the interests of its depositors, creditors or shareholders; the competence, experience or integrity of an acquiring person indicates that it would not be in the interests of depositors, creditors or shareholders to permit such person to acquire control; the proposed acquisition is unfair, unjust or inequitable to the bank or to its depositors, creditors or shareholders; or the applicant fails to furnish all the required information.

Although I intend to support the basic thrust of the change of control provisions of Title VI, I will recommend amending the bill in several respects. First, I believe that instead of requiring advance approval in each and every case, the bill's purposes could be achieved

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equally well by requiring 60 days' prior notice of any change in control of an insured bank and empowering the bank's primary federal regulator to step in within that time period and disapprove the change in control on the basis of one or more of the standards set forth in the bill. I believe such a notice approach would provide greater flexibility in achieving the bill's goals. I would retain the standards presently embodied in the bill as a basis for such disapproval.

Second, I will recommend that enforcement authority under this bill be vested in the three federal bank regulatory agencies rather than being consolidated in the FDIC. Certainly, the Comptroller of the Currency and the Federal Reserve System are better able than the FDIC to recognize and deal with undesirable changes in control of the national and state member banks that those agencies regularly examine.

5. Elimination of the prohibition on the payment of interest on demand deposits

I have long favored the elimination of the prohibition on the payment of interest on demand deposits, as well as the elimination of interest rate ceilings generally. This is based on my belief that the pricing mechanism is a far more efficient means of allocating resources than systems involving restrictions and controls. Moreover, almost inevitably restrictions and controls lead to undesirable and often unanticipated side effects. Abuses arising out of the use of compensating balances in connection with bank stock loans is an excellent illustration of this phenomenon. The fact that interest cannot be paid

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on correspondent balances leads to a murkiness in pricing which results in great potential for abuse. Allowing the payment of interest on these balances would help to minimize the potential for abuse in this area.

Having said this, I should hasten to add that the "unbundling of services" would not totally eliminate the potential for abuse, because many of the services which are provided by correspondent banks are intangible and inherently difficult to price.

D. Advantages and Disadvantages of Other Measures for Minimizing Abuse Associated with Bank Stock Loans

In your letter of August 31, 1977, you listed a series of proposals and sought our views as to the advantages of each.

1. Require a more extensive disclosure of the details of bank stock loans to the directors of the bank involved, to the regulatory agencies, and to the public. More extensive disclosure of bank stock loans to the directors of the banks involved and to the regulatory agencies is, in my judgment, highly desirable. However, absent a clear-cut indication that an approach which relies on the supervisory agencies and bank boards of directors is ineffective, I would have reservations about detailed public disclosure of bank stock loans. My concerns here arise primarily out of my view that there is a right to privacy with respect to the details of an individual's financial affairs which ought not to be overridden except where there is a clear public interest to be served. In this instance, I believe that the public interest can be served through vigorous action on the part of bank boards and the agencies, thereby obviating the necessity of breaching the privacy of individual borrowers.

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2. Prohibit bank stock loans to officers or directors of correspondent banks. The arguments for prohibition are substantial. Forcing the borrower to deal with a bank other than his bank's correspondent would eliminate a major possibility for abusive conduct. Moreover, prohibitions are easier to administer than a strategy which involves examiner scrutiny of transactions to determine whether they involve overreaching -- a highly subjective process.

Nevertheless, it must be recognized that there are significant disadvantages to such an approach. First, it has generally been my experience that legal restrictions or prohibitions are rarely effective in eliminating the most significant abuse. Rarely are agencies or legislatures willing to draft a prohibition sufficiently broad that cannot be easily avoided. Second, a prohibition in this area would cut off a ready means of financing which has helped to broaden the base of bank ownership in this country and has provided a source of capital in some "distress" bank situations, without a demonstration that abuses are widespread and without any certainty that those abuses which do exist would be avoided.

3. Prohibit bank stock loans at preferential rates compared to other comparable loans. I strongly favor the approach which is suggested by this proposal; that is, that those involved in a conflict of interest not be accorded a preference. However, I believe that it would be a mistake to focus on interest rates alone. Rather, I would favor a rule that required that such transactions be effected on terms and conditions no more favorable than would be afforded in a comparable transaction not involving a

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correspondent relationship. This recognizes that interest rates never tell the entire story. A loan extended at a rate well above the prime rate may be abusive if the collateral is weak or if the borrower's cash flow cannot support his obligations. Conversely, an apparently preferential interest rate may be justified by considerations not reflected on the face of the loan.

4. Require banks to pay interest on correspondent balances and to levy explicit charges for correspondent services. As I have indicated, I believe that permitting the payment of interest on correspondent balances would remove much of the potential for abuse in this area. I do not believe, however, that explicit pricing should be required for two reasons. Because of the intangible nature of many of the services provided, explicit pricing of every facet of the correspondent relationship may be difficult. Such a requirement, if meaningful, would be difficult to administer. In my judgment the great bulk of the benefits to be gained from explicit pricing will be gotten by allowing interest to be paid on correspondent deposit balances.

5. Subject all bank stock loans to the margin requirements set by the Federal Reserve Board. On the surface, the imposition of margin requirements on bank stock loans would appear to have merit from a bank supervisory standpoint. However, the imposition of such requirements would tend to restrict the availability of credit to large investors having access to capital funds and operate to the detriment of the small investor who is a sound credit risk but who lacks sufficient funds or alternative sources of funds. In addition, determination of market value for those

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bank stocks which are not actively traded would pose significant administrative problems.

As has already been noted, the FDIC has a policy that applies to any newly organized bank applying for deposit insurance, prohibiting a single individual from financing more then 75 percent of his stock and that no more than 50 percent of the total stock may be financed. If the agencies were given the power to disapprove changes of control of operating banks, as discussed before, it is likely that similar requirements pertaining to the financing of such purchases would be imposed by the FDIC.

6. Permit depositors or minority shareholders to recover treble damages whenever an officer or director of the bank receives a below market interest rate bank stock loan. Finally, we are opposed to permitting depositors or minority shareholders to recover treble damages whenever an officer or director of a bank receives a below market interest rate bank stock loan. Ostensibly, such a provision would encourage the enforcement of a prohibition against preferential bank stock purchase loans by providing shareholders with a financial incentive to monitor these transactions and to bring actions against them. At the same time, the potential loss of three-times the putative gain (or interest rate advantage) would presumably deter officers and directors from entering into such transactions. The concept of treble damages is embodied in antitrust law. Treble damages awarded to private litigants injured in their "business or property" by virtue of antitrust law violations are intended to facilitate

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enforcement of the laws as well as to give an injured party ample recompense for the wrong suffered. Government antiturst law enforcers are, by reason of limited resources, able to bring only a selected number of enforcement actions and are dependent in large part upon injured members of the business community to report transgressions. The situation is entirely different in the case of banks. Insured banks are regularly examined. Thus, the same incentives are not needed and, indeed, might simply encourage unwarranted suits.

IV. LOANS TO FAVORED CUSTOMERS

To the extent that the questions which you asked with respect to favored customers deal with persons who are not insiders of the banks, they raise potentially difficult questions of policy -- questions which neither Congress nor the agencies have addressed fully. As I have indicated, the FDIC regards overreaching in the context of a conflict of interest (e.g., transactions between a bank and an insider or his related interest) as serious abuse and responds vigorously when it is detected. This is true both in the case of transactions between an insider or his interests and a bank and in the case of transactions between an insider and his bank's correspondent. Where there is no conflict of interest, what constitutes an abusive preference is an especially murkey question since the granting or dening of credit involves making distinctions among persons and entities based on judgments which are highly subjective.

Rather than attempting to assure that all customers are treated fairly relative to all other customers, both the law and regulatory policy

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attempt to achieve two objectives. First, as I have indicated, various strategies are employed to assure that insiders do not abuse their financial institutions by obtaining preferential treatment. And, secondly, the law, and hence the regulatory authorities, seek to assure that certain categories of persons are not discriminated against. At present, neither the law nor regulatory policy addresses the question whether noninsiders, who are members of certain classes or categories of persons, are privileged or whether such privilege is abusive. Because the FDIC examination process does not directly address the matter of preferences among similarly situated customers where there is no conflict of interest or a question as to the violation of the civil rights laws, we do not have readily available data from which to draw meaningful inferences as to the extent to which such preferences exist, with the exception of loans to certain insiders of other banks.

As I have indicated, examiners are required to list all loans to officers of other banks, except for loans of insignificant amounts, on Form 6500/22. Loans to officers of other banks are common. This, of course, is to be expected since bank officers are often severely restricted in their ability to obtain financing from their own bank. Our review of 261 insured nonmember commercial bank examination reports revealed that 38 percent of the 125 small banks, 66 percent of the 105 medium-sized banks and 81 percent of the 31 large banks had extended credit to officers of other banks at the time of the examination. In the survey of 303 insured state nonmember commercial banks that were being examined during the

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first part of September, we found 154 of 250 small banks, 40 of 45 medium-sized banks and 7 of 8 large banks, or 66 percent of the total sample, that made loans to officers of other banks. Examiners reported apparent preferential treatment of officers of other banks in 22 of the 201 banks extending such loans, including 11 small banks, 9 medium-sized banks and 2 large banks.

It should be noted that although the examination process does not attempt to detect preferences which are accorded nonbankers and non-insiders, a particularly abusive preference is likely to be discovered and criticized because it would probably violate acceptable credit standards. Whether one favors additional regulatory or statutory measures to curb preferential loans not involving a bank's insiders or the insiders of another bank depends in large part upon whether it would be feasible to devise a regulatory structure which could assess the fairness of granting a credit and the fairness of a credit's terms. I believe that it would be very difficult to devise such a scheme. Moreover, while I strongly favor governmental intervention to eliminate self-dealing or to protect groups of persons likely to be discriminated against, I would be profoundly troubled by a regulatory structure adequate to enforce a prohibition against any preference.

V. OVERDRAFTS

A. Frequency of the Practice

Information on overdraft practices was collected for 189 banks that were being examined during the week beginning September 12, 1977.

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Examiners were instructed to collect information relating to overdrafts of officers, directors and major shareholders of the bank being examined; officers, directors, and major shareholders of corporations doing substantial business with the bank being examined; and individuals doing substantial amounts of business with the bank being examined -- specifically, public officials and attorneys. Examiners were asked to list for each of these categories all "free" overdrafts exceeding $100.00 for the previous 90 days.

We have serious reservations about the accuracy of the statistical data gathered for overdrafts of individuals associated with corporations which do a substantial business with the bank. Bank records do not identify directors, officers, employees and 10 percent shareholders of these corporations, and the bankers' knowledge of the identity of such individuals may well be limited. However, we feel that the figures related to insiders of the banks are quite accurate. The results for correspondent bankers and other banks are reasonably accurate.

Data on overdrafts are presented in Table 3. The figures indicate that during the 90-day period preceding the examination date, overdraft activity by insiders occurred in 122 banks, or approximately 64 percent of the 189 banks surveyed. The dollar volume of free overdraft activity of insiders amounted to less than 1 percent of the total amount of all free overdrafts. For the 189 banks combined, daily average free overdrafts to all depositors amounted to $26.7 million or 0.4 percent of their total deposits. Of this amount, a daily average of $209,000 was accounted for

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Table 3

FDIC EXAMINATION SURVEY OF FREE OVERDRAFTS
IN 189 INSURED STATE NONMEMBER BANKS

	Number Banks Included in Survey	Percent of Total	Aggregate Average Daily Overdrafts (1) (000 omitted)	Percent of Total	Average Daily Overdrafts Per Bank Column (3) Divided by Column (1)	Average Amount of Deposits per Bank (000 omitted)
Aggregate Overdrafts Total for 90 Days	189	100.00	$26,687	100.00	$141,198	$38,600
Insiders of Subject Bank (2)	122	64.10	209	0.78	1,716	40,907
Correspondent Banks (2)	6	3.20	9	0.03	1,467	63,443
Other Banks (2)	6	3.20	7	0.02	1,100	39,273
Corporations Doing Substantial Business With Bank (2)	30	15.90	231	0.86	7,693	39,522
Public Officials	15	7.90	3	0.01	227	66,909
Attorneys	24	12.70	24	0.09	1,008	63,254

(1) Aggregate Daily Average based on the 90-day period preceding the start of the examination.

(2) Includes Overdrafts of Directors, Officers, Employees, 10% or more shareholders, and their interests.

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by insiders. It should be noted, however, that while the dollar amount of insider free overdrafts is small in relation to the aggregate amount of free overdrafts of all bank customers for the 122 banks, there is considerable variation from bank to bank.

The distribution of insider free overdrafts relative to all customers' free overdrafts is shown in Table 4. Of the 189 banks surveyed, 67, or 36 percent, had no free overdrafts to insiders. In another 50 banks, free overdrafts to insiders amounted to less than 1 percent of all free overdrafts. Overdrafts to insiders exceeded 5 percent of total free overdraft activity in 20 percent of the surveyed banks and was confined largely to small banks. However, of the 37 banks constituting this 20 percent, the average daily volume of insider free overdrafts appeared to be abusive only in the three banks where insiders accounted for more than 50 percent of the aggregate overdraft volume.

Free overdrafts to directors, officers, employees and 10 percent shareholders of other banks were reported for only six correspondent banks and for six other banks not having a correspondent relationship. During the 90-day survey period, average daily overdrafts in these two categories totaled $16,000, or about .05 percent of aggregate free overdraft volume to all bank customers. Remembering the caution that overdraft data for directors, officers, employees and 10 percent shareholders of corporations may not be reliable, such activity in 30 banks for which examiners were able to supply these data indicated that free overdrafts for this class of bank customer amounted to less than 1 percent of total daily average free overdraft activity.

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Table 4

FREQUENCY DISTRIBUTION OF INSIDER FREE OVERDRAFTS AS A PERCENTAGE OF FREE OVERDRAFTS TO ALL CUSTOMERS DURING THE 90-DAY SURVEY

	Insider Overdrafts as a Percentage of All Customer Overdrafts							
	50+%	25-49%	15-24%	5-14%	1-4%	less than 1%	0%	Total
Number of Banks	3	8	7	19	35	50	67	189
Percent of Banks	1.6	4.2	3.7	10.0	18.5	26.5	35.5	100
Average Deposit Size Bank	$11,736M	$12,823M	$13,953M	$24,415M				
Average Daily Overdrafts (all bank customers)	$23,744	$11,977	$12,900	$22,522				
Average Daily Overdrafts (insiders)	$20,511	$ 3,933	$ 2,500	$ 2,367				
Average Insider Overdrafts to Total Overdrafts	86.4%	32.8%	19.4%	10.5%				

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Free overdrafts to public officials were detected in 15 banks and to attorneys in 24 banks. For the 15 banks combined, free overdrafts to public officials averaged $3,400. For the 24 banks combined, free overdrafts to attorneys averaged about $24,200. Again, free overdrafts of these classes of customers were negligible in relation to the aggregate amount of overdrafts.

We also reviewed overdraft practices in our survey of 261 bank examination reports. These reports revealed that eight small banks, four medium-sized banks and one large bank were criticized about insider overdraft abuses. Based on these figures, approximately 3 percent of all insured state nonmember banks would be cited for insider overdraft abuses. Thus, while a high percentage of banks permit insiders free overdrafts based on the 189 banks examined in a single week, few are actually cited for overdraft abuses by insiders in the bank examination report based on the findings of our survey of 261 bank examination reports. Most insider overdrafts are not criticized because the insider's account is seldom overdrawn for more than a few days, and overdrafts do not occur very often. Overdrafts that were substantial or persisted over a lengthy period of time are criticized in the examination report.

The responses of our Regional Directors on the frequency of insider overdraft abuses were consistent with the findings in the two surveys that there does not appear to be widespread abuse by insiders of overdraft privileges. Citations in our examination reports indicate that criticism of insider overdrafts is generally harsh. Citations also indicate that in approximately half the cases, management promised to take

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corrective action at the time of the examination. It is our policy to take vigorous action to correct overdraft abuses and it is our firm belief that such action has been effective.

B. <u>FDIC Procedures and Practices with Respect to Overdrafts</u>

At this point, I would like to outline briefly the examination techniques that are employed to review and analyze overdrafts in state nonmember insured banks. At the outset, it should be emphasized that overdrafts involving insiders are scrutinized far more carefully than overdrafts involving noninsiders and that significant overdrafts by insiders should prompt immediate examiner criticism and vigorous supervisory action if they are continued or repeated. Because of the vigorous scrutiny to which insider overdrafts are subjected, it is unlikely that insiders in most banks have preferred access to overdrafts.

Because most insured state nonmember banks have computerized accounting systems, examiners are usually furnished with a computer listing of all overdrafts. In those banks that still have manual systems, overdraft figures are developed from examiners' review and analysis of the demand deposit ledgers. Examiners also review cash items and checks drawn on the bank which have been rejected during the posting process. To facilitate detection of insider overdrafts a list of bank directors, officers and employees is obtained from the bank or it is developed independently by examiners or by some combination of the two preceding methods. Identification of insider relatives is a difficult process. However, an adequate list usually can be put together by reviewing the stock ledger, insider

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transactions records and the minutes of meetings of the loan committee and the board of directors. Any overdrafts to insiders are flagged to assure follow up action in a later point in the examination.

The overdraft listing is compared with loans to individuals made by other departments of the bank to determine tie-in relationships. If such relationships exist the overdrafts are analyzed in concert with other extensions of credit. Large overdrafts are appraised with particular emphasis on the size, duration, frequency, existence of other account balances, credit experience with the borrower, charges levied and the bank's policy in granting overdrafts. Smaller overdrafts not tied to a loan are customarily discussed with the appropriate officer of the bank. After applying the normal credit judgment standards, an overdraft may be accorded an adverse classification in the report of examination.

The review and analysis of overdrafts also results in the detection of overdrafts to officers, directors and stockholders of other banks. Large overdrafts and frequent use of overdrafts are automatically flagged for an appraisal of repayment capacity. Furthermore, it is standard procedure to determine the obligor's place of employment and position. This procedure permits detection of overdrafts to other bankers.

When overdraft abuses are uncovered, the field examiner discusses the matter thoroughly with the chief executive officer or the board of directors of the bank. He emphasizes the objectionable nature of the practice and attempts to obtain a commitment for corrective action. He then comments on the matter in the examiner's "comments and conclusions"

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page of the report of examination. If applicable, pertinent remarks also appear on the violations of law and adverse classification pages of the examination report. The examiner's comments are followed up and reinforced in the letter that accompanies transmittal of the final report of examination to the bank. In cases where the overdraft abuses are especially severe, the bank is requested to submit a progress report detailing corrective action that has been taken. If the examiner is unable to obtain a commitment for corrective action, or if a bank's commitment is dishonored, senior officials from the FDIC regional office and state banking department will meet with bank management. Additional steps that may be taken include sending examiners on special visits to the bank to check on the bank's progress in effecting correction and increasing the frequency of examinations. If none of these actions is effective, an enforcement action under Section 8(b) of the FDI Act is initiated.

C. An Assessment of the Need for Additional Laws and Regulations Pertaining to Overdrafts

As I have indicated, insider overdrafts are subjected to especially vigorous supervisory response. In addition, special attention is paid to overdrafts by other bankers to avoid the possibility of reciprocal relationships. It is the view of FDIC staff -- a view with which I concur -- that we have adequate tools and techniques to respond effectively to abusive overdrafts. Of course, here again, the passage of S. 71 would serve to buttress existing tools.

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VI. FAILURE TO COMPLY WITH CERTAIN BANKING LAWS OR REGULATIONS

In your letter of August 31, 1977, you asked:

> "What is the degree of compliance with various provisions of the banking laws and regulations imposed on bank officers and directors for which there are no criminal penalties for non-compliance? These provisions include limitations on loans to executive officers (12 USC 375a(1)); requirements for bank executive officers to file reports with their boards of directors on their loans from other banks (12 USC 375a (6)); and requirements for the principal officers and directors of national banks to file reports with their banks on their outside business interests (12 USC CFR 23.3)."

Although the laws and regulations you mention apply only to national banks, many states do have similar laws or regulations. Due to variations in various state statutes, it is difficult to generalize regarding restrictions placed on loans to nonmember bank directors, officers, employees or their interest. However, a survey which we conducted recently indicates that 41 states require some form of approval of loans to these individuals or entities. Approval in writing by the board of directors or a committee of the board is usually required prior to origination of the loan. We are aware of no state law imposing criminal penalties for violations. The extent and scope of state laws requiring executive officers to file reports with their boards of directors on their loans from other banks has not yet been determined but is believed to be limited.

In the course of our regularly scheduled examinations, examiners routinely check for compliance with the provisions of state law. Particular scrutiny is accorded those provisions which deal with insiders.

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In those instances in which apparent violations are discovered, they are documented in the Report of Examination and immediate corrective action sought. When compliance is not obtained or when the violations are of a particularly serious nature more stringent supervisory measures are taken.

We did not attempt a systematic survey to discover the extent of compliance with such provisions of state law. Examiner personnel indicate, however, that noncompliance with these provisions is ordinarily inadvertent and technical in nature ant that, overall, compliance is generally satisfactory.

In your letter, you also sought our view as to whether compliance would be strengthened "if violators were subject to administratively imposed civil penalties as contained in S. 71 or to criminal penalties." There is little doubt that further sanctions would assist in achieving a somewhat higher degree of compliance as a general rule. For this reason, we have strongly urged enactment of the civil penalties provisions provided in S. 71. We do not believe, however, that the imposition of criminal sanctions is appropriate in this area, especially in light of the poor results that have been achieved in seeking prosecutions and convictions under 18 U.S.C. § 656.

VII. INSURANCE COMMISSIONS

Your letter of September 20, 1977, asked us to specifically address the subject of insurance commissions. A detailed study was

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impossible in the time available; however, we have quickly surveyed our Regional Directors, asking them to describe current practices in their regions and to each address the questions you raised. Although we are not able to present a detailed and comprehensive picture of practices in this area, we can speak with some degree of authority based upon the responses of our Regional Directors.

A. Practices with Respect to Insurance Commissions

In about half of our regions, insiders commonly receive insurance commissions. Elsewhere, the practice is infrequent due to prohibitive laws, area practice and/or supervisory pressure. Where the practice is common, the insurance commissions often constitute significant portions of the recipients' income and are an important part of their ability to service any outstanding debt, including debt incurred to acquire the stock of their bank. Commissions are more likely to go to insiders in banks with concentrated ownership.

Our Regional Directors all indicate that they find no relationship between payment of insurance commissions to insiders to service bank stock loans and the placement of correspondent balances with the lending bank. Although our Regional Directors have found no clear connection between the making of poor loans and the receipt of insurance commissions, we cannot state that there is no such connection. They note that frequently the commissions are paid to a controlling owner of the bank who is not an active loan officer and therefore does not directly control daily credit

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decisions. Also, they report that in many instances the payment of insurance comissions to an insider occurs in banks where other forms of insider abuse are found.

Many of these observations are based upon impressions gained from the many years of experience of our Regional Directors. However, some of our regions are currently engaged in surveys to better quantify these impressions. Table 5 summarizes survey results in one of our regions. That study, covering 108 banks, shows 61 cases (56 percent) where none of the commission went to the bank; 14 cases (13 percent) where the bank received part; and 33 (31 percent) where the bank received all. Of the total commissions received $629,000 (35 percent) went to the banks and $1,178,000 (65 percent) went to insiders.

Another region surveyed 160 banks and found that half kept all credit life commissions, 67 gave the income to insiders and 11 split the commissions in some manner. In this survey, $2,573,000 was added to bank earnings and $2,686,000 flowed to the benefit of insiders. These surveys so far are not conclusive, but suggest that the smaller the bank the more likely it is that the amount of commissions generated where the funds go to the bank is less than if they are paid to others.

B. FDIC Policy and Practices with Respect to Insurance Commissions

The FDIC has sought to curb abusive conduct involving credit life insurance since the 1950s. For a period of time, FDIC examiners were instructed to file criminal irregularity reports. However, because of the

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Table 5

SURVEY ON INSURANCE PREMIUMS

	Bank Size in Millions		
	Under $25	$25 to $50	Over $50
Number of Banks	81	12	15
Insurance Income-Total	$1,106,000	$244,500	$456,800
Amount paid to bank	$ 268,300	$100,900	$259,700
Percent of total	24.3%	41.3%	56.8%
Amount paid to insiders	$ 837,800	$143,600	$197,100
Percent of total	75.5%	58.7%	43.2%
Number of Banks Where Bank Receives $0	52	7	2
Percent of Banks	64.2%	58.3%	13.3%
Number of Banks Where Bank Receives All	20	3	10
Percent of Banks	24.7%	25.0%	66.7%
Number of Banks Where Bank Receives Portion	9	2	3
Percent of Banks	11.1%	16.7%	20.0%
Total Assets (All Banks)	$808,100,000	$399,900,000	$1,245,500,000
Insurance Income Paid to Banks/Total Assets	.03%	.03%	.02%
Insurance Income Paid to Insiders/Total Assets	.10%	.04%	.02%
Total Insurance Income/ Total Assets	.14%	.06%	.04%

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difficulty in proving willful misapplication of bank funds with intent to defraud the bank, in 1961 a determination was made that credit life insurance in most cases should be dealt with as a supervisory matter. At that time the Corproation's current policy was put into effect.

This policy is formally set forth in a memorandum to all Regional Directors issued in April 1975 which provides that if an insurance agency business is being conducted on the premises of a state nonmember insured bank, examiners are to check to see that the bank's board of directors and shareholders are fully informed of and approve the details of the operation of the agency. Examiners are also instructed to determine that the plan to operate the insurance agency and any material changes thereto, as well as any remuneration which should be paid to the bank for the use of the bank personnel, premises or equipment in connection with the operation of the insurance agency, have been approved by the board of directors and the shareholders of the bank. Furthermore, the instructions require that the bank be reimbursed for the use of bank space, equipment and personnel. While the guidelines do not prescribe a formula for ascertaining the amount of such reimbursement, it must be reasonably related to the dollar value of the space, equipment and personnel employed. A copy of the guidelines is attached as Exhibit G.

In a few instances, the FDIC has found it necessary to enforce this policy through the use of its cease and desit power. For example, this year the FDIC issued a cease and desist order requiring one particular

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bank, among other things, do disclose to all shareholders full and complete details regarding the expenses incurred by the bank in connection with an insurance business operated by certain directors and officers of the bank and the manner of distribution of income derived from the sale of such insurance on bank premises during 1975 and 1976. The order also required that the board of directors adopt a resolution providing that, if commissions derived from the sale of credit life insurance and other forms of insurance written by bank personnel or written on bank premises incidental to bank loans are not to be retained by the bank, then two-thirds of the outstanding shares of voting stock of the bank must ratify the arrangement after full and complete disclosure of the details of the sale of such insurance. That portion of the cease and desist order was also disseminated to all Regional Offices for instructional purposes in July 1977. A copy of the memorandum forwarding the pertinent portion of the cease and desist order to the Regional Offices is attached as Exhibit H.

C. Complete Disclosure and Approval vs. Prohibition

The FDIC's guidelines on the operation of credit life insurance agencies by directors or officers of state nonmember insured banks are premised on the notion that the best method for conducting an insurance business, including the distribution of the income from that activity, is properly left to the judgment of management and the shareholders of each bank. However, the Comptroller of the Currency has issued a regulation regarding the distribution of income from the sale of credit life, accident and health insurance. While I have not studied this final regulation in

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detail, I believe that it will prohibit a national bank from diverting insurance commissions to any of its employees, directors, officers or principal shareholders. In states with insurance laws prohibiting the flow of such income to a bank, the Comptroller's regulation suggests alternatives can be found such as having the bank purchase insurance for all borrowers on a loan-by-loan basis or by means of a group policy.

There are senior staff members of the FDIC, including several of our Regional Directors, who agree with the position taken by the Comptroller. Their arguments have merit. First, they argue that the Comptroller's method is simple to administer and removes difficult questions of fact which need to be resolved under the FDIC's guidelines. Second, they suggest that the income from the sale of insurance rightfully belongs to the bank and all its shareholders and that permitting payment of that income to insiders condones an unsafe and unsound banking practice, an unlawful distribution of the bank's income other than by the payment of dividends, and a breach of the fiduciary obligations of officers and directors of the bank. Finally, they believe that the practice of allowing bank officers and directors to receive income directly from credit life insurance sales involves an inherent conflict of interest which may affect the lending officer's judgment in making a loan, and as a consequence induce him to make a loan he might not otherwise consider sound.

I recognize the cogency and the appeal of these arguments. However, other members of the FDIC staff retort with powerful arguments for the proposition that this decision is properly left to the bank owners,

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with appropriate protection for minority interests. First, if there is complete disclosure of the operation of the insurance agency and approval by the shareholders and directors of a bank and the bank is reimbursed for the use of its equipment, personnel or space, it is difficult to sustain the argument that the directors and officers engaging in such activity have breached their fiduciary duties or are committing an unsafe and unsound practice. Secondly, many banks in small communities are unable to offer their officers and employees salaries competitive with those of similarly-situated institutions without the added remuneration derived from commissions from the sale of credit life insurance and thus could not attract competent management. Third, in those cases in which state law prohibits banks from acting as agents for the sale of credit life insurance, the options to the bank as to how to make credit life insurance available to its loan customers would be limited. Perhaps the only manner in which such banks could offer customers such insurance would be through the purchase of group policies for their borrowers. The cost of group policies would either reduce profits or increase interest rates on loans. Finally, some argue that we are talking about the basic powers of a bank and as such the decision rightfully should remain with the chartering authority.

For my own part, I believe that the essential thrust of the FDIC's policy is the proper one with respect to state nonmember insured banks. I do favor, however, some tightening of our guidelines to further protect the interests of minority shareholders. For example, we might require

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that, in a situation where a control group or person dominates a bank, a majority of the outside directors and minority shareholders be required to approve the insurance agency operation.

Although my current view is to retain and buttress the present FDIC approach in this area, I respect the views of the Comptroller and many of our staff and will in the coming months carefully study the respective positions and the data provided by the studies and surveys underway in several of the Regional Offices. I shall be happy to report to the Committee the results of the surveys and any further modification of FDIC policy.

VIII. ACTIONS UNDER THE FINANCIAL INSTITUTIONS SUPERVISORY ACT OF 1966

In accordance with the Committee's request, there is attached a short description of each action taken by the Corporation under Section 8 of the FDI Act since 1971 (Exhibit I). Summaries for the period 1971 through 1976 repeat those previously provided to the Congress and the general public in our 1976 Annual Report and through previous communications to this Committee. The data for 1977 to date is new but will be repeated in this year's Annual Report. The following summary lists the number of actions pursuant to Section 8 during this period:

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	Section 8(a) Terminate Insurance	Section 8(b) Cease and Desist	Section 8(c) Temporary Cease and Desist	Forma[l] Written Agreem[ent]
1971	5	7		1
1972	5	10		1
1973	1	8		1
1974	3	4		
1975	5	8		
1976	8	24	5	
1977	2	27	8	
TOTAL	29	88	13	3

Of the 88 cease and desist actions which have gone to a final order, only one (Case #29) was issued after a hearing. The rest were consented to by the bank. We have also had one instance (Case #63) in which the bank was not complying substantially with a cease and desist order and we obtained court enforcement.

Cease and desist actions are taken for a wide variety of reasons and most cases involve a combination of problems requiring attention. However, of interest to these hearings, 35 of the 51 Section 8(b) orders issued in 1976 and 1977 to date deal at least in part with correction of problems caused by insider loans and overdrafts, excessive or unjustified compensation to insiders, unwarranted loan participations with related banks, or improper payment of credit insurance commissions. In addition to the insider problems, these actions, in general, deal with the need for improved management, reduction of classifications, elimination of losses, sale of new capital, new or improved credit, investment and audit policies and correction of violations of law and regulation, including various consumer protection statutes.

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You have asked us to set forth the standards in effect for instituting, monitoring and rescinding our enforcement actions. The basic criteria are included in the statute, namely, the bank is engaging or has engaged in unsafe or unsound practices, the bank is violating or has violated a law, rule, or regulation, or any condition imposed in writing by the Corporation or a written agreement entered into with the Corporation, or there is reasonable cause to believe the bank is about to do these things. We have attempted to avoid spelling out any formal, rigid standards beyond those so that we are free to consider the facts and circumstances of each individual bank. The nature of the problem and the best possible corrective action varies from bank to bank.

Our staff is provided general guidelines upon which to base recommendations and instructions for preparation of such actions. We refer you to the attached copies of our Division of Bank Supervision's General Memorandum Number 8 and Section V of the Manual of Examination Policies (Exhibits J and K).

In practice, Section 8 action is taken when there is reasonable cause to believe that a particular bank's problems, which fall within the guidelines set forth in the statute, will not be corrected by routine supervisory methods and that, in fact, such less formal methods have proven unsuccessful.

Once the order of correction is issued, monitoring of a bank's compliance with the formal action is accomplished through a stepped-up program of progress reports submitted by the bank, examiner visitations

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and full examinations of the bank at appropriate intervals. If it is determined through these efforts that a bank is not substantially in compliance with provisions of the order or is not making a good faith effort to comply, we take further action to enforce the order by means of court action.

Formal enforcement actions are usually terminated only when the bank is in substantial complaince with the provisions of the order, as evidenced by an examination, or when the purpose of the order has otherwise been served. Since most corrective orders would normally include requirements that appropriate policies and internal controls be adopted by the bank so as to avoid future repetition of the problems, the order is not lifted until we are assured that such policies and controls have been adopted and are being followed.

Finally, you have inquired about the public availability of final actions under the FISA of 1966. Pursuant to the general policy of the FDIC and the provisions of the Freedom of Information Act, all final orders against banks are available upon specific request. In providing such orders, financial data derived from reports of examination and the names of individual bank customers which might be named in the order are deleted.

IX. DIRECTORS

A. Liability of Directors

The National Bank Act and most state banking codes do not specifically set forth the basis for holding bank directors personally

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liable for loan losses; hence, statutory provisions relating to the duties, responsibilities and liabilities of bank directors have rarely been the basis for holding them personally responsible for such losses. For the most part, their legal liability for loan losses is predicated upon common law principles established by numerous reported court decisions. Of course, the National Bank Act does place limitations on the amount of loans which can be made to any borrower (12 U. S. C. § 84) and, in our opinion, directors of a national bank can be held personally liable for losses resulting from loans they approve which exceed such limitations (12 U. S. C. § 93). Similar loan limitation provisions are also contained in many state banking codes.

The FDIC, as receiver or liquidator of a closed bank, has important responsibilities which have served to illuminate the seriousness of the duties one undertakes upon election to a bank's board. In this capacity, the agency always conducts a careful and comprehensive investigation in order to determine if a closed bank's former directors were derelict in their duties. We have frequently found that they were and, in those cases, we either instituted suit or made a claim which resulted in a satisfactory settlement. For the period January 1, 1960, to the present there have been 101 bank closings. In 58 of these cases, the principal cause of closing was abusive self-dealing. Table 6 shows the directors' liability status of these 101 cases. In 40 cases we have either instituted suit against the former directors of the closed bank or achieved a settlement prior to filing suit. In 29 cases our investigation has not yet been

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Table 6

DIRECTORS' LIABILITY STATUS AS OF SEPTEMBER 23, 1977
IN 101 BANKS THAT CLOSED FROM JANUARY 1960 TO PRESENT*

	Number of Banks with Self-Serving Practices	Number of Failed Banks
Filed suit or made claim	24	40
Still investigating	16	29
No basis for claim	18	32
TOTAL	58	101

*Does not include the two Corporation purchases - Wilmington and Puerto Rico

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completed. However, preliminary investigation indicates that a cause of action against directors exists in many of these cases. Accordingly, we anticipate that quite a few of these will also be litigated. Finally, in 32 of the 101 closings we concluded that the directors either were not derelict in their duties in some respect and therefore not personally liable or they had insufficient financial resources to justify the expense of litigation.

All suits that we file seek substantial recoveries from the former directors of the closed bank on the general basis that they neglected to exercise due care and diligence in the performance of their fiduciary duties. In addition to such general allegations of negligence, however, the complaints also set forth specific acts of commission or omission on their part.

While each complaint differs in many important respects, the allegations we have frequently made in our director liability claims include, among others (i) making of self-serving, improvident and/or ecesssive loans, (ii) failing to correct conditions and practices criticized by the appropriate regulatory authority, (iii) failing to properly supervise officers and employees, (iv) failing to make periodic audits, (v) failing to establish and implement adequate internal procedures and controls, (vi) approving payment of improper dividends, (vii) failing to maintain adequate liquidity, (viii) failing to regularly attend directors' meetings, (ix) concentrating too much of a bank's resources in a limited number of investments, and (x) failing to exercise independent judgment, i.e., permitting themselves to be dominated by the bank's principal shareholder.

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In my judgment, the impact of the lawsuits which we have filed in major bank failures in recent years has had an incalculable effect in raising the sensitivities of bank directors with respect to their responsibilities.

B. <u>Adequacy of Laws with Respect to Certain Practices</u>

Existing case law in the various states requires bank directors to exercise due care, prudence and diligence with respect to the management of a bank's affairs and in the use of preservation of its property and assets. Bank directors who approve exorbitant salaries for bank officers, approve payment of exorbitant or improper stock dividends, or knowingly permit the use of bank assets for nonbusiness purposes violate the common law duties imposed upon them. Under existing case law, they should incur personal liability for such improper activities.

At the same time, it should be recognized that there have been significant variations in state court application of common law standards. Moreover, suits by minority shareholders against open banks have been relatively rare. For this reason, the expansion of the FDIC's Section 8 powers to allow the agency to proceed directly against individuals would significantly enhance the likelihood of recovery vis-a-vis directors who abuse banks which do not fail.

C. <u>Political Contributions</u>

Provisions of federal law prohibit national banks from making a contribution or expenditure in connection with any election to political office

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or in connection with any primary election or political convention or caucus held to select candidates for any political office. The statute prohibits state banks from making a contribution or expenditure in connection with any election at which presidential or vice presidential electors or a Senator or Representative in, or a Delegate or Resident Commissioner to, Congress are to be voted for, or in connection with any primary election or political convention or caucus held to select candidates for any of the foregoing offices.

Officers and directors of banks (both state and national) are prohibited by this same law from consenting to any contribution or expenditure by the bank. Although the penalty for this violation is criminal in nature, knowing violation of this statute could, in our opinion, result in the imposition of civil liability under the common law. However, a loan made by a bank in accordance with applicable banking laws and regulations and in the ordinary course of business is not a "contribution or expenditure."

X. DOUBLE COLLATERAL

You have asked us to comment on the extent to which the posting of the same collateral at two different banks is covered by existing law. Existing laws dealing with contracts, negotiable instruments, and several transactions adequately cover the subject. This is especially true if the lending institution couples adherence to the law with proper internal controls, lending policies and audit practices.

As part of the training each bank examiner receives in credit analysis, he is taught what legal documentation and procedures are

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necessary to perfect a lien on the various types of collateral which may be offered. This training covers both personal and real property. As part of the appraisal of the loan portfolio, the examiner will verify that the bank's security interest is properly perfected. If the collateral is of a type which should be in the physical possession of the bank, possession will be verified on a spot-check basis. The bank's audit program should include procedures for verifying that the necessary documentation and/or collateral are in the bank's possession. As to negotiable collateral, such as stocks, bonds or certificates of deposit, sound banking practice requires that the loan proceeds not be disbursed until the collateral is in the possession of the bank or the bank has a recognized, valid due bill or other evidence that it has a legal claim on that security.

In summary, a borrower's real or personal property is not and ought not to be considered as collateral unless a statutory or possessory lien has been perfected in accordance with applicable law.

XI. CONFLICTS OF INTEREST INVOLVING BANK EXAMINERS

Although bank examiners often leave the Corporation to enter the employ of banks and bank holding companies, and although this suggests the potential for abuse, the Corporation has taken great care over the years to detect any signs of abuse arising out of this potential conflict of interest. We believe that the record of the Corporation is truly remarkable in this regard. Nevertheless, we are aware that conflicts of interest may be a source of potential abuse. Therefore, we

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support the approach embodied in S. 555, the "Public Officials Integrity Act of 1977." Title V of that bill which was recently passed by the Senate would revise 18 U.S.C. 207: (a) to permanently bar any former federal employee from becoming involved in any specific case in which he was personally and substantially involved in any time during his government service; (b) to prohibit such an employee, for a period of two years after leaving federal service, from representing anyone other than the United States in any specific case which was under his official responsibility during his last 12 months of government service; and (c) to prohibit any former top-level federal official, for a period of one year after leaving federal service, from initiating any contact with his former department or agency relating to matters actually pending before such department of agency.

We believe that logic dictates dealing with these conflict of interest questions in the broader, government-wide context, rather than singling out the financial regulatory agencies for special legislation of this nature. To the extent that they exist, these problems are certainly not limited to the regulators of financial institutions.

Finally, it should be noted that the FDIC has responded to criticisms and recommendations outlined in the GAO report to the Congress of June 1, 1977 dealing with standards for ethics for Corporation officers and employees. Proposed amendments to FDIC regulations governing employee responsibilities and conduct incorporate with minor exceptions and some improvements GAO's recommendations. Basically,

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the proposed amendments to Part 336 of FDIC's regulations: (a) include specific criteria for employees in bank examiner positions (GS-13 and above) and certain other employees (GS-9 and above whose decisions or actions could have an economic impact on the interests of nonfederal enterprises) to file financial disclosure statements; (b) improve guidelines for determining conflicts of interest; (c) provide for the use of a greatly expanded disclosure and reporting form to enforce statutory prohibitions and Corporation regulations; and (d) improve procedures for collecting and reviewing statements.

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EXHIBIT A

FDIC

REGIONAL DIRECTOR

FEDERAL DEPOSIT INSURANCE CORPORATION

BANK STOCK LOANS

Dear Sir:

An examination of ....

as of the close of business.. disclosed the bank held, as collateral,

stock of..

Respectfully,

....

Regional Director

Stockholder	Borrower	Number of shares	Certif-icate number	Original date of loan	Balance of loan	Inter-est rate

FDIC 6500/22 (8-71) Formerly DE-24

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EXHIBIT B

FDIC

REGIONAL DIRECTOR

FEDERAL DEPOSIT INSURANCE CORPORATION

OFFICER LOANS

Dear Sir:

An examination of ....

as of the close of business ....disclosed the following direct and indirect

liabilities of officers of ....

Respectfully,

....

Regional Director

Name and Title of Officer	Original Amount	Current Balance	Description and Purpose*

*Include origination and maturity dates, endorsers, guarantors and security, if any; if indirect, so note.

FDIC 6500/23 (8-71) FORMERLY DE-25

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EXHIBIT C

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

OFFICE OF THE CHAIRMAN

October 26, 1970

TO THE EXECUTIVE OFFICER OF THE
INSURED STATE NONMEMBER BANK ADDRESSED

Subject: Use of Interbank Deposits as Compensating Balances for Loans to Individuals Connected with Depositing Bank

The Assistant Attorney General in charge of the Criminal Division of the Department of Justice has suggested that his views on the above subject be communicated to all insured banks. The following quotation from his letter to the Comptroller of the Currency should receive the close attention of all bankers to whom it might apply. A similar letter is being sent to all National banks by the Comptroller of the Currency and to all State member banks by the Board of Governors of the Federal Reserve System.

"Reference is made to the conversations which representatives of the Criminal Division have had with you and members of your staff concerning the practice of bank officials utilizing the correspondent accounts of their banks for the purpose of compensating lending banks for loans granted to these officials. By using these non-interest bearing correspondent accounts in this manner, some borrowing officials have been able to obtain loans at preferential rates and to circumvent other statutes and administrative regulations promulgated for the protection of Federally regulated or insured banks. Since the borrower maintains these balances as a condition of the loan, he is able to utilize the funds and credits of his bank for his own personal benefit.

"Investigation into this area disclosed that this practice is fairly widespread, particularly in certain areas of the country, both in the initial acquisition of a bank and at subsequent times. There are no cases, at the present time, construing this practice as a misapplication under the criminal statutes. We believe, however, that where the facts demonstrate a clear detriment to the bank and a concomitant benefit to its officers this activity would, at a minimum, constitute a breach of the fiduciary duty owed by the officials to the bank and might in certain situations warrant prosecutive action.

"In light of the foregoing, your office . . . . may wish to consider advising the banking industry of our view that the above practice might constitute a violation of Federal criminal statutes."

Frank Wille

Frank Wille
Chairman

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C O P Y

September 18, 1970

Honorable William B. Camp
Comptroller of the Currency
Department of the Treasury
Washington, D.C.

Dear Mr. Camp:

Reference is made to the conversations which representatives of the Criminal Division have had with you and members of your staff concerning the practice of bank officials utilizing the correspondent accounts of their banks for the purpose of compensating lending banks for loans granted to these officials. By using these non-interest bearing correspondent accounts in this manner, some borrowing officials have been able to obtain loans at preferential rates and to circumvent other statutes and administrative regulations promulgated for the protection of Federally regulated or insured banks. Since the borrower maintains these balances as a condition of the loan, he is able to utilize the funds and credits of his bank for his own personal benefit.

Investigation into this area disclosed that this practice is fairly widespread, particularly in certain areas of the country, both in the initial acquisition of a bank and at subsequent times. There are no cases, at the present time, construing this practice as a misapplication under the criminal statutes. We believe, however, that where the facts demonstrate a clear detriment to the bank and a concomitant benefit to its officers this activity would, at a minimum, constitute a breach of the fiduciary duty owed by the officials to the bank and might in certain situations warrant prosecutive action.

In light of the foregoing, your office, together with the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Federal Home Loan Bank Board, may wish to consider advising the banking industry of our view that the above practice might constitute a violation of Federal criminal statutes.

We are forwarding a copy of this letter to the Chairmen of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board.

Sincerely,

WILL WILSON
Assistant Attorney General

Federal Deposit Insurance Corporation

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EXHIBIT D

FDIC

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

OFFICE OF DIRECTOR · DIVISION OF BANK SUPERVISION

R/D-36-71 (4-22-71)

MEMORANDUM TO: Regional Directors

SUBJECT: Use of Inter-bank Deposits as Compensating Balances for Loans to Individuals Connected with Depositing Bank

Reference is made to a letter to the executive officers of all insured State nonmember banks from Chairman Wille, dated October 26, 1970, regarding the captioned subject. The letter contained quotations from a letter signed by the Assistant Attorney General in charge of the Criminal Division of the Department of Justice. Essentially, the Assistant Attorney General stated that where the facts demonstrate a clear detriment to the bank and a concomitant benefit to its officers, the subject activity might in certain situations warrant prosecutive action. Following distribution of Chairman Wille's letter, a number of letter-reports citing violations of this nature have been forwarded to this office.

Recently there has been an informal communication by the Department of Justice to the Corporation indicating that the policy of that agency will be to consider prosecution if the transactions of this type occurred after October 22, 1970 and to decline to consider prosecution if the activities occurred prior to that date. Consequently, it is the opinion of our Legal Division that matters of this type occurring prior to October 22, 1970 need not be brought to the attention of the Department of Justice.

Please be guided accordingly.

John L. Flannery

John L. Flannery
Director

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EXHIBIT E

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

OFFICE OF DIRECTOR · DIVISION OF BANK SUPERVISION

R/D-20-72 (3-1-72)

MEMORANDUM TO: Regional Directors

SUBJECT: Use of Interbank Deposits as Compensating Balances for Loans to Individuals Connected with Depositing Bank

This is with further reference to the letter dated October 26, 1970, from Chairman Wille to Executive Officers of Insured State Nonmember Banks, and our memorandum to Regional Directors dated April 22, 1971, both on this subject and noting the interest of the Department of Justice therein.

Reports of activities of this kind made to this office should contain, along with any other relevant information, the following:

1) The date, amount, maturity, and interest rate of and collateral for the loan by the depository bank;

2) The name of the borrower and his relationship to the depositing bank;

3) Whether the interest rate charged appears preferential when compared with other loans made by the depository bank at that time;

4) Whether the loan has been renewed, and, if so, when and on what terms and conditions;

5) The amount of the compensating balance and the date it was made;

6) Whether the balance is dormant;

7) Whether the depositing bank receives any services in return for the deposit; and

8) Copies of any written agreement or understanding concerning the relationship between the loan and the compensating balance and of any other relevant documents.

E. J. Roddy

Edward J. Roddy
Director

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EXHIBIT F

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

OFFICE OF DIRECTOR · DIVISION OF BANK SUPERVISION

R/D-6-74 (1-25-74)

MEMORANDUM TO: Regional Directors

FROM: Edward J. Roddy
Director
E Roddy

SUBJECT: Compensating Balance Guidelines

Attached are guidelines prepared by the Legal Division to assist examiners in investigating certain compensating balance arrangements. Appropriate distribution may be made to your examiners.

In determining whether a letter report to the United States Attorney is in order, a few cautionary comments should be kept in mind. Correspondent bank accounts are essential to the conduct of banking as we know it. They inevitably grow as the size of banks and the scope of their operations grow. It is both proper and sound for correspondent bankers to pursue enduring and profitable relationships with "respondent" banks by any legal means available. In reviewing correspondent balance/loan arrangements, the emphasis should be on detriment to the "captive" respondent bank, and it is this fact that should be thoroughly investigated and supported in any allegations of criminal abuse. Preferential treatment of "insiders" is only a secondary or ancillary consideration, albeit, an essential one in supporting any charges of criminal irregularities.

You will notice one change in procedure. Examiners are currently expected not only to bring alleged criminal irregularities perpetrated by bank personnel to the attention of the bank's Board of Directors, but also to request (and in some instances insist) that the Board promptly notify the bonding company of all facts related to the alleged irregularity and to obtain affirmative evidence of the continued coverage of the fidelity bond with respect to those responsible for the alleged irregularities. Because the specific standards for evaluating the propriety of a compensating balance arrangement have not yet been well established, the usual procedure of having the bonding company notified will not be followed unless specific recommendation to do so in that particular case is received from the Legal Division.

Enclosure:
Guidelines

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Guidelines for Examiners Investigating Arrangements where Bank's Correspondent Deposits may serve as Compensating Balances for Loans to Bank Officials and their Associates

I. GENERAL

The maintenance by one bank ("depositing bank") of an appropriate deposit account (the "correspondent account") with another bank (the "correspondent bank") is essential to the conduct of banking business. 1/ However, an officer, director or other person influential in the affairs of the depositing bank may abuse his position of influence by causing an amount in excess of the bank's reasonable correspondent needs to be maintained in such a correspondent account and then trading off its economic power for his own financial benefit in his relations with the correspondent bank. 2/ Such an arrangement may, depending on the circumstances, constitute a breach of a bank official's fiduciary obligations to the depositing bank and, derivatively, to its depositors, creditors and shareholders; in some cases, the arrangement may also involve a criminal offense.

Accordingly, if a bank you are examining maintains a correspondent account with another bank which has extended credit to a person influential in the management of the depositing bank, or anyone associated with him (or if you discover that the examined bank has a deposit from another bank and has outstanding extensions of credit to an influential person in the other bank or his associates) and where there is evidence that the depositing bank may have suffered a detriment because of the loan/deposit arrangement, the situation should be thoroughly investigated.

If, after the investigation, it appears that (1) the consideration received by the depositing bank for its deposit is inadequate and (2) preferential treatment has been accorded by the correspondent bank to the influential person or

---

1/ The most essential type of correspondent service is item clearing. Other types of correspondent services may include investment advice, trust information, payment of cashier's checks, data processing services, and assistance with securities transactions.

2/ Improper compensating balance arrangements, of course, are not the only method whereby funds of a bank may be misapplied to obtain preferential treatment for a person influential in a bank's affairs in his personal financial relations with another bank. There are numerous other types of reciprocal "tie-in" arrangements whereby funds of one bank can be used improperly to compensate another bank for preferential treatment accorded by the second bank to persons influential in the first bank. Among such arrangements could be inappropriate purchases of or participations in poor loans; investment in poor quality securities contained in the second bank's investment portfolio; and exorbitant fees. For simplicity, however, we have restricted our discussion to the more traditional deposit-loan arrangements.

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his associate, the matter should be made the basis of a letter report of irregularity. The report should be transmitted through the Regional Director to the Legal Division which will review the results of your investigation and, with your assistance, will coordinate any further preparation which may be necessary for enforcement purposes including, where the facts so warrant, referral to the Department of Justice for criminal prosecution. Because the specific standards for evaluating the propriety of a compensating balance arrangement have not yet been well established, the usual procedure of having the bonding company notified will not be followed unless specific recommendation to do so in that particular case is received from the Legal Division.

We recognize that the initial general determination whether the compensating balance arrangement is irregular and therefore merits further consideration as a potential enforcement matter is by its nature not susceptible to simple specific guidelines; it depends upon careful consideration and balancing of all pertinent facts. However, while your ultimate conclusion in this regard must draw upon your overall experience, the following matters should be specifically considered in analyzing the arrangement and should be discussed in any letter report which you determine to transmit in this regard. It should be noted that each of these items is merely an indication of whether there may be an irregular compensating balance arrangement. The existence or nonexistence of any of these items does not necessarily show whether the arrangement is or is not irregular.

II. SPECIFIC MATTERS TO BE CONSIDERED IN ANALYZING SUSPECT COMPENSATING BALANCE ARRANGEMENTS.

A. Deposit Account

A deposit account may be considered detrimental to the depositing bank where it exceeds the bank's normal correspondent needs. In making this determination, the account should be analyzed in the following respects for the period coinciding with the relevant extensions of credit.

1. Amount of deposit balance

   (a) Compare deposit amount with applicable reserve requirements (describe the particular requirements and the alternative methods, if any, for their satisfaction);

   (b) describe historical level of correspondent balances (considering the growth pattern of the bank);

   (c) identify changes in level of correspondent balances. If sudden increases have occurred, can these be correlated with increases in correspondent business activity?; and

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(d) discuss establishment of correspondent relationship. Is it one of long standing? If recent, what was the basis for its establishment?

2. Activity in deposit account

(a) State whether the account is dormant or active (if active, generally describe the volume of daily activity); and

(b) specify the terms of the account agreement (and note any actual variances from these terms).

3. Depositing bank's borrowing position -- Is the depositing bank, during the maintenance of the deposit, in a borrowing position with respect to any bank? Specify any such borrowings and calculate their expense.

4. Services performed by correspondent bank -- Assess the value of services performed by the correspondent bank for the depositing bank:

(a) What, if any, services are performed (see, e.g., n.1, supra);

(b) describe any other arrangements which the depositing bank may have with any other institution or person covering the type of services described in response to (a);

(c) have the depositing and correspondent banks attempted to establish the value of such services?; and

(d) state your own estimate of the value of such services and the basis for your estimate. Where feasible, compare the value of such services with that of similar services provided by other institutions or persons in the same market area.

B. Extensions of Credit

In analyzing preferential aspects of a loan to officials of the depositing bank or their associates, all significant terms of the loan should be considered. These terms should be specifically identified and compared with ordinary terms for loans of similar types, relying on your general knowledge of customary banking practices and any additional information which you may be able to

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develop through sources in the depositing bank. (At the initial stage of the investigation, it would probably be imprudent to approach the correspondent bank for information relating to its lending practices.)

1. Ordinary significant terms -- Significant loan terms, of course, include amount; interest rate and whether the rate will be adjusted upon a change in general interest rate levels; maturity; repayment terms; and collateral required as security. 3/ Also note, if you are able to develop the information through sources in the depositing bank, whether the loan terms (which may appear quite ordinary on the surface) are being complied with.

2. "Tie-in" adjustment provision -- Is there any indication that the deposit funds are necessary to finance the loan (i.e., that the correspondent bank would not be in a position to make the loan except for the deposit)? Also, describe any provision for adjusting terms of the loan (usually the interest rate) based upon changes in the correspondent balance. It is anticipated that discovery of such an express provision will be rare. However, special attention should be accorded to any correlation between a change in the terms of the loan and the amount of the correspondent balance.

III. GENERAL INITIAL EVALUATION OF INTERRELATIONSHIP BETWEEN LOAN AND DEPOSIT.

Definite conclusions regarding the actual interrelationship between the deposit and loan may be difficult to establish at this initial stage of investigation. Nevertheless, any observations which you have in this regard can be valuable.

The following matters should be considered:

1. Describe any agreement or understanding relating to the compensating balance arrangement. In this regard you should, during the course of your examination of a bank, where a suspect loan/deposit exists, directly inquire of officials of the depositing bank -- and particularly the persons having loans from the correspondent bank -- whether there is any such agreement or understanding. 4/ If the agreement or understanding has been reduced to written form, a copy of it and any other relevant papers should be submitted with your initial written report.

3/ Where a loan is collateralized by securities, state the method used for valuation. If the securities are stock of the depositing bank, also show both the market price (if any) and the book value.

4/ In appropriate circumstances, intentional falsehoods made to a Corporation examiner during the course of a bank examination may be subject to criminal penalties under 18 U.S.C. § 1001.

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2. Consider whether the borrower is sufficiently influential in the affairs of the depositing bank to cause placement of an excessive deposit in the correspondent bank. State the basis for your conclusion. You should attempt to trace responsibility for the decision to make the deposit. In cases where the borrower's influence is indirect in nature, describe the decision-making process and the borrower's role in it.

3. Attention should also be refocused on coincidences (dates and amounts) between the deposit account and the correspondent loan.

4. Has the correspondent loan been brought to the attention of the Board of Directors of the depositing bank? If representations are made that the matter has been considered by the Board, verify these representations. Copies of any Board minutes reflecting meetings at about the time when the loan and/or deposit was made should be attached to your report.

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EXHIBIT G

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

OFFICE OF DIRECTOR • DIVISION OF BANK SUPERVISION

R/D-47-75 (4-17-75)

MEMORANDUM TO: Regional Directors

SUBJECT: Operation of Insurance Agencies in Conjunction With State Nonmember Insured Banks

This memorandum is concerned with the operation of an insurance agency on the premises of a State nonmember insured bank under circumstances where the agency is not owned by the bank, and profits from the operation of the agency inure to its owners' benefit and not to the bank. In addition, the operation of the separate insurance agency on the bank's premises usually occasions the utilization of bank space, equipment, and personnel. This memorandum is intended to provide guidance in evaluating such an arrangement.

While each case should be analyzed on its own fact situation and in accordance with applicable laws and regulations of the State in which the bank is located, utilization of bank space, equipment and personnel in connection with the operation of an insurance agency which is not an integral part of the bank would normally require reimbursement to the bank. The amount of reimbursement should be reasonably related to the dollar value of the bank space, equipment or personnel employed, directly or indirectly, in the conduct of the insurance business. Accordingly, there is no fixed formula or "rule of thumb" for ascertaining the precise amount of such reimbursement and that determination is largely a matter for the bank's board of directors. However, the Division of Bank Supervision is concerned when a bank is inadequately compensated for any expenses it incurs in furnishing personnel, equipment, space, etc., to this nonbanking activity. In reviewing the adequacy of reimbursement, it is recognized that certain benefits may accrue to the bank incidental to the operation of an insurance agency; nevertheless, only those benefits (tangible or intangible) that have a measurable value should be given consideration.

In all cases, the bank's directors <u>and</u> shareholders should be fully informed regarding the details of the operation of a separate insurance agency on the premises of the bank. The plan and any material changes thereto should be approved by the bank's shareholders. Expenses incurred by the bank in connection with such activity and related compensation therefor (or lack thereof) are expected to be approved formally

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by the board of directors at least on an annual basis. Exceptions to this practice should be discussed with bank management by the Examiner and appropriately commented upon in reports of examination. In addition, attempts to circumvent reasonable compensation to the bank, through the payment of bonuses, etc., should also be discussed with management and commented on.

It is recommended that bank management disclose completely to its bonding company any such nonbanking activity, if this be the case, conducted by its personnel (or others) on its premises. Management would be well advised to obtain acknowledgement from the bonding company that such activities do not impair coverage under the bank's blanket bond. Examiners should discuss and comment upon exceptions to this recommendation as appropriate.

Finally, in those instances where the Examiner believes, based on the known facts, that a violation of applicable statutes or regulations has occurred, or where there is no question that a criminal violation has been committed, the matter should be handled in the usual manner as prescribed in the Manual of Examination Policies.

E Roddy

Edward J. Roddy
Director

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EXHIBIT II

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

OFFICE OF DIRECTOR - DIVISION OF BANK SUPERVISION

July 27, 1977

MEMORANDUM TO: Regional Directors

FROM: John J. Early
Director
John J Early

SUBJECT: Insider Abuse of Credit Life Insurance Activities

Attached is a copy of a corrective Order adopted by our Board of Directors in a recent set of actions under Section 8(b) of the FDI Act. The banks against which the Orders have been finally adopted in one case and are being negotiated in three others are in a state where it is legal for a bank to sell credit life insurance on its own. It is the Corporation's opinion that the premiums in these cases had been diverted to an insider in an abusive manner.

The attached example corrective Order is not meant in any way to change existing instructions, policies or practices in our supervision of credit life insurance activities in insured Nonmember banks. However, should abuses or undesirable practices be disclosed, the attached might serve as an example of corrective action which you can consider.

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13. (a) Within 60 days from the date of this ORDER, the bank shall disclose in writing to all shareholders of the Bank full and complete details concerning the expenses incurred by the Bank in connection with the insurance business undertaken by the [redacted] and [redacted], and the manner of distribution of income derived from the sale of such insurance sold on Bank premises during 1975 and 1976. As part of the disclosure required hereunder, these parties, to the extent of their knowledge, shall provide to all the Bank's shareholders the information set forth in Paragraph 13(c)(1)(a)-(g) below for the years 1975 and 1976.

(b) Following the date of this ORDER, the Bank shall not permit the sale of credit life insurance or any other type of insurance written by the Bank personnel or written on Bank premises incidental to Bank loans unless the board of directors of the Bank shall, at least annually (but not more than 30 days prior to the regular annual meeting of the Bank's stockholders), review and determine by appropriate resolution whether the Bank will itself engage in the insurance agency business or otherwise retain or not retain, as the case may be, all commissions received on such credit life insurance or other forms of insurance written by Bank personnel or written on Bank premises incidental to Bank loans.

(c) Following the date of this ORDER, the board of directors of the Bank may adopt a resolution in accordance with the provisions of Paragraph 13(b) of this ORDER not to retain all commissions received on credit life insurance and other forms of insurance written by Bank personnel or written on Bank premises incidental to Bank loans, provided that both the following conditions and limitations are satisfied:

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(1) Formal ratification by a vote of two-thirds of the outstanding shares of voting stock of the Bank at their next regular annual meeting based upon full and complete disclosure of (a) the details and manner in which such insurance policies are written by Bank personnel, (b) the number of Bank personnel engaged (directly and/or indirectly) in writing such policies, (c) the approximate number of Bank manhours employed in writing and processing such policies, (d) the amount of Bank space and equipment utilized in the conduct of such insurance business, (e) the total amount of income (commissions) received incidental to such insurance business, (f) the identity of the owner (or owners) of the insurance agency, or other individuals that receive such income, and (g) the corporate opportunity available to the Bank with respect to the Bank's engagement in the insurance business. The foregoing disclosures shall be made based upon information and figures obtained by the Bank for the year preceding the stockholders' meeting.

(2) Execution of a written agreement between the Bank and the insurance agency through which such insurance policies are written wherein the agency agrees to reimburse the Bank in an amount that is reasonably related to the aggregate dollar value of (a) the number of Bank personnel and manhours involved, and (b) the amount of Bank space (including taxes thereon), equipment, utilities and supplies utilized in the conduct of such insurance business.

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EXHIBIT I

FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(b)
(Cease and Desist Actions)

Attached is a case-by-case summary of 39 Cease and Desist actions issued by the Corporation since January 1971. It should be noted that several such actions are now in various stages of processing.

In addition to the listing, it should also be noted a number of other Cease and Desist actions have been authorized by the Corporation's Board of Directors which were never stipulated to by banks or adopted in final form by our Board because of favorable interim affirmative actions on the part of either the banks or management-shareholders. In effect, the threat of a Cease and Desist action has caused many favorable affirmative action programs on the part of banks which negated the need for finalizing the authorized Cease and Desist actions.

Also attached is a summary of each of the three formal written agreements between banks and the Corporation which were ratified by our Board of Directors. In the case of formal written agreements, noncompliance thereof can be enforced by a subsequent Cease and Desist action.

Section 8(m) of the Federal Deposit Insurance Act provides the State supervisory authorities with the opportunity to initiate independent corrective action after the Corporation has served notice of intent to take formal action. While in most cases the State supervisory authorities choose to join the Corporation in any such action, some State banking laws do provide for independent cease and desist actions which have been utilized in a number of instances -- either prior to notice of intent on the part of the Corporation or subsequent thereto.

A compilation of these State supervisory authority cease and desist actions is not maintained by the FDIC, but the corrective orders are analyzed and checked for compliance on a case-by-case basis at each examination of the involved banks.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(b)
(Cease and Desist Actions)

nk No. **Summary**

1 Deposits--$64,556,000

Cease and Desist order entered on 6-17-71. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to reduction in volume of municipal bonds, other assets realignment to improve liquidity, curtailment of direct and indirect loans to insiders, acceptable management, and injection of new capital funds.

Order terminated 12-10-71 following the sale of controlling interest by the unsatisfactory management, sale of new capital funds, substantial compliance with the Cease and Desist order, and the designation of new management.

2 Deposits--$46,107,000

Cease and Desist order entered on 7-12-71. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to elimination of transactions with self-serving ownership.

Order terminated 1-12-73 following change of stock control and a revamping of the board of directors.

3 Deposits--$7,328,000

Cease and Desist order entered on 7-12-71. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to elimination of transactions with self-serving ownership.

Order terminated 5-1-72 following the sale of controlling interest by the unsatisfactory management and restoration of the capital accounts to an acceptable level.

4 Deposits--$1,025,000

Cease and Desist order entered on 7-12-71. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to elimination of transactions with self-serving ownership.

Order terminated 4-17-72 following the sale of controlling interest by the unsatisfactory management and restoration of the capital accounts to an acceptable level.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(b)
(Cease and Desist Actions)

Bank No.	Summary
5	Deposits--$20,238,000 Cease and Desist order entered on 7-12-71. Bank ordered to cease and desist unsafe and unsound practices and take affirmative action with respect to elimination of transactions with self-serving ownership. Order terminated 12-10-71 following the sale of controlling interest by the unsatisfactory management and restoration of the capital to an acceptable level.
6	Deposits--$5,096,000 Cease and Desist order entered on 7-12-71. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to correction of violations of laws and regulations, correction of operating deficits, and restoration of the capital accounts to an acceptable level. Order terminated 7-8-74 following substantial compliance with corrective orders, favorable trends, improved prospects and augmented capital.
7	Deposits--$4,649,000 Cease and Desist order entered on 11-19-71. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to elimination of transactions with a self-serving ownership and management. Order terminated 5-2-74 following change of control, management and asset improvement.
8	Deposits--$6,513,000 Cease and Desist order entered on 1-6-72. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to providing its shareholders with adequate information pertaining to the conditions and activities of the bank in full compliance with various requirements of Sections 12, 13 and 14 of the Securities Exchange Act of 1934 and Section 335 of the Federal Deposit Insurance Corporation's Rules and Regulations. Substantial compliance with the order was accomplished in 1972 although the order remains outstanding.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(b)
(Cease and Desist Actions)

Summary

Deposits--$5,128,000

Cease and Desist order entered on 2-15-72. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to misuse of credit facilities by controlling stockholders.

Order terminated 5-29-74 when compliance with all conditions was accomplished.

Deposits--$18,866,000

Cease and Desist order entered on 3-31-72. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to hazardous lending policies and inadequate capital caused by incompetent active management and a complacent directorate.

Order terminated 8-28-73 when substantial compliance with almost all conditions had been accomplished.

Deposits--$1,795,000

Cease and Desist order entered on 5-5-72. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to sharply declining asset condition and capital inadequacy resulting from two successive inept management/ownership groups.

Order terminated 6-25-73 following change of management/ownership, improved asset condition and substantial compliance with other parts of the order.

Deposits--$3,614,000

Cease and Desist order entered on 5-5-72. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to an excessive volume of high-risk loans, sizeable loan losses, and inadequate capital which resulted from policies of a liberal, self-serving and domineering controlling owner and weak, ineffective management.

Only partial compliance has been accomplished--new management--and order remains outstanding.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(b)
(Cease and Desist Actions)

Bank No. **Summary**

13 Deposits--$59,975,000

Cease and Desist order entered on 8-18-72. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to failure to correct repeated and flagrant violations of applicable laws and regulations.

Order terminated 5-14-73 upon compliance with requirements contained therein.

14 Deposits--$3,742,000

Cease and Desist order entered on 11-21-72. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to excessive risk in the loan account, inadequate capital, willful and continued violations of applicable statutes, and generally unsatisfactory operations resulting from liberal lending policies of self-serving controlling interests.

Order terminated 6-19-74 following substantial compliance with the corrective requirements.

15 Deposits--$4,703,000

Cease and Desist order entered on 11-21-72. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to excessive exposure in the loan account, increasing loan losses, an inadequate and diminishing level of capital, and unsatisfactory operations under the self-serving domination of the controlling interests.

Order terminated 2-8-74 after substantial improvements in the bank's asset-capital condition and operations within the constraints of the Cease and Desist order.

16 Deposits--$1,953,000

Cease and Desist order entered on 12-4-72. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to excessive risk in the loan account, increasing losses and a shrinking level of capital which resulted from liberal lending policies fostered by the bank's management/ownership.

Order terminated 2-8-74 following examinations which disclosed improvements, and full or substantial compliance with all corrective provisions.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(b)
(Cease and Desist Actions)

Summary

Deposits--$1,309,000

Cease and Desist order entered on 12-18-72. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to an excessive volume of classified loans, inadequate capital and poor liquidity resulting from expansionary and liberal policies of inexperienced management/ownership.

The bank was in substantial compliance with the order at the latest examination but the order remains outstanding.

Deposits--$2,528,000

Cease and Desist order entered on 2-12-73. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to excessive adversely classified loans, and an inadequate capital structure which developed as a result of liberal lending policies and the weak management ability of ownership and its subservient staff.

Order terminated 2-11-75 following substantial improvement in the bank's asset-capital condition.

Deposits--$28,025,000

Cease and Desist order entered 4-23-73. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to heavy and severe adverse classifications of loans extended to a group of related construction firms which resulted in violations of law, heavy losses, deterioration of other segments of the loan portfolio, and capital inadequacy.

Order terminated 12-23-74 following the elimination of the adversely classified concentrations of credit and the injection of new capital funds.

Deposits--$3,829,000

Cease and Desist order entered 5-21-73. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to excessive risk in the loan account, a declining level of capital protection, deficit earnings resulting from heavy loan losses and other problems stemming from a management dispute resulting in the resignation of three directors including the former executive officer. The order to cease and desist included requirements for management improvements, rehabilitation of asset condition, a capital improvement program, and adoption of written lending and internal operating policies.

Recommendation for termination in process, based on substantial compliance with order.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(b)
(Cease and Desist Actions)

Bank No.	Summary
21	Deposits--$3,057,000 Cease and Desist order entered 6-25-73. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to excessive adversely classified credits involving several out-of-area and/or self-serving loans, potential losses from irregularities, and inadequate capital protection. Order terminated 8-11-75 as conditions were fulfilled including the injection of new equity capital.
22	Deposits--$2,913,000 Cease and Desist order entered 7-31-73. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to unsound securities transactions and excessive municipal bond holdings which threatened the solvency of the bank through the resulting market depreciation, illiquid position and trading losses incurred. Bank was found in substantial compliance with the order at subsequent examinations but the order remains outstanding.
23	Deposits--$5,466,000 Cease and Desist order entered 7-31-73. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to the failure to comply with Federal Reserve Regulation Z. Order terminated 11-26-75 after bank was found to be in compliance with the order.
24	Deposits--$51,573,000 Cease and Desist order entered 9-24-73. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to providing acceptable management, implementing and maintaining lending, investment, and operating policies in accord with sound banking practices, conforming to all applicable laws, rules, regulations, and reducing the excessive volume of weak credits. Order terminated 11-26-75 when the bank was found to be in compliance with the order.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(b)
(Cease and Desist Actions)

Bank No. | Summary

25 Deposits--$4,136,000

Cease and Desist order entered 10-15-73. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to high volume of adversely classified loans, an excessive delinquency ratio, continued violations of laws and regulations, and deteriorated capital adequacy which resulted from the increasingly liberal lending policies of the controlling stockholder and executive officer, coupled with a complacent directorate and incompetent staff.

Order terminated 9-2-75 following improvements in asset quality, substantial compliance with requirements included in the order to cease and desist, and the revitalization of sincere concern to effect improvements by the staff and directorate.

26 Deposits--$13,887,000

Cease and Desist order entered 1-29-74. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to excessive loan classifications, inept and self-serving management, violations of law, concentrations of credit, and uncontrolled expenses.

Order terminated 7-24-74 following the sale of control of the bank to a new group and injection of capital funds.

27 Deposits--$3,911,000

Cease and Desist order entered 4-11-74. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to serious asset problems which developed as total loan volume was rapidly expanded, capital inadequacy developed as the loan portfolio deteriorated in credit quality, hazardous lending and collection policies, and violations of laws and regulations.

Termination was recommended on 1-8-76 when the bank was found to be in substantial compliance; however, due to the illness of the bank's chief executive officer the termination recommendation has been held in abeyance.

28 Deposits--$2,857,000

Cease and Desist order entered on 6-7-74. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to the heavy volume of adverse classifications, speculative land contracts to out-of-territory borrowers, lack of sound lending, investment and operating policies, and an inadequate capital structure.

Bank subsequently closed.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(b)
(Cease and Desist Actions)

Bank No. | Summary

29 Deposits--$49,542,000

Cease and Desist order entered 6-11-75. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to the large volume of adversely classified loans which far exceeded capital and reserves, and centered in two massive concentrations of credit. Other weaknesses consisted of an overloaned and illiquid position, inadequate capital protection and numerous, frequent and flagrant violations.

The order has been substantially complied with although the injection of new capital funds remains to be accomplished. Management officials and their attorneys continue to contest the order. The order remains outstanding.

30 Deposits--$15,114,000

Cease and Desist order entered 10-15-74. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to the massive volume of weak loans, and loan losses taken in recent years, an inadequate margin of capital protection, an overloaned and illiquid position, poor earnings and a pattern of numerous and repeated violations.

The bank is in substantial compliance with the order and a recommendation to terminate the action is in process.

31 Deposits--$18,380,000

Cease and Desist order entered 3-26-75. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to unauthorized and unlawful acts by its officers, directors or employees, including the exceeding of lending limits and the acceptance of securities collateral without observing prudent banking practices to prepare for the lawful and orderly disposition of such securities in the event such disposition became necessary.

Order outstanding.

32 Deposits--$9,924,000

Cease and Desist order entered 5-9-75. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets and loan volume, adherence to loan policy, compliance with laws, rules and regulations, loan documentation, internal routine and controls, injection of new capital funds, and discontinuance of cash dividends.

Order outstanding.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(b)
(Cease and Desist Actions)

Summary

Deposits--$7,202,000

Cease and Desist order entered on 5-9-75. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, curtailment of loans to insiders, injection of new capital, reduction of borrowings and loan volume, compliance with laws, rules and regulations and loan policy, and discontinuance of cash dividends.

Order outstanding.

Deposits--$6,501,000

Cease and Desist order entered on 6-19-75. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, injection of new capital, compliance with laws, rules and regulations and loan policy, provisions for adequate liquidity, borrowings, and discontinuance of cash dividends.

Order outstanding.

Deposits--$1,833,000

Cease and Desist order entered 8-11-75. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management and management policies, reduction of adversely classified assets, provisions for adequate capital and liquidity, and compliance with laws, rules and regulations and loan policy.

Order outstanding.

Deposits--$6,046,000

Cease and Desist order entered 8-28-75. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, injection of new capital, and compliance with laws, rules and regulations and loan policy.

Order outstanding.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(b)
(Cease and Desist Actions)

Bank No.	Summary
37	Deposits--$5,305,000 Cease and Desist order entered 10-17-75. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to reduction of adversely classified assets and compliance with laws, rules and regulations and loan policy. Order outstanding.
38	Deposits--$7,742,000 Cease and Desist order entered 1-29-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, injection of new capital, limitations on advances of credit to borrowers, compliance with laws, rules and regulations, retention of credit life and accident insurance commissions, discontinuance of cash dividends, and elimination of a concentration of credit. Order outstanding.
39	Deposits--$9,129,000 Cease and Desist order entered 2-18-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to reduction of adversely classified assets, refraining from participating in any new loans and in any extension, renewal, refinancing, or additional extension of loans acquired from closely related banks, compliance with laws, rules and regulations including Financial Recordkeeping Regulations and the Fair Credit Reporting Act, injection of new capital, and discontinuance of dividends. Order outstanding.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(b)
(Formal Written Agreements)

Bank No. Summary

1 Deposits--$12,251,000

Written agreement entered into on 10-27-71. Bank agreed for purposes of effecting correction of unsafe and unsound practices to take affirmative action with respect to providing acceptable management, eliminating and reducing adversely classified assets, correction of internal control deficiencies, adoption of and compliance with an internal audit program, correction of and future compliance with all applicable laws, rules and regulations, and adoption of and compliance with a written loan policy.

The most recent examinations of January 1974 and November 1975 indicate substantial compliance with the agreement. The most recent report of examination is being reviewed in the Review Section and consideration is being given to recommending that the agreement be terminated.

2 Deposits--$13,957,000

Written agreement entered into on 3-2-72. Bank agreed for purposes of effecting correction of unsafe and unsound practices to take affirmative action with respect to providing acceptable management, eliminating and reducing adversely classified assets, adoption of and compliance with a written loan policy, injection of new capital, establishment of an unearned income account, adoption of and compliance with an internal audit program, correction of internal control deficiencies, and correction of and future compliance with all applicable laws, rules and regulations.

The agreement is outstanding; however, the 7-14-75 FDIC examination report indicates the bank appears to be in substantial compliance with the agreement.

3 Deposits--$1,958,000

Written agreement entered into on 2-14-73. Bank agreed for purposes of effecting correction of unsafe and unsound practices to take affirmative action with respect to the controlling shareholder purchasing for a period of three years from date and within 60 days after the completion of any FDIC examination of the bank, any loan which was classified Loss or Doubtful in subject bank that originated in the controlling shareholder's chain of banks, other than subject bank, and any loan held by and originating outside subject bank's regular trade area, and subject bank was to divest itself of any loan originated in any of the controlling shareholder's banks which were held in subject bank that had been classified Substandard at another of the affiliated banks and purchased by subject bank.

The agreement is outstanding, however, stock control has changed and the most recent examination as of 2-27-76 is being processed in the Regional Office and indicates substantial compliance. Consideration is being given by the Regional Office to recommend termination of the agreement.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(a)
(Action to Terminate Insured Status)

Attached is a case-by-case summary of 19 Termination of Insurance actions issued by the Corporation since January 1971. It should be noted that several such actions are now in various stages of processing.

In addition to the listing, it should also be noted a number of other Termination of Insurance actions have been recommended but were withdrawn prior to action by our Board because of favorable interim affirmative actions on the part of either the banks or management-shareholders. As in the case of Cease and Desist actions, the threat of Termination of Insurance has caused many favorable affirmative action programs on the part of banks which negated the need for finalizing the actions.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(a)
(Action to Terminate Insured Status)

Bank No.

Summary

1 Deposits--$11,143,000

Notice of Intention to Terminate Insured Status issued 1-22-71. Bank was found in an unsafe and unsound condition and ordered to provide an active and capable management, eliminate by charge-off or otherwise certain classified assets, correct all violations of law listed in the report of examination, and to adopt and strictly follow written loan policies if continued insured status was desired.

The action was terminated 6-30-71 when subject was merged with another bank.

2 Deposits--$13,419,000

Notice of Intention to Terminate Insured Status issued 3-12-71. Bank was found in an unsafe and unsound condition and ordered to provide an active and capable management, eliminate from its books certain assets, by charge-off or otherwise, correct all violations of law listed in the examination report, adopt and strictly follow written loan policies, pay no cash dividends without the prior consent of the Banking Commissioner and the FDIC, reduce the loan-to-deposit ratio, not accept or acquire, directly or indirectly, brokered deposits, eliminate from its capital accounts all income collected but not earned, and to provide adequate capital and reserves if continued insured status was desired.

The action was terminated 12-17-71 based upon substantial compliance with the corrective orders.

3 Deposits--$3,827,000

Notice of Intention to Terminate Insured Status issued 6-30-71. Bank was found in an unsafe and unsound condition and ordered to provide an active and capable management, eliminate from its books certain assets, by charge-off or otherwise, reduce the remaining classified assets, correct all violations of law listed in the report of examination, adopt and strictly follow satisfactory written loan policies, pay no cash dividends without the prior consent of the Commissioner of Banking and the FDIC, and put the assets of the bank in such form and condition as to be acceptable to the Commissioner of Banking and the FDIC if continued insured status was desired.

The action was terminated 4-6-73 based upon substantial compliance with the corrective orders.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(a)
(Action to Terminate Insured Status)

ank No. Summary

4 Deposits--$5,925,000

Notice of Intention to Terminate Insured Status issued 11-19-71. Bank was found in an unsafe and unsound condition and ordered to provide an active and capable management, eliminate from its books certain assets, by charge-off or otherwise, refrain from extending credit, directly or indirectly for the benefit of a director, reduce the remaining classified assets, adopt and strictly follow satisfactory written loan policies, pay no cash dividends without the prior consent of the Commissioner of Banking and the FDIC, and the assets of the bank were to be put in such form and condition as to be acceptable to the Commissioner of Banking and the FDIC if continued insured status was desired.

The action was terminated 7-7-72 based upon substantial compliance with the corrective orders.

5 Deposits--$12,609,000

Notice of Intention to Terminate Insured Status issued 12-17-71. Bank was found in an unsafe and unsound condition and ordered to eliminate from its book assets, by charge-off or otherwise, certain classified assets, and other assets of the bank were to be put in a satisfactory form and condition if continued insured status was desired.

The action was terminated 7-14-72 based upon substantial compliance with the corrective orders.

6 Deposits--$8,202,000

Notice of Intention to Terminate Insured Status issued 1-27-72. Bank was found in an unsafe and unsound condition and ordered to provide acceptable management, eliminate or reduce adversely classified assets, adopt acceptable loan policies, correct violations of law, and provide acceptable capital funds if continued insured status was desired.

The action was terminated 5-14-73 based upon substantial compliance with the corrective order.

7 Deposits--$4,079,000

Notice of Intention of Terminate Insured Status issued 3-17-72. Bank was found in an unsafe and unsound condition and ordered to provide acceptable management, eliminate or reduce adversely classified assets, adopt acceptable loan policies, correct violations of law, and provide acceptable capital funds if continued insured status was desired.

The action was terminated 12-4-72 based upon substantial compliance with the corrective order.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(a)
(Action to Terminate Insured Status)

Summary

k No.

8 Deposits--$1,857,000

Notice of Intention to Terminate Insured Status issued 5-1-72. Bank was found in an unsafe and unsound condition and ordered to provide acceptable management, eliminate or reduce adversely classified assets, adopt acceptable loan policies, and provide acceptable capital funds if continued insured status was desired.

The action was terminated 6-11-73 based upon substantial compliance with the corrective order.

9 Deposits--$12,649,000

Notice of Intention to Terminate Insured Status issued 10-30-72. Bank was found in an unsafe and unsound condition and ordered to eliminate or reduce adversely classified assets, obtain supporting documents prior to extending credits, adopt acceptable loan policies, and provide acceptable capital funds if continued insured status was desired.

The action was terminated 3-1-74 based upon substantial compliance with the corrective order.

10 Deposits--$5,540,000

Notice of Intention to Terminate Insured Status issued 11-21-72. Bank was found in an unsafe and unsound condition and ordered to provide acceptable management, eliminate or reduce adversely classified assets, obtain supporting documents prior to extending credits, strictly adhere to its written loan policies, correct violations of laws and provide acceptable capital funds if continued insured status was desired.

The action was terminated 5-29-74 based upon substantial compliance with the corrective order.

11 Deposits--$3,913,000

Notice of Intention to Terminate Insured Status issued 5-14-73. Bank was found in an unsafe and unsound condition and ordered to eliminate or reduce adversely classified assets, adopt acceptable loan policies, correct violations of law, and provide acceptable capital if continued insured status was desired.

The action was terminated 8-11-75 based upon substantial compliance with the corrective orders and the termination of affiliation with the bank by the control ownership.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(a)
(Action to Terminate Insured Status)

Bank No.	Summary
12	Deposits--$18,555,000
	Notice of Intention to Terminate Insured Status issued 6-28-74. Bank was foun in an unsafe and unsound condition and ordered to provide acceptable managemen eliminate or reduce adversely classified assets, adopt acceptable loan policie and correct violations of law if continued insured status is desired.
	The action to terminate insured status is in the hearing stage.
13	Deposits--$13,765,000
	Notice of Intention of Terminate Insured Status issued 8-12-74. Bank was foun in an unsafe and unsound condition and ordered to provide acceptable managemen eliminate or reduce adversely classified assets, adopt acceptable loan policie pay no cash dividends without prior written consent, provide acceptable capita and correct violations of law if continued insured status was desired.
	The action was terminated 8-11-75 because of temporary compliance; however, du to further deterioration and the length of time since the issuance of the init order, a new order was simultaneously issued.
14	Deposits--$6,557,000
	Notice of Intention to Terminate Insured Status issued 8-12-74. Bank was found in an unsafe and unsound condition and ordered to provide acceptable management eliminate or reduce adversely classified assets, adopt acceptable loan policies limit investment in securities to U. S. Government and/or Agency obligations maturing within five years, cease paying preferential rates of interest on certificates of deposit or other obligations to ownership interests, and correct violations of law if continued insured status was desired.
	The Commissioner of Banking closed the bank on 5-30-75.
15	Deposits--$4,174,000
	Notice of Intention to Terminate Insured Status issued 6-19-75. Bank was found in an unsafe and unsound condition and ordered to provide acceptable management, eliminate or reduce adversely classified assets, reduce its loan volume, adopt and comply with a loan policy, discontinue cash dividends, and obtain a certain level of capital if continued insured status was desired.
	Bank closed on 1-12-76.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(a)
(Action to Terminate Insured Status)

Summary

Deposits--$821,000

Notice of Intention to Terminate Insured Status issued 7-25-75. Bank was found in an unsafe and unsound condition and ordered to provide acceptable management, eliminate or reduce adversely classified assets, define an acceptable trade area, curtail direct and indirect loans to insiders, restrict its loan volume, comply with certain investment restrictions, comply with all applicable laws, rules, and regulations, discontinue cash dividends, and obtain a certain level of capital if continued insured status is desired.

An examination to determine the extent of correction was made on 11-25-75 and the bank was found not to be in compliance with the order. A recommendation to continue the action is in process.

Deposits--$13,849,000

Notice of Intention to Terminate Insured Status issued 8-11-75. Bank was found in an unsafe and unsound condition and ordered to provide acceptable management, eliminate or reduce adversely classified assets, reduce and maintain loan volume at a certain level, eliminate all adversely classified insider loans and reduce and maintain all such loans at a certain level, adopt and comply with a loan policy, discontinue cash dividends, obtain a certain level of capital, comply with all applicable laws, rules, and regulations, and refrain from participating in any transactions with a certain affiliate if continued insured status is desired.

An examination to determine the extent of correction was made on 10-31-75 and the bank was found not to be in compliance with the order. The action is now in the hearing stage.

Deposits--$16,089,000

Notice of Intention to Terminate Insured Status issued 9-16-75. Bank was found in an unsafe and unsound condition and ordered to provide acceptable management, eliminate or reduce adversely classified assets, adopt and comply with a loan policy, provide for an orderly liquidation of certain stock holdings, comply with applicable laws, rules, and regulations, appoint a committee to approve and control expenses, discontinue cash dividends, and obtain a certain level of capital if continued insured status is desired.

An examination to determine the extent of correction has just been completed and a determination will be made as to whether the action should be continued.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(a)
(Action to Terminate Insured Status)

Bank No.	Summary
19	Deposits--$15,883,000 Notice of Intention to Terminate Insured Status issued 10-9-75. Bank was found in an unsafe and unsound condition and ordered to provide acceptable management, eliminate or reduce adversely classified assets, reduce and maintain loan volume at a certain level, reduce its overdue loans not to exceed a certain percentage of outstanding loans, maintain a primary and secondary reserve position equal to a certain percentage of total resources, adopt and comply with loan and investment policies, and obtain a certain level of capital if continued insured status was desired. Bank closed on 10-24-75.

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Formal Actions

A listing and description of each termination of insurance action initiated under Section 8(a) of the FDI Act and cease and desist orders issued under Section 8(b) or 8(c) of the Act may be found in the following schedules.

Removal proceedings, against an officer or director of an insured state nonmember bank who violates a law, rule, regulation, or final cease and desist order, or who engages in an unsafe and unsound practice that constitutes a breach of his fiduciary duty, may be initiated by the Corporation under Section 8(e) of the Federal Deposit Insurance Act. The Corporation is authorized to take such action if it determines that the conduct will cause substantial financial losses or other damages to the bank or will seriously prejudice the interests of the bank's depositors, and that the conduct involves personal dishonesty. During 1976, one such order was issued against the chairman of the board and president of an insured state nonmember bank who was charged by the Corporation with misapplication of bank funds by diverting bank assets to his own personal use and with selling property to the bank at a price greater than its market value.

Section 8(g) of the FDI Act provides that when an officer, director, or other person who participates in the management of an insured nonmember bank is charged, in an information, indictment, or complaint authorized by a U. S. Attorney, with the commission of, or participation in, a felony involving dishonesty or a breach of trust, the Corporation may suspend or prohibit the person from participating in the affairs of the bank. Suspension proceedings are initiated by the issuance of a Notice and Order of Suspension and Prohibition, served on the individual involved, that specifies the charges and further orders the individual to be suspended from his position and prohibited from participating in the affairs of the bank. The suspension and/or prohibition remains in effect until the matter is disposed of or terminated by the FDIC. If convicted of the offense, a removal order may be issued. The FDIC issued one such order in 1976 against a bank officer who was reinstated after acquittal.

In light of a court decision in which Section 8(g) was held to be unconstitutional, the provisions of this section are no longer used; however, consideration is being given to requesting an amendment to this section of our Act.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(a)
(Action to Terminate Insured Status)

Summary

0 Deposits - $18,920,000 Assets - $20,006,000

Notice of Intention to Terminate Insured Status issued 4-8-76. Bank was found to be in an unsafe and unsound condition and ordered to provide acceptable management, eliminate or reduce adversely classified assets, reduce overdue loans to a specified level, reduce the book value of other real estate in accordance with statutory provisions, comply with applicable laws, rules and regulations, discontinue cash dividends and obtain a certain level of capital if continued insured status was desired.

Bank closed on June 3, 1976.

1 Deposits - $33,134,000 Assets - $36,289,000

Notice of Intention to Terminate Insured Status issued 6-16-76. Bank was found to be in an unsafe and unsound condition and ordered to provide acceptable management, eliminate or reduce adversely classified assets, eliminate adversely classified loans to insiders and certain shareholders of the bank and holding company, eliminate concentrations of credit, discontinue cash dividends and management fees, comply with applicable laws, rules and regulations, adopt and follow acceptable loan policies, and obtain a certain level of capital if continued insured status was desired.

An examination to determine the extent of correction was made on 10-18-76 and the bank was found not to be in compliance with the order. The action is in the hearing stage.

22 Deposits - $2,865,000 Assets - $3,032,000

Notice of Intention to Terminate Insured Status issued 7-6-76. Bank was found to be in an unsafe and unsound condition and ordered to provide acceptable management, eliminate or reduce adversely classified assets, reduce loan volume to a specific level, limit investments in securities to U. S. Treasury and/or Agency obligations, eliminate adversely classified loans to insiders, provide adequate liquidity, comply with applicable laws, rules and regulations, adopt and follow acceptable loan policies, discontinue cash dividends, and obtain a certain level of capital if continued insured status was desired.

An examination to determine the extent of correction was recently completed and a determination will be made as to whether the action should be continued.

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Bank No. | Summary

23 Deposits - $68,015,000 Assets - $73,100,000

Notice of Intention to Terminate Insured Status issued 7-22-76. Bank was found to be in an unsafe and unsound condition and ordered to provide acceptable management, comply with applicable laws, rules and regulations, eliminate or reduce adversely classified assets, reduce overdue loans to a specific level, adopt and follow acceptable loan policies, discontinue cash dividends, refrain from the purchase or sale of loan participations or extending credit to insiders of closely related banks, refrain from extending credit to or secured by stock of the holding company, and obtain a certain level of capital if continued insured status was desired.

An examination to determine the extent of correction was recently completed and a determination will be made as to whether the action should be continued.

24 Deposits - $11,354,000 Assets - $12,173,000

Notice of Intention to Terminate Insured Status issued 9-7-76. Bank was found to be in an unsafe and unsound condition and ordered to provide acceptable management, eliminate or reduce adversely classified assets, reduce overdue loans to a specific level, comply with applicable laws, rules and regulations, adopt and follow acceptable loan policies, discontinue cash dividends, adopt and follow acceptable internal control and audit procedures, refrain from preferential treatment of insiders, and obtain a certain level of capital if continued insured status was desired.

An examination to determine the extent of correction is currently in process.

25 Deposit - $4,185,000 Assets - $4,726,000

Notice of Intention to Terminate Insured Status issued 9-7-76. Bank was found to be in an unsafe and unsound condition and ordered to provide acceptable management, eliminate or reduce adversely classified assets, reduce overdue loans to a specific level, eliminate adversely classified loans to insiders, reduce the volume of extensions of credit to insiders to a specific level, comply with applicable laws, rules and regulations, reduce the book value of other real estate in accordance with statutory requirements, and obtain a certain level of capital if continued insured status was desired.

An examination to determine the extent of correction is to be scheduled in the near future.

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Federal Reserve Bank of St. Louis

Summary

Deposits - $7,946,000 Assets - $9,033,000

Notice of Intention to Terminate Insured Status issued 10-19-76. Bank was found to be in an unsafe and unsound condition and ordered to provide acceptable management, eliminate or reduce adversely classified assets, reduce overdue loans to a specific level, comply with applicable laws, rules and regulations, discontinue cash dividends, adopt and follow acceptable loan policies, actively seek fidelity insurance coverage, and obtain a certain capital level if continued insured status was desired.

The bank is being closely monitored until the expiration of the corrective period when an examination will be conducted to determine the extent of correction.

Deposits - $163,479,000 Assets - $176,828,000

Notice of Intention to Terminate Insured Status issued 11-19-76. Bank was found to be in an unsafe and unsound condition and ordered to provide acceptable management, eliminate or reduce adversely classified assets, adopt a plan to control expenses, eliminate concentrations of credit, comply with applicable laws, rules and regulations, reduce overdue loans to a specific level, adopt and follow acceptable loan policies, discontinue cash dividends, and obtain a certain level of capital if continued insured status was desired.

Bank closed on 12-3-76.

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Federal Reserve Bank of St. Louis

FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(b)
(Cease and Desist Actions)

No.

Summary

Deposits - $7,742,000 Assets - $8,723,000

Cease and Desist order entered 1-29-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, injection of new capital, limitations on advances of credit to borrowers, compliance with laws, rules and regulations, retention of credit life and accident insurance commissions, discontinuance of cash dividends, and elimination of a concentration of credit.

Deposits - $9,129,000 Assets - $9,822,000

Cease and Desist order entered 2-18-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to reduction of adversely classified assets, refraining from participating in any new loans and in any extension, renewal, refinancing, or additional extension of loans acquired from closely related banks, compliance with laws, rules and regulations including Financial Recordkeeping Regulations and the Fair Credit Reporting Act, injection of new capital, and discontinuance of dividends.

Deposits - $5,927,000 Assets - $7,662,000

Cease and Desist order entered on 3-30-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to reduction of adversely classified assets, injection of new capital, compliance with laws, rules and regulations, loan policy, and discontinuance of cash dividends.

Deposits - $3,104,000 Assets - $3,471,000

Cease and Desist order entered on 6-3-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, injection of new capital, compliance with laws, rules and regulations, loan policy, and discontinuance of cash dividends.

Deposits - $6,447,000 Assets - $7,178,000

Cease and Desist order entered on 7-22-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, injection of new capital, compliance with laws, rules ~~and~~ regulations, loan and investment policies, and discontinuance of cash dividends.

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Federal Reserve Bank of St. Louis

Bank No. Summary

43 Deposits - $4,246,000 Assets - $4,647,000

Cease and Desist order entered on 9-7-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, injection of new capital, compliance with laws, rules and regulations, loan policy, and discontinuance of cash dividends.

44 Deposits - $44,591,000 Assets - $48,704,000

Cease and Desist order entered on 9-7-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, injection of new capital, elimination of transactions with affiliates, compliance with laws, rules and regulations, loan and investment policies, and discontinuance of cash dividends.

45 Deposits - $35,744,000 Assets - $38,493,000

Cease and Desist order entered on 9-7-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets and overdue loans, discontinuance of cash dividends, injection of new capital, compliance with laws, rules and regulations, loan policy, and elimination of loan transactions with affiliates.

46 Deposits - $4,817,000 Assets - $5,164,000

Cease and Desist order entered on 9-22-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to elimination of loans to an insider, reduction of adversely classified assets, acceptable management, compliance with laws, rules and regulations, loan policy, audit program and fidelity coverage.

47 Deposits - $13,041,000 Assets - $14,194,000

Cease and Desist order entered on 9-22-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets and overdue loans, discontinuance of cash dividends, injection of new capital, compliance with laws, rules and regulations, loan policy, and elimination of loan transactions with affiliates.

48 Deposits - $87,936,000 Assets - $106,193,000

Cease and Desist order entered on 10-6-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with

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Federal Reserve Bank of St. Louis

k No. Summary

respect to elimination, collection, and/or establishment of repayment programs for overdrafts and loans to insiders, and compliance with laws, rules and regulations.

Deposits - $24,684,000 Assets - $27,926,000

Cease and Desist order entered on 10-6-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to elimination, collection, and/or establishment of repayment programs for overdrafts and loans to insiders, and compliance with laws, rules and regulations.

Deposits - $21,623,000 Assets - $25,242,000

Cease and Desist order entered on 10-6-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, injection of new capital, collateral for loans to certain insiders and related interests, limitations on total credit extended to an individual or concern and reduction to such limitations, compliance with laws, rules and regulations, loan and investment policies, and discontinuance of cash dividends.

Deposits - $17,334,000 Assets - $18,546,000

Permanent Cease and Desist order entered on 10-6-76 following issuance of a Temporary Cease and Desist order. Bank ordered to cease and desist from an unsafe and unsound practice and take affirmative action to prohibit payment of checks against uncollected funds for deposit accounts of an insider and a foreign bank.

Deposits - $138,906,000 Assets - $153,816,000

Cease and Desist order entered on 10-19-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets and overdue loans, limitations on payment of cash dividends, injection of new capital, compliance with laws, rules and regulations, and loan policy.

Deposits - $28,055,000 Assets - $30,394,000

Cease and Desist order entered on 10-19-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets and overdue loans, discontinuance of cash dividends, injection of new capital, compliance with laws, rules and regulations, loan policy,

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Federal Reserve Bank of St. Louis

Bank No. Summary

53 and discontinuance of overdrafts and preferantial rates of interest to insiders.

54 Deposits - $30,758,000 Assets - $33,743,000

Cease and Desist order entered on 11-16-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, injection of new capital, discontinuance of cash dividends, compliance with laws, rules and regulations, loan policy, and implementation of internal controls and an audit program for electronic data processing operations.

55 Deposits - $88,291,000 Assets - $98,248,000

Cease and Desist order entered on 12-16-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to injection of new capital in compliance with conditions included in an order issued in 1974 in connection with Corporation consent to establish a branch.

56 Deposits $13,383,000 Assets - $14,846,000

Cease and Desist order entered on 12-16-76. Bank ordered tó cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, injection of new capital, limitations on new extensions of credit to insiders and related interests and concentrations of credit, reduction of loan volume, compliance with laws, rules and regulations, loan and investment policies, and discontinuance of cash dividends.

57 Deposits - $20,205,000 Assets $22,872,000

Cease and desist order entered on 12-16-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to collection and/or elimination of adversely classified loans to certain insiders and their related interests, reduction of adversely classified assets, acceptable management, injection of new capital, compliance with laws, rules and regulations, and loan policy.

58 Deposits - $2,158,000 Assets - $2,376,000

Cease and Desist order entered on 12-16-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, limitation on extensions of credit to any one borrower and related entities, discontinuance of participating in loans with certain related banks, elimination of loans to persons located outside the bank's normal

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ank No. Summary

58 trade area, reduction of remuneration of certain officers and directors, compliance with laws, rules and regulations, loan policy, and discontinuance of cash dividends.

59 Deposits - $7,266,000 Assets - $8,055,000

Cease and Desist order entered on 12-16-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, discontinuance of participating in loans with certain related banks, elimination of adversely classified loans to insiders, reduction of concentrations of credit, elimination of loans to persons located outside the bank's normal trade area, compliance with laws, rules and regulations, loan policy, and discontinuance of cash dividends.

60 Deposits - $3,605,000 Assets - $4,012,000

Cease and Desist order entered on 12-16-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, discontinuance of participating in loans with certain related banks, elimination of adversely classified loans to insiders and loans to persons located outside the bank's normal trade area, reduction of remuneration to certain officers and directors, compliance with laws, rules and regulations, loan policy, and discontinuance of cash dividends.

61 Deposits - $3,227,000 Assets - $3,579,000

Cease and Desist order entered on 12-16-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, overdue loans, and concentrations of credit, elimination of adversely classified loans to insiders, discontinuance of participating in loans with certain related banks, compliance with laws, rules and regulations, loan policy, and discontinuance of cash dividends.

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Federal Reserve Bank of St. Louis

FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(c)
(Temporary Cease and Desist Actions)

nk No.

Summary

1 Deposits - $17,334,000 Assets - $18,546,000

Temporary Cease and Desist order issued 7-22-76. Bank ordered to cease and desist from an unsafe and unsound practice and take affirmative action to prohibit payment of checks against uncollected funds for deposit accounts of an insider and a foreign bank.

A permanent cease and desist order was issued on 10-6-76.

2 Deposits - $16,697,000 Assets - $18,885,000

Temporary Cease and Desist order issued 7-22-76. Bank ordered to cease and desist from an unsafe and unsound practice and take affirmative action with respect to discontinuance of paying cash dividends pending resolution of charges against the bank concerning nonpayment of fair value of stock held by shareholders dissenting to conversion from National to State charter.

Temporary order terminated 12-3-76 following resolution of the matter.

3 Deposits - $15,726,000 Assets - $17,532,000

Temporary Cease and Desist order issued 10-6-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action to prohibit insider transactions involving extensions of credit to or for the benefit of directors, officers or the principal shareholder or purchase or sale of assets to or for the benefit of the principal shareholder, additional credit to borrowers whose loans are classified doubtful or loss, and payment of cash dividends.

Bank closed 11-19-76.

4 Deposits - $6,328,000 Assets - $8,531,000

Temporary Cease and Desist order issued 10-19-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action to discontinue declaration or payment of cash dividends.

5 Deposits - $3,819,000 Assets - $4,301,000

Temporary Cease and Desist order issued 12-23-76. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action to discontinue extending credit, directly or indirectly, over a specified amount to any insider or entering into any business transaction with an insider.

The bank's directors stipulated to the issuance of a permanent Cease and Desist order during January 1977.

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Federal Reserve Bank of St. Louis

FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(a)
(Action to Terminate Insured Status)
1977

Summary

Bank No.

28 Deposits - $12,586,000 Assets - $13,432,000

Notice of Intention to Terminate Insured Status issued 4-19-77. Bank was found to be in an unsafe and unsound condition and ordered to provide acceptable management, eliminate or reduce adversely classified assets, reduce overdue loans to a specific level, eliminate concentrations of credit, correct violations of laws and regulations, increase capital, provide a plan for controlling expenses, eliminate loan documentation deficiencies, limit its loan volume to a specific relationship to deposits, adopt and follow an acceptable written loan policy, discontinue cash dividends, adopt acceptable internal control and audit procedures, adopt a policy prohibiting preferential treatment to insiders, and obtain a certain level of capital if continued insured status was desired.

An examination to determine the extent of correction is in progress.

29 Deposits - $27,558,000 Assets - $33,583,000

Notice of Intention to Terminate Insured Status issued 9-19-77. Bank was found to be in an unsafe and unsound condition and ordered to provide acceptable management, not to extend credit directly or indirectly to or for the benefit of the controlling shareholder, his relatives or related interests, eliminate or reduce adversely classified assets, eliminate concentrations of credit, correct violations of laws and regulations, adopt and follow acceptable loan and investment policies, discontinue cash dividends, adopt an investment policy to provide adequate liquidity, eliminate loan documentation deficiencies, provide additional capital, and obtain a certain level of capital if continued insured status was desired.

An examination to determine the extent of correction is to be made at the end of the corrective period.

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Federal Reserve Bank of St. Louis

FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(b)
(Cease and Desist Actions)
1977

k No.

Summary

62 Deposits - $8,503,000 Assets - $9,303,000

Consent Cease and Desist Order entered 1-5-77. Bank ordered to cease and desist from unsafe and unsound banking practices and take affirmative action with respect to reduction of adversely classified assets and delinquent loans, adoption of an appropriate written loan policy, prohibition of overdrafts to the bank's official family and, compliance with laws, rules and regulations.

63 Deposits - $6,839,000 Assets - $7,148,000

Consent Cease and Desist Order entered 2-1-77, following the issuance of a Temporary Cease and Desist Order. Bank ordered to cease and desist from extending credit of any kind, direct or indirect, in any amount in excess of $5,000, to any insider of the bank or person related to an insider; and from entering into any business transaction in any amount in excess of $5,000 with any insider or person related to an insider of the bank.

64 Deposits - $18,746,000 Assets - $20,709,000

Consent Cease and Desist Order entered 2-1-77. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to reduction of adversely classified assets; preparation of a list of and elimination of overdrafts to insiders; injection of new capital; provisions for adequate internal controls, outside audit and loan policy; and compliance with laws, rules, and regulations, including consumer protection laws.

65 Deposits - $6,150,000 Assets - $6,783,000

Consent Cease and Desist Order entered on 2-1-77. Bank ordered to cease and desist from unsafe and unsound banking practices and take affirmative action with regard to a comprehensive audit, the development and implementation of adequate internal controls, the full and complete compliance with consumer protection statutes, and the correction of all other violations of laws, rules, and regulations.

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Federal Reserve Bank of St. Louis

Bank No. Summary

66 Deposits - $7,662,000 Assets - $8,846,000

Consent Cease and Desist Order entered 2-1-77. Bank ordered to cease and desist from unsound and unsafe banking practices and take affirmative action with respect to acceptable management, reduction of classified assets, adoption of an appropriate written loan policy, compliance with laws, rules and regulations, elimination of adversely classified loans to insiders and loans to persons residing outside the bank's normal trade area, reduction of the volume of loans to the bank's official family and delinquent loans, maintenance of adequate cash reserves, reduction of salaries, bonuses, expense allowances and management fees to the president and one director, and discontinuance of cash dividends.

67 Deposits - $16,587,000 Assets - $17,983,000

Consent Cease and Desist Order entered 2-1-77. Bank ordered to cease and desist from unsafe and unsound practices and to take affirmative action with respect to acceptable management, reduction of adversely classified assets, injection of capital, compliance with laws, adopt and follow acceptable loan and investment policies, reduction of credit extended to insiders, reduction of total overdue loans, and discontinuance of cash dividends.

68 Deposits - $18,912,000 Assets - $20,687,000

Consent Cease and Desist Order entered 3-15-77. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, independent and realistic appraisals of real estate maintained as collateral, elimination of assets classified Loss and Doubtful, discontinuance of loans to certain insiders, limitation of lines of credit to and reduction of concentrations of credit to a specific relationship to capital and reserves, an injection of capital, elimination of loan documentation deficiencies, prohibition from repurchase of asset participations sold without recourse, restrict participations sold to a nonrecourse basis, compliance with laws, and discontinuance of cash dividends.

69 Deposits - $9,286,000 Assets - $10,484,000

Consent Cease and Desist Order entered 6-27-77. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to elimination of losses and 50 percent of Doubtful classifications, prohibition from extensions of credit to certain insiders, limitation of lines of credit to a specific relationship to capital and reserves, reduction of concentrations of credit, an injection of capital, elimination of loan documentation exceptions, prohibition from repurchase of asset participations sold without recourse, restriction of participations sold to a nonrecourse basis, compliance with laws, discontinuance of cash dividends.

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Federal Reserve Bank of St. Louis

Summary

70 Deposits - $9,538,000 Assets - $9,751,000

Consent Cease and Desist Order entered 2-15-77. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, establish repayment schedules for loans, elimination of loan documentation exceptions, reduction of concentrations of credit, discontinuance of overdrafts to insiders, reduction of total outstanding loan volume, adoption of written loan and investment policies, adoption of a program to provide adequate liquidity, an injection of capital, adoption of a written internal audit program, compliance with laws and regulations, and discontinuance of cash dividends.

71 Deposits - $11,982,000 Assets - $13,513,000

Consent Cease and Desist Order entered 3-15-77. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of classified assets and overdue loans, adoption of written lending, collection and investment policies, discontinuance of participation transactions with and reduction in deposit balances with related banks, elimination of adversely classified loans to insiders, reduction of loan volume, restrict salaries, fees, bonuses and expense allowances to amounts commensurate with services performed by directors, officers and employees, correction of violations of law, discontinuation of cash dividends, and an injection of capital.

72 Deposits - $14,570,000 Assets - $16,926,000

Consent Cease and Desist Order entered 3-15-77. Bank was ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, adoption of lending, collection and investment policies, reduction of remuneration paid to the bank's president, discontinuance of participation transactions, and reduction of deposit balances with related banks, elimination of loans originating outside the bank's normal trading area, elimination of adversely classified loans to insiders, reduction of loan volume, an injection of capital, correction of violations of law, and discontinuance of cash dividends.

73 Deposits - $15,159,000 Assets - $16,710,000

Consent Cease and Desist Order entered 4-5-77. Bank was ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, adoption of acceptable lending, collection and investment policies, reduction in concentrations of credit, correction of violations of law, correction of loan documentation deficiencies, implementation of proper accrual accounting methods, disclosure to shareholders of all details concerning an insider operated credit life insurance agency on the bank's premises and adequate reimbursement to the bank for use of premises, personnel and equipment, and prohibition of extending credit to a certain insider.

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Bank No. Summary

74 Deposits - $10,520,000 Assets - $11,518,000

Consent Cease and Desist Order entered 6-13-77 after a preliminary hearing. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to reduction of adversely classified assets, extensions of credit in the form of overdrafts to employees, trade area limitations, provisions for adequate collateral and credit file documentation, internal controls and outside audit, injection of new capital, acceptable management, and compliance with laws, rules and regulations.

75 Deposits - $9,119,000 Assets - $10,596,000

Consent Cease and Desist Order entered 4-19-77. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to compliance with insider regulations, reduction of adversely classified assets, injection of new capital, provision for adequate liquidity, compliance with laws, rules and regulations, loan policy, and discontinuance of cash dividends.

76 Deposits - $24,733,000 Assets - $26,489,000

Consent Cease and Desist Order entered 4-19-77. Bank ordered to cease and desist from violations of consumer protection laws and to take affirmative action to correct these violations and develop procedures to assure future compliance.

77 Deposits - $3,012,000 Assets - $3,204,000

Consent Cease and Desist Order entered 5-3-77 to assure additional correction following simultaneous discontinuance of a Section 8(a) citation. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, restrictions on loan volume and type of securities investments, limitations on and elimination of adversely classified insider loans, provision for adequate liquidity, injection of new capital, compliance with laws, rules and regulations, loan policy, and discontinuance of cash dividends.

78 Deposits - $6,765,000 Assets - $7,753,000

Consent Cease and Desist Order entered 5-23-77. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, adoption of written lending, collection and investment policies, injection of new capital, correction of violations, reduction of loan volume and discontinuance cash dividends.

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Bank No.

Summary

79 Deposits - $7,337,000 Assets - $8,114,000

Consent Cease and Desist Order entered 5-23-77. Bank ordered to cease and desist from and take affirmative action with respect to violations of the Truth-in-Lending Act and future compliance.

80 Deposits - $21,774,000 Assets - $23,956,000

Consent Cease and Desist Order entered 6-13-77. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management; loan policy; reduction of adversely classified assets and concentrations of credit; restrictions on insider loans; use of methods to avoid recognition of past due loans; compliance with laws, rules, and regulations; administration of the trust department; and discontinuance of cash dividends.

81 Deposits - $19,971,000 Assets - $21,587,000

Consent Cease and Desist Order entered 6-13-77. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, reduction of adversely classified assets, loan policy, reduction of loan volume, and discontinuance of cash dividends.

82 Deposits - $29,792,000 Assets - $32,832,000

Consent Cease and Desist Order entered 6-13-77. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to reduction of adversely classified assets, reduction of overdue loans, elimination of loan documentation deficiencies, and loan policy.

83 Deposits - $12,627,000 Assets - $13,757,000

Consent Cease and Desist Order entered 6-13-77 to replace a temporary cease and desist order. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to reduction of loans to the chairman and his interests, prohibition of additional credit to the chairman until his loans were reduced below that level, restrict opening an approved but unopened branch office until changes in the plans for the branch were approved, acceptable management, reduction in classified assets, increase capital to a certain level, adoption of loan and investment policies, compliance with laws and regulations, and discontinuance of cash dividends.

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Federal Reserve Bank of St. Louis

Bank No. Summary

84 Deposits - $10,452,000 Assets - $11,165,000

Consent Cease and Desist Order entered on 6-13-77. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to acceptable management, providing additional directors reduction of adversely classified assets and overdue loans, loan policy, and discontinuance of cash dividends.

85 Deposits - $9,360,000 Assets - $10,204,000

Consent Cease and Desist Order entered 6-27-77 to replace a temporary order to cease and desist. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to reduction of adverse classifications; adoption of written lending policies; collection of outstanding and limitations on future out-of-area loans; limitations on credits to or for the benefit of one borrower, elimination of loan documentation deficiencies, prohibition of repurchase of participations sold without recourse, recording on the books any liability for repurchase agreements outstanding; correction of all violations of laws and regulations, including consumer law violations; injection of new capital; review of all compensation to bank officers; limitations on bonuses and expense allowances to or for officers; review of income and expense statements monthly; disclosure to the shareholders of all details on an insider credit life insurance agency operated on the premises, approval of two-thirds of any decision not to retain such income for the bank but in any event reasonable reimbursement to the bank for use of premises, personnel and equipment; discontinuance of cash dividends; compliance with a separate letter agreement between the bank and the chartering authority; reimbursement for nonbank related expenses paid to the former controlling shareholder and requires the former control owners to repay such expenses; efforts to collect loans made to or related to the former control owners and prohibition of any new credit to these individuals; and review and a possible revision of the interest rate being paid on a certificate of deposit held by the present control owners.

86 Deposits - $13,280,000 Assets - $14,337,000

Consent Cease and Desist Order entered 7-14-77. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative actions with respect to acceptable management, injection of new capital, adoption and adherence to acceptable written lending and investment policies, reduction of adverse classifications, elimination of overdrafts to insiders, elimination of certain insider loans, and compliance with laws, rules, and regulations.

87 Deposits - $7,244,000 Assets - $8,192,000

Consent Cease and Desist Order entered 7-28-77, replacing a temporary cease and desist order. Bank ordered to cease and desist from unsafe and unsound practices and take affirmative action with respect to correction of violations of law, a review of the compensation paid to the chairman of the board and his interests, reductions in classified assets, continued efforts to obtain fidelity coverage, and discontinuance of dividends.

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Summary

Deposits - $51,009,000   Assets - $57,061,000

Consent Cease and Desist Order entered 9-9-77. Bank ordered to cease and desist from and take affirmative action with respect to violations of consumer protection laws and future compliance.

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FEDERAL DEPOSIT INSURANCE CORPORATION
Federal Deposit Insurance Act - Section 8(c)
(Temporary Cease and Desist Actions)
1977

Summary

nk No.

6 Deposits - $12,627,000 Assets - $13,757,000

Temporary Cease and Desist Order issued 3-17-77. Bank was ordered to cease and desist from extending any credit to or for the benefit of the bank's chairman of the board or to any individual or entity whereby the proceeds of such credit would accrue, directly or indirectly, to the benefit of the chairman of the board. The bank was also ordered to cease and desist from opening a previously approved but unopened branch office pending completion of these administrative proceedings.

A permanent cease and desist order was issued on 6-13-77.

7 Deposits - $6,981,000 Assets - $7,575,000

Temporary Cease and Desist Order issued 4-1-77. The bank and its officials were ordered to cease and desist from offering, selling and offering for sale and transferring on the bank's books any stock of subject bank owned directly, indirectly or beneficially by any of the directors; making any further payments of any kind under a lease between the bank and a partnership composed of the directors; and, entering into any business transactions or extension of credit with any bank insider or person related to a bank insider.

The temporary order was terminated on 6-13-77.

8 Deposits - $11,224,000 Assets - $12,122,000

Temporary Cease and Desist Order issued 5-11-77. The bank was ordered to cease and desist from entering into any business transaction with and/or from extending direct or indirect credit to or for the benefit of the bank's former chairman of the board, his wife, or any persons related to them.

The temporary order remains outstanding.

9 Deposits - $5,648,000 Assets - $6,508,000

Temporary Cease and Desist Order issued 5-11-77. The bank was ordered to cease and desist from entering into any business transaction with and/or from extending direct or indirect credit to or for the benefit of the bank's former chairman of the board, his wife, or any person related to them.

The temporary order remains outstanding.

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Bank No.	Summary	
10	Deposits - $3,370,000	Assets - $3,672,000

Temporary Cease and Desist Order issued 5-11-77. The bank was ordered to cease and desist from entering into any business transaction with and/or from extending direct or indirect credit to or for the benefit of the bank's executive vice president, his wife, or any person related to them.

The temporary order remains outstanding.

11 Deposits - $9,360,000 Assets - $10,204,000

Temporary Cease and Desist Order issued 5-11-77. Bank was ordered to cease and desist from entering into any business transaction with and/or from extending any direct or indirect credit to or for the benefit of the former chairman of the board, his wife, or any person related to them.

A permanent cease and desist order was issued on 6-27-77.

12 Deposits - $7,333,000 Assets - $8,638,000

Temporary Cease and Desist Order issued 5-11-77. Bank was ordered to cease and desist from entering into any business transaction with and/or extending any direct or indirect credit to or for the benefit of the former chairman of the board, his wife, or any person related to them.

The temporary order remains outstanding.

13 Deposits - $102,558,000 Assets - $115,319,000

Temporary Cease and Desist Order issued 9-19-77. The bank was ordered to cease and desist from entering into any business transactions which exceed $10,000 in the aggregate with the chairman of the board, his interests, or any person related to him.

The order remains outstanding.

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EXHIBIT J

FEDERAL DEPOSIT INSURANCE CORPORATION

DIVISION OF BANK SUPERVISION

WASHINGTON

General Memorandum No. 8

Revised August 1975

SUBJECT: SUPERVISORY PREPARATION FOR POSSIBLE SECTION 8 PROCEEDINGS

Sections 8(a) and 8(b)

Section V of the Manual of Examination Policies contains a comprehensive treatment of these remedial provisions of our Act, their underlying philosophies, guidelines upon which to base recommendations, and instructions for report preparation and processing. It is the intent of this memorandum to augment that information and to reiterate the importance of timeliness and accuracy in the preparation and processing of examination reports and other supporting documentation.

Recommendations from the Regional Director for initiation of Section 8(a) or 8(b) action should be definitive, unqualified, and unconditional and contained in a separate letter or memorandum (not a Problem Memorandum) addressed to this office. The recommendation should include a listing of the charges (unsafe or unsound practices, condition, or violations) and the desired corrective measures. In order to speed processing within this Division as well as the Legal Division, it is preferred that the recommended charges and corrective orders be arranged in a simple list, leaving the legal phraseology to the Legal Division. Some examples follow:

Charges

Unsatisfactory management

Inadequate capital

Hazardous lending and collection policies and practices

Excessive volume of adversely classified assets

Corrective orders

Provide acceptable management

Provide adjusted capital and reserves of no less than $1,250,000 [8(a)] or take all steps necessary to increase total capital and reserves by $750,000 [8(b)]

Adopt and follow acceptable (lending) (investment) (operating) policies

Eliminate Loss and 50% of Doubtful

Reduce the remaining 50% of Doubtful and Substandard to no more than $350,000 [8(a)] within 120 days and to $200,000 within 240 days [8(b)].

(NOTE: The corrective period in a Section 8(a) case is by statute not more than 120 days. However, the time periods deemed appropriate in an 8(b) Order for each item of correction may vary and should be set with practical considerations of fulfillment in mind.)

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All recommendations for Section 8(a) or 8(b) action should include the attitude of the state authority with respect to the proposed action. Contact with the state authority may be via telephone; however, a written submission of his views relative to the contemplated Section 8 action should be requested.

Reports of Examination containing Section 8(a) or 8(b) recommendations, concurred in by the Regional Director, should not be distributed until clearance has been given by this Division and the Legal Division. Accordingly, all recommendations for Section 8 action should contain a statement similar to the following: "Normal distribution of the examination report will be withheld until advice is received from the Washington Office." Clearance to release the report will be telephoned by the Problem Bank Section to the Regional Office and confirmed by a brief memorandum.

At a reexamination of a bank which has been served a Cease and Desist Order, particular attention should be given to measuring management's adherence to loan, investment, or operating policies to which the bank may have been required by the Order to adopt and strictly adhere. Presumably, if policies acceptable to the Corporation and the state authority are followed, along with the other remedial measures contained in the Order, the bank will be rehabilitated. Conversely, if the acceptable policies are violated, such violations may cause additional deterioration in the bank's condition and serve as a basis for further action against the bank and/or its directors or officers by the Corporation.

To insure that federal securities laws are complied with in capital offerings to other than insiders by state nonmember banks, any Order issued under Sections 8(a) and 8(b) requiring a capital increase will contain a proviso that all materials to be used in the sale of the capital receive the Corporation's review prior to sale.

Section 8(e)

Invocation of Section 8(e) requires that the acts giving rise to the proposed action must include, among other things, personal dishonesty and actual or probable substantial financial loss or other damage to the bank. The amount of any such loss or other damage should be weighed in relation to the size of the bank. The attitude of the state authority should be included with all recommendations from the Regional Office for Section 8(e) action.

Section 8(g)

The propriety of voluntary suspension, resignation, or issuance of a formal Notice and Order of Suspension in each case falling within the purview of Section 8(g) is determined on an ad hoc basis. In the case of a director, our Legal Division advises that voluntary suspension is preferable to resignation since suspension does not create a vacancy on the board of directors and, therefore, does not afford an opportunity for such vacancy to be filled by a designee who may merely act on behalf of and at the direction of the indicted resignee. Additionally, it is important that all voluntary suspension letters indicate not only suspension from office but that the individual will not participate in any manner in the conduct of the affairs of the bank pending final disposition of the indictment.

In order that future cases may be handled both uniformly and expeditiously, the following procedure should be utilized:

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1. Upon learning of a possible Section 8(g) case, immediately attempt to obtain a copy of the indictment from the appropriate prosecuting authority. Do not contact the bank. If a copy of the indictment cannot be obtained, notify the Problem Bank Section by telephone, and efforts will be made to get a copy through our Legal Division.

2. Follow with a letter to the Division Director, briefly setting forth the circumstances, and indicate your recommendation. If a copy of the indictment was obtained, it should accompany the letter.

3. A concurrent review of the matter will be made by this office and the Legal Division.

4. This office will telephonically advise the form of action to be taken. Until such notice is given, refrain from discussing the case with the bank or individual involved. In cases where voluntary action has been decided as appropriate, the telephonic advice will be confirmed by letter including any pertinent instructions.

John J. McCarthy
Deputy Director

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EXHIBIT K

SECTION 8(a) -- TERMINATION OF INSURANCE

I. Introduction

Section 8(a) provides an effective method by which our Board can compel insured banks to cease unsafe and unsound practices and violations and to restore the bank to a safe and sound condition, or to suffer the consequence of noncompliance, namely termination of insured status. The principal objective of section 8(a) is to secure the necessary corrections and not to terminate a bank's insured status. The statute, therefore, is primarily remedial in nature.

The authority to terminate a bank's insured status under section 8(a) carries with it grave responsibility. Deposit insurance membership is a valuable status and its loss would have serious adverse effects on the bank concerned. Equity as well as logic mandate, therefore, that in any case section 8(a) be applied judiciously, with fairness, without haste or prejudice, and only after all other means for accomplishing correction have been exhausted.

Obviously, the use of this provision of our Act for punitive or retaliatory purposes is unwarranted, and threats, oral or written, to resort to section 8(a) for the purpose of effecting correction, must be avoided.

The Corporation, aware both of its responsibilities to insured banks and the depositing public generally and of the seriousness of section 8(a) action in terms of an individual bank, has developed procedures for its application which should preclude bias and abuse.

II. Outline of Section 8(a) and Corporation Procedure

In order that each Examiner may have a clear understanding of his part in cases involving section 8(a), the applicable provisions of our Act and an outline of the Corporation's procedure are discussed below.1/

A. Initiation of Proceedings

Section 8(a) provides in part that:

1. When the Board of Directors finds that:

   a. An insured bank or its directors or trustees

      (1) have engaged or are engaging in unsafe or unsound practices, or

      (2) violated (a) an applicable law, rule, regulation or order, or (b) any condition imposed in writing by the Corporation in connection with the granting of any request by the bank, or (c) any written agreement entered into with the Corporation, or

   b. The bank is in an unsafe or unsound condition to continue operations as an insured bank,

   the Board of Directors gives a statement regarding such practices, condition or violations to the Comptroller of the Currency in the case of a National bank or a District bank, to the appropriate State authority having supervision over the banks in the case of

1/ With certain exceptions more particularly set forth in the section of this Manual dealing with "Section 8(b) and 8(c) - Cease and Desist Proceedings", the procedures set forth herein are generally applicable to proceedings instituted under our cease and desist powers.

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a State bank, and to the Board of Governors of the Federal Reserve System in the case of a State member bank.2/

The "statement" (hereafter referred to as "Findings and Order") is in the nature of an initial pleading or a complaint and the furnishing of copies of it to the proper Supervisory Authority and the bank initiates proceedings to terminate a bank's insured status under section 8(a). The Findings and Order specify the violations, the unsafe or unsound practices and condition complained of in the form of findings together with appropriate corrective measures and, in virtually every case, refer to the report or reports of examination upon which the action is in large measure based. These reports of examination together with the testimony of the Examiners concerned constitute the bulk of the evidence upon which the Corporation must rely to sustain the validity of the findings or charges made. Consequently, it is of the utmost importance that the facts in the examination reports be set out in detail and in clear and unambiguous form.

The preparation of an examination report in which recommendations are made for action under section 8(a) is described hereafter in greater detail.

Upon receipt in a Regional Office of an examination report containing section 8(a) charges, the Regional Director, after giving consideration to the surrounding circumstances and the merits of the Examiner's contentions, forwards the report of examination to Washington together with a separate letter or memorandum containing his recommendations. In many instances the Regional Director will still be able to obtain correction through means other than the procedure outlined herein. In such instances, further action may be forestalled, and his communication will so recommend.

Upon receipt of the examination report in Washington, if the Division of Bank Supervision and the Legal Division agree that action under section 8(a) is warranted, appropriate recommendations are made to the Board of Directors for final decision. Should the Board of Directors decide to proceed, a copy of the Findings and Order is transmitted to the appropriate Supervisory Authority and to the bank. A copy of the Findings and Order is also furnished to the appropriate Regional Director.

B. <u>The Corrective Period</u>

Section 8(a) further provides in part that:

1. The bank has not more than 120 days from the date of service of the Findings and Order in which to correct the violations or unsafe or unsound practices or condition described therein.
2. The 120-day corrective period may be shortened to not less than 20 days,
    a. by the Board of Directors if it determines in its discretion that the insurance risk to the Corporation is unduly jeopardized, or
    b. by the Supervisory Authority.
3. If, at the end of the corrective period, the Board of Directors decides to proceed further, the Board of Directors gives the bank not less than 30 days written notice of intention to terminate the bank's insured status and fixes a time and place for a hearing.
4. Evidence may be produced at the hearing and, based upon such evidence, the Board of Directors makes findings which are conclusive.
5. Failure of the bank to appear at the hearing shall be deemed as consent to the termination of its insured status.

2/ Hereafter the Comptroller of the Currency, the State supervisory authorities and the Board of Governors of the Federal Reserve System will be collectively referred to as the "Supervisory Authority".

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Generally, the Findings and Order provide that the bank has 120 days from the date of receipt to make the required corrections unless the Supervisory Authority fixes a shorter time of not less than 20 days. It is, therefore, necessary for the Board of Directors to ascertain what corrections have been made during the corrective period so as to be able to determine whether to discontinue the proceedings or to proceed further. Accordingly, a reexamination of the bank is made at the conclusion of the corrective period.

C. Reexamination and Final Decision

The report of the reexamination, which is hereafter discussed in greater detail, must be thorough in all respects and must include a detailed record of all corrections made and the manner in which improvements, if any, were accomplished. Furthermore, the report must show the extent to which the violations and the unsafe or unsound practices have been discontinued and the bank has been restored to a safe and sound condition. After consideration of the reexamination report by the Regional Director, he shall forward the report to the Washington Office with his recommendation relative to the advisability of proceeding to terminate the bank's insured status.

After considering the factual data contained in the reexamination report and the recommendations of the Regional Director, the Division of Bank Supervision and the Legal Division, the Board of Directors will determine whether the bank has fully or substantially complied with the requirements of the Findings and Order. If the Board of Directors finds that there has been full or substantial compliance, it will issue an order discontinuing the section 8(a) proceedings against the bank, or, if the circumstances preclude such finding, it will give written notice of the time and place for a hearing. In either case, copies of the Order or the written notice are transmitted to the Supervisory Authority, the bank, and the Regional Director.

D. Hearing

Any hearing under section 8(a) is a formal adversary proceeding and is held pursuant to the applicable provisions of the Administrative Procedure Act. The hearing is presided over by an Administrative Law Judge and is analogous to a trial without a jury in Federal District Court. Unless the bank chooses not to litigate the matter, the Corporation has the burden of proving the allegations made in the Findings and Order through the production of evidence at the hearing. The Corporation's evidence generally consists of the reports of examination mentioned previously and the testimony of Examiner personnel. However, any and all relevant evidence, such as pertinent bank records and admissions made by directors, officers and other personnel of the bank, may be used as appropriate. The bank may be represented by counsel, who has the right to cross-examine Corporation witnesses and present evidence in rebuttal or in mitigation of the Corporation's allegations. From the evidence adduced, the Administrative Law Judge makes recommended findings and a recommended decision to the Board of Directors. Based upon the entire record of the evidence produced at the hearing, the Board of Directors will make its final written findings and order of disposition.

III. Bases for Section 8(a) Action

A. General

In 1966, section 8(a) was amended in several important respects. Under the former section 8(a) the only grounds for terminating a bank's insured status were the commission by a bank, its directors or trustees of unsafe or unsound practices or the violation of a law or regulation to which the bank was subject. Under the 1966 amendments, in addition to these grounds, the following were added: the violation of an applicable order, or written condition imposed by the Corporation in connection with the granting of any application or other request of the bank, or any written agreement entered into with the Corporation; or the bank is in an unsafe or unsound condition to continue operations as an insured bank. In addition, the former section 8(a) required, as a matter of law, that the Corporation prove that the unsafe or unsound practices were continuing over some period of time. The 1966 amendment deleted the words "have continued" so that now it is only necessary to prove that the bank, its directors or trustees have engaged or are engaging in such practices. The distinction could be significant because

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under the present section 8(a) the single commission of several but separate unsafe or unsound practices, or even the commission of only one unsafe or unsound practice could be a legally sufficient basis for instituting action to terminate the insured status of a bank. However, from a practical standpoint, action under section 8(a) would not normally be taken unless the bank is in an unsafe or unsound condition. Only under exceptional circumstances would such action be taken where there has not also been a record of persistent failure on the part of the bank's management to heed the recommendations and warnings of the Corporation and the Supervisory Authority. Limiting the use of section 8(a) powers as indicated is especially appropriate in light of the Corporation's intermediary enforcement powers now available under its cease and desist authority contained in sections 8(b) and 8(c) of the Act.

B. Unsafe or Unsound Practices

The concept of unsafe or unsound practices is one of general application which touches upon the entire field of the operations of a banking institution. It would, therefore, be virtually impossible to attempt to catalog within a single all-inclusive or rigid definition the broad spectrum of activities which are included by the term. Thus, a particular activity not necessarily unsafe or unsound in every instance may be so when considered in light of all relevant facts.

Like many other generic terms widely used in the law, such as "fraud", "negligence", "probable cause", or "good faith", the term "unsafe or unsound practices" has a central meaning which can and must be applied to constantly changing factual circumstances. Generally speaking, an unsafe or unsound practice embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the insurance fund administered by the Corporation.

Every objectionable practice, however, is not automatically to be construed as unsafe or unsound. The question of how serious the practice is, and what its likely results will be, form important considerations. Obviously operating the bank in an insolvent condition or with impaired capital is not only an unsafe or unsound practice but also clearly evidences that the bank is in an unsafe or unsound condition.

Our Act does not define the term "unsafe or unsound practices" but our Board of Directors in previous section 8(a) proceedings has established examples of such practices. Thus, the following, among others, have been found to be unsafe or unsound practices by our Board of Directors:

1. Operating with management whose policies and practices are detrimental to the bank and jeopardize the safety of its deposits.

2. Operating with a total adjusted capital and reserves which is inadequate in relation to the kind and quality of the bank's assets.

3. Operating in such a way as to eliminate undivided profits and a portion of surplus as evidenced by the bank's total adjusted capital and reserves.

4. Operating the bank in such a manner as to result in a deficit net operating income.

5. Operating the bank with a serious lack of liquidity, especially in view of the bank's asset and deposit structure.

6. Engaging in speculative and hazardous investment policies in disregard of a balanced security account as to maturity and other factors.

7. Paying excessive cash dividends.

8. Engaging in hazardous lending and collection policies and practices as evidenced by, among other things, the following:

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a. An excessive volume of loans subject to adverse classification;

b. An excessive volume of loans without adequate documentation, including but not limited to, credit information;

c. Excessive net loan losses;

d. An excessive volume of loans in relation to the bank's total assets and total deposits;

e. An excessive volume of weak and self-serving extensions of credit to controlling shareholders, directors, officers, their associates and related interests, a significant portion of which is adversely classified;

f. Excessive concentrations of credit, a substantial (significant) portion of which is adversely classified (or otherwise criticized);

g. Indiscriminate participation in weak and undocumented loans originated by related banks;

h. The unwarranted practice of extending credit in the form of overdrafts to directors, officers, their associates and related interests;

i. Failing to adopt formal written loan policies;

j. An excessive volume of overdue loans;

k. Failing to diversify the bank's loan portfolio.

9. Failing to heed the admonitions and follow the recommendations of the Corporation and the Supervisory Authority.

With reference to unsafe or unsound practice number 2. "inadequate adjusted capital and reserves" etc., this charge is usually present in most section 8(a) citations. What constitutes such inadequacy depends upon the particular facts and circumstances of each case. The adequacy of adjusted capital and reserves must be weighed in relation to the overall asset condition of the bank. Whether or not an additional charge of impairment of capital should be made depends upon the provisions of governing statutory law. However, it should be noted that a bank may have the minimum capital required by applicable statutory law, but nevertheless our Board of Directors may find that its adjusted capital is inadequate in view of its asset condition, and that the operation with such inadequate adjusted capital is an unsafe or unsound practice.

Another unsafe or unsound practice usually present in a section 8(a) citation is number 1. This charge is premised upon evidence of facts which, in themselves, constitute grounds for more specific charges. This charge should not be made against a bank unless there is evidence, for example, that total adjusted capital and reserves is inadequate or that hazardous policies and practices have been engaged in which are cited as unsafe or unsound.

C. Unsafe or Unsound Condition

Although the statutory language of section 8(a) does not require it, prudence and equity mandate that an absolutely essential element of every section 8(a) action is that the bank be in an unsafe or unsound condition to continue operations as an insured bank. It does not necessarily follow, however, that action under section 8(a) is automatically triggered when a bank is in an unsafe or unsound condition. Proceeding under our cease and desist authority contained in section 8(b) or 8(c) may offer a feasible alternative.

As in the case of unsafe or unsound practices, it is impossible to define precisely what constitutes an unsafe or unsound condition because the condition of a bank is dependent on an analysis of virtually every aspect of the bank's operation and position within a given time frame. As a minimum, the bank's asset condition, liability position, investment portfolio, capital position, earnings posture, liquidity position, and the calibre of management must be carefully

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evaluated. While precise definition of unsafe or unsound condition is not possible, it is certain that a bank's condition need not deteriorate to a point where it is on the brink of insolvency or ripe for receivership before its condition may be found to be unsafe or unsound.

D. Violations of Law, Regulation, Condition, Order, or Written Agreement

Charges arising from violations of law, regulation, a written condition imposed by the Corporation in connection with a request by the bank, applicable order, or a written agreement between the bank and the Corporation are as a rule definite and ascertainable and, therefore, are generally more readily proven than charges based on unsafe or unsound practices.

If the Examiner is not sure of his position but believes a violation has occurred, he may list the same in the Open Section of the report of examination provided he qualifies his finding by the use of the term "apparent violation" and clearly states his reason for believing that a violation exists.

Regardless of whether the report of examination is intended for use in section 8(a) proceedings, great care should be exercised by the examiner in listing a violation and this is especially true where a possible violation of a rule or regulation is involved. The erroneous designation of conduct as a violation tends to discredit the report of examination and detract from its value as evidence. Where the Examiner is not reasonably sure that a violation exists, he should promptly report the facts to the Regional Director and be guided by the Regional Director's advice thereon in the preparation of his report of examination.

IV. Reports of Examination Containing Section 8(a) Charges

Because of the seriousness of making section 8(a) charges against a bank, it is desirable that an Examiner consult with his Regional Director before submitting a report of examination containing section 8(a) charges. In some cases, such consultation may occur prior to the commencement of an examination, in which event it may be agreed to include recommendations for citation in the Confidential Section of the report of examination if the facts so warrant.

Where charges under section 8(a) are to be made in a report of examination, the following should be observed:

a) Only the Corporation's Board of Directors is authorized to make a finding of "unsafe or unsound". Therefore, Examiners should avoid the use of the statutory words "unsafe and unsound" in the Open Section of the examination report. Synonyms and other descriptive terms such as "undesirable, unacceptable, and objectionable practices" are, however, permissible and desirable.

b) In the Examiner's Comments and Conclusions on page 1 of the report, under the general heading "Undesirable and Objectionable Practices", each specific practice regarded as unsafe or unsound and the facts upon which such conclusion is based should be listed and discussed in the order of importance under appropriately descriptive sub-headings and captions. Where violations of law or regulations are also present, normally they should be listed under a separate sub-heading in summary fashion. These discussions should include all relevant facts, should make reference to other schedules in the Open section of the report where full details are presented, and should substantiate the conclusion that the bank is in an unsafe or unsound condition. In addition, the Examiner's comments should include any statement made by the bank's officers or directors either supporting any charge made by the Examiner or showing any corrective action. It is also important that the Examiner quote facts and criticisms from previous examination reports, from letters of the Supervisory Authority to the bank, from letters of inquiry regarding correction of criticisms from the Regional Director, and that the Examiner call attention forcibly to incomplete corrective promises of the management. Other comments and conclusions not germane to the "Undesirable and Objectionable Practices" should be reported on a separate page or pages under a general heading, "Other Comments and Conclusions".

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c) The order in which the violations and unsafe or unsound practices and facts evidencing the unsafe or unsound condition of the bank are listed and discussed in the Open Section must conform with the order and discussion of these matters in the Supervisory Section. The Supervisory Section will, however, contain the Examiner's recommendation for citation, using the term "unsafe or unsound" where appropriate. The discussion in the Supervisory Section will ordinarily be brief, but should include reference to those schedules in the Open Section where supporting facts are presented. The discussion in the Supervisory Section should also include any other facts which for practical reasons it would be inadvisable to incorporate in the Open Section. For example, in many instances it is alleged that the bank is extending self-serving credit to a director or an officer, his associates and his related interests. In such a case, the facts warranting the conclusion that certain individuals are his associates or that he has an interest in certain business entities should be spelled out in detail in the Supervisory Section of the report of examination. Furthermore, the operative facts showing in what manner such individual, his associates, or related interests are receiving a preference over other similarly situated borrowers should be shown in the Supervisory Section. Where such information cannot be obtained through customary examination techniques, the Regional Director should be apprised of the situation so he may consider the possible use of the more formal investigative method under section 10(c) of our Act. The Examiner should frankly express his opinion on the facts and the possible consequences of the recommended procedures, avoiding, however, confused statements of combined facts and opinions. Violations, which in the Examiner's opinion, support action under section 8(a) should be specifically noted in the Supervisory Section and accompanied by a statement identifying such violations as constituting section 8(a) charges. Since the full information on violations is ordinarily set forth in the Open Section, reference may be made to those pages or schedules where the detailed facts are included. With regard to violations of law or regulation, the statute or regulation violated should be cited.

d) In addition to setting forth the unsafe or unsound practices and violations as indicated above, the Examiner should also detail in the Supervisory Section the measures necessary to correct such practices and violations and to restore the bank to a safe and sound condition. The following are examples of corrective measures imposed by our Board of Directors in an actual case and are shown here only for illustrative purposes:

1. The bank shall provide an active and capable management satisfactory to and to be approved by the Commissioner of Banks of the State of ______________ (the "Commissioner") and the Director of the Division of Bank Supervision of the Federal Deposit Insurance Corporation (the "Director"). This management shall include an experienced executive officer who shall be given stated authority by the board of directors of the bank. This authority, as established by the board of directors of the bank shall include the responsibility for implementing and maintaining lending, investment, and operating policies in accord with sound banking practices.

2. The bank shall eliminate from its book assets, by charge-off or otherwise, the following:

   (a) All assets or portions of assets classified "Loss" in the Report of Examination of the Federal Deposit Insurance Corporation (hereinafter referred to as the "Corporation") of ________________.

   (b) Not less than 50% of the aggregate of the remaining assets classified "Doubtful" in the Report of Examination of the Corporation of ________________.

3. The bank shall not extend credit, directly or indirectly, to or for the benefit of the controlling shareholder(s). The bank shall

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not extend credit, directly or indirectly, to, or for, the benefit of any corporation, partnership, or organization of any kind whatsoever in which the said controlling shareholder(s) has (or have) any ownership or beneficial interest of 25% or more.

4. The bank, after eliminating the adversely classified assets described in paragraph two above, shall reduce the remaining assets classified "Doubtful" and "Substandard", as set forth in the Report of Examination of the Federal Deposit Insurance Corporation of ____________, as follows: the remaining "Doubtful" to not more than __________ and the "Substandard" to not more than __________.

5. After the bank has received notice through receipt of either a Report of Examination of the Corporation or a Report of Examination of the State of ____________ Banking Division that any borrower has an extension or extensions of credit which have been classified "Doubtful" or "Loss", the bank shall not extend, directly or indirectly, additional credit to any such borrower or borrowers so long as the extension or extensions of credit so classified remain outstanding. This requirement does not preclude the bank from renewing any extension or extensions of credit so classified, provided that, in the event of any such renewal, the bank shall not increase such extension or extensions of credit.

6. The bank shall adopt and strictly follow written loan policies satisfactory to the Commissioner and the Director. Such loan policies shall provide, among other things, that the bank's loan volume shall not exceed a reasonable level in relation to either total deposits or total assets.

7. The bank shall pay no cash dividends without the prior consent of the Commissioner and the Director.

8. In addition to the above requirements, the assets of the bank shall be put in such form and condition as to be acceptable to the Commissioner and the Director, or his designee, and the bank shall provide total adjusted capital and reserves of not less than ______. The total adjusted capital and reserves shall take into consideration classification of assets made by the Corporation in the first examination of the bank following the termination of the fixed correction period, and the classification shall be in accord with the Corporation's stated standards of classification, and shall include assets which are adversely classified as a result of the said examination. Adjusted capital and reserves is to be determined by the method and with the calculation set forth in the Analysis of Capital and Reserve on page two of the Report of Examination of the Corporation.

As previously indicated, action under section 8(a) is a serious procedure and involves charges which must be proven. It is therefore essential that all classifications and appraisals be sustainable and justified by supporting data and clearly stated comments. Arbitrary classifications must be avoided. Thus, examination reports in which such charges are incorporated must contain in the Open Section all pertinent facts, including the names of individuals responsible, dates, amounts, and the effect of each transaction.

V. Reexamination Reports

The primary purpose of the reexamination of the bank made at the end of the corrective period is to enable our Board of Directors to ascertain the extent to which corrections required by the Findings and Order have been made. Accordingly, this second report of examination must contain in the Supervisory Section a listing of each specific charge and of each specific corrective order contained in the Findings and Order together with full and complete comments and facts showing whether the bank discontinued each unsafe or unsound practice and satisfied each corrective requirement. In the course of making such listing and comments, the Examiner should indicate whether the bank has been restored to a safe and sound condition.

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Depending on the substance of the particular charge or corrective order, the corrections reported in the Supervisory Section should be shown either in terms of the situation existing at the time of the examination which was used as a basis for making the initial charge ("initial examination") or as of the reexamination date. For example, if the corrective order requires the elimination of all those assets classified "Loss" and 50% of those classified "Doubtful" as of the date of the initial examination, only the current status of those assets may be considered. No additional "Loss" or "Doubtful" classifications which might have occurred during the corrective period should be considered in analyzing this particular corrective order. On the other hand, if the corrective order also requires that the bank's assets be put in an acceptable form and condition, the assets of the bank must be viewed in light of all of the facts, circumstances and changes which took place during the corrective period, including any new or additional adverse classifications of assets which may have been made.

In the Supervisory Section, the Examiner should state his opinion on the ability and intention of bank management to operate the bank successfully, to discontinue the unsafe and unsound practices or violations, and to make any other remaining corrections. His recommendations with respect to the pending proceedings should also be stated.

The Open Section of the reexamination report should not differ in any material respect from an examination made in the regular course. Accuracy of classifications, schedules and comments is essential since the report weighs heavily in the Board of Directors' decision whether to continue the section 8(a) proceeding and may be used as documentary evidence in a hearing. The examination report should be completed with all pertinent facts included in the Open Section. The Examiner should not, however, set forth in the Open Section any of his conclusions as to whether the practices or violations complained of have been corrected, nor should he refer in any manner to the pending section 8(a) proceedings. Comments of this type should be strictly confined to the Supervisory Section.

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SECTIONS 8(b) AND (c) -- CEASE AND DESIST PROCEEDINGS

I. Introduction

As stated in that part of the manual pertaining to section 8(a) actions, commencement of a proceeding to terminate the insured status of a bank under section 8(a) of the Federal Deposit Insurance Act should be used only after all other efforts to compel an insured bank to discontinue unsafe or unsound practices or violations of law or regulations and to restore the bank to a safe and sound condition have been tried and have failed. Moreover, although actions taken under section 8(a) have generally been effective in successfully resolving serious problem situations, the severity of the ultimate penalty implicit in any 8(a) action limits its use as a remedial supervisory instrument.

In 1966, the Congress gave to the Corporation and to the other Federal banking supervisory agencies additional and intermediary powers with respect to banks engaging in or about to engage in, among other things, unsafe or unsound practices or violations of law or regulations. The new authority permits the use of "cease and desist" powers in situations where the available facts and evidence reasonably support the conclusion that a bank is engaging in or is about to engage in an unsafe or unsound practice or violation of law. By ordering it to cease and desist from such practices and/or to take affirmative action to remedy the effect thereof, a bank's condition may be prevented from reaching such serious proportions as to require the more severe measures imposed by section 8(a). The Corporation's "cease and desist" powers are contained in section 8(b) and 8(c) of the Federal Deposit Insurance Act.

II. Section 8(b) -- Cease and Desist Proceedings

A. General

Section 8(b) provides that:

1. The Corporation may issue and serve a Notice of Charges upon a State nonmember insured bank

   a. If the bank is engaging or has engaged in unsafe or unsound practices;

   b. If the bank is violating or has violated a law, rule, or regulation, or any condition imposed in writing by the Corporation with regard to approval of a request or application, or a written agreement entered into with the Corporation;

   c. If there is reasonable cause to believe the bank is about to do either or the above.

2. The notice shall contain a statement of facts relating to the practices or violations and fix the time and place for a hearing to determine whether a cease and desist order shall be issued.

3. A cease and desist order becomes effective 30 days after it is served upon the bank, or at the time indicated if issued upon the consent of the bank.

4. The order remains in effect as issued until modified or terminated by the Corporation, or set aside by a reviewing court.

(Refer to section 8(b) of the Federal Deposit Insurance Act.)

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Section 8(b) permits the Corporation to order an insured bank and its directors, officers, employees, and agents (1) to cease and desist from certain practices and violations, and (2) to take affirmative action to correct the conditions resulting therefrom. The practices may be affirmative in nature, such as hazardous lending practices or negative in nature, such as the failure of management to take specific action when needed. The failure of a bank to comply with any cease and desist order which has become final can be the basis for a subsequent section 8(a) termination of insurance action or can be the basis for the taking of legal action by the Corporation in a Federal District Court to enforce the order.

Prior to the initiation of section 8(b) or section 8(c) proceedings, the State supervisor is required to be notified as to (1) the Corporation's intention to institute cease and desist proceedings; (2) the grounds for such action; and (3) depending on the circumstances of each case, the time in which the Corporation will defer further action pending the taking of satisfactory corrective action by the State authority. However, failure to so advise the State supervisor does not affect the legality of action taken under either section 8(b) or section 8(c).

B. <u>Evidence Required</u>

Section 8(b) provides that our Board of Directors need only be of the <u>"opinion"</u> that an insured bank is engaging in or has engaged in any of the aforementioned grounds <u>or have reasonable cause</u> to believe that the bank is about to engage in such violation or practice. Mere suspicion, however, is not sufficient grounds to institute such enforcement proceedings. Any such action must rationally be based upon facts and evidence, as the Corporation has the burden of proving any formal charges set out in a notice of charges. Consequently, documentation in the files of requests made of management, of promises by bank officials, and of conferences with bank directors and/or officers is of a primary necessity. Furthermore, if portions of the bank's records are needed to establish any of the charges, copies of those records should be made and retained as part of the necessary documentation in the case. If to be used at all in connection with any section 8(b) proceeding, the report of examination should, of course, set forth all pertinent facts, i.e., names dates, amounts, and the effect of transactions, rather than rely on generalities. Thus the Examiner and Regional Director contemplating a recommendation for action under section 8(b) should ask the question: What facts do we have to support each of the charges and conclusions reached? If there are gaps in the evidence, an effort should be made to fill them.

C. <u>Actual Commission of Unsafe Act Not Required</u>

An important aspect of the use of section 8(b) proceedings is that it permits the Corporation <u>to prevent</u> the commission of an unsafe or unsound practice or violation. The section may thus be used to prevent a developing situation from reaching serious proportions. Assume, for example, that four banks are all owned or controlled by the same group of individuals and that the owners have, through various self-dealing transactions, misused three of these banks but have not yet similarly abused the fourth bank. The Corporation in this situation could, through a cease and desist order, ban all loans and fees to the ownership or controlling interest -- not only as to the three abused banks, but also as to the fourth bank even though no self-dealing had as yet transpired with regard to that bank. The basis for the order against the fourth bank would be that the Corporation had reasonable cause to believe, because of the abusive self-dealing transactions committed by the owners with regard to the other related banks, that similar unsafe or unsound practices would occur at the remaining bank.

D. <u>Enforcement of Affirmative Corrective Acts</u>

Under section 8(b) the Corporation may both prohibit unsafe or unsound practices or violations of law and may also require that affirmative steps be taken to undo the harm resulting from previous violations or unsafe or unsound practices. For example, if the bank is being operated with an excessive amount of substandard loans, a cease and desist order issued pursuant to a section 8(b) action could require the bank to take affirmative action to reduce the dollar volume of such loans to an amount specified in the order.

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E. Consent Cease and Desist Orders

In nearly every instance, the Corporation attempts to use a procedure under section 8(b) known as the consent cease-and-desist order in an effort to eliminate the need for time-consuming administrative hearings. The consent cease and desist procedure is premised upon the agreement to a stipulation between representatives of the Corporation and the bank's board of directors whereby the bank agrees to the issuance of a proposed cease-and-desist order. The effect of following this procedure is to reduce considerably the time period between initial review of the case and the date on which an enforceable and binding cease-and-desist order is issued. Under this approach, copies of the proposed Stipulation, Notice of Charges, and Order to Cease and Desist are furnished to the Regional Director who in turn is advised to send a copy of each document to the State supervisor and to the bank's board of directors. A meeting is first arranged with the State supervisor and he is asked to join in the enforcement action with the Corporation or to execute a waiver stating in essence that he has no objection to the action proposed. Thereafter, a meeting with the bank's board of directors is scheduled. If agreement is reached at the meeting, the Stipulation is executed by the bank's board of directors, Corporation representatives, and the State supervisor, unless a waiver has been signed. Among other things, the Stipulation usually will provide for waiver by the bank of its right to a hearing and its consent to the immediate issuance of an agreed upon cease-and-desist order. If the Stipulation is agreed upon by all parties, it is submitted to the Corporation's Board of Directors for final approval and for the issuance of the agreed upon cease-and-desist order. If either the State supervisor or the bank's board of directors refuses to agree to a Stipulation and if satisfactory alternative procedures cannot eventually be agreed upon (such as a written agreement), then formal action under section 8(b), or if warranted section 8(c), generally will be recommended to the Corporation's Board of Directors.

F. Recommendation of Action

The recommendation for section 8(b) action is not necessarily dependent upon an examination of the bank or, where a bank has been or is being examined, upon completing of a report of examination. If sufficient evidence is otherwise available, there is little or no reason to await an examination of the bank or completion of a report of examination before recommending cease and desist action. Under such circumstances, the matter may be fully covered in a letter, prepared or transmitted by the Regional Director, containing appropriate charges, proposed corrective measures, the recommendation for such action, and copies of the appropriate documents substantiating the charges.

In those instances where there is a report of examination, the report normally would be prepared in the same manner as discussed under section 8(a) action. While this form is preferable, the charges and proposed corrective measures alternatively may be included in a letter from the Regional Director provided they are adequately discussed and documented in the report of examination. In either case, it is important to include as many detailed facts pertaining to the alleged practice or violation as is reasonably possible.

G. Determination of Compliance

The periods for compliance with the various segments of the cease and desist order are determined individually and, for example, may include four or five different periods ranging from 30 days to ten or twelve months from the date of issuance of the order. Virtually every order to cease and desist will require the bank to submit progress reports to the Regional Director at specified intervals setting forth the form and manner of compliance with the substantive requirements of the order. While these progress reports should be useful, interim visitations of the bank should be made as a cross check on the accuracy of the bank's progress reports and its degree of compliance. Of course, examinations of the bank will serve to determine compliance with the order and such examinations may be scheduled to coincide with one of the specified corrective periods. A memorandum reporting the results of the visitation should suffice to police the extent of compliance with the order. In the case of an examination, the report of examination should be handled as discussed under section 8(a) re-examinations. Any time the bank fails to comply substantially with any of the requirements of the order within the time specified, that matter should immediately be brought to the attention of the Regional Office together with recommendations for appropriate action to be taken under the circumstances.

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III. Section 8(c) -- Temporary Cease and Desist Proceedings

Ordinarily, when cease and desist proceedings require an administrative hearing, anywhere from three to eight months could elapse before a final cease and desist order is issued. Section 8(c) of the Federal Deposit Insurance Act, however, provides the Corporation with the power to act with the utmost speed when the facts so dictate. Paragraph (1) of section 8(c) permits the Corporation to issue a temporary cease and desist order, which is immediately effective, whenever the violation(s) or threatened violation(s) or the unsafe or unsound practice(s) specified in the notice of charges served upon the bank, or their continuation, is (are) likely to cause insolvency or substantial dissipation of its assets or earnings, or is likely to otherwise seriously prejudice the interests of its depositors. The temporary cease and desist order remains in effect pending completion of the administrative proceedings, unless within ten days after the bank has been served with such order, the bank obtains relief in Federal District Court.

Because of the nature of this action, recommendation probably would be forthcoming from the Regional Office without the benefit of a completed report of examination. For the same reason, consent procedures will not apply in this instance.

(Refer to section 8(c) of the Federal Deposit Insurance Act.)

IV. The Written Agreement

In appropriate cases the Corporation will enter into a written agreement with a bank, and the written agreement, like the consent cease-and-desist order, is based on a voluntary acceptance by the bank. Although the Corporation is not required to coordinate a written agreement with the State supervisory authority, an opportunity to join in the enforcement procedure should be extended.

Written agreements have taken three forms to date. First, those which are expressly approved and authorized by the Board of Directors of the Corporation pursuant to Board resolution in advance of any meeting with the bank boards of directors. It then becomes a written agreement between the Corporation and the bank on the date on which it is executed by the bank's board and by the designee of the Corporation's Board of Directors. This type is seldom used.

Second, those which originate as consent cease-and-desist orders but which as a result of negotiations with the bank's board of directors, are subsequently changed to a written agreement. After agreement is reached at the meeting between the bank's board of directors and representatives of the Corporation, the Board of Directors of the Corporation will expressly ratify the agreement, pursuant to Board resolution, or reject it. If ratified, it then becomes a written agreement between the Corporation and the bank.

Third, those which are termed a letter agreement. This type never receives the authorization or express approval of the Board of Directors of the Corporation.

The letter agreement is an effective enforcement tool that is designed to be utilized quickly at the Regional level. In discharging their supervisory responsibilities, Regional Directors or their representatives historically have met with bank managements in an effort to obtain correction of undesirable conditions or practices. The letter agreement provides a means to confirm in writing any understanding reached or commitment obtained from the bank's directors at such a meeting. It is not to be used as a form of written ultimatum or as the proposed order is used in the consent cease and desist procedure. Although its contents would read much like an order issued under a section 8(a) or 8(b) action, the letter agreement is not by itself enforceable under the provisions of the Federal Deposit Insurance Act. Failure to comply with its provisions, however, would be a basis for more formal procedures under section 8.

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The letter agreement is not a substitute for more formal proceedings under sections 8(a) or 8(b). Generally the use of letter agreements is confined to corrective measures agreed to by a bank's board of directors when first a bank shows problem characteristics. If previous corrective suggestions have not been followed, or if previous commitments to undertake corrective steps have not in fact been met, then more formal proceedings under section 8 should be considered.

The letter agreement is to be drawn after the meeting, and signed by each bank director present, the Regional Director and State supervisor, if he chose to participate.

V. Examples of Corrections Ordered by the Corporation's Board of Directors Under Section 8(b) and/or Included in Written Agreements.

The following are examples of the type of corrective measures taken by the Corporation's Board of Directors under its cease and desist authority:

a. Where insider loans and self-serving fees to the ownership element existed, an absolute ban was imposed on any loans or fees to the ownership element, or to any corporation, partnership or other entity in which the ownership element had actual or working control;

b. Where the bank suffered from inadequate capital and self-serving transactions by the ownership element, a ban was imposed on the payment of cash dividends without the prior written consent of the Corporation and the State supervisor;

c. Where a bank's investment portfolio was overloaded in long-term municipal securities, it was ordered that the bank's investments should be limited to U.S. Treasuries or agency obligations with maturities of not more than seven years, or high grade corporate securities with maturities of not more than two years, or high grade corporate notes with maturities of not more than one year;

d. Where a bank was in an extended borrowing position because of a lack of liquidity and forward loan commitments, a ban on borrowings was imposed except on those borrowings needed to meet depositor withdrawals or irrevocable forward loan commitments outstanding as of the date of the Stipulation;

e. Where written loan policies were nonexistent or inadequate, the Corporation ordered adoption and strict adherence to acceptable written loan policies;

f. Correction of violations of laws and regulations was ordered;

g. Elimination of all loans classified "Loss" and 50 percent of loans classified "Doubtful" in the latest FDIC report of examination was ordered;

h. Where self-dealing through management service contracts with the ownership element existed, a ban was imposed on management service contracts except with the express prior written approval of the Corporation and the State supervisor;

i. A prohibition was ordered against the extensions of additional credit to any bank borrower with existing extensions of credit classified "Doubtful" or "Loss";

j. Where a lack of liquidity was a problem and no State reserve requirements existed, the maintenance of "cash and due from banks" was ordered maintained at a certain level in order to alleviate the illiquidity;

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k. Where out-of-territory loans presented a problem, the bank was required to define its trade area and, with rare exception, confine its lending to such area;

l. Where additional capital was needed, a program was ordered for the raising of additional capital; and

m. Where self-dealing transactions occurred involving related banks and the ownership element, a ban was imposed on the buying and selling of all assets between related banks.

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I. Section 8(e)

Section 8(e) gives the Corporation the power to order the removal of any director or officer of an insured State nonmember bank when it is determined, after notice and hearing, that:

a. The director or officer has committed any violation of law, rule, or regulation, or of a cease and desist order which has become final, or has engaged or participated in any unsafe or unsound practice in connection with the bank, or has committed or engaged in any act or omission or practice which constitutes a breach of his fiduciary duty; and

b. The bank has suffered or will probably suffer substantial financial loss or other damage or that the interests of its depositors could be seriously prejudiced by reason of his actions; and

c. The violation, practice, or breach is one involving personal dishonesty on the part of the director or officer.

It further permits removal of a director or officer for his conduct or practices with respect to "another insured bank or other business institution" which resulted in substantial financial loss or other damage and which evidences his personal dishonesty and unfitness to continue as a director or officer.

In addition, a director or officer can be immediately suspended or prohibited from participation in any manner in the conduct and affairs of the bank pending completion of proceedings regarding his removal if the Corporation deems it necessary for the protection of the bank or the interests of its depositors. Similar to proceedings under section 8(c), an emergency suspension or order of prohibition remains effective pending completion of the proceedings unless the person affected applies within ten days for a stay of such suspension or prohibition. As in the case of action proceedings under section 8(b), the State supervisor is required to be notified and given an opportunity, depending on the circumstances of case, to take satisfactory corrective measures. Failure to notify the State supervisor, however, does not affect the legality of the action taken under section 8(e).

II. Section 8(g)

Section 8(g) permits suspension of any director, officer, or other person from participation in the bank's affairs by written notice and without a hearing, if that person is charged in any information, indictment, or complaint authorized by a U.S. Attorney, with the commission of any felony involving any dishonesty or breach of trust. Our Legal Division has concluded that the provisions of this section also encompass State grand jury indictments and informations. Notice also shall be served on the bank. Suspension shall remain in effect until either lifted or made permanent through issuance of a removal order by the Corporation after resolution of the criminal case.

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