

DOCUMENT RESUME

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[FDIC Actions on the Bank of Wheeling, West Virginia]. FOD-78-1; B-114831. March 6, 1978. 5 pp.

Report to Sen. William Proxmire, Chairman, Senate Committee on Banking, Housing and Urban Affairs; by Elmer B. Staats, Comptroller General.

Contact: Field Operations Div.

Budget Function: General Government: Executive Direction and Management (802).

Organization Concerned: Bank of Wheeling, WV; Federal Deposit Insurance Corp.

Congressional Relevance: Senate Committee on Banking, Housing and Urban Affairs. Sen. William Proxmire.

The Federal Deposit Insurance Corporation's (FDIC's) procedures and actions in notifying the proper authorities of alleged violations of criminal law at a bank were evaluated. The FDIC had formal, required procedures for reporting suspected criminal violations, and optional followup and other legal or administrative procedures reinforced the required procedures. The bank's first FDIC examination showed that the bank was in good financial condition. The next examination, 7 months later, showed that the bank was near insolvency because it had granted several bad loans and that criminal laws had probably been violated. The FDIC took required and administrative actions by preparing internal memoranda and by conducting a meeting on the bank's insurability. Two months after the second examination, the regional examiner sent a memorandum to headquarters stating: (1) because the FBI had been notified and was investigating the case, a report to the U.S. Attorney was not prepared; and (2) the bank's bonding company had been notified of possible criminal actions. Technically, the FDIC did not follow its reporting procedures because it did not send a letter to the U.S. Attorney stating that criminal laws might have been violated. However, while not completely in accordance with established procedures, the FDIC's actions were effective because the proper authorities were notified. (RBS)

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20540

MAR 6 1978

E-114831

The Honorable William Proxmire
Chairman, Committee on Banking,
Housing, and Urban Affairs
United States Senate

Dear Mr. Chairman:

You asked us to see whether the Federal Deposit Insurance Corporation had adequately looked into alleged irregularities at a bank referred to in your request. We only evaluated the Corporation's procedures and actions in notifying the proper authorities of alleged violations of criminal law. We did not examine the validity of the allegations. We examined procedures, interviewed personnel, and reviewed documents on how the Corporation reported and acted on the bank's problems. After looking at the Corporation's stated procedures during the 1960s and the procedures actually followed, we concluded that the Corporation's actions, while not completely in accordance with established procedures, were effective because the Corporation had notified the proper authorities.

REPORTING PROCEDURES BEFORE 1973

The Corporation had formal, required procedures for reporting suspected criminal violations, such as embezzlement and forgery. Optional followup and other legal or administrative procedures reinforced these required procedures.

Required procedures

Regional examiners were to follow one of two required procedures for reporting suspected violations, depending on their severity. Other general procedures were to be followed in all cases.

For both required procedures, examiners were to prepare a memorandum for Corporation headquarters in Washington, D.C., and a letter report for the U.S. Attorney, Department of Justice. In the first procedure, which was applicable to less

FOD-78-1
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B-114831

serious violations, the letter and memorandum were to be forwarded to headquarters. There the letter was to be processed through the Corporation's Division of Bank Supervision and the Legal Division before being sent to the U.S. Attorney. The report and a copy were to be sent to the U.S. Attorney, with copies going to Justice, the State supervisory authority, and Corporation files.

In the second procedure, applicable to more serious violations, the letter and a copy were to be sent directly to the U.S. Attorney, bypassing headquarters, if the regional examiner found beyond a reasonable doubt that a serious Federal crime had been committed which would warrant prosecution. Copies of the letter were to be sent to the State supervisory authority, the Federal Bureau of Investigation (FBI), and Corporation headquarters files. Even before sending the letter, in these serious cases, the examiner was to notify the local office of the FBI and Corporation headquarters.

In 1971, procedures were changed to provide that, if the FBI were already investigating suspected criminal violations or if the examiner knew that the FBI had been notified, a letter would not be sent to the U.S. Attorney. The Corporation's General Counsel felt that, in such cases, a letter provided no additional information.

Other procedures

A Corporation official said the Legal Division generally checks on the status of significant cases referred to the U.S. Attorney. In any event, the FBI usually sends a report to the Corporation on cases it investigates.

While Justice is investigating the alleged criminal acts, the Corporation can take administrative actions. Such actions may be taken, for instance, if bank officers are engaged in unsafe or unsound banking practices, if the bank is near insolvency because of the possible violation, or if officers have violated a written agreement with the Corporation. Administrative actions include (1) removing bank officers or directors and dismissing other persons, (2) requiring the bank to stop any unsafe or unsound practices, and (3) revoking a bank's Federal insurance. These actions may be taken separately or simultaneously.

If the Corporation believes that a bank is using unsafe or unsound banking practices, it may notify the bank and hold a hearing to determine whether the bank should stop these practices. If the Corporation concludes at the hearing that the bank's practices could lead to insolvency or deplete its assets, the Corporation may issue an order requiring the bank to end these practices. When a bank's problems are serious enough to warrant this order, the bank may be placed on the Corporation's problem bank list, if it is not already listed. This list highlights for the Corporation's management those banks whose problems could result in paying out insurance funds. Banks placed on this list are examined by the Corporation more often than other banks.

The Corporation may notify the bank and the appropriate banking authority that the bank is an insurance risk and that its problems must be corrected within a certain time limit. If the problems are not corrected, the Corporation notifies the bank that a hearing will be held to determine whether its Federal insurance will be revoked.

CORPORATION REPORTING PROCEDURES
ON THE BANK

The bank's first Corporation examination showed that the bank was in good financial condition. The next examination, 7 months later, showed that the bank was near insolvency because it had granted several bad loans and that criminal law probably had been violated. Specific problems found included:

- Such unsound finances that the bank had barely enough assets to cover its liabilities.
- Weak management practices that were harmful to the bank.
- Continuing lax credit, lending, and collection policies and practices.
- Failure of the officers and directors to comply with State law and Corporation regulations.

The Corporation then took required and administrative actions by preparing the internal memorandum and conducting a meeting on the bank's insurability. Two months after the second examination, the regional Corporation examiner sent

B-114831

a memorandum to headquarters, stating the reported violations. The memorandum said that (1) because the FBI had been notified and was investigating the case, a report to the U.S. Attorney was not prepared and (2) the bank's bonding company had been notified of possible criminal actions.

The Corporation held a meeting to determine how serious the bank's financial problems were and whether administrative remedies were needed. As a result, 4 months after the second examination, the Corporation took administrative action against the bank and its officers. The bank was directed to correct the situation in order to remain insured. Specifically, the bank was to:

- Remove one of the officers from active management so that he wouldn't directly or indirectly influence bank policies.
- Provide active and capable executive management approved by the Corporation and State banking authorities.
- Eliminate all assets classified as losses by the Corporation examiner.
- Reduce, by at least one-half, the substandard assets identified in the examination.
- Eliminate nonconforming assets or make them conform to the requirements of the law.
- Eliminate the three loans that violated Corporation regulations or make them conform.
- Adopt policies that would reduce the large concentrations of credit and would diversify the types of loans granted.
- Put assets in a form acceptable to the Corporation and the State authority and provide an adjusted capital account of at least \$500,000.

A copy of the Corporation's findings and recommendations was to be sent to the State supervisory authority and the bank. The bank was placed on the problem bank list.

B-114831

The bank largely complied with the Corporation's conditions, and the proceedings were discontinued 6 months after they began. Two years later, the bank was removed from the Corporation's problem bank list.

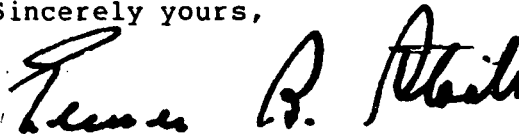
CONCLUSIONS

Technically, the Corporation did not follow its reporting procedures because it did not send a letter to the U.S. Attorney saying that criminal laws might have been violated. However, the FBI had been notified of possible violations, was investigating the case, and had the Corporation supply it with data during its investigation. The result was the same as if the letter had been sent; the appropriate authority had been notified. In 1971 the Corporation changed its procedure and no longer required a letter to the U.S. Attorney if the FBI had already been notified.

Because many people are concerned with the adequacy of the Corporation's procedures, our audit of the Corporation for fiscal year 1977 will include determining whether the Corporation is following present reporting procedures for suspected violations of criminal laws.

As arranged with your office, copies of this report will be available to interested parties who request them.

Sincerely yours,



Comptroller General
of the United States