

Mr. Chairman, we are glad to have this opportunity to appear before your subcommittee today in connection with its continuing study of the Federal effort against organized crime.

The Federal Deposit Insurance Corporation was established in 1933 to provide protection for bank depositors and to restore and maintain confidence in banks insuring bank deposits. Among

Statement
of

Chairman K. A. Randall
Federal Deposit Insurance Corporation

before the
Subcommittee on Legal and Monetary Affairs
Government Operations Committee

February 7, 1968

Bank to protect depositors and to restore and maintain confidence in banks insuring bank deposits. Among the criticisms by our examiners in our examination reports are an area of special concern calling for corrective action by management. We discussed in some detail this aspect of our activities in the hearings before your subcommittee in 1967.

I would like to emphasize at this point that our concern with crime in banking is not part of our broader concern with the continued viability of banks insured by Federal Deposit Insurance and with the contribution that the Corporation can make in protecting the community's wealth of persons in the form of bank deposits. This is our primary focus. Accordingly, I would like to give the subcommittee a brief description of certain of our practices and procedures which emphasize the principal methods whereby the presence of organized crime elements in banks might be detected.

Mr. Chairman, we are glad to have this opportunity to appear before your subcommittee today in connection with its continuing study of the Federal effort against organized crime.

The Federal Deposit Insurance Corporation was established in 1933 to provide protection for bank depositors and to restore and maintain confidence in banks by insuring bank deposits. Stemming from its function as an insurer, the Corporation has responsibilities to help promote the health and vigor of the banking system through bank examination and supervision, which includes evaluation of bank safeguards against internal or external crimes. The failure of a bank to protect itself against crime subjects the institution to criticism by our examiners in our examination reports as an area of operations calling for corrective action by management. We discussed in some detail this phase of our activities in the hearings before your subcommittee in 1963.

I would like to emphasize at this point that our concern with crime in banking is but part of our broader concern with the continued viability of banks covered by Federal deposit insurance and with the contribution that the Corporation can make to protecting the community's means of payment in the form of bank deposits. This is our primary focus. Accordingly, I would like to give the subcommittee a brief description of certain of our practices and procedures which constitute the principal methods whereby the presence of organized crime elements in banks might be detected.

Pursuant to our law, the Corporation maintains a sizable staff of bank examiners in the field totaling some 1,030. The basic purpose of such examinations is indicated by Section 10(b) of our Act which states that an examiner "shall make a full and detailed report of the condition of the bank to the Corporation." The FDIC examiners have authority to examine insured State banks which are not members of the Federal Reserve System and we attempt to follow a policy of examining these banks, of which there are over 7,700, at least once each year. Special examinations may on occasion be made of national and State member banks but only when, in the judgment of the Corporation's Board of Directors, this is necessary to determine the condition of a bank for insurance purposes. Our examiners also have authority under a law enacted in 1966 to conduct examinations of affiliates of banks examined by them whenever it is deemed necessary to determine the relationship between the bank and its affiliates and the effect of such relations upon the bank.

FDIC bank examinations are designed: (a) to verify and evaluate the assets of the bank; (b) to establish the nature and extent of liabilities; (c) to determine the adequacy of the capital account of the bank; (d) to ascertain conformity with applicable statutes; (e) to appraise the management and the soundness of the management policies and operations; and (f) to suggest and initiate corrective programs.

In every examination, bank management is carefully appraised. In this process, a review of the bank's loans, on the basis of infor-

mation in the bank's files and discussions with bank officers, may be quite revealing. An increasing volume of loans with undesirable characteristics as to type and purpose of the loans, borrowers' reputations and ability to pay, the quality of the security, and other factors, most commonly reflects weak management but could also indicate the possible presence of dishonesty or improper influences being brought to bear upon management. On the liability side of the ledger, unusual and unexplained activity in certain deposit accounts, drawing against uncollected items frequently and in large amounts, and indications of check kiting are some of the signs of possible trouble. New directors and officers are the subject of special inquiry as to their background, other interests, and dealings with the bank. Also included as a part of the examination reports are detailed questionnaires on internal controls and routine and on security devices and procedures.

Another important feature of bank examination is concerned with the evaluation of a bank's physical security and the degree of protection maintained against robberies and burglaries. Because banks constitute a major source of ready cash, they are liable to be particularly attractive targets to criminal elements -- whether operating individually or as part of a group conspiracy. The spread of banking facilities, their new designs, and their location in areas readily accessible to the public make them quite vulnerable to external attack. Since we testified before your Committee in 1963, we have intensified our efforts to encourage responsibility on the part of bank management to take appropriate steps to guard against both internal and external crimes.

Corrective action in the case of operating banks ordinarily is sought through the joint efforts of the State banking authorities and FDIC examiners to persuade bank officers and directors to make the necessary changes. This procedure generally has proved to be effective in virtually all situations. In addition, the State authorities, who have the primary supervisory responsibility, commonly have powers which can be used to apply further pressure where needed.

In acting upon applications by banks for deposit insurance as well as upon various applications by insured banks for branches and similar matters, the FDI Act requires that among six specific factors the general character of the bank's management be considered. And management is the factor that is particularly pertinent to the discussion today.

Management is scrutinized by the Federal Deposit Insurance Corporation when state-chartered banks apply for insurance. Moreover, the management factor is covered by the Office of the Comptroller of the Currency when a national bank is chartered, and it is an important consideration when a state bank seeks membership in the Federal Reserve System. (All national banks and state-chartered members of the Federal Reserve System are insured automatically without action by our Corporation.) Our responsibilities, together with the other Federal banking agencies, require constant alertness and continual vigilance against the possibility of criminal infiltration of banks or influence upon bank management as well as diligence in dealing with the more common problems of internal and external crimes against banks.

When a bank applies for Federal deposit insurance, the proponents in such cases are required to furnish detailed financial statements and background information for all of the proposed directors and principal officers. The Corporation's examiners also conduct a full field investigation of the application, including personal interviews with and inquiries in the community concerning these individuals. Other information sources available in the field or in Washington and elsewhere are also drawn on to the extent necessary to resolve questions concerning the proposed management. If the findings are not accepted, withdrawal of questionable individuals from proposed management may be suggested or the application for insurance denied.

Various remedies are available to the Corporation in the event that direct discussions with the bank fail to produce the desired results in solving a management problem or correcting an otherwise unsatisfactory situation. It is not often necessary for the Corporation to resort to formal action, but from time to time proceedings have been instituted under Section 8(a) of the FDI Act to terminate a bank's deposit insurance if corrections are not made by the bank within a specified time period. Since the enactment of the Financial Institutions Supervisory Act of 1966, the Corporation has available a less drastic method for dealing with unsatisfactory situations in banks, including the management issue -- the authority to issue temporary and permanent cease-and-desist orders and to suspend and remove officers and directors. Under Section 19 of our Act, moreover, it is unlawful for any person who has been convicted

of any criminal offense involving dishonesty or breach of trust to serve as a director, officer, or employee of an insured bank without the written consent of the Corporation.

Because undesirable elements may attempt to gain control over operating banks to promote their own interests, changes in the control of banks are of particular concern to this Corporation and to other bank supervisory authorities. A law enacted in 1964 upon our recommendation requires that, whenever there is a change in the ownership of the stock of any insured bank which results in a change in control, the chief executive officer of the bank shall report the facts to the appropriate Federal banking authority upon obtaining knowledge of such change. Reports also are required from insured banks when they extend loans secured by twenty-five percent or more of the stock of an insured bank and the stock has been transferred to the borrower within the preceding year.

The reports on change of control for insured nonmember banks are made to this Corporation. Reports for national banks and state member banks are made to the Comptroller of the Currency and the Board of Governors of the Federal Reserve System, respectively, with copies furnished for our files. Upon receipt of such a report from an insured nonmember bank, our Supervising Examiner for the FDIC District in which the bank is located immediately undertakes such investigation of the character and ability of the purchaser of the bank as is deemed necessary. Frequently, the new owners are already known to us or satisfactory information may be obtained with minimum effort. On the other hand, it may be

necessary to make extensive investigations and to utilize all available sources, including FBI name checks in some instances. Early examinations of the banks or other supervisory action may be indicated in some cases. In any event, new owners and managements are subject to close and special scrutiny for the purpose of evaluation.

In addition, under the Securities Exchange Act of 1934, as amended in 1964, the Corporation administers the registration and reporting of 171 insured State nonmember banks having more than 500 shareholders. Regulations adopted by the Corporation pursuant to the Act require the public disclosure by these banks, in connection with proxy solicitation, of information with respect to stock ownership, remuneration, and transactions with the bank, of "insiders" -- directors, officers, large shareholders and their associates.

The Act also requires every director and officer, as well as large shareholder (10% or more), of a registered bank to report his beneficial ownership of securities therein. In addition, changes in such beneficial ownership must be reported to the Corporation within the first 10 days of the month following the change.

As a regular part of our examining and supervisory procedure -- but relevant also to our discussion on the detection of criminal elements in banking, the FDIC cooperates with other bank supervisory authorities at both the State and Federal levels and with the law enforcement agencies. Channels of communication are opened and maintained, but there is no formal apparatus for the exchange of information. As far as we can determine, this system

has worked satisfactorily and provides a desirable degree of flexibility in our operations.

Each of our regional offices is in the charge of a Supervising Examiner who has the responsibility for the work in his area. Since all of the banks which we regularly examine are State banks, the primary supervisory authorities are the State banking departments. So, it is essential that we coordinate our activities with those of the State departments. Our Supervising Examiners communicate regularly with the State authorities; there is free and full exchange of information, as well as cooperation in promoting corrective action. In addition, our Supervising Examiners also are in touch with the representatives of the Comptroller of the Currency and the Federal Reserve Banks responsible for the examination of national and State member banks within their respective Districts.

At the Washington level, there is also interchange of information between the three Federal banking agencies at both the staff and policy levels, facilitating the coordination of policies and procedures. The Corporation has also made a particular effort to strengthen its liaison with the State banking authorities through periodic meetings and exchange of information in all areas of mutual concern.

In connection with violations of Federal law -- criminal or civil -- the FDIC cooperates closely with the various Federal agencies concerned with law enforcement. Arrangements with the Federal Bureau of Investigation make available to us, on a confidential basis, information resulting from investigations involving

banks and bankers and, as mentioned earlier, enable us to request name checks of individuals under investigation by us where such action appears advisable. We, in turn, are able to assist the FBI from time to time. To a lesser extent, information may be exchanged with other agencies on a confidential basis.

Our staff is under instructions to see that crimes relating to banks and involving insured nonmember banks are reported to the proper authorities, either by the banks themselves or by our examiners. For example, whenever an examination discloses -- or we otherwise learn about -- a possible violation of the Federal criminal statutes, a letter report is prepared, addressed to the United States Attorney for the district in which the bank is located. This report, containing all pertinent information known to the examiner, is forwarded to our Washington office and, after review by our Legal Division, sent to the United State Attorney, with copies supplied to the Criminal Division of the Department of Justice. In urgent cases, the examiner may immediately telephone his Supervising Examiner and simultaneous notice may be given to the FBI locally and sometimes also in Washington, with the letter report following. In addition, satisfactory working relationships are maintained between members of our staff and personnel of the Criminal Division of the Department of Justice and other Federal investigatory agencies which facilitate informal consultation and mutual assistance as circumstances dictate.

The preceding comments describe generally the procedures employed by the Corporation in carrying out its statutory responsibilities. The hearings today are directed primarily toward the

problem of organized crime. The Corporation, as you recognize, is a bank supervisory and insuring agency -- and not a law enforcement agency. In our experience, moreover, organized crime has, to our knowledge, not been significant in banking due in part, at least, to the Federal and State supervision to which banks are subject. Nevertheless, whenever we discover or are informed of possible criminal violations, our practice is to notify the proper enforcement agency promptly so that appropriate action may be taken and extend to the agency our fullest cooperation.

In closing, the Corporation would like to state its opinion that the existing arrangements have worked most satisfactorily. While dishonesty in bank management cannot be completely eliminated, examinations and our investigative procedures serve as a most useful and effective deterrent to crime in banks. Moreover, these examinations and investigations are safeguards against the likelihood of major undetected infiltration by criminal elements. We want to assure your subcommittee, however, that we are willing to consider any steps consistent with our statutory powers and responsibilities that will further improve cooperation and coordination between the Federal supervisors of financial institutions and the Department of Justice and other agencies in dealing with the problems that organized crime may pose for banking.