NEWS RELEASE

FOR RELEASE P.M., NOVEMBER 6, 1971 PR-57-71 (11-3-71)

Increased use of cease and desist powers as a tool in supervising problem banks was predicted today by Irvine H. Sprague, Director, Federal Deposit Insurance Corporation, in a talk before the Maine Bankers Association.

Sprague said the cease and desist authority has been utilized eight times so far this year and, if proven successful, such actions will supplement and possibly even substantially replace action to terminate insurance, the traditional FDIC disciplinary tool in the past.

"The Corporation is still feeling its way in this area," Sprague said, "but we have found the cease and desist action to be much quicker and more appropriate for a wide range of problem banks when regulatory pressures should fall somewhere between the traditional consultations with a bank's Board of Directors and the ultimate termination of insurance."

Citing need to strengthen the cease and desist authority, Sprague repeated FDIC's request to Congress to give the various regulatory authorities power to remove bank officers for willful violation of final cease and desist orders.

Sprague also discussed recent FDIC merger and branching decisions, pointing out, among other things, that 90 percent of all merger applications submitted to the FDIC for decision between April 1, 1970 and November 1, 1971 have been approved.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

When Halsey Smith called me in July asking me to speak before the Maine bankers in November I was delighted.

We have lived in Washington fifteen years now and each fall Margie suggests that we take a ride into New England to enjoy the scenery.

So I accepted and here we are ---- in Bermuda.

We're in between seasons now in a number of ways, which makes it a little difficult to talk to you.

The Congress will be adjourning soon, without any action on H.R. 5700, the Banking Reform Act of 1971, and it really is impossible at this point to predict what will happen to the bill next year. There was far from a consensus this year. It seems fair to speculate, however, that the Congress may face-up to questions relating to bank trust departments, interlocking directorates, brokered deposits, and cease and desist powers -- I can certainly hope so.

Another unknown at this point in time is the findings of the Presidential Commission, which this very week is meeting in New York to firm up its recommendations to the President. Here again it seems reasonable to assume that there will be major recommendations going to the powers of various financial institutions and the way they are regulated. How the Congress will react is open to question. Some changes should be possible without approval of Congress, but probably no changes of real substance will be made without Congressional approval, and that, in my personal opinion, is the way it should be.

Also, it is too early to do anything but speculate about Phase II of the President's economic program. The wage and price boards have been named and we'll just have to wait to assess their performance. One thing does seem clear, the program simply has to contain profits and prices and wages so that

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the housewife and the worker really believe they are not being discriminated against. The ultimate question, of course, is jobs.

So perhaps it would be best today to discuss with you some of the operations of the FDIC; what we have been doing this year and why. Three areas of interest: (1) Problem banks and supervision, (2) merger actions, and (3) branching.

PROBLEM BANKS

Bill Camp says there are no problem banks -- just some requiring tender loving care, but we do have a problem list at FDIC and the number and size of banks that we carry on the list have increased over the past decade. Ten years ago there were 175 banks classified as "problems" and holding deposits of $1.1 billion. When I joined the Corporation three years ago, there were 243 with deposits of $3.4 billion. The number since has fluctuated from 212 to 252. Today there are 244 with deposits of $4.7 billion.

(To put the matter into perspective, the 244 problem banks represent less than 1.8 percent of the 14,199 banks in the country and their deposits represent only 0.8 percent of the total deposits in all insured banks.)

Composition of the problem bank list is constantly changing as some banks work out their deficiencies while problems in other banks are identified. For example, in the past twelve months our Division of Bank Supervision removed 119 banks from their problem list and added 116.

The turnover figures are significant. They mean that as the problem banks are identified through examinations the supervisory authorities concentrate on them and the banks often show speedy improvement.

The current list includes 184 State nonmember banks, 19 State member banks, 40 national banks and one mutual savings bank. Of these, 58 are classed as "serious problems."

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

About three-fourths of our current problem banks are in the $1 million to $25 million deposit categories, with 40 percent under $5 million. However, about one-third of our exposure, represented by the deposit totals, is concentrated in the five largest problem banks.

Over 50 percent of the problem banks are currently clustered in ten States, while ten States are not represented at all, and it is good to report today that Maine is in the latter category.

"Problem" designations are recommended by our Regional Directors and are made by the Director of the Division of Bank Supervision after Washington review. FDIC Board action is not involved. The criteria are banks that "threaten ultimately to involve the Corporation in a financial outlay unless drastic changes can be brought about" and banks of lesser degree of vulnerability "which give cause for more than ordinary concern and require aggressive supervisory attention."

Most problem cases reflect some combination of poor quality assets, excessive losses, depleted capital, and speculative or inadequate management. Typically, such banks operate with marginal liquidity and the problem memorandum often refers to management that is self-serving and indifferent to statutory restrictions as well as sound banking practices.

On occasion there has been a recent change in controlling ownership in which the new owners borrowed heavily to finance the purchase. A classic case passed over my desk just last week. An individual put up just $1,000 of his own money and borrowed over $500,000 to finance his purchase of the bank. It took him less than a year to get it on the problem list. Banks that are willing to make these kinds of loans often pay the price in heavy losses when the banks whose purchase they finance close.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

I am not aware of any banks on the list that got into trouble solely for making minority or small business or social-type loans or by being unduly concerned about the consumer or for trying to better serve its community.

In the past two years we have intensified the pressure on the problem institutions to improve their condition and intend to further increase the attention in coming months. Since January 1, the FDIC has instituted three 8(a) proceedings which could ultimately end in lifting deposit insurance for the banks involved, and six 8(b) consent cease and desist decrees requiring major overhauling of the banks' practices. In addition, we have executed two written agreements which are enforceable under Section 8 of our Act and which impose a strict corrective program. During 1970 there were seven 8(a) cases instituted and no 8(b) cases.

All of these actions are taken only after admonitions to bank management and Boards of Directors do not show results. Discussions with bank directors and management continue to be a basic regulatory tool.

> (Keep in mind that we are secondary supervisors only, and regularly examine only State nonmember banks. We do not close banks. The primary supervisors are State authorities and the Comptroller of the Currency, either of whom may have extensive and independent disciplinary authority. Normally, we work out a corrective program cooperatively with State supervisors.)

As a practical matter, most 8(a) citations end short of insurance removal. Of the 210 cases initiated between 1934 and 1971, only 13 went to the extent of FDIC action to actually terminate insurance. The usual pattern is for the bank to clean up its condition rather than lose insurance and this is one of the reasons that our Legal Division has favored using the 8(a) route exclusively in the past.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

However, this year, in searching for quicker remedies and means of taking action short of insurance removel, we have turned increasingly to the 8(b) power, cease and desist. We hope in the process to determine the effectiveness of this power when contrasted with the 8(a) power we have utilized almost exclusively in the past.

Problem insitutions can anticipate additional cease and desist activity. We have instructed our 14 Regional Directors to review all of their problem banks and to recommend early cease and desist actions in all appropriate cases. Also, we have established a Compliance Unit in our Legal Division that is called into the picture at an early stage. Prior consultation with the State supervisor is a prerequisite for any cease and desist action involving a State nonmember bank.

An 8(a) action has some advantages in certain problem bank cases, but it is time consuming and not always appropriate. We have found the 8(b) route to be much quicker and more appropriate for a wide range of problem banks when regulatory pressures should fall somewhere between the traditional consultations with a bank's Board of Directors and the ultimate termination of insurance. The Corporation is still feeling its way in this area, but we have found that in eight cases this year, bank directors have accepted our full correction program on a consent basis. Under the law, a consent cease and desist is just as binding as a contested one, imposed by the court.

We have asked the Congress to stengthen our hand in this area by giving the regulatory authorities power to remove bank officers for willful violation of final cease and desist decrees. Now we are limited in our removal power to the cases in which we can prove personal dishonesty. A man can ruin a bank by being stupid or greedy without meeting the legal requirements of dishonesty.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

BANK ASSISTANCE

We have had five cases of assistance to failing banks to date in 1971 -- three involved payouts up to the insurance limit after the bank closed, one involved the assumption of all deposit liabilities by another bank, and one involved assistance to an operating bank. This is somewhat lower than the nine payout or assumption transactions of 1970 and seven of 1969, but still above the average of three and a half bank closings a year for the past quarter century. This year's group has been interesting in that it has provided three firsts for the Corporation.

(1) Sharpstown State Bank in Texas closed in January, and the Corporation set a new all-time record in payout cases, with about $50 million returned to insured depositors so far. We were able to begin payments just eight days after the bank closed in spite of the fact that it had 27,000 deposit accounts that had to be reconciled. Our liquidators moved $12 million out to depositors in the first four days, removing a lingering Corporation myth that a payout transaction when a big bank closed might be too tough to handle. Bank automation helped considerably.

(2) The Birmingham Bloomfield Bank closing in Michigan in February required a record Corporation outlay of $107 million to enable a new bank to assume 100 percent of the deposit liabilities of the closed bank. We were able to work this out over a long weekend without a lapse of a single banking day and with no loss to any depositor, including public agencies with substantial public funds on deposit.

(The record FDIC outlay prior to 1971 was $23 million in 1940. Historically, about half the bank closings end in assumption of deposits by a new or existing institution and about half in a payout. The decision is determined on

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

whether the Board of Directors can make a finding that an assumption transaction is less costly to the Corporation. In most of the payout cases, as in Sharpstown, it is impossible to make such a finding because of substantial unknown contingencies or substantial doubt as to the value of assets.)

(3) In the Unity Bank and Trust Company of Boston in July, we used for the first time in the Corporation's history the 13(c) authority under which we can purchase assets, make deposits, or loan money to a going institution if our Board can make a finding that the particular bank is essential to provide adequate banking service to the community. We purchased a $1.5 million capital note in the Unity Bank after it was taken over by the State Commissioner in conservatorship and new management provided. The bank serves a highly concentrated minority area in Boston and its stock is widely held as a community venture. We certainly do not look at this transaction as a precedent for handling all banks in danger of closing. In fact, we expect use of our 13(c) authority to be very rare.

MERGER POLICY

Bankers chide me occasionally about our "negative policy" on mergers, but the statistics just don't support this kind of comment.

Between April 1, 1970, when the present Board was constituted, i.e., Frank Wille, Chairman, Bill Camp, and Irv Sprague, and November 1, 1971, we acted on 77 merger applications. Sixty-nine were approved and eight denied, a 90 percent approval rate.

The denials fall into some pretty well defined categories as we seek to interpret the law as laid down in Phillipsburg and other Supreme Court decisions and at the same time to express the Board's concern about undue concentration, particularly in some States that are way out of balance.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

(1) In Tennessee, we denied the merger of two Knoxville banks, the $72 million Valley Fidelity Bank and Trust Company and the $32 million Bank of Knoxville. These banks were the third and fifth largest of six banks, serving an already highly concentrated commercial banking market in Knox County. This proposal had a striking resemblance to the percentages involved in the Phillipsburg case, where the Supreme Court found a violation of Section 7 of the Clayton Act.

(2) In Hawaii, we denied a proposed merger between the Bank of Hawaii and the Hawaiian Trust Company, which would have combined the largest commercial bank in Hawaii (deposits $572 million; 37 percent of the State's total commercial bank deposits) and the largest trust company in Hawaii (trust assets $1 billion; 50 percent of the State's total corporate fiduciary business). At the time there were only seven commercial banks in Hawaii, and only three independent trust companies. Bank of Hawaii, in our judgment, was the most likely of the commercial banks to set up a trust department of its own, so that the proposed merger not only eliminated potential competition between the two institutions but would have added dramatically to the concentration of banking resources in an already highly concentrated Statewide market.

(3) In Washington, we denied the proposed merger of United Mutual Savings Bank and State Mutual Savings Bank, both headquartered in Tacoma. This consolidation would have resulted in a $100 million institution holding nearly 30 percent of Pierce County's deposits in thrift institutions, i.e., mutual savings banks and savings and loan associations, while the share of deposits held by the two largest thrift institutions would have increased to 62 percent.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

(4) Also in Washington, we denied the merger application of Washington Mutual Savings Bank, a $750 million institution, and the $5 million Grays Harbor Savings and Loan Association. This proposal would have permitted the largest mutual savings bank in Washington, which had some 22.9 percent of the State's total thrift institution deposits and was more than three times the size of the next largest thrift institution, to expand further by merger, thereby establishing a precedent for additional mergers by leading banks in highly concentrated markets. We are being sued on that decision, but we actually welcome the litigation because it involves three key issues: (i) the proper "line of commerce" for assessing the competitive impact of a merger between mutual thrift institutions, (ii) whether the regulatory agencies may deny merger applications even though violations of Section 7 of the Clayton Act are not found, and (iii) whether small additions to a dominant bank can be refused where less anticompetitive merger alternatives are available to the smaller institution.

(5) In North Carolina, a merger of First-Citizens Bank and Trust Company, the State's fourth largest bank, and the Lucama-Kenly Bank, a $7 million institution, was denied. The latter operates three offices in close proximity to each other in a local market where First-Citizens already held one-third of the area's commercial bank deposits and would have increased that share to 37 percent. We found the existing offices of First-Citizens were reasonably available alternatives to each of Lucama-Kenly's offices and that the proposed merger would have adversely affected public choice in a concentrated local market.

(6) In Maryland, the proposed merger of the $18 million Westminster Trust Company and the $15 million Bank of Westminster was denied. Both banks

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

are headquartered in Westminster, Maryland, and operate branch systems in a local market of some 70,000 persons. Direct existing competition would have been eliminated. In addition, their consolidation would have reduced the number of banking alternatives in the center of this market from three to two, created an institution holding 21 percent of the total market, and concentrated 55 percent of the market in its two largest banks.

(7) In Indiana, we denied the proposed merger of Anderson Banking Company (deposits $60 million) and The State Bank of Lapel (deposits $3.4 million). The former is the largest commercial bank in Madison County, Indiana, and already controlled about 30 percent of the deposits in the market area of the smaller bank. Direct competition would have been eliminated and the banking resources of the market would have been further concentrated. We were of the opinion that the Lapel bank should seek a less anticompetitive merger partner rather than adding to the strength of the area's dominant bank. It was important to our decision that Indiana allows branching and merging only on a county-wide basis.

(8) In Georgia, we recently denied a merger proposal between two affiliated banks, The Citizens and Southern Emory Bank and The Citizens and Southern Bank of Tucker. Affiliates in the Citizens and Southern system presently control 41.8 percent of the bank deposits in DeKalb County, a mushrooming portion of the Atlanta area. We found that purchase of Tucker bank by the C & S system in 1965 was anticompetitive and should not now be ratified, even though there was little likelihood that either existing or potential future competition would be eliminated.

The merger denials have all come after exhaustive staff study and debate and total attention of the Board members. Each decision is accompanied

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

by a detailed decision specifying the reasons and the reasoning.

As these decisions flow, they should provide an invaluable guide to the thinking of the Corporation for those who are contemplating a merger move. Copies may be obtained from our Information Office.

BRANCHING

Just last month a series of FDIC branching decisions attracted some attention as we denied six branch applications of the Citizens and Southern banking group for locations in DeKalb County, part of the highly concentrated Atlanta area.

The denials were based on competitive grounds, which we found to be a proper consideration under the "convenience and needs" test. We started from a factual analysis which showed that the C & S system already held nearly 42 percent of commercial bank deposits in DeKalb County. We further determined that de novo branches, in some instances, can be used to prevent competitors from getting a foothold in a growing area, and that regulatory policy in such cases should attempt to weigh benefits of service and convenience against the disadvantages of perpetuating a concentrated market already dominated by the applicant bank. We approved one C & S branch in DeKalb County where no other bank was serving the area, but denied the rest where recent branch approvals had been given to competitors.

We recognized that most de novo branches are "procompetitive" and expect to use this new policy only sparingly in markets where an applicant bank already has an overwhelming advantage in terms of offices and deposits.

In closing, let me say that in all the time I've been in Washington and particularly since I've been with the FDIC, there has never been a better climate of cooperation between the regulatory authorities.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Disagreements there are, of course, but they are always on top of the table. And in the areas where joint action is required, such as interest rate regulations, implementing new consumer laws, or joint supervisory efforts, the cooperation is superb. It's a real pleasure to be involved with people like Frank Wille and Bill Camp and Tom DeShazo and Louie Robertson, the people I work with most on problem bank cases.

I've tried to cover some matters of real concern to all of us in a somewhat sketchy manner and now, in the remaining minutes, I'm available for questions.

# # # # # # #

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis