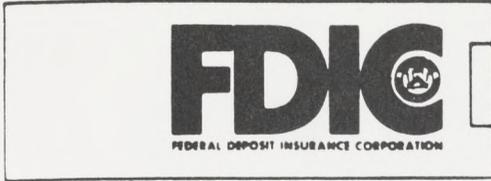


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This statement further explains the FDIC's reports to Congress of January 1973 and 1974 on the status of the liquidation of the United States National Bank, San Diego, California ("USNB") and the reports on the Franklin National Bank, New York ("Franklin") liquidation which were made as part of the FDIC's annual report to Congress. Copies of these reports are available to the public upon request. The FDIC's liquidation of the USNB and Franklin National Bank is discussed in the following statement.

Statement on

Current Status of United States National Bank [of San Diego] and Franklin National Bank Receiverships.

Presented to the

Subcommittee on Financial Institutions,
Supervision, Regulation and Insurance
House Committee on Banking, Currency and Housing
House of Representatives

by

Frank Wille, Chairman
Federal Deposit Insurance Corporation

July 21, 1975

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FEDERAL DEPOSIT INSURANCE CORPORATION

This statement further supplements FDIC's reports to Congress of year-end 1973 and 1974 on the status of the receivership of the United States National Bank, San Diego, California ("USNB") and the reports on the Franklin National Bank, New York ("Franklin") receivership which FDIC has issued at least quarterly since Franklin's failure. Copies of these reports are attached. The dates supplied in this update reflect the positions of the USNB and Franklin receiverships on June 30 of this year.

Franklin National Bank

As a result of the competitive bidding which followed the Comptroller of the Currency's closing of Franklin on October 8, 1974, the European-American Bank and Trust Company agreed to purchase certain of Franklin's assets and to assume \$1.6 billion of its liabilities, including all of its deposit liabilities. European-American has now selected substantially all of the approximately \$1.49 billion in assets it agreed to select under the October 8, 1974 Agreement with FDIC. This selection is expected to be completed by the end of this month.

Total FDIC collections with respect to the Franklin assets being liquidated by the Corporation had increased to approximately \$394 million as of June 30. This figure includes the collection of principal and interest on loans made by Franklin, the receipt of interest on securities and other assets of Franklin and the sale of some assets, including the sale of the foreign subsidiary of Franklin's Edge Act subsidiary. In addition, FDIC has initiated an orderly liquidation of Franklin's securities, an undertaking which may last for a number of years.

Payments from these collections in the aggregate amount of over \$347 million have been made by FDIC to the Federal Reserve Bank of New York and have reduced the principal amount due on Franklin's "window" loan on the day it closed from \$1.723 billion to \$1.376 billion. (Interest on the loan will not be due until October 8, 1977). Under prevailing market conditions, the Corporation plans to continue paying the Federal Reserve Bank of New York amounts collected in its liquidation efforts over and above the amount required to maintain a sufficient working balance.

Expenses of the liquidation through June 30, 1975 amounted to approximately \$4.8 million. This figure includes FDIC's liquidation staff in New York City of 115 individuals and legal counsel both within and outside the United States.

When Franklin closed, many persons who depended upon it to meet their credit needs were left without credit facilities.*/ While a substantial percentage of such persons have been able to make substitute banking arrangements, others have not. To remedy this situation, FDIC has initiated a program for bringing together borrowers and financial institutions or intermediaries capable of providing continued financing. FDIC's contact at this point has been with the commercial banks in the Long Island Bankers Association and the mutual savings banks located in the Greater New York area. Future efforts of a similar nature with other financial institutions can be expected.

FDIC succeeded to Franklin's positions in several hundred pending lawsuits upon its appointment as receiver. Most of these actions involved collection matters. Among the more significant of the litigation matters, however, were five purported class actions seeking damages on behalf of purchasers of securities issued by Franklin's parent, the Franklin New York Corporation, and four derivative suits claiming damages on behalf of the holding company's stockholders. These suits have all now been transferred to the United States District Court for the Eastern District of New York for coordinated or consolidated pretrial proceedings.

Recent developments in another lawsuit are worth mentioning at this time. Following the October 8, 1974 closing of Franklin, the plaintiff in a major lawsuit which was pending against Franklin filed motions to join FDIC and European-American in the suit as additional defendants. The plaintiff asserted, among other things, that the purchase and assumption transaction stripped the receivership estate of any assets from which payment could be

*/ As receiver for a national bank, FDIC is limited in its ability to provide ongoing financing for many of the bank's former customers. FDIC cannot simply continue to make loans. The most FDIC may do is to make advances to former customers of the bank where it finds that such action is necessary to protect existing receivership assets (12 C.F.R. 306.1 and 306.2).

In a related development, the Corporation is a defendant in a recent action filed by a Long Island builder who had been a substantial borrower from Franklin. The suit alleges in part that substantial damages were sustained because of the Corporation's failure to provide the plaintiff with additional financing in connection with the completion of a partially constructed office building. The request for continued financing was rejected by FDIC's Board after due consideration because it could not make the required finding.

made to contingent creditors of Franklin and that either the Corporation or European-American had assumed Franklin's liabilities. The court held in effect that consideration of any action against the Corporation and European-American was premature until after plaintiff's claim had been successfully proved against Franklin and after all the liabilities of the receivership estate had been determined.

The November 23, 1974 report on Franklin discussed in some detail the pre-closing problem of Franklin's foreign exchange exposure. Briefly summarized, in order to protect the international financial markets the Federal Reserve Bank of New York ultimately agreed to assume Franklin's foreign exchange position in exchange for Franklin's deposit, net of confirmation risk, of approximately \$9.7 million, to cover possible losses and Franklin's agreement to make up any additional shortfall. I am pleased to report that based upon the handling of Franklin's foreign exchange contracts by the Federal Reserve Bank of New York, no additional loss to the receivership from this source is anticipated. In fact, the Corporation may ultimately recover approximately \$6.7 million of the funds Franklin deposited with the Federal Reserve Bank of New York if a recently negotiated tentative settlement agreement with the parent company of a foreign corporation, which had been principally controlled by Sindona interests, is finalized.

Finally, I should like to report on two additional recent developments. First, the problem which had existed with respect to certain domestic branches which had been financed by Franklin under special trust agreements has been resolved. European-American has now selected all 33 of these branches at their aggregate appraised value of \$18 million free and clear of any encumbrances.

Second, the bidding papers between FDIC and each bidding bank allowed the successful bidder to call upon FDIC for total capital support of a maximum of \$150 million to be funded by FDIC. European-American has previously received FDIC capital note assistance in the amount of \$100 million. We recently learned that European-American has decided not to exercise its option with respect to the additional \$50 million.

It is still premature to make any precise estimate of the total recovery likely to be realized on the Franklin assets being administered by the Corporation. Most of these assets have not yet been appraised, and the task of marshalling the records on the approximately six thousand assets being administered by the Corporation has not been concluded. It seems likely at this time that the first reasonably accurate estimates of ultimate recoveries from all Franklin assets acquired by the Corporation will not be made until the latter part of the year. Of course, any estimates made even then will be subject to change as the liquidation progresses.

United States National Bank

In this second supplemental report on the status of the USNB receivership, I will just briefly give you an update on some of the more significant statistics relating to the receivership and then turn to recent developments in litigation arising out of the USNB closing.

Total collections on the receivership assets now amount to \$36.4 million. The receivership estate has repaid approximately \$25 million from these collections to the Federal deposit insurance fund, reducing the amount the receivership owes the fund to under \$297 million.

The receivership has incurred total expenses of \$2.7 million. Projecting the remaining life of our liquidation in San Diego at 9 years, we estimate future expenses to reach a total of \$6.6 million, representing legal fees of \$4.5 million, salary costs of \$1.6 million and other expenses of \$.5 million.

In my testimony on the USNB receivership before this Subcommittee last December, I stated that certain events, including FDIC's payment of some \$47.7 million in disputed letter of credit claims, had caused FDIC's Board of Directors to anticipate adding substantially to the \$48.3 million reserve for loss in regard to the receivership. I reported to the Subcommittee that our best estimate at that time was for an addition to the reserve of \$50 to \$100 million. Unfortunately, the larger amount of our estimation subsequently appeared to be needed. As a result, due in part to a substantial disparity between the book value and currently appraised value of certain assets held by the receivership, we have now established the reserve for loss at \$150 million. This reserve in turn may fluctuate in the future depending upon the Receiver's success in liquidating the remaining assets and in defending and pursuing litigation involving the receivership estate.

Turning to litigation matters, the major litigation affecting the USNB receivership has increased in both volume and scope since my last report to the Subcommittee on December 12, 1974. This litigation primarily involves, as plaintiffs or defendants, certain persons affiliated with or related to USNB's controlling shareholder, C. Arnholt Smith. In addition, there has been increased activity in the cases involving USNB's letters of credit as the result of a decision by the Ninth Circuit Court of Appeals in the case of International Westminster v. FDIC.

As you may recall, the Purchase and Assumption Agreement between the Receiver of USNB and Crocker did not provide for the transfer to Crocker of liabilities and assets of persons or entities which appeared to be controlled by or in close association with C. Arnholt Smith. Pursuant to its statutory duty to collect all the assets of the receivership, the Receiver has filed thirteen separate lawsuits against some thirty-five members of this group seeking recovery of nearly \$100 million in compensatory damages and over

\$40 million in punitive damages. Most of these actions seek recovery on presently unpaid promissory notes. Named as defendants in these actions are all of those parties which appear to have participated in and benefited from the diversions of United States National Bank funds to entities other than those which appear as obligors on the notes. However, the present capacity of many such persons to repay the funds in the event of favorable court decisions is, at best, doubtful.

Although C. Arnholt Smith is named as defendant in five such actions brought by the Receiver, one suit which was filed against Smith as a sole defendant is of particular interest. This lawsuit seeks to recover approximately \$45 million under a personal indemnity given by Mr. Smith to USNB pursuant to a Cease and Desist Order issued by the Comptroller of the Currency in May of 1973. The Comptroller's Order required Mr. Smith to indemnify the bank against any losses resulting from many of the loans, extensions of credit or guarantees in favor of the group affiliated with or related to him. Smith has just filed an answer admitting the basic facts surrounding the execution of the Indemnity Agreement, contending, however, that the loans upon which the action is based are not 'losses,' that the Receiver has not taken the necessary steps to collect the obligations, that the Comptroller of the Currency forced him to sign the agreement under duress and that he was induced to sign the agreement by the Comptroller's promise not to close the bank. These allegations have not yet been answered by the Receiver.

The Receiver is at the same time defending various actions brought by certain Smith-related persons or entities. The reorganization trustee for the Westgate-California Corporation ("Westgate") has filed a suit in the Federal District Court for the Southern District of California which seeks to recover \$1.5 billion in actual and punitive damages from some 180 defendants. In addition to the Receiver, some of those named as defendants in this action are Mr. C. Arnholt Smith, former directors of USNB, and many members of the Smith-related group. The Westgate suit alleges several years of self-serving domination by Mr. Smith and his associates and seeks recovery for securities fraud and other alleged wrongs. The reorganization trustee for Westgate has also filed a petition in the U.S. Court of Claims against the United States whereby it seeks to recover \$100 million for an alleged unconstitutional taking of Westgate property by various agencies of the Federal Government. The petition alleges that the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Reserve Bank of San Francisco, and the FDIC undertook a course of regulatory activity which had the effect of strengthening the United States National Bank and protecting the Corporation's insurance fund at the expense of Westgate and its subsidiaries. In addition, the reorganization trustee for Westgate and M. J. Coen, another person closely related to Mr. Smith, have each filed administrative claims for damages pursuant to the Federal Tort Claims Act based upon various injuries allegedly caused by wrongful regulatory activities by the four above-mentioned agencies. The Receiver has filed an application

with the Chapter X Reorganization Court for an order requiring the trustees to dismiss all three of these actions on the basis that the claims are without merit, the continuation of the actions will deplete the assets of the debtor estate, and that the trustees have not filed required reports with the court demonstrating the benefits of such action and obtained leave of court to commence them.

Finally, yet another person closely related to Mr. Smith, Hollis Roberts, has filed suit against the Comptroller of the Currency, the Corporation, USNB, Mr. Smith and others seeking approximately \$27 million compensatory and punitive damages for alleged wrongs.

The lawsuits involving the still outstanding letters of credit issued by USNB are still pending and since my last report to this Subcommittee, there has been significant activity in these cases. In January of this year, the Court of Appeals for the Ninth Circuit in the case of International Westminster v. FDIC reversed and remanded the case to the trial court in order to allow the plaintiffs to file amended pleadings. The decision of the court of appeals did not disturb the rulings of law which had been made by the trial court. Shortly thereafter, amended pleadings were filed by the plaintiffs in these actions. Plaintiff's motion for summary judgment in one of the cases was recently denied, causing plaintiffs in the other cases to withdraw similar motions. All cases are now in the pre-trial discovery stage in the Southern District of California.

The letter of credit cases represent some of the most significant litigation in FDIC's history. They involve far more than the \$47 million in losses claimed by the plaintiffs. At issue is FDIC's statutory authority and flexibility to divide a large complex bank into its "good" and "bad" parts for the purpose of salvaging those "good" parts necessary to insure needed and continued banking services in the community. Such flexibility is needed in order to avoid, in appropriate cases, the necessity for handling a large bank closing by merely paying off its insured deposits and liquidating the entire bank.

Finally, the Subcommittee is no doubt aware that all criminal action against C. Arnholt Smith and Philip A. Toft was dropped when both parties settled their criminal liability with no contest pleas. Messrs. Smith and Toft were each fined and each received a suspended jail sentence.