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THE UNITED STATES NATIONAL BANK RECEIVERSHIP

Statement of the

Comptroller of the Currency

James E. Smith

before the

Subcommittee on Bank Supervision and Insurance
House of Representatives

November 27, 1973

I was sworn in as Comptroller of the Currency on July 5, 1973. The most immediate and serious problem awaiting me was that of United States National Bank, San Diego, California. Some indications of that bank's difficulties were:

-- our most recent examination of that bank showed criticized assets of almost $300 million.

-- on May 24, 1973, the Comptroller's Office had issued a Cease and Desist Order which severely curtailed the lending activities of the bank and which called for the removal of the bank's chairman of the board and principal shareholder, Mr. C. Arnholt Smith.

-- on May 31, 1973, the Securities and Exchange Commission had filed a lawsuit which strongly implied that Mr. C. Arnholt Smith and his companies had misused approximately $50 million of the bank's assets.

-- in June 1973, the bank had lost $100 million in deposits.

On July 18, 1973, the president of the Federal Reserve Bank of San Francisco and our Regional Administrator of National Banks met with me in my Office to discuss the United States National Bank situation. From then until the bank was closed on October 18, 1973, I personally spent over half of my time with the rescue effort for United States National Bank.

Our first concern, of course, was to protect the depositors and other creditors. I did not, before October 18, 1973, spend much time attempting to discover how this situation had come about. I was concentrating instead on the salvage operation.

Since October 18, I have begun a thorough review of the history of our regulation of this bank. That review has not yet been completed. I thus am unable now to give this Committee a complete history of United States National Bank, or any precise recommendations for corrective action. I will, however, be glad to discuss with the Committee the information that is available to me and my tentative conclusions.

FACTS RELATING TO UNITED STATES NATIONAL BANK

1. C. Arnholt Smith acquired USNB in the early 1930s. Before that he was a respected officer with Bank of America. USNB then had deposits of approximately $1.8 million. Under Mr. Smith's leadership, USNB grew to a billion dollar institution. Mr. Smith's reputation with the Comptroller's Office was generally good. So far as I now know, he had always taken care of any problems arising in his bank when asked to do so by the Comptroller's Office.

2. On June 26, 1972, a routine examination of USNB was begun under the supervision of National Bank Examiner William E. Martin. An unusual problem was discovered in connection with a loan by the bank to a subsidiary of Westgate California Corporation. Westgate California Corporation was a conglomerate of which Mr. C. Arnholt Smith was president and chairman of the board. Its subsidiaries included tuna canning plants,

an airline, a hotel, and a Yellow Cab company. In reviewing the loans to one of the Westgate subsidiaries, our examiner noticed that several million dollars in acceptances due to the bank recently had matured and been paid off by a company whose current financial statement showed no liquid assets out of which these payments could have been made. Inquiry established that the funds had come from another, apparently unrelated company, which recently had borrowed several million dollars on the strength of a USNB letter of credit. Further inquiry showed that the total loans by USNB to subsidiaries of Westgate California Corporation were $20 million more than the borrowings from banks reported on Westgate's consolidated financial statement. These unexplained transactions, among others, gave our examiners reason to distrust the records of the bank relating to loans to the subsidiaries of Westgate California Corporation, and our examination team began independent verification of the use of loan proceeds. This verification called into question not only loans to subsidiaries of Westgate, but also loans to British Columbia Investment Company and its subsidiaries and affiliates.

The examiner's verification showed that the proceeds of many loans were not used for the purposes stated in the bank's credit files. Through an often complex web of simultaneous transactions involving several companies, the funds loaned to one company were ultimately

being used to pay off the maturing debt of another company. The examiner concluded that the $112 million in credit extended to the subsidiaries of Westgate California Corporation were being used interchangeably among these companies, and thus should be combined for purposes of the lending limits established in the National Bank Act. When so combined, these credits exceeded the limit by $95 million. Similarly, the $142 million credit extended to BCIC and its affiliates, when combined, exceeded these lending limits by $138 million.

3. At the conclusion of the examination, on September 12, 1972, the examiner and our Regional Administrator, Mr. Larsen, met with the board of directors of the bank. The board was told that the communal use of loan funds and the inaccuracy of bank records involving these loans, including occasions when funds were deposited directly to accounts other than the borrowers', represented deceptive and improper use of bank records that could be construed as criminal violations. The board was also informed of the inaccuracies and inadequate financial statements of many of the Westgate and BCIC borrowers, as well as many deficiencies in the collateral for these loans. The board was warned that, because of these factors, the examiner had critized the creditworthiness of loans totalling 370 percent of the bank's capital. The board was also informed that the bank's contingent liabilities on letters of credit could create a severe liquidity crisis

for the bank. Except for President Smith and Executive Vice President Richard Woltman, the board members said little during this meeting. Mr. Smith promised full correction of the matters criticized in the examination report.

Following the board meeting of September 12, 1972, Mr. Martin's report of his examination was typed in our regional office. On September 28, 1972, the bank was sent a copy of that report, together with a letter from Regional Administrator Larsen reiterating many of the points discussed at the September 12 meeting. Mr. Larsen stated in part that the examination report disclosed:

> . . . an extremely low liquidity position, numerous and serious violations of law and regulations, and extremely vulnerable internal control exceptions and operating deficiencies. All of these matters reflect unfavorably upon the quality of the bank's active management, and were discussed with you in considerable detail during our special meeting in Los Angeles.
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> The inordinately large amount of classified assets . . . consists predominantly of direct loans to, and stand-by letters of credit issued for the benefit of various subsidiaries of Westgate California Corporation and British Columbia Investment Company aggregating $115,374,731 and $148,786,711, respectively, both of which far exceed the legal lending limitations of the bank.
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Aside from the credit hazards and serious exposure of the bank to the sheer volume of advances to subsidiaries of Westgate California Corporation and British Columbia Investment Company, this examination also disclosed many irregularities involved in these transactions. In numerous instances, the proceeds of loans to one company were creditied to the account of another, and in some instances proceeds of loans and other funds in the account of Sovereign State Capital Company were used for the payment to other banks of personal obligations of President and Chairman of the Board C. Arnholt Smith and the San Diego Padres Baseball Club which he controls.

* * *

In view of the highly unsatisfactory condition of your bank, it will be our purpose to schedule future examinations more frequently until such time as marked improvement is clearly indicated. You are also requested to submit semi-montly reports covering in detail your progress toward eliminating or appropriately adjusting each of the variously criticized loans, vioaltions of law, and other matters requiring your attention as outlined throughout the examination report and further commented upon in this letter.

* * *

4. On November 6, 1972, a letter was sent to our regional office from the bank, signed by each of its directors, agreeing "to comply with proper practices and procedures set forth in the Regional Administrator's September 28, 1973, letter." This letter enclosed elaborate discussions of some of the problems raised by the examiner, and in some instances disagreed with the examiners interpretations of various statutes regulating lending by national banks. The letter also enclosed a loan by loan tabulation on the credits criticized by Examiner Martin, which showed a substantial reduction in the outstanding credits to Westgate California Corporation.

A small reduction was shown in the loans to BCIC and its subsidiaries. On November 20, 1972, Regional Administrator Larsen responded to the board of directors, noting the bank's progress at collection, requiring the bank's continued diligent efforts toward improvement and supporting the statutory interpretations of Examiner Martin.

5. On September 26, 1972, our regional office sent to the United States Attorney in San Diego, the Criminal Division of the Department of Justice, and the FBI in San Diego, a detailed report prepared by Examiner Martin of 25 separate transactions discovered during his examination which might violate the criminal laws of the United States. On April 23, 1973, pursuant to a request from the U. S. Attorney's office, National Bank Examiner Martin was authorized to assist the U. S. Attorney with his investigation of the matters previously referred by our Office and to testify before the Federal Grand Jury. As a result of the January 1973 examination, a second report involving possible criminal violations, detailing twenty-two separate transactions, was sent to the Department of Justice on May 1, 1973.

6. On October 18, 1972, the Comptroller's Office sent a copy of the June 1972 examination report, together with a memo discussing the report, to the FDIC. In December 1972, a member of the SEC staff called and requested to review this report. Upon request of the SEC, this report was made available for review by its staff in January 1973.

7. On December 29, 1972, Mr. C. Arnholt Smith wrote Regional Administrator Larsen requesting that the next examination of USNB be done by someone other than Mr. Martin. On January 5 Mr. Larsen responded that he was not disposed to assign the next examination of USNB to another examiner.

8. On January 8, 1973, National Bank Examiner Martin began another examination of USNB. This examination showed a decrease in the credit extended to Westgate California Corporation and subsidiaries to $76 million. An enormous increase, however, from $143 million to $264 million, had taken place in the total credit outstanding to BCIC and related companies. Despite previous criticisms of the practice, loans to one company were still being used to repay the debts of another company. The examiners were unable to trace readily some of the loan proceeds because the various companies had established new checking accounts at other banks. Loan documentation on the Westgate and BCIC credits continued to be inadequate and/or unreliable. The examination was concluded on March 22, 1973.

9. Examiner Martin and Regional Administrator Larsen held a series of meetings with representatives of the bank to discuss the results of Mr. Martin's examination. On March 19, 1973, they met with the three top officers of the bank; on March 20 they met with attorneys for the bank; and on March 22 with the entire board of directors. Mr. Larsen and Examiner Martin informed each of these groups of the precarious condition of the bank. The representatives of the bank, particularly its attorneys, disputed the examiner's interpretation of statutes dealing with lending limits, letters of credit, and investment in bank premises. At their request, the final official copy of this report was not submitted to the bank for about two weeks to give the attorneys time to brief their arguments.

On May 1, 1973, Regional Administrator Larsen wrote the bank, enclosing a copy of the January examination report and summarizing the position taken at the March 22 meeting of the bank's board of directors. This letter stated in part:

> As revealed by the previous examination report, classified assets consist predominantly of direct loans and standby Letters of Credit issued for the benefit of various subsidiaries of Westgate California Corporation and British Columbia Investment Company.
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> Since that time, sales of various British Columbia Investment Company subsidiaries have been effected, but have not been substantiated as genuine and the presumption that they are merely nominal transactions undertaken in a vain attempt to superficially adjust serious violations of 12 U.S.C. 84 cannot be ignored. Therefore, lines of direct credit aggregating $33,400,934 and $187,707,839, respectively, to Westgate California Corporation and British Columbia Investment Company subsidiaries are still considered in excess of 12 U.S.C. 84, and constitute the joint and several liability of approving Directors should any loss accrue to the bank. It should be remembered that the amounts quoted above represent only direct liabilities of the borrowers and do not include an additional $42,632,051 in Letters of Credit issued on behalf of Westgate California Corporation subsidiaries, and $76,569,891 on behalf of subsidiaries of British Columbia Investment Company. Extensions of credit aggregating approximately $20 million to British Columbia Investment Company subsidiaries have been well documented as the sources of funds used to reduce the indebtedness of various subsidiaries of Westgate California Corporation by the same amount. This continuing commingling of funds appears to further expose the fallaciousness of the reported sale of certain British Columbia Investment Company subsidiaries. Furthermore, the apparent sudden decision to remove the checking accounts of many involved borrowers to State chartered banks in California and other states appears to be an obvious attempt to frustrate regulatory review.
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> The extension of direct credit and issuance of standby Letters of Credit to companies and other borrowers, the businesses of which are obviously intentionally intertwined with the financial interests of Mr. C. Arnholt Smith, Chairman of the Board of your bank, has precipitated the present situation. The standby Letters of Credit have been used to lend the bank's

reputation and creditworthiness to borrowers who may not otherwise be credit worthy, in an attempt to sustain the various diverse affairs of Westgate California Corporation and British Columbia Investment Company. The banks across the country, and overseas, which have extended credit to these borrowers, look to your bank for repayment and, since the borrowers generally lack liquidity and sound support, only a continuous roll-over of debt can sustain this credit pyramid. Viewed in this context, it may be conjectured that the commingling of funds is a further manifestation of this pyramid, used not only to delude this office, but to veil the true extent of the credit pyramid from the eyes of potential lenders and the financial community in general.

The bank was directed to:

1. Reduce outstanding domestic Letters of Credit by an amount not less than $5,000,000 each month and to reduce foreign Letters of Credit commensurately.

2. Make no further direct or indirect advances to subsidiaries of Westgate California Corporation, present or former subsidiaries of British Columbia Investment Company, or to the parent corporations, related companies, or interested individuals, other than those advances absolutely necessary to protect existing outstanding indebtedness of these entities to the bank.

3. Undertake to immediately increase liquidity to 20% net liquid assets to net deposits, and in no case below 15%.

The provisions of this letter were formalized in a Cease and Desist Order on May 24, 1973.

10. On April 26, 1973, the SEC called our Office to invite members of the Comptroller's staff to a meeting on April 30 to discuss the intended filing by the SEC of a complaint naming USNB as a defendant. Representatives of the FDIC also were at that meeting. At this meeting staff members of the SEC stated that Westgate California Corporation and Mr. C. Arnholt Smith had been engaged in fraudulent sales of assets

of Westgate which distorted Westgate's reported earnings. These sales were financed by USNB. The banking agencies received from the SEC a memo detailing the transactions on which the SEC was focusing. The SEC staff believed that the bank was inextricably involved in these transactions and must be named as a defendant in any legal proceedings. The SEC intended to ask for an injunction against some of the bank's lending practices, and asked whether the banking agencies would be willing to join in such proceedings. The SEC staff mentioned the possibility of seeking a court appointed receiver for the bank.

On May 10, 1973, the Acting Comptroller wrote the Chairman of the Commission about the SEC proposed legal action. The letter referred specifically to the Cease and Desist Order which our Office was attempting to obtain, and stated in part:

> This Office has been actively pressing the directors and officers of the bank to take all steps necessary to prevent any future self-serving loans to Smith-controlled companies and also to pursue an aggressive program of liquidation of the existing insider loans.
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> With the exception of the Westgate and British Columbia Investment Corporation self-serving loans, the bank appears to be operated with due regard for the depositors' and shareholders' interests. In our judgment, unless there is a sudden loss of public confidence caused by the naming of the bank in a Commission-instituted fraud suit, the internal weaknesses in the bank's assets and management can be corrected without a receivership and consequent losses to depositors and shareholders.
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> The United States National Bank ranks eighty-sixth among the fourteen thousand commercial banks in the country. It has deposits of over $1 billion. A large percentage of these deposits are corporate accounts and are in excess of the $20,000 FDIC insurance coverage. It is obvious that the publicity attendant to the filing of a court action naming

> the bank as a party to fraud in substantial amounts and praying for removal of the bank management or other injunctive relief against the bank would raise serious apprehension on the part of the large corporate depositors and others doing business with the bank. The subsequent runoff of demand and other short-term time deposits could quickly exhaust the liquid assets of the bank with resultant acts of insolvency. Under the law in that event, we would have no option other than to appoint the FDIC as receiver to pay off insured depositors and liquidate remaining assets.
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> This would constitute by far the largest bank to close its doors in the history of the country. Ripple effects to other banks, many of which hold obligations guaranteed by United States National, and other depressing effects on the economy of the area served by the bank can well be imagined. We strongly urge, therefore, that no action be taken by the Commission with respect to the bank without the fullest consultation with the banking agencies and that this Office be given an opportunity to review and comment upon the contents of any court complaint or public announcement proposed to be issued by the Commission naming the bank, prior to its release.

Further staff discussions were held between the two agencies, and on May 18 we supplied the SEC with a draft of our proposed Cease and Desist Order, and related documents. In telephone calls of May 22, 1973, and in a meeting on May 23, 1973, the staff and two of the Commissioners stated that the SEC was willing, in view of our Cease and Desist Order, not to name the bank as a defendant in the action. The SEC insisted, however, that we make a public announcement of the contents of our Cease and Desist Order. The Acting Comptroller stated his position in a letter sent to each of the Commissioners on May 25, 1973. That letter stated in part:

> Finally, we suggest that this Office is both statutorily responsible for and experienced in the supervision of banks with asset and management problems, and that we can operate most effectively in the manner which Congress has designated, i.e., in "private" (12 U.S.C. § 1818(h)(1)) and

without the necessity of having our supervisory arrangements approved by a district court in a lawsuit instituted by the Commission.

The kinds of problems which can be caused by unwarranted public government action are reviewed in a letter I sent to Chairman Cook on May 10, 1973. I am enclosing a copy of that letter for your information. I wish to add only that we estimate that members of the public have invested between six and seven million dollars in United States National Bank at the current market price of the bank's stock. By contrast, we estimate the uninsured deposits in the bank -- i.e., the deposits not protected by the Federal Deposit Insurance Corporation -- to be approximately 600 million dollars.

I am calling this matter to your attention so that the Commission can be fully aware of these facts when it makes its decision.

* * *

I am authorized to say that Chairman Wille of the Federal Deposit Insurance Corporation concurs in the statements herein, and in my letter of May 10 to Chairman Cook, concerning the harmful consequences which your staff's proposed action could have upon the bank, and concerning the appropriateness and effectiveness of the federal banking agencies dealing with management and asset problems of banks without the filing of a public lawsuit by the Commission or any other government agency.

11. The Comptroller's Cease and Desist Order of May 24, 1973, has been mentioned several times already. That Order was obtained with the consent of each of the directors of USNB. In addition, Mr. C. Arnholt Smith signed the Order in his individual capacity. The Order required:

A. That the bank make no loans or extensions of credit the proceeds of which were used in any way for the benefit of Westgate California Corporation, BCIC, or any related companies or individuals.

B. That the bank appoint a committee of five of its officials to collect all outstanding loans to these companies.

C. That the bank document properly all credit files and perfect its interest in collateral.

D. That Mr. C. Arnholt Smith resign as an officer and director of the bank and refrain from any further participation in the affairs of the bank other than using his best efforts when requested by the bank, to collect the outstanding loans to Westgate, BCIC, and related companies or individuals.

E. That Mr. C. Arnholt Smith indemnify the bank against any losses resulting from loans to extensions of credit to Westgate, BCIC or related companies or individuals.

F. That Mr. C. Arnholt Smith agrees not to sell or transfer any of his shares of USNB without express written approval of the Comptroller, and agrees to establish a voting trust with a trustee acceptable to the Comptroller, subject to the Comptroller's removal, and subject to some extent to the Comptroller's direction in the voting of the shares.

12. On May 31, 1973, the SEC filed its complaint. The complaint did not name USNB as a defendant. It did allege in part however:

> Beginning in at least 1969, Defendant C. A. SMITH as an officer, director, and chairman of USNB has been unilaterally approving loans and other extensions of credit from USNB to entities which he owns or controls, to nominees acting at his direction, and to related entities and individuals (collectively referred to hereafter as "the entities"). In addition, Defendant C. A. SMITH has been causing USNB to issue letters of credit in favor of the entities. Many of these loans and other extensions of credit have been granted on the basis of collateral appraised only by C. A. SMITH himself. Defendant C. A. SMITH, furthermore, has unilaterally approved numerous unsecured loans made by USNB to the entities which used the proceeds of such loans to make principal and interest payments on loans previously made to them. Among other things, defendant C. A. SMITH deceived USNB as to the purpose and the use to be made of such loans and the participation of C. A. SMITH and his affiliates in transactions accomplished through such activities. Defendant C. A. SMITH caused USNB to disseminate statement publicly that did not fully and accurately reflect all facts concerning the matters alleged herein.

13. During the month of June 1973, approximately $100 million in corporate certificates of deposit were withdrawn from USNB. To meet its liquidity demands, the bank had to borrow heavily from other banks and from the Federal Reserve Bank of San Francisco. On July 6, these borrowings reached $80 million. The interest rate charged the bank was as high as 15 percent. Largely due to the cost of these borrowings,

the bank was experiencing an operating loss of approximately $1 million per month. The resulting liquidity squeeze accelerated the need to find a prompt solution to the asset problems.

14. On July 18, 1973, a meeting was held in my Office with Regional Administrator Larsen, John Balles, President of the San Francisco Federal Reserve Bank, and representatives of the Federal Reserve Board and the Federal Deposit Insurance Corporation. It was decided then that the Federal Reserve Bank would continue to loan funds to United States National, and that the Comptroller's Office would undertake an updated evaluation of the loans to Westgate, BCIC, and related entities.

On July 23, 1973, National Bank Examiner Hans Reisz undertook an examination just of the loans and extensions of credit to Westgate, BCIC, and related entities. He reported the results of this examination personally to me on August 27, 1973. Mr. Reisz estimated that $45 million of these loans and letters of credit were uncollectible and should be called losses. He identified another $98 million in loans and letters of credit whose collectibility he thought was doubtful. His evaluation was still hampered in many instances by a lack of proper credit information in the bank's files. If his evaluations were accurate, it was probable that USNB was insolvent. Its equity capital was $50 million. In addition, the bank had outstanding approximately $15 million in Capital debentures. Management of USNB met with me on August 29, 1973. They did not dispute Mr. Reisz' evaluation.

15. In view of the grave nature of Examiner Reisz' report I immediately arranged a meeting with the FDIC and the Federal Reserve Board. A copy of Mr. Reisz' report was given to the FDIC, and the FDIC was queried as to what assistance it might provide in this situation. Discussions that other banks in California had held with the management of USNB and with the Comptroller's Office beginning as early as June 1973, made it seem unlikely that any other bank would be willing to take over USNB without FDIC assistance.

On September 7 the FDIC advised me that the most likely solution was a takeover of USNB by another bank with FDIC assistance. The large amount of contingent and unknown liabilities of USNB, and the voluminous

adverse publicity surrounding the bank made it unlikely that the bank could be saved by direct FDIC assistance without another bank being involved. There were over $230 million in uninsured or unsecured deposits, and our Office viewed the closing up, liquidation, and payout of this bank as an unacceptable alternative. Meetings were arranged in Washington with representatives of Wells Fargo Bank, N.A., Crocker National Bank, and Bank of California, N.A. Each of these three banks already had expressed a serious interest in a possible acquisition of USNB. Wells Fargo and Crocker had, by this time, made a considerable evaluation of USNB's condition.

16. On September 10, 1973, I met with representatives of the FDIC, the Department of Justice, the Internal Revenue Service, and the SEC. During this meeting I advised the other agencies of the probable failure of USNB and of our attempt to work out a solution other than a closing up of the bank and a paying off of depositors. I wished the other agencies to be aware of this problem in whatever action they might take.

17. As previously arranged, we met at the FDIC on September 14 and 17, 1973, with representatives of Wells Fargo Bank, N.A., Crocker National Bank, and Bank of California, N.A. We discussed the evaluation of the problem loan portfolio which had been made both by the staffs of these banks and by our examiners. We also discussed the nature of assistance which might be provided by the FDIC and which might be required by each of these banks. These discussions seemed to make clear that a receivership of USNB, followed by an FDIC assisted takeover, was unavoidable.

Based on these discussions, the FDIC determined that it could minimize losses to itself as receiver by attempting to sell a so-called "clean" bank. The FDIC, as receiver, would offer for sale all, or almost all, of the deposit liabilities of USNB and all of its major assets except the loans to Westgate California Corporation, BCIC, and related companies and individuals. To make up the difference between the liabilities transferred and the assets sold, the FDIC would supply a balancing amount of cash. This package, it was thought, would attract the largest possible number of potential purchasers. The FDIC staff began to draft papers for this transaction. In addition, our Office and the FDIC contacted Bank of America, Security Pacific National Bank, United California Bank, and Union Bank to advise them of the impending sale of USNB on a so-called "clean" bank basis. Thus all banks which appeared to be able to take over USNB were contacted. In addition, some preliminary discussions were had by management of USNB with foreign banking interests. Also two groups of individuals interested in organizing a new bank to take over USNB contacted our Office. In early October, drafting sessions lasting more than a week were held in San Francisco at which the Comptroller's Office, the FDIC, and representatives of interested banks hammered out the papers which ultimately were used by the FDIC in the sale of USNB liabilities and assets.

18. On October 8, 1973, a meeting was held with the FDIC to resolve the remaining questions concerning the package which the FDIC would offer to interested banks. We also began to work out the administrative details necessary to the FDIC (as receiver) taking over of the bank. It was decided a few days later that we would attempt to arrange the transaction for Friday evening, October 19.

19. When the outline of events to come in San Diego became clear to us, Chairman Wille and I on September 24, 1973, visited with Assistant Attorney General Kauper and Deputy Assistant Attorney General Baker of the Antitrust Division to discuss with them the competitive effects of an emergency take over of USNB. Two days later Mr. Baker and some of his staff met with us to present informally the Antitrust Division's views, and on October 5, 1973, he gave us those views in writing. In summary, the Antitrust Division had some difficulties with an acquisition of USNB by Bank of America, Security Pacific National Bank, or United California Bank because each of these banks had a substantial competitive overlap with USNB. Even one of these banks, however, would have been acceptable from the antitrust standpoint upon a demonstration that no reasonable alternative existed. As to the remaining four banks, there was no substantial competitive overlap with USNB, and the Department of Justice advised that it would not seek to challenge the takeover of USNB by any of these four banks.

20. On October 17 part of the members of my staff who were concerned with this transaction were in California arranging final details, and others still were in Washington. The concerned FDIC staff was similarly split between California and Washington, and also New Orleans where the FDIC Liquidation Division was holding its biennial conference. I was visiting my parents in Pierre, South Dakota. I received a telephone call from Robert Pierpoint of CBS News, who recited for me with great accuracy the details of the impending demise of USNB, and asked if I had any comment. Following an "off-the-record" discussion of this story, Mr. Pierpoint readily saw the disruption which could be caused by premature disclosure of this story. In what seems to me to be in the best tradition of responsible journalism, Mr. Pierpoint agreed (contingent on the approval of his superiors) to withhold the broadcast of this story for the day or two necessary for the government to act to protect the depositors. A telephone call from the Los Angeles Bureau of the Wall Street Journal similarly disclosed their awareness of our plans. The Wall Street Journal likewise agreed to withhold publication of the story the following day. I was quite concerned about other journalists who might have this story, and decided (with Chairman Wille's full concurrence) to accelerate the closing of the bank to the afternoon of October 18. The Federal Reserve Bank of San Francisco, whose facilities we used, the directors and staff of the FDIC, my own staff, and the banks who were expected to be bidders cooperated magnificently in rescheduling the closing up and sale of USNB.

21. On October 18 at 3 p.m. in the Federal Reserve Bank of San Francisco, I declared USNB to be insolvent and appointed the FDIC as receiver. At 4 p.m. Chairman Wille solicited bids from the three bidders who were present -- Crocker National Bank, Wells Fargo Bank, N.A., and Union Bank. Crocker National Bank bid $89.5 million. This bid was substantially higher than the second bid, and was well above the amount which the FDIC thought was necessary to comply with its statutory criteria of giving assistance to a takeover transaction only if the cost of such assistance is less than a payoff of depositors. At 4:30 p.m. the directors of the FDIC unanimously accepted Crocker's bid. Crocker immediately submitted, and I immediately approved, an application under the Bank Merger Act of 1966 to acquire assets and liabilities of USNB, and an application under the National Bank Act to establish branches at all of the former banking offices of USNB.

22. We had been in contact the previous week with the United States District Court in San Diego. It was determined by the court that Judge Leland Nielson would handle matters arising from the FDIC's receivership. Judge Nielson was already presiding over the pretrial phases of the SEC litigation. In a transaction of this magnitude, which we hoped to accomplish in a short space of time, we thought it advisable to give the court as much advance notice as possible. Attorneys from the FDIC, from the U.S. Attorney's Office, and from my office thus visited with Judge Nielson on October 11 to inform him of the impending receivership of USNB, and of the anticipated sale of its assets which

the court would be asked to approve. On the evening of October 18 attorneys for the FDIC were waiting in San Diego and were notified by telephone of the results of the bidding. They immediately petitioned the court for approval, which was granted at 6:15 p.m.

23. A joint team of examiners from the Comptroller's Office and the FDIC simultaneously had entered all 63 offices of USNB shortly before it was closed at 3 p.m. These examiners worked late into the night preparing the financial statements as of the bank closing and verifying assets. Representatives of the successful bidder, Crocker National Bank, arrived at each branch early the next morning, and the next day all former offices of USNB opened at the normal hour as branches of Crocker National Bank. The transaction took place so smoothly that the story didn't even make the front page of the San Diego newspaper that morning.

24. Details concerning the transaction between the FDIC as receiver and Crocker National Bank, and questions concerning the present status of the receivership I will leave to Chairman Wille to answer.

SUMMARY AND COMMENTS

1. Chairman St. Germain's letter inviting me to testify asks specifically if there was a failure of cooperation among the banking agencies which would support the need for a unified federal bank regulatory agency. I believe the cooperation among the Comptroller's Office, the Federal Deposit Insurance Corporation and the Federal Reserve System in this instance was magnificient. The largest bank failure in the history of the United States was handled in such a way that it was hardly noticeable to the depositors. The day following the closing and sale, deposits rose $2 million. The value of the bank as a going business concern was retained and realized. There were, of course, differences of opinion from time to time among the dozens of staff members of these three agencies who were working on this problem, but these differences were resolved amicably and reasonably, and with a high degree of goodwill. In short, there is no basis in the dealings among the banking agencies in this transaction to conclude that uncooperativeness among the agencies dictates the forming of a new unified banking agency.

2. In the way of legislation, we are reviewing the statutes concerning loans to persons or businesses affiliated or associated with officers, directors, or major shareholders of national banks. This review is not complete, and I hope to have some more specific

recommendations at a later time. We have tentatively identified as a problem area the provisions of Section 2 of the Banking Act of 1933, 12 U.S.C. §221a, which require a 50 percent stock ownership of a national bank before an affiliation can be established. I believe that an additional test for affiliation of actual control, direct or indirect, might have been useful in the USNB situation and in connection with some other banks in which problems have arisen with loans to control persons. In the USNB situation, for example, there was no doubt that Mr. Smith controlled the bank, although he owned only about 36 percent of the outstanding shares. If we had been able to use this kind of "control" test rather than the present statutory standard, the Comptroller's Office would have had an unquestionable basis for limiting and collateralizing these loans as provided in Section 23A of the Federal Reserve Act, 12 U.S.C. §371c.

3. In the Comptroller's Office we are also reviewing our existing interpretation of the lending limit statute, 12 U.S.C. §84. As that statute is now interpreted, loans to subsidiaries of a parent company, when the subsidiaries are independent of each other and use the proceeds separately, need not be combined unless the parent company is also borrowing. We intend to study how this position might be modified without disrupting legitimate borrowing relationships.

4. Similarly, we are re-examining our rulings relating to letters of credit. Under the current practices followed by all three banking agencies, banks may issue stand-by letters of credit which are not considered loans, but contingent liabilities. Thus, neither the letters of credit nor the underlying customer obligation is reflected on the bank's balance sheets. Similarly, letters of credit have not been considered loans for purposes of statutory lending limits. Some have suggested that stand-by letters of credit are unlawful and should be prohibited all together. Our Office has suggested to the Federal Reserve System and to the Federal Deposit Insurance Corporation that letters of credit should be made subject to the lending limits. The discussions with these agencies are still going on. Similarly, we are considering a requirement that such letters of credit and the underlying customer obligations be reflected on the bank's balance sheets.

5. We are also undertaking an evaluation of the way in which our Office at the field level and here in Washington reviews and acts upon examination reports of banks in which problems seem to exist. We established two years ago an Enforcement and Compliance Section in the Comptroller's Office, and the duties of that Section may be expanded to include routine review of some examination reports.