TESTIMONY OF

L. WILLIAM SEIDMAN
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

ON

THE PROSECUTION OF FINANCIAL CRIMES

BEFORE THE

SUBCOMMITTEE ON CRIMINAL JUSTICE
COMMITTEE ON THE JUDICIARY
UNITED STATES HOUSE OF REPRESENTATIVES

9:30 A.M.
WEDNESDAY, JULY 11, 1990
ROOM 2226, RAYBURN HOUSE OFFICE BUILDING

Good morning, Mr. Chairman and members of the Subcommittee. It is a pleasure be here today to discuss the actions the Federal Deposit Insurance Corporation and the Resolution Trust Corporation are taking to identify and punish those involved in fraud and abuse in the banking and savings and loan industries and to comment on pending legislation to improve prosecutions of financial institutions crime.

The FDIC and the RTC have long put the fight to curtail fraudulent activity in financial institutions at the top of their regulatory agendas. In the last five years, we have developed specially trained fraud squads to pursue those committing fraud and have given our examiners special tools to help in detecting such abuses. Greedy and unscrupulous individuals, insiders, advisors or related parties must not be allowed to profit at the expense of the deposit insurance funds and the American taxpayer.

Our testimony will outline the FDIC and RTC programs to prevent, detect and punish fraud and abuse by individuals and financial institutions. We also will comment on H.R. 5050 which recently was reported by the Financial Institutions Subcommittee of the House Banking Committee. H.R. 5050 is designed to provide the banking regulators and law enforcement agencies with additional tools to control fraudulent activities by individuals involved with banks and thrifts. While a number of other bills are pending in the House on this subject, our comments will focus on H.R. 5050 since it is the one that primarily affects the FDIC and the RTC.

The FDIC and the RTC have authority to bring civil -- but not criminal -- actions against banks and thrifts for fraudulent or other unlawful activities. Our prosecution of civil fraud cases provides an additional significant role in the prosecution of financial crimes. We investigate every failed bank and thrift to determine whether civil or criminal activity was involved in a bank or thrift failure. In addition, our examiners look carefully for evidence of fraudulent activity during the regular examination process of all open institutions. In the case of both failed and open institutions, we refer suspected criminal activity to the appropriate law enforcement agencies.

We also provide much of the basic information needed by the law enforcement agencies throughout all stages of a criminal prosecution. To that end, we participate in the regional inter-agency bank fraud working groups to encourage communication and improve coordination of criminal investigations.

The FDIC also uses administrative enforcement actions to stop fraud and abuse in operating institutions. In addition, the FDIC and the RTC bring civil suits for money damages and restitution (against officers, directors and other insiders) after an institution has failed.

Detecting and Reporting Fraud and Abuse in Open Institutions

FDIC examiners are trained to detect the signs of fraud and other illicit or improper insider actions. Potential problems often can be uncovered when certain warning signs are evident. In 1987, we developed a list of time tested "red flags" to assist our examiners in the early detection of apparent fraud and insider abuse. The "red flag" list has been expanded once and now is in the process of being updated and expanded again. Examples of the areas that the "red flags" cover include: linked financing/brokered transactions; loan participations; offshore transactions; lending to buy tax shelter investments; and wire transfers. When "red flag" warnings are detected, specially trained members of our "fraud squad" may be called in to pursue the matter using their special training.

Training and role of examiners. New examination personnel begin their careers as Assistant Examiners and usually serve a minimum of three years before they can qualify as commissioned examiners. During these first three years, Assistant Examiners are required to attend four schools that include training in investigatory techniques and detection of insider abuse and fraud. Assistant Examiners also receive on-the-job training in the detection of insider abuse and fraud.

Through the training process, our examiners gain a familiarity with the principal criminal statutes applicable to insured institutions. They also learn how to complete the standard criminal referral forms (Reports of Apparent Crime) used by all financial institution regulators. Additionally, examiners receive instruction on potential problems and warning signs pertaining to bank fraud and insider abuse -- namely, the red flags. The Division of Supervision's Manual of Examination Policies also sets out alternative investigative procedures appropriate to particular circumstances and addresses the handling of criminal violations when they are discovered.

An examiner's detection of management fraud or other abuse in an operating state nonmember bank generally results in one or more administrative enforcement actions by the FDIC and, in some cases, criminal referrals to the respective U.S. Attorney and the appropriate criminal investigatory agency. Criminal referrals prepared by examiners are reviewed by regional office staff and forwarded to the FBI and U.S. Attorney as soon as possible. However, when examiners detect significant apparent violations, we immediately contact the FBI and the U.S. Attorney by telephone before the examiner prepares the written referral. When requested by law enforcement agents, our examiners will assist in developing evidence and appear as expert witnesses.

<u>Role of institutions</u>. Bank directors and management also bear great responsibility for preventing and detecting fraud and insider abuse. Bank directors must assure that appropriate internal controls are in place. Bank management and employees who suspect a criminal violation are required -- under Part 353 of the FDIC's Rules and Regulations -- to submit Reports of

Apparent Crime to the appropriate FDIC Regional Office, the U.S. Attorney, the appropriate State Banking Authority and the appropriate Federal investigative authorities (either the FBI, the Secret Service, the Postal Service, or the IRS) within thirty days of discovering the suspicious activity. Two different forms are used for this purpose. The Report of Apparent Crime (Short Form) is used to report suspected criminal violations involving less than $10,000 and suspicious transactions that indicate possible money laundering. The Report of Apparent Crime (Long Form) is used to report suspected criminal violations involving amounts of $10,000 or greater and all cases, regardless of amount, involving an executive officer, director or principal shareholder of the institution.

Copies of Reports of Apparent Crime involving amounts of $10,000 or greater, those involving executive officers, directors and major shareholders, and those involving suspected money laundering are forwarded by the regional offices to the FDIC's Special Activities Section in Washington. Those reports are reviewed and certain data from the reports are entered into an automated records system. During 1988 and 1989, the Special Activities Section received 902 and 938 reports, respectively.

The Special Activities Section forwards Reports of Apparent Crime indicating losses of $200,000 or more to the Department of Justice for special tracking. The individual U.S. Attorneys then make decisions about which criminal cases to pursue. Reports forwarded for tracking totaled 200 in 1988 and 284 in

1989. The Department of Justice enters information from these reports into a computer tracking system and periodically advises the FDIC of their status.

Reports of Apparent Crime filed by banks usually result from such events as teller shortages, false entries, theft, false statements on loan applications, embezzlement or misapplication of funds, check kiting, mysterious disappearance of bank funds, or money laundering.

FDIC "Fraud Squad" Investigations of Fraud

The FDIC has its own "fraud squad." Created in 1986, it is a national investigations unit that investigates fraud and other criminal activities when necessary in operating institutions and in all closed insured banks and in those thrifts that were closed before January 1, 1989. (The RTC's investigatory activities will be addressed below.)

The FDIC's investigations unit is comprised of over 500 investigators and staff. (This number does not encompass attorneys, examiners and other staff who deal with fraud in their day-to-day activities, but who are not full time investigators or support staff for the "fraud squad.") Investigators receive specialized training in all phases of financial institution operations, accounting, investigative techniques and specific fraudulent schemes. The result is a team of individuals who are well equipped to look into the affairs of failed institutions, as well as operating institutions when called upon to do so.

Each time a financial institution is declared insolvent, an investigative team is dispatched to determine 1) what caused the failure, 2) whether any criminal activity took place and 3) whether any professional liability claims exist. The investigations unit currently is pursuing approximately 942 active claims and investigations.

When possible criminal activity is discovered, the investigators file criminal referrals with the appropriate law enforcement agency. Since 1987, approximately 331 such referrals have been made. The investigators also follow up on these referrals through participation in the local bank fraud working groups. These groups bring together law enforcement personnel and representatives of the financial institution regulatory agencies on a monthly basis to discuss various issues related to bank fraud and other criminal activity. Each of the FDIC's regional offices and consolidated office sites has a designated participant in the local working groups or a contact person for the U.S. Attorney's offices and relevant investigative agencies.

Participation in these groups aids financial institution civil and criminal fraud prosecution in many ways. Few people are as familiar with the records of the financial institution or have the analytical expertise as the investigative team assigned to the failed institution. This expertise is made available in formal and informal ways to aid civil and criminal authorities in discovering, documenting and prosecuting fraud. In some instances, individual investigators are assigned full-time to a grand jury investigation.

The investigations unit also documents and requests restitution pursuant to the Victim and Witness Protection Act when individuals are convicted of crimes involving failed financial institutions.

RTC Investigations of Fraud in Closed Institutions

Investigations unit. The RTC also has its "fraud squad" with a corps of trained, experienced financial investigators. The RTC's Office of Investigations -- which now has approximately 300 investigators and staff -- projects to have 300 investigators by year-end. The Office provides the investigatory support to initiate civil and criminal recoveries from thrift owners, managers and professionals -- such as accountants and lawyers -- who caused losses through fraudulent or criminal conduct or professional malpractice. Recoveries can come from insurance policies covering professional conduct or directly from the assets of insiders and professionals. Successful recovery, however, requires thorough investigation and, in many instances, litigation.

The investigator's task is to: gather facts about insider abuse; identify the individuals who caused the thrift's losses; assess the degree of culpability of each party -- from negligent and reckless mismanagement to fraud or criminal conduct -- and help determine whether and what sort of litigation should be initiated to maximize recoveries. Investigators are involved throughout the civil litigation process, supporting the RTC attorneys and outside counsel.

A second, but equally important, responsibility of the Office of Investigations is to assist the Department of Justice and other Federal agencies in prosecuting individuals who engaged in criminal conduct, particularly those who benefited personally at the taxpayers' expense. RTC investigators are being trained to work with law enforcement agents to achieve our mutual objectives. Similarly, law enforcement agents are being trained to understand and respect the RTC's responsibility to recover assets for the thrift receiverships.

The investigator's initial task after RTC is appointed conservator of an insolvent thrift is to conduct a preliminary investigation of the facts leading to insolvency and to prepare a "Preliminary Findings Report." As of June 30, 1990, 397 Preliminary Findings Reports had been completed, representing about 87 percent of the 454 thrifts under the RTC's control.

<u>Insider abuse and misconduct in insolvent thrifts</u>. As a result of our experience over the past few months, we estimate that:

- Approximately 50 percent plus of RTC-controlled thrifts have had suspected criminal misconduct referred to the Department of Justice;

- In about 40 percent of RTC-controlled thrifts, insider abuse and misconduct contributed significantly to the thrift's insolvency;

- About 15 percent of the thrifts appear to have been involved in irregular and possibly fraudulent transactions with other financial institutions.

The average asset size of RTC-controlled thrifts is about $500 million, and they are complex organizations with numerous subsidiaries and affiliates. Many were owned or dominated by one individual and operated more like real estate development organizations, investment banks, or mutual funds than thrift institutions.

This situation allows for abuse and lack of control. It creates opportunities for self-dealing, fraud, theft and other misconduct to occur unabated. The RTC works with other Federal agencies and, where necessary, retains investigators with specialty skills in securities, commodities, and other disciplines to assist in documenting complex and sophisticated schemes of abuse and misconduct by insiders and other affiliated parties.

Trends and patterns of fraud and misconduct. Evidence of insider abuse and misconduct in RTC thrifts ranges from embezzlement and loan fraud to complex schemes to generate paper accounting profits that allowed cash to flow to thrift owners through subsidiaries or personal holding companies. Many of the complex lending schemes involve over-valued property that was swapped several times between borrowers or among various thrifts. These "land flip" schemes created false values and generated excessive fees that were parceled out to appraisers, brokers, developers and others -- including thrift insiders. Real estate development loans were made with no recourse to the borrower if the project failed. We are investigating these situations, as well as instances of unauthorized trading in mortgage-backed securities, junk bonds and other financial instruments in which insiders took the profits and pushed the losses onto the institution.

The example of Drexel Burnham Lambert and Michael Milken is a case in point. As announced last month, a special FDIC and RTC task force is actively and aggressively investigating possible claims against Drexel and Michael Milken for substantial losses suffered by failed financial institutions in junk bond investments. Based on preliminary information available to us, we anticipate filing claims in the Drexel bankruptcy proceedings against the $750 million pool being administered by the Securities and Exchange Commission, and for any civil recoveries available.

Abuses are more prevalent in the Southwest and Southern California. More recent problems are arising in the Northeast and Florida. The RTC's Central Region, comprising Arkansas and 11 midwestern states, reports far and away the lowest percentage of thrifts exhibiting fraud and abuse -- less than 30 percent.

Civil Actions Against Directors, Officers, and Institution-Affiliated Parties

When an insured depository institution fails, the FDIC or the RTC becomes the legal owner of the institution's claims against its former directors, officers, employees, attorneys, accountants, and other professionals employed by the institution. In the case of every failed institution and those placed in conservatorship, the FDIC or the RTC conducts an investigation of potential professional liability claims. These investigations focus on whether the potential claim is meritorious and, if so, whether it would be cost effective to bring a civil suit seeking money damages.

The Professional Liability Section of the FDIC's Legal Division is responsible for litigating the FDIC's cases involving: directors' and officers' liability ("D&O"); attorney malpractice; accountants' liability; commodity and securities brokers' liability; claims under bankers blanket bonds; and certain appraiser malpartice cases. This section also works in conjunction with the RTC's Office of Investigations to pursue similar actions on behalf of the RTC.

Prior to February 1989, when the savings and loan conservatorship program began, the FDIC had pending investigations of professional liability claims involving approximately 500 institutions. The FDIC also had more than 100 lawsuits on file.

Following the merger with the Federal Savings and Loan Insurance Corporation (FSLIC) in August 1989 and the creation of the RTC -- which formally took over those savings institutions placed in conservatorship after January 1, 1989 -- the FDIC became responsible for the investigation of potential claims and the prosecution of viable claims involving a vastly increased caseload of institutions. The FDIC and RTC currently are conducting investigations in 1300 institutions and have filed more than 500 lawsuits against former directors, officers and other professionals for damages ranging from $1 million to $1 billion. The 1300 institutions we have responsibility for in-house can be broken down as follows:

Banks	550 Institutions
Thrifts (old FSLIC)	350 Institutions
Thrifts (RTC)	400 Institutions

In 1989, the FDIC's and the RTC's recoveries for professional liability claims totaled approximately $100 million. This figure includes old FSLIC recoveries taken in after the August 9, 1989 merger. During 1989, an additional $50 million in recoveries was received by FSLIC prior to August 9 for professional liability claims. A rough breakdown of these recoveries follows:

FSLIC Thrifts (prior to August 9)	$50 million
FSLIC Thrifts (after August 9)	$35 million
FDIC Banks (1989)	$60 million
RTC Thrifts (1989)	$4 million

Our recoveries for the first quarter of 1990 alone total more than $100 million. Settlements and judgments during the first half of 1990 will produce recoveries totalling in excess of $200 million. That is in excess of $1 million per day in recoveries.

Over the past few years, the FDIC has litigated claims involving approximately 50 percent of those institutions for which it has been appointed receiver. This percentage of claims in litigation may drop somewhat -- particularly as to the RTC thrifts -- because of a scarcity of recovery sources, including D&O insurance and personal assets among many of the potential defendants.

The FDIC and the RTC contract with approximately 150 law firms to prosecute professional liability claims. Our in-house attorneys supervise and manage this litigation to ensure consistency in arguing legal issues and conformity to case plans and budgets, among other things. In-house attorneys also directly conduct settlement negotiations involving claims.

Much of the litigation now pending in the Professional Liability Section involves claims brought against former directors and officers who managed the failed institutions. These claims range from fraud and insider abuse to grossly negligent failures to conduct or supervise the financial institution's affairs.

Although historically many of the FDIC's cases are based on abusive lending practices, that is not the only basis for filing suits. We also have brought suits based on the payment of unreasonable dividends, imprudent or illegal investments in bank buildings, speculative securities trading, unreasonable compensation and expenses paid to directors and officers, and fraudulent "land flips" and other complex real estate transaction schemes.

As mentioned before, the FDIC and the RTC pursue those directors, officers, and other professionals who have committed fraud upon failed financial institutions if our investigation supports such allegations. However, it is not cost effective to pursue suits against such individuals when the litigation costs would exceed any collectible judgement. In those cases in which fraud or dishonest conduct by professionals is present, but in which the FDIC or the RTC determines that cost considerations prohibit filing civil suits, every effort is made to encourage and assist criminal prosecutions by the appropriate law enforcement authorities.

Fraud and dishonesty underlie FDIC claims brought under financial institutions "bankers blanket" or fidelity bonds. Fidelity bonds insure the financial institution against losses caused by the fraudulent or dishonest activity of an institution's employees. The FDIC and the RTC have aggressively pursued claims under fidelity bonds covering failed banks and thrifts. The FDIC's largest single recovery in the first quarter of 1989, for example, involved the settlement of a bond claim for $60 million.

Open Institution Enforcement

The Compliance and Enforcement Section of the FDIC's Legal Division provides legal support, advice, and counsel to the Division of Supervision ("DOS") and prosecutes civil enforcement actions on behalf of DOS against depository institutions or institution-affiliated parties whose activities pose a threat to depositors or the deposit insurance funds. The Compliance and Enforcement Section acts as the "district attorney's office" for DOS, which must police the banking industry through such administrative actions. DOS and Compliance and Enforcement are the first line of protection for the Federal deposit insurance funds.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) greatly enhanced the enforcement powers of all of the Federal banking agencies. Civil money penalties for violations of laws, rules, regulations and orders have increased from $1,000 per day to ranges of $5,000 to $1,000,000 per day per violation. Call report penalties have increased from $100 per day per violation to ranges of $2,000 to $1,000,000 per day per violation. Other enforcement powers have been clarified -- such as jurisdiction over individuals separated from insured depository institutions, personal liability of individuals to insured depository institutions, records-keeping, and the like. New enforcement powers have been added, including the right to suspend temporarily the deposit insurance of an institution operating with no tangible capital under the capital guidelines of the appropriate Federal banking agency, and the cross-guaranty provisions rendering affiliated depository institutions liable for losses reasonably anticipated by the FDIC when a commonly-controlled institution fails.

The most common administrative enforcement tool used by the FDIC is the cease-and-desist order. Cease-and-desist orders are used to halt and correct unsafe or unsound banking practices committed by state nonmember banks or individuals related to those institutions. In 1988 and 1989, the FDIC issued 98 and 97 cease-and-desist orders, respectively.

The FDIC also has the ability to terminate an insured institution's Federal deposit insurance for engaging in unsafe or unsound practices or for violations of law. As mentioned above, FIRREA also gave the FDIC the power to suspend temporarily the deposit insurance of institutions not meeting tangible capital requirements. In 1988, the FDIC initiated 77 proceedings to terminate deposit insurance. During 1989, the FDIC initiated 73 such proceedings and 1 proceeding to suspend deposit insurance temporarily.

The FDIC can remove directors, officers, and other institution-affiliated parties from any involvement in an institution's affairs if the individual violates any law or engages in unsafe or unsound practices. The FDIC also is authorized to assess substantial civil money penalties against depository institutions and institution-affiliated parties for violations of law or outstanding enforcement orders. During 1988, the FDIC issued 33 final removal orders and assessed civil money penalties in 10 instances. In 1989, we issued 10 final removal orders and assessed civil money penalties against institutions or individuals in 9 cases. In general, there has been a shift in emphasis over the past few years to enforcement actions against individuals, in keeping with the FDIC's commitment to reduce insider abuse.

Cross-guaranty actions, as mentioned above, are a new enforcement power granted to the FDIC by FIRREA. In such actions, commonly-controlled depository institutions may be assessed for the loss reasonably anticipated by the FDIC due to the default of a related depository institution. The first such action was initiated in 1989.

H.R. 5050, the Financial Crimes Prosecution and Recovery Act of 1990

On the whole, the FDIC and RTC support H.R. 5050 since it would provide the FDIC and the RTC with a number of important new enforcement tools. These new tools will allow us to combat financial institutions fraud more effectively and save money for the Federal deposit insurance funds. A detailed discussion of the individual provisions of H.R. 5050 -- as well as recommended amendments -- are contained in the attachment to this statement.

We favor Title IV of the bill, the "Taxpayer Recovery Act," which contains proposed amendments to the Federal Bankruptcy

Code. These amendments would enhance the FDIC's ability to recover funds from individuals who have defrauded federally insured financial institutions. These individuals often file personal bankruptcy to discharge judgments or debts based on fraudulent, wrongful or criminal conduct. Although the FDIC has actively attempted to prevent such discharges, the Bankruptcy Code and case law interpreting it often make it difficult for the FDIC to prevent these individuals from avoiding these debts. Title IV would remedy this situation. The attachment contains a few recommended changes, however, that are needed to clarify that all of the enhancements would apply to the RTC, as well as the FDIC, and in their corporate, conservatorship and receivership capacities.

Another very important area to the FDIC is Section 318 of H.R. 5050. Section 318 would provide us with the ability to prohibit or limit excessive or abusive golden parachutes in depository institutions. The FDIC thinks it unconscionable that directors, officers and others responsible for an insured institution's failure -- or near-failure -- should be able to line their pockets with an insured institution's money at the expense of the Federal deposit insurance funds. Paying golden parachute money to a director, officer, or other responsible party in the case of a failed or failing insured institution amounts essentially to paying that person with a check drawn on the Federal deposit insurance funds. H.R. 5050's golden parachute provisions are necessary to enable the FDIC to limit the liabilities of the funds.

Section 305 is another very important provision. It would make the law very clear that the FDIC and the RTC have priority over competing claims against former directors, officers, employees, accountants or other professionals that had provided services to a failed institution. The FDIC also favors the provisions of H.R. 5050 that would: allow the FDIC and RTC to make prejudgment attachments of the assets of persons obligated to failed insured depository institutions; authorize the FDIC and the RTC to have access to income tax returns in exercising their liquidation and conservatorship powers -- although we request that the authority be expanded to encompass enforcement actions taken by the FDIC in its corporate capacity against open institutions; and provide the FDIC with the ability to avoid certain fraudulent transfers of assets made within five years of the appointment of a receiver.

We object, however, to Section 205. That section would allow the Attorney General to retain civil money penalties assessed and collected for banking crimes affecting financial institutions. In the FDIC's view, civil money penalties collected for banking crimes should be used to reimburse the appropriate deposit insurance fund for losses suffered as a result of actions involving failed financial institutions. As it is, the deposit insurance funds are rarely made whole for their losses from insured institution failures. Depriving the insurance funds of a source of reimbursement from civil money penalties simply further increases those losses. We do believe it is appropriate, however, for the Department of Justice to be reimbursed from the civil money penalty collections for its actual costs of investigating and pursuing these actions.

We have many substantive and technical comments on the specific provisions of H.R. 5050 that are included in the detailed attachment. Among other things, we suggest that a number of the bill's provisions need to be amended to ensure that all of the new enforcement tools apply to both the FDIC and the RTC. In addition, some of the provisions need to be modified to clarify that they apply to the FDIC and the RTC acting in their corporate, conservatorship and receivership capacities. We would be happy to work with the Subcommittee to further explain our comments and the suggested amendments we have included in the attachment.

Conclusion

In conclusion, Mr. Chairman and members of the Subcommittee, the FDIC and the RTC are vitally concerned with the threat that fraud and insider abuses pose to the continued safety and soundness of insured institutions and the deposit insurance funds. We believe that our aggressive enforcement efforts, the increased penalties and stronger enforcement authority provided to us in FIRREA, and the legislative initiatives now being considered in H.R. 5050 will prove to be a formidable deterrent to financial institution fraud and abuse.

July 11, 1990

FDIC & RTC COMMENTS ON H.R. 5050

THE FINANCIAL CRIMES PROSECUTION & RECOVERY ACT OF 1990

June 29, 1990 Committee Print

This memorandum contains the FDIC's and the RTC's comments on H.R. 5050 as reported by the Subcommittee on Financial Institutions, Supervision, Regulation and Insurance of the House Banking Committee. Where appropriate, we have included in the attached Appendix revised statutory language that reflects the FDIC's and RTC's recommended changes to the legislation.

<u>Page 2, Section 2, Definition of "Appropriate Federal Banking Agency"</u>

This term is defined as it is in the FDI Act. However, for purposes of this bill, such a definition is insufficient since it does not include the RTC. Also, the definition may be interpreted to apply only to the "appropriate Federal banking agency" in its corporate capacity, but not as receiver or conservator. [See Appendix p. 1]

<u>Page 2, Section 2, "Definitions"</u>

H.R. 5050 uses the definition of "institution-affiliated party" contained in the FDI Act. However, that definition applies a "knowing and reckless" standard to independent contractors which is not appropriate in the context of H.R. 5050. Therefore, we suggest the addition of a new defined term, "institution-related party" which will be defined in the same way as "institution-affiliated party" except it will not include the "knowing and reckless" requirement. [See Appendix p. 2]

<u>Pages 2-8, Title I, "National Commission on Financial Crimes"</u>

<u>Section 103(a)(1)</u>

This provision establishes the membership composition of the National Commission on Financial Crimes. Sub-section (a)(1) provides for two government employees to be among five individuals who are to be appointed by the president.

The FDIC believes that at least one of the government employees should come from a federal banking regulatory agency (e.g., FDIC, RTC, OCC, the Fed, or OTS). [See Appendix p. 3]

The FDIC is also concerned about Commission members or employees divulging information from confidential bank examination reports. Therefore, we recommend the addition of a new section patterned after 18 U.S.C. 1906. [See Appendix p. 3]

Section 104(c)(1)

This provision empowers the Commission to obtain information necessary to its mission from any department or agency of the United States. However, it would appear to require the disclosure of information subject to attorney-client or work product privileges. The Corporation recommends that language be added to protect any potential civil litigation privileges that may be applicable to the requested information. [See Appendix p. 4]

Pages 8-10, Sections 201-203, "Local Financial Crimes Strike Forces"

The FDIC defers to the Department of Justice with regard to any comments concerning these sections.

Page 11, Section 204(b), "Report of Apparent Crime"

While the FDIC supports this provision, we have several concerns with the way it has been drafted. First, this subsection refers only to priority in the investigation of matters referred by federal banking agencies, but not their prosecution. In our opinion, both investigation and prosecution of these matters should have a priority. Second, this subsection applies only to referrals from the agency which is the primary regulator of the financial institution involved. Thus, if the FDIC discovers an irregularity at a national bank or at a Federal Reserve member bank, the statute does not require that our referral to the Department of Justice be given priority. Also, referrals from the RTC are not included.

Moreover, this section ignores a very valuable source of referrals, the institutions themselves. Whenever the FDIC examiners uncover apparent fraud in an open and viable depository institution, the institution is required to file a Report of Apparent Crime. This serves several purposes. Primarily, it places responsibility for oversight of the activities of the institution where it belongs - with the institution's management. It also encourages the institution's management to take a strong stance against criminal activity, both with the institution's employees, as well as the public. These criminal referrals coming from viable institutions can serve as a valuable tool to early detection of bank fraud. Such referrals should be given as much consideration and priority as those made by the banking agencies. We therefore recommend that this section be amended to include any referral of criminal activity involving an insured depository institution, regardless of the source of the referral. Lastly, this subsection should apply to institutions and their affiliates. [See Appendix p. 5]

Page 12, Section 205, "Availability of Civil Money Penalties"

Section 205 amends Section 951 of FIRREA to provide for the disbursement of all civil money penalties collected under that Section to the Attorney General. It is the FDIC's position that the civil money penalties collected by the Attorney General for banking crimes affecting financial institutions should be used to reimburse the appropriate insurance fund (if the institution is in receivership or liquidation) or the institution itself (if it is not in receivership or liquidation). However, it is our opinion that the Department of Justice should be reimbursed from the collections for the costs of investigating and pursuing these actions. [See Appendix p. 6]

Pages 12-17, Section 206, "Administrative Subpoena Authority"

Section 206 permits the FBI to compel production of documents and other physical evidence before a grand jury is empaneled or without issuance of a grand jury subpoena which subjects the material to Rule 6(e) restrictions.

Because this section will allow materials collected by the FBI to be shared with regulatory agencies with a need for the information without conflict with Rule 6(e), we support it. However, we see one serious problem with the provision. To the extent that the materials sought by use of this administrative subpoena are customer records of a bank or S&L, customers will have to be notified of the subpoena pursuant to the Right To Financial Privacy Act. Obviously, this notice will alert them to the investigation.

In cases where the FBI wishes to subpoena information from an administrative agency, the FDIC is concerned that any potential civil litigation privileges that may be applicable be maintained. Thus, the Corporation recommends that this provision parallel the procedures currently in use for grand jury subpoenas. In those cases, the FBI is required to obtain the consent of the U.S. Attorney prior to issuing such a subpoena. This section should also explicitly provide that any potential civil litigation privileges would not be waived by providing the information. [See Appendix p. 7]

Page 17, Section 207, "Additional Resources"

The FDIC has no comment with regard to this section.

Pages 17-18, Section 208, "Interagency Coordination"

Section 208 specifically authorizes the agencies to provide and the Attorney General to accept the assistance of agency attorneys and investigative personnel to assist DOJ in the prosecution of crimes affecting savings associations.

In principle, we support this provision, although we see no real need for it. The Department of Justice already can reach the same result through designation of agency attorneys as Special Attorneys or Special Assistant U.S. Attorneys and designation of other agency employees as agents of a grand jury.

Pages 18-19, Section 209, "Savings Association Law Enforcement Improvement"

This section governs DOJ follow-up on criminal referrals and efforts to obtain restitution.

The FDIC believes that the language in subsection (a) is counter-productive. Instead of requiring that at least one half of the pending criminal referrals be addressed by a certain date, it would be more effective to require that DOJ initiate action on the most important cases. The recent Top 100 Criminal Referrals submitted by FDIC/OTS would be an excellent example.

In subsection (b) of Section 209, the Attorney General is required to take "appropriate action" to recover amounts lost as a result of fraud or embezzlement by any person from a savings association. The term "appropriate action" is undefined and hence vague. Does it mean opening an investigative file, obtaining an indictment, or securing a conviction? The term is also troubling in that it could be read to require control by the Attorney General of claims brought by the RTC or FDIC. If so, such a provision is contrary to the provisions found in Section 11(c)(2)(C) of the FDI Act.

We recommend that section 209 be redrafted to address the Top 100 Criminal Referrals and define what specific action is desired by Congress. The FDIC would be happy to assist in this effort, but did not attempt it due to the policy considerations involved. [See Appendix p. 8]

Pages 19-20, Section 210, "Appearance Before Congress"

The FDIC defers to the Department of Justice with regard to any comments concerning this section.

Pages 20-21, Section 301, "Subpoena Authority"

Section 301 of H.R. 5050 is drafted to give the RTC, as well as the FDIC, as conservator or receiver, the authority to issue subpoenas to gather information in determining claims and liquidating assets of failed financial institutions. The provision, with the minor amendments described below, will provide the RTC with a powerful tool in conducting closed institution investigations. However, the provision is problematic as it pertains to the FDIC, as receiver. The FDIC has authority to issue administrative subpoenas under Section 10(c) of the Federal Deposit Insurance Act. Thus, if Congress fails to pass Section 301, adverse parties may infer that the FDIC does not have authority under Section 10(c). Either the statute itself or the legislative history must make clear that this provision is only meant to expand RTC's authority and to clarify FDIC's existing authority. We propose the following explanatory language be added to the Committee Report:

> This provision clarifies existing subpoena powers conferred pursuant to 12 U.S.C. §1820(c) to both FDIC in its corporate capacity and as receiver or liquidator of failed financial institutions. Most courts have generally recognized FDIC subpoena powers in connection with its investigations of claims arising out of failed financial institutions. This provision only clarifies existing FDIC subpoena powers while expanding the authority to include the RTC and, with regard to any pending claims challenging the FDIC's authority to issue subpoenas under existing law, this provision will be completely neutral.

The recommended amendments conform the provision to the FDIC's authority under Section 10(c). As such, the term "subpoena" has been substituted for the word "summons" and the authority to issue the subpoenas can be appropriately delegated by the Board of Directors. The provision, as submitted, prevented delegation. The FDIC has long exercised its subpoena authority by delegation. To prevent delegation would cause an enormous and unnecessary burden on the already busy schedules of both the FDIC and RTC Boards and would be inconsistent with the existing FDI Act Section 10(c) authority. [See Appendix p. 9]

Pages 21-22, Section 302, "Access to IRS Records"

This section authorizes the FDIC and RTC to have access to income tax returns and return information in exercising their liquidation/conservatorship powers. We recommend that this section by expanded to include the administration of sections 7, 8, 11, 12, 13 and 18 of the Federal Deposit Insurance Act - the sections which authorize the FDIC to order restitution and reimbursement, and which grant the FDIC the authority to assess civil money penalties.

Since the FDIC, acting in its corporate capacity pursuant to its enforcement powers, can order restitution or reimbursement to an institution by an institution-affiliated party before the institution may be closed, access to income tax returns and return information could assist the agency in getting an "early start" in making restitution to the institution. This could lead to recovery while the institution is still viable, possibly preventing the closing of the institution. Currently, in the case of civil money penalties, the FDIC must expend valuable resources in collecting these penalties, with no tool available to determine what assets the individual might have. [See Appendix p. 10]

Pages 22-25, Section 303, "Foreign Investigations"

The FDIC believes that it is inappropriate for subsection (b) to mandate that the FDIC and RTC, as receiver and conservator, maintain permanent offices to coordinate foreign investigations and investigations on behalf of foreign banking authorities. As in the rest of this section, the agencies should be given the discretion to do these things if they feel such action is warranted, either on a temporary or permanent basis. [See Appendix p. 11]

Page 25, Section 304, "FDIC Corporate Powers"

This provision is intended to clarify existing authority of the FDIC. The FDIC considers this provision unnecessary.

Pages 25-27, Section 305, "Priority of Claims"

Section 305 of H.R. 5050 is drafted to give the FDIC and RTC priority over competing claims against former directors, officers, employees, accountants or other professionals formerly providing services to the failed institution.

in the FDI Act includes independent contractors, such as attorneys, appraisers and accountants, <u>only</u> if they have acted <u>knowingly or recklessly</u>, imposes a very high standard. This additional requirement for independent contractors, originally enacted in connection with the enhanced enforcement powers conferred by FIRREA on the regulatory agencies, is illogical in the context of the priority proposal. This higher standard is appropriate in enforcement proceedings where the subject of those proceedings may lose his/her job or be banned from the industry. However, it is not appropriate in this context where the FDIC and RTC will be attempting to collect on a debt. Therefore, we have substituted the newly defined term "institution-related party." We also have extended the use of the priority beyond execution of judgment to include <u>satisfaction</u> of any judgment.

New language concerning an exception to the priority rule also has been added to Section 305. This new language adds to a general exception for claims by other Federal agencies and the United States, by including "any Federal Reserve Bank or Federal Home Loan Bank". This language is unnecessary since any claims by the Federal Reserve or Federal Home Loan Banks are normally secured. To clarify and narrow this exception, we have substituted the phrase "except for any claim of any federal agency under Section 6321 of the Internal Revenue Code of 1986 or Section 3713 of Title 31, United States Code", which was included in an earlier version of this bill, to protect government liens for unpaid taxes and other government claims for indebtedness.

Since this proposal calls for prospective application only, clarifying language must be added to the legislative history to avoid the unnecessary implication, should this proposal fail to be enacted, that the FDIC is not entitled to a priority under case law in some jurisdictions.

The following clarification is suggested for insertion in the legislative history:

> This provision would provide a priority for the FDIC over certain competing claims against directors, officers, accountants, attorneys and other parties. Several trial courts previously recognized this priority while others did not. Most recently a federal appeals court reversed a district court order which had recognized the priority as to claims against third parties which are filed after enactment. With regard to pending claims, the provision will be completely neutral. That is, it should neither support nor under cut any party's position with regard to whether the FDIC is already entitled to a priority under existing law.

[See Appendix p. 12]

Pages 27-29, Section 306, "Fraudulent Conveyances"

Section 306 provides the FDIC with the ability to avoid fraudulent transfers of assets by institution-related parties and debtors, if the transfers were made within 5 years of the appointment of the receiver. Current law is limited to fraud against the depository institution. This provision will be a welcome tool in the FDIC's continuing fight to combat financial institution fraud. However, we have three suggestions which would strengthen Section 306.

The Corporation's first suggested revision is to Section (17)(A)(1) and provides that attempts to defraud the Corporation or other federal banking agencies will result in an avoidable transfer. The current provision is limited to fraud against the depository institution.

Our second amendment adds Sections (17)(A)(1) through 2(B)(iii) and recognizes that fraud can be both actual, as set forth in subpart (A)(1), and constructive, as set forth in subpart (A)(2). This provision is drawn from the Bankruptcy Code and allows the FDIC to avoid transfers based on both actual and constructive fraud.

The third amendment is found at (17)(D). This subsection provides that the rights of the Corporation take precedence over the rights of a trustee in bankruptcy. Without this provision, if a debtor or an institution-related party filed bankruptcy, he or she would be able to argue that Section 306 was superseded by the bankruptcy code. Such an argument would render Section 306 virtually meaningless. [See Appendix p. 13]

Pages 29-31, Section 307, "Prejudgment Attachments"

Proposed new paragraph 18 amends Section 11(d) of the Act (12 U.S.C. § 1821(d)) to provide generally for prejudgment attachment of the assets of any person obligated to failed insured depository institutions. The FDIC's recommended language clarifies the ability of the FDIC to request a prejudgment attachment in connection with any of the powers conferred on it as a receiver or liquidator by Sections 11, 12 and 13 of the Act, and deletes what appears to be an unnecessary "willfulness" requirement if the term "institution-affiliated party" is used instead of "institution-related party." (As discussed earlier on page 1 hereof.)

With regard to paragraph 4 of subsection (b) on page 30, if pre-judgment attachment is limited only to section 8(i) offenses, the FDIC will lose a valuable tool in conserving assets in a restitution/reimbursement action. Thus, we also recommend that this section be changed to encompass actions under all of Section 8, as well as Sections 7 and 18 of the FDI Act.

Additionally, in the portion of this proposed legislation which proposes to amend section 8(i) of the Act, the term "court" is not defined. Since 8(i) deals with administrative hearings, it seems that perhaps the best way to accomplish this process is to require that application be made in federal court while the administrative action is pending. Section 8(h) of the FDI Act deals with hearings and judicial review. We therefore propose that this provision be added to section 8(h) of the Act, and expanded to include all civil money penalties issued by the appropriate Federal banking agency, as well as restitution/reimbursement actions.

The Corporation also recommends that the power to utilize such attachments be expanded to include situations where the FDIC can demonstrate that fraud has occurred. This would parallel at least one favorable court decision obtained in the Fifth Circuit. [See Appendix p. 14]

<u>Pages 31-32, Section 308, "Concealment of Assets"</u>

This provision should be amended to include the FDIC and RTC in their corporate capacities since certain claims are sometimes transferred to the agencies to be pursued in their corporate capacity as opposed to as receiver or conservator. [See Appendix p. 15]

<u>Pages 32-33, Section 309, "Mandatory Education for Directors"</u>

We commend this proposed change to the FDI Act. It has long been the position of the FDIC that many banking law violations are directly attributable to improper education or lack of education of officers and directors of insured depository institutions. The only change we would offer here is to require completion every 5 years. For small institutions with limited staffs, comprehensive training may lead to staffing shortages while such training is going on. By increasing the time to five years, this allows for a greater "spread" time for employees to attend training. [See Appendix p. 16]

<u>Pages 33-34, Section 310, "Grand Jury Secrecy"</u>

Section 310 would permit a court, on application of the Attorney General, to disclose Grand Jury materials gathered during an investigation of a banking law violation to personnel of a financial institution regulatory agency for general use in matters within the agency's jurisdiction. Disclosure may be made on a showing of substantial need.

We support this provision since it will simplify the process and procedures for the regulatory agencies to obtain grand jury materials for use in their own actions. This will increase the efficiency of the government's efforts to combat and punish fraud and recover assets taken by fraud through the elimination of the substantial duplication of investigative efforts caused by current Rule 6(e) restrictions and procedures. However, the FDIC believes that the standard used should be "relevancy" as opposed to a "substantial need." [See Appendix p. 17]

<u>Page 34, Section 311, "Restitution in Certain Fraud Cases"</u>

This section attempts to offset the adverse consequences of the recent <u>Hughey</u> decision issued by the U.S. Supreme Court. That decision held that convicted defendants can only be required to pay restitution for losses directly tied to counts which they plead guilty to or for which they are found guilty by a judge or jury.

The FDIC fully supports the intent of section 311 but believes that it could be drafted more clearly. In addition, this section should be expanded to include administrative proceedings undertaken for enforcement purposes. [See Appendix p. 18]

<u>Pages 34-35, Section 312, "Civil Forfeiture"</u>

This section would: 1) make the proceeds of the new offense found in Section 308 of concealing assets from the FDIC or RTC subject to forfeiture; 2) permit the Attorney General, in addition to the Secretary of the Treasury, to seize forfeitable proceeds derived from offenses affecting financial institutions; and 3) allow the forfeited assets to be given to the appropriate regulatory agency, the appropriate insurance fund or the affected financial institution without regard to the distinction, found in current law, as to whether the institution is open or closed.

Since we support enactment of the new proscription against concealment, we support the first objective. We also support the other two since each adds flexibility to the forfeiture process.

Pages [illegible], Section [illegible], [illegible]

In keeping with the amendments proposed in section 205 of this legislation which allow the Attorney General to retain civil money penalties assessed and collected by him for purposes of defraying expenses in enforcing certain provisions of law, we recommend that all civil money penalties collected by the FDIC be retained by the FDIC and covered into the appropriate insurance fund, to help defray the expenses of the costs to the funds incurred by administration of enforcement activity, as well as receiverships, and liquidations. The other Federal banking agencies, notably the OTS, should also be allowed to use any such funds collected to defray the costs of administration of all enforcement activities. [See Appendix p. 19]

Pages 37-38, Section 314, "Breach of Fiduciary Duties"

Section 523(a)(4) of the Bankruptcy Code provides that a debt based upon "fraud or defalcation while acting in a fiduciary capacity" is not dischargeable. In the past, the FDIC has had difficulty convincing Bankruptcy Courts that a breach of fiduciary duty by directors, officers, controlling persons, and affiliated parties of a failed insured depository institution constitutes a "defalcation" within the meaning of Section 523(a)(4). This proposed Section 314 would make it clear that a breach of fiduciary duty by any one of these individuals constitutes a "defalcation."

However, this section would make any judgment owed by a director, officer or controlling person based upon a breach of fiduciary duty owed to the institution, no matter who the debt is owed to, (e.g., to a borrower) not dischargeable. If it is the committee's intent to enhance the recovery to taxpayers, it should be limited in scope to debts owed to the FDIC, RTC or other financial regulatory agencies. [See Appendix p. 20]

Pages 38-43, Section 315, "Technical Amendments to Title 18"

The FDIC has no comments on this Section.

Page 43, Section 316, "Wiretap Authority for Bank Fraud"

This Section would give the Attorney General authority, not contained in present law, to apply for a court order permitting wiretaps in connection with investigations of 18 U.S.C. §§215 (bribery of bank officials), 1014 (false statements on loan applications), 1343 (presently wire fraud, to be amended as fraud by use of facility of interstate commerce) and 1344 (bank fraud).

Presumably the inclusions of these financial institution related offenses in the wiretap predicates is intended to underscore the fact that Congress takes a serious view of fraud as it affects our insured financial institutions. However, comment on the wisdom of this approach and the choice of statutory provisions is best left to the Department of Justice.

Pages 43-44, Section 317, "Whistleblower Protection"

The FDIC has no comment with regard to this section.

Pages 44-49, Section 318, "Golden Parachutes"

The FDIC strongly supports this section of the proposed legislation. We recommend several minor drafting changes on pages 47 and 49. The FDIC also recommends the deletion of subparagraph 3(D)(iii), since that language unintentionally limits subparagraph 3(D)(i). [See Appendix p. 21]

Page 49, New Section 319, "Clarification of FDIC Authority"

This is a proposed new section that is needed to cure a major problem that the FDIC is currently facing.

The FSLIC Resolution Fund provisions, as currently codified, create two basic problems:

1. The Corporation, in managing the FRF, is not explicitly given any of its normal powers under Sections 9, 11, 12, 13 or 15 of the FDI Act.

2. Nowhere in FIRREA is the Corporation explicitly appointed receiver for savings and loan associations that failed prior to January 1, 1989.

These two problems have been exhibited in many different ways. When the FDIC, as receiver for pre-January 1, 1989 receiverships, has brought suit to collect on notes, litigants have argued that the FDIC is not the receiver for these institutions. They have alternatively argued that even if the FDIC is receiver, it has none of its receivership powers under Section 11 of the FDI Act. Similarly, certain title insurance companies have refused to issue title insurance to FDIC as receiver, arguing that they cannot find any reference to these pre-January 1, 1989 receiverships in FIRREA. Similar problems exist when the FDIC has attempted to collect on assets that are in the FRF.

In crafting a legislative clarification to correct these problems, it is important to maintain the distinction between FRF assets and liabilities and the assets and liabilities of each of the pre-January 1, 1989 receiverships. The FSLIC Resolution Fund is only composed of those assets and liabilities that belonged to FSLIC in its corporate capacity (i.e., those assets that the FSLIC corporate purchased as part of its S&L assistance agreements). The pre-January 1, 1989 receivership estates each have their own assets and liabilities. Any receivership liability can only be paid from the liquidation of that failed institution's assets. If this distinction were to be blurred, the FRF could become responsible for these receivership liabilities.

To correct the existing problems we need the two provisions set forth in the Appendix hereto. However, the more important of the two provisions is subsection (9). [See Appendix p. 22]

<u>Pages 49-54, Title IV, "Taxpayer Recovery Act"</u>

In general, the "Taxpayer Recovery Act" found at page 49 of H.R. 5050 contains proposed amendments to the Bankruptcy Code which would enhance the FDIC's ability to recover funds from individuals who have defrauded federally insured financial institutions. These individuals often file personal bankruptcy proceedings to discharge judgments or debts for damages based upon fraudulent, wrongful (and in some instances criminal) conduct. Although the FDIC has actively attempted to prevent this, the Bankruptcy Code and case law interpreting it often make it difficult for the FDIC to prevent these individuals from avoiding these debts.

The FDIC supports the Taxpayer Recovery Act, and suggests that a few changes be made in order to clarify and/or ensure that all of the enhancements would apply to the FDIC and RTC in their corporate, conservatorship and receivership capacities. These suggested changes are to Sections 403 and 404 (b) of the Bill.

<u>Section 401</u>: This section gives Section 401 of H.R. 5050 the short title "Taxpayer Recovery Act of 1990."

<u>Section 402</u>: This section of the bill would add two new subsections to 11 U.S.C. 523 (a).

<u>Section 402 (3), page 49, line 23 -</u>

This section adds new subsection (a)(11) to Section 523 of the Bankruptcy Code. Section 523 (a) (11) would make it clear that a judgment for criminal restitution (that arose out of an act that caused loss to an insured depository institution) is not dischargeable. In <u>Davenport v. Pennsylvania</u>, (decided June,

1990) the Supreme Court has stated that criminal restitution is dischargeable in a Chapter 13 Plan under Section 1328 (a) of the Bankruptcy Code. New Section 523 (a) (11) would close this "loophole."

Section 402 (3), page 50, line 5 -

This section adds new subsection (a) (12) to Section 523 of the Bankruptcy Code. New section 523 (a) (12) provides that any judgment, order or consent decree entered by any court or any settlement agreement that obligates the debtor to pay damages, a penalty, fine, forfeiture, restitution, reimbursement, indemnification, or guarantee against loss, or for acts involving actual fraud or defalcation by a fiduciary with respect to an insured depository institution is not dischargeable. The FDIC sues many officers, directors, and controlling persons who caused losses to insured financial institutions. Although the FDIC has been successful in recovering large judgments for damages against these individuals, these individuals often use the bankruptcy system to escape paying these judgments. The FDIC has had considerable difficulty convincing the Bankruptcy Courts to find that these judgments fit into the debts currently listed in 523 (a) as nondischargeable.

The addition of 523 (a) (12) will eliminate these problems. First, 523 (a) (12) adds a specific category for the judgments obtained by the FDIC against these individuals. In addition, since 523 (a) (12) specifically provides that a judgment, order or consent decree is not dischargeable, this Section will eliminate the need for the FDIC to relitigate these cases in the bankruptcy courts.

In addition, this section would make enforcement penalties and other debts owed to the FDIC nondischargeable.

Section 403, page 50, line 15 -

This section adds new subsection (e) to section 523 of the Bankruptcy Code. Currently, section 523 (a) (4) of the Bankruptcy Code provides that an individual's debt for damages due to "fraud or defalcation while acting in a fiduciary capacity" is excepted from discharge. In the past, the FDIC has had difficulty utilizing this section since Bankruptcy Courts look to state law to determine who is a "fiduciary," and state law often does not define "fiduciary" to include the directors, officers or other affiliated parties in control of an insured depository institution. New section 523 (e) states that these individuals "shall be considered to be acting in a fiduciary capacity with respect to the purposes of" 523 (a) (4).

Section 403, page 50, line 23 -

This section adds new subsection (f) to section 523 of the Bankruptcy Code. Currently, section 523 (a) (2) (A) excepts a debt from discharge if it is a debt for money or property procured through fraud or false pretenses. Section 523 (a) (2) (B) excepts a debt from discharge if it is a debt for money or property that was acquired through the use of a false financial statement. Pursuant to 523 (a) (2) (A), in order for a creditor to prevail, it must prove that it relied upon the false representation made by the debtor. Pursuant to 523 (a)(2)(B)(iii), a creditor must show that it reasonably relied upon the false financial statement in order to block the discharge of a debt procured through the use of a false financial statement. The FDIC often has difficulty fulfilling the "reliance" element of proof, since many times an officer or director of the failed institution did not rely on the false statement or false financial statement in making the loan (ie: where the borrower participated in a scheme with bank officers designed to defraud the bank). This new subsection would make it clear that the FDIC need not prove that it or the failed institution relied on a false statement or false financial statement in order for a bankruptcy court to find these types of debts, when owed to the FDIC, are not dischargeable.

Section 403, page 51, line 5 -

This section would add new subsection (g) to Section 523 (a) of the Bankruptcy Code. Current Section 523 (c) puts the burden an objecting creditor to file a complaint to determine the dischargeability of a debt of the type listed in Sections 523 (a) (2), (4) or (6). If a creditor fails to so file within the time constraints imposed by the court (usually within 60 days from the first meeting of creditors, unless extended by the court), the debt is discharged. Therefore, creditors who maintain that a debtor owes them money or property procured through fraud, the use of a false financial statement, fraud by a fiduciary, or willful and malicious injury have the burden of establishing that the debt is not dischargeable.

This amendment would greatly assist the FDIC in its attempts to recover funds from individuals who have defrauded insured depository institutions, since, the FDIC often finds it difficult or impossible to comply with the 60 day deadline set by the bankruptcy court to object to the discharge of debts. Often, the FDIC does not complete the investigation of the individuals who were involved in wrongdoing at the failed institution within 60 days of the takeover of an institution. If the debtor filed his or her bankruptcy proceeding just before or just after the FDIC seized control of the failed financial institution (which is often the case), the FDIC will not discover the identity of the wrongdoing debtor or the transactions that the debtor was involved in prior to the expiration of the 60 day deadline.

This amendment would give the FDIC 120 days from the date of the debtor's first meeting of creditors, or 120 days from the date of the appointment of a conservator or receiver of a failed financial institution (whichever is longer) to file an objection to the discharge of a particular debt of the debtor. In RTC purchase and assumption transactions, many loans are transferred from a receiver to an acquiror and then can be "put" back to RTC Corporate (pursuant to the purchase and assumption agreements). Therefore, the RTC would like to see an amendment to this section which would provide that the 120 days will run from the date of the appointment of the conservator or receiver, the date of the debtor's first meeting of creditors, or the date of the "put" to RTC Corporate (whichever is longer). In order to provide some finality to this extension of time, subsection (g)(2) provides that in no event will the FDIC have beyond the period of limitations provided Section 11(d)(14) of the FDIA to file this Complaint.

Please note that the reference on line 25 to Section 11 (d)(4) of the FDIA is incorrect. The appropriate citation to the federal statute of limitations applicable to the FDIC is found in Section 11 (d)(14) of the FDIA.

<u>Section 403, page 52, line 1 -</u>

This section adds a new subsection (h) to Section 523 (a) of the Bankruptcy Code, which contains definitions applicable to the amendments discussed above. Subsection (h)(3), on line 10, defines "appropriate Federal financial agency" by reference to 12 U.S.C. 1818 (e)(7)(D). This definition is insufficient because it does not include the Resolution Trust Corporation. Specifically, 12 U.S.C. 1818 (e)(7)(D) defines "appropriate Federal financial institutions regulatory agency" to include "the appropriate Federal Banking agency, in the case of an insured depository institution" (see Section 1818 (e)(7)(D)(i)). Section 1813 (q) defines "appropriate Federal banking agency" to include the Comptroller of the Currency, the Board of Governors of the Federal Reserve, the FDIC and the OTS. Since the RTC is not a regulatory agency, however, it is not included within the definition of "appropriate Federal financial agency." [See Appendix p. 23]

Also, due to the wording of this definition, it may be interpreted to apply only to the "appropriate Federal financial agency" in its corporate capacity. Since many objections to the dischargeability of debts are asserted by conservators or receivers, this definition should be expanded to include them.

Section 404 (a), page 52, line 25 -

This section amends section 1328 (a) of the Bankruptcy Code. Currently, criminal restitution and debts owed to the FDIC for money or property procured through fraud are dischargeable in a Chapter 13 plan under Section 1328 (a). The amendments to Section 1328 (a) provide that these debts owed to the FDIC would not be dischargeable.

Section 404 (b), Page 53, line 14 -

This section would amend Section 522 (c) of the Bankruptcy Code to allow the FDIC to invade the exempt property of a debtor in order to satisfy a judgment that the Bankruptcy Court has determined is not dischargeable under Section 523 (a) (2), (4), (6), (11), or (12). This amendment also uses the term "appropriate Federal financial institutions regulatory agency" and defines that term by referencing 12 U.S.C. 1818 (e)(7)(D). As discussed above, this would not include the RTC. [See Appendix p. 23]

FDIC & RTC COMMENTS ON H.R. 5050

APPENDIX

Page 2, Section 2, Definition of "Appropriate Federal Banking Agency"

(2) **APPROPRIATE FEDERAL BANKING AGENCY.**--The term "appropriate federal banking agency" has the meaning given to such term in section 3(q) of the Federal Deposit Insurance Act. It shall also include the Resolution Trust Corporation, and shall include all such agencies whether acting in their corporate capacity or as receiver or conservator.

Page 2, Section 2, "Definitions"

On page 2, line 15, insert the following new subsection (3):

A new section 3(y) shall be added to The Federal Deposit Insurance Act, 12 U.S.C. 1813(y), as follows:

(y) INSTITUTION-RELATED PARTY.-- The term "institution-related party" shall mean any insured depository institution's director, officer, employee, agent, attorney, accountant, appraiser or any other party employed by or providing services to an insured depository institution.

Page 3, Section 103(a)(1), "Commission on Financial Crimes"

On page 3, line 18, add the following new sentence at the end of subsection (a)(1):

At least one of the officers or employees of the United States so appointed shall be employed by either the FDIC, RTC, OCC, Federal Reserve Board, or the OTS at the time of appointment.

On page 4, line 5, add the following new subsection and renumber the subsequent paragraphs accordingly:

(b) DISCLOSURE OF INFORMATION FROM A BANK EXAMINATION REPORT.-- Any member or employee of the Commission with access to a depository institution's examination report, or material derived therefrom, who discloses the names of borrowers or the collateral for loans of any member bank of the Federal Reserve System, or depository institution insured by the Federal Deposit Insurance Corporation, without first having obtained the express permission in writing from the Comptroller of the Currency as to a national bank, the Board of Governors of the Federal Reserve System as to a State member bank, the Office of Thrift Supervision as to a savings association, or the Federal Deposit Insurance Corporation as to any other insured depository institution, or from the board of directors of such depository institution, except when ordered to do so by a court of competent jurisdiction, or by the direction of the Congress of the United States, or either House thereof, or any committee of Congress or either House duly authorized, shall be fined not more than $5,000 or imprisoned not more than one year or both.

Page 6, Section 104(c)(1), "Powers of Commission"

On page 6, line 14, delete subsection (2) and insert the following new subsection:

(2) PROCEDURE.-- Upon request of the Chairperson of the Commission, the head of that department or agency may furnish the information requested to the Commission on such terms and conditions necessary to preserve otherwise applicable privileges. The furnishing of information requested by the Commission pursuant to this section shall not constitute a waiver of any otherwise applicable privilege.

Page 11, Section 204(b), "Priority for Financial Crime Referrals"

On page 11, beginning on line 15, delete subsection (b)(1) and insert the following:

(1) IN GENERAL.-- The Attorney General shall prescribe by a regulation that the investigation and prosecution of any referral from the FDIC, RTC, Office of the Comptroller of the Currency, Office of Thrift Supervision, the Board of Governors of the Federal Reserve System or the insured depository institution relating to any financial crime involving any insured depository institution in default or in danger of default or any troubled institution or any affiliate of any such institution shall be given priority in case management.

Page 12, Section 205, "Civil Money Penalties"

On page 12, line 8, delete subsection (g) and insert the following new subsection:

(g) DISBURSEMENT - - Penalties collected under authority of this section shall be paid to:

(1) The Federal Deposit Insurance Corporation or the Resolution Trust Corporation, as appropriate, when the conduct which gave rise to the penalty caused a loss to an insured financial institution, if the affected financial institution is in receivership or liquidation - -

(A) to reimburse the agency for payments to claimants or creditors of the institution; and

(B) to reimburse the insurance fund of the agency for losses suffered by the fund as a result of the receivership or liquidation.

(2) To the financial institution, if it is not in receivership or liquidation, as restitution, upon the order of the appropriate Federal financial institution regulatory agency.

(h) The Department of Justice shall be entitled to recover its reasonable costs of investigating and prosecuting such action under Section 951 from any such penalty before the penalty is paid to such agency.

(i) If no loss to an insured financial institution can be established that was caused by the conduct which gave rise to the action under Section 951, any penalty shall be paid to the Treasury. However, any Federal financial institution regulatory agency which provided assistance in the investigation or prosecution of any such action shall be entitled to reimbursement of the reasonable expenses of such assistance from any such penalty.

Page 16, Section 206, "Administrative Subpoena Authority"

On page 16, line 22, add the following new subsection (g):

With regard to subpoenas to be served upon administrative agencies, the FBI shall obtain the consent of the appropriate United States Attorney prior to issuing such a subpoena. The provision of any requested information by any federal agency shall not waive any applicable privileges that could be otherwise asserted in any pending or future civil litigation.

Page 19, Section 209, "Savings Association Law Enforcement"

On page 19, line 10, delete all of subsection (b).

Pages 20-21, Section 301, "Subpoena Authority"

On page 20, line 11, insert the words "CLARIFICATION OF" before the word "SUBPOENA."

On page 20, line 17, delete the word "SUMMONS" and insert in its place the word "SUBPOENA."

On page 20, line 19, delete the word "or", insert a comma after the word "conservator" and insert the words "or exclusive manager" after the word "receiver"

On page 20, line 21, delete the word "the" and insert in its place the word "an"

On page 21, line 6, delete the words "LIMITED TO" and insert the word "OF" in their place.

On page 21, line 7, delete the word "summons" and insert the words "subpoena or subpoena duces tecum" in its place.

On page 21, line 9, insert the words "or their designees" after the word "Directors", and delete the word "summons" and insert the words "subpoena or subpoena duces tecum" in its place.

On page 21, line 13, insert the words "or their designees)." after the word "Corporation", and delete the remainder of that sentence.

On page 21, line 16, add a new subsection (iii) as follows:

(iii) RULE OF CONSTRUCTION.-- This subsection shall not be construed as limiting any rights that the Corporation, in any capacity, might otherwise have under Section 10(c) of this Act.

Pages 21-22, Section 302, "Access to IRS Records"

On page 22, line 6, delete the words "section 11" and insert instead "sections 7, 8, 11, 12, 13 and 18"

Pages 22-25, Section 303, "Foreign Investigations"

On page 25, line 5 insert the following language in place of the existing provision:

(2) may each maintain an office on a temporary or permanent basis to coordinate foreign investigations or investigations on behalf of foreign banking authorities.

Pages 25-26, Section 305, "Priority of Certain Claims"

On page 26, line 1, delete the word "affiliated" and insert the word "related"

On page 26, line 8, delete the words "the United States, or any Federal Reserve bank or Federal home loan bank" and insert the words "under Section 6321 of the Internal Revenue Code of 1986 or Section 3713 of Title 31, United States Code."

On page 26, line 11, insert the words "and satisfaction" after the word "execution"

Pages 27-29, Section 306, "Fraudulent Conveyances"

On page 28, line 3, delete the word "affiliated" and insert in its place the word "related"

On page 28, line 9, after the word "involuntarily" insert a dash, delete the remainder of that sentence and add the following:

(1) made such transfer or incurred such liability with actual intent to hinder, delay, or defraud the insured depository institution, the Corporation or any appropriate Federal banking agency; or

(2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(B)(i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(ii) was engaged in business or a transaction or was about to engage in business or a transaction, for which any property remaining with the institution-related party or debtor was unreasonably small capital; or

(iii) intended to incur, or believed that the institution-related party or debtor would incur, debts that would be beyond the institution-related party's or debtor's ability to pay as such debts matured.

On page 29, line 8, insert the following new subsection:

(D) RIGHTS UNDER THIS SECTION.-- The rights of the Corporation under this section shall be superior to any rights of a trustee or any other party under Title 11.

Pages 29-31, Section 307, "Prejudgment Attachments"

On page 29, lines 16-17, delete the words "(in the Corporation's capacity as conservator or receiver for any insured depository institution)," and insert the words "in connection with exercising the powers conferred by this section and Sections 12 and 13 of the Act,"

On page 29, line 23, delete the words "affiliated" and insert the word "related"

On page 29, line 23, insert the words "or may be" after the word "is"

On page 30, line 7, insert the words "or that the Federal banking agency can demonstrate that a fraud has occurred" after the word "appointed."

On page 30, line 9, delete the words "Section 8(i)" and insert instead "Section 8(h)"

On page 30, line 10, delete the words "(12 U.S.C. 1818(i))" and insert instead "(12 U.S.C. 1818(h))"

On page 30, line 14, delete the words "paragraph (1), the court may," and insert instead "this section, or section 7 or 18 of this Act"

On page 30, line 15, insert after "agency" the following:

"to the United States district court, or the United States court of any territory, within the jurisdiction of which the home office of the depository institution is located, the court may"

Pages 31-32, Section 308, "Concealment of Assets"

On page 32, line 3, insert the words "Corporations or" after the word "from"

On page 32, line 7, insert the word "corporate" after the word "corporation's" and insert the word "or" after the word "capacity."

On page 32, line 10, insert the words "or in its corporate capacity" after the word "receiver"

Pages 32-33, Section 309, "Mandatory Education"

On page 33, line 8, delete the word "3" and insert the word "5"

Page 34, Section 310, "Grand Jury Secrecy"

On page 34, line 3, delete the words "a substantial need" and insert the word "relevancy."

Page 34, Section 311, "Ability to Order Restitution"

On page 34, line 11, delete the entire section and insert a new section as follows:

When the FDIC, RTC, OCC, OTS or the Board of Governors of the Federal Reserve Syustem is the victim of a federal offense listed in title 18 of the U.S. Code, restitution may be ordered beyond those counts of an indictment or information which form the basis of a guilty plea or verdict. Restitution to an open institution may also be ordered on a similar basis in administrative proceedings designed to protect the safety and soundness of that institution.

Pages 35-37, Section 313, "Civil Penalties"

On page 35, delete lines 18-21 and insert instead "deleting 'deposited in the Treasury' and inserting instead 'paid to the appropriate Federal banking agency.'"

On pages 35-36, delete lines 24-25 and lines 1-2, and insert instead "deleting 'deposited in the Treasury' and inserting instead 'paid to the appropriate Federal banking agency.'"

On page 36, delete lines 5-8, and insert instead "deleting 'deposited in the Treasury' and inserting instead 'paid to the appropriate Federal banking agency.'"

Pages 37-38, Section 314, "Breach of Fiduciary Duties"

On page 38, line 4, delete the word "affiliated" and insert the word "related"

Page 47, Section 318, "Golden Parachutes"

On page 47, line 5, insert a comma after the word "action" and delete the word "or."'

On page 48, line 6, insert the word "and" after the semi-colon.

On page 48, beginning on line 10, delete the words "in the account" after the word "segregated"

On page 48, beginning on line 18, delete all of subsection (iii)

On page 49, beginning on line 8, insert a semi-colon after the word "policy", delete the remainder of that section and insert the following language:

however, any such commercial insurance policy is expressly prohibited from covering any liability or legal expense of the institution which is described in paragraph (3)(B)(ii).

Page 49, Section 319, "Clarification of FDIC Authority"

On page 49, line 11, add the following new section:

Section 319 -- CLARIFICATION OF FDIC AUTHORITY

Section 11(a) of the Federal Deposit Insurance Act (12 U.S.C. § 1821(a)) is amended by inserting after subsection (7) the following new subsections:

"(8) Use of FDIC Powers. -- As of August 10, 1989, the Corporation shall have the same rights, powers and authorities to carry out its duties with respect to the assets and liabilities of the FSLIC Resolution Fund as the Corporation has under sections 9, 11, 12, 13 and 15 with respect to insured depository institutions."

"(9) Corporation as Receiver. -- As of August 10, 1989, the Corporation shall succeed the Federal Savings and Loan Insurance Corporation as conservator or receiver with respect to any institution for which the Federal Savings and Loan Insurance Corporation was appointed conservator or receiver on or before December 31, 1988. When acting as such conservator or receiver, the Corporation shall have all of the rights, powers and authorities as the Corporation has as a conservator or receiver under this Act.

Page 52, Section 403, "Definitions, etc."

On page 52, line 13, insert the following words after the word "Act":

and shall also include the Resolution Trust Corporation, and shall refer to each agency whether it be acting in its capacity as conservator or receiver or in its corporate capacity.

On page 53, line 23, delete the words "8(e)(7)(D) of the Federal Deposit Insurance Act) or a conservator or receiver of an insured depository institution (as defined in section 3(c)(2) of the Federal Deposit Insurance Act)" and insert the words "(as defined in Section 523(h)(3) of this Title)"