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STATEMENT ON

UNITED AMERICAN BANK IN KNOXVILLE  
KNOXVILLE, TENNESSEE

PRESENTED TO

SUBCOMMITTEE ON COMMERCE, CONSUMER, AND MONETARY AFFAIRS  
COMMITTEE ON GOVERNMENT OPERATIONS  
HOUSE OF REPRESENTATIVES

BY

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WILLIAM M. ISAAC, CHAIRMAN  
FEDERAL DEPOSIT INSURANCE CORPORATION

10:00 a.m.  
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Room 2154, Rayburn House Office Building

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Mr. Chairman, we appreciate this opportunity to appear before your subcommittee to discuss the failure of United American Bank in Knoxville, Tennessee (UAB). We are submitting for the record a detailed regulatory history of UAB and the circumstances surrounding its failure. My opening statement will highlight the salient issues.

UAB for years operated on the fringe of soundness. It eschewed caution in favor of leverage, reasonable conservatism in favor of aggressiveness, and diversification in favor of real estate concentration and loans to insiders or quasi-insiders and their interests. With these policies, UAB needlessly exposed itself to adversity if and when the environment of economic expansion and inflation abated. UAB was a bank bordering on being out of control, both in an operational sense and in credit administration. Borrowers called the shots, partly because of the leverage a weak debtor always has over a creditor, but perhaps to a greater degree due to personal and business relationships with the man or men who made the decisions at UAB.

Jake F. Butcher acquired control of the bank in late 1974. The bank for a number of years had been a marginal performer with low earnings, comparatively high asset classifications and a dependence on high-cost deposits.

The May 1975 examination by the Comptroller of the Currency found the bank continuing to manifest problems in about the same proportion as in 1974, with loan classifications equal to 83% of capital (equity and reserves). This level of classifications was considered somewhat higher than normal in the aftermath of the 1974-75 recession. The April 1976 exam by the Comptroller showed conditions improving, with higher earnings and adverse classifications reduced to 50% of capital.

In late 1976 the bank converted to a state charter. The FDIC and the State of Tennessee examined the bank in early 1977 and found a continuation of the improving trend, with asset classifications at 30% of capital.

The Comptroller had been critical of the bank's policies relating to dividends, executive remuneration and credit life insurance premiums. FDIC examiners visited the bank immediately upon its conversion to a state charter to gather information concerning the bank, especially insider activities. On January 11, 1977, the FDIC's Regional Director wrote to the UAB board requesting that it conform to the FDIC's policy on credit life insurance premiums,

which required reimbursement to the bank of its expenses and disclosure of the arrangements to, and approval by, the bank's directors and stockholders.

Following the first FDIC exam, the FDIC Regional Director expressed his concerns in the areas of liquidity, capital, credit life commissions, adverse asset classifications, "official family" debt and out-of-area lending. Corrective actions were promised. At this stage, the bank was considered a marginal operation but clearly not of any serious concern.

Conditions remained stable through 1978, but the 1979 exam showed a significant, although not alarming, increase in loan classifications. Salaries and insider loans were criticized at a meeting with the bank's board, and a commitment for capital augmentation was obtained.

The bank showed good improvement in 1980. This did not last long, however, as the 1981 exam again revealed significant deterioration in asset quality and liquidity.

The FDIC had a long-held, general sense of discomfort about UAB, which was heightened by the 1981 exam. The bank had always been considered a "near-problem" or "borderline"

bank -- not sufficiently bad enough to trigger a formal enforcement action but sufficient to require closer than normal scrutiny and frequent "jawboning."

In May 1982, the FDIC met with the bank's board to outline the FDIC's mounting concerns about the bank. The board was informed that unless substantial improvements were evident by year-end, a formal enforcement action would be forthcoming.

The Butcher organization consisted of approximately 40 loosely-affiliated banks and S&Ls operating in two FDIC regions and three different Federal Reserve Districts. A total of seven different regulatory agencies were responsible for supervising the various institutions. The FDIC decided that the 1982 exam should involve a coordinated review of all of the major Butcher-affiliated banks. The Comptroller and the Federal Reserve were contacted to coordinate the examinations of their institutions. The FDIC committed 150 examiners and support personnel from three of its regions to the simultaneous examination of 12 banks.

The results of that effort are now well known. Massive loan losses were identified in UAB, and the bank was closed by the Tennessee Banking Commissioner.



A number of questions have been raised concerning the UAB failure. I would like to address a few of them.

A. The Conversion to a State Charter. Some people have noted the bank's charter conversion in 1976, suggesting that it may have been done to escape enforcement action by the Comptroller's Office and that the FDIC may have been derelict in pursuing the bank after the conversion. Nothing could be further from the truth.

First, the bank converted to a state charter primarily for the purpose of withdrawing from the Federal Reserve System, thereby avoiding very costly reserve requirements. This same action was taken by over six hundred banks from 1970 until the passage of the Monetary Control Act of 1980. No doubt a secondary consideration in the conversion was the higher lending limits available under state law.

Second, UAB was monitored by the FDIC continuously from the date of its conversion despite the fact that it was clearly not identified as a problem bank and, indeed, its condition was substantially improved as of the last exam by the Comptroller. The Comptroller had expressed concerns about some of the bank's practices. The FDIC expressed the same concerns, and obtained corrections, following the conversion. It is important to recognize that none of those

items -- executive compensation, credit life commissions and dividend policies -- played the slightest role in the bank's failure.

Third, the FDIC was not then and is not now regarded as an agency to which banks turn to escape supervision. Our very reason for being is to maintain stability and confidence in the banking system by preventing or correcting problems whenever possible. If the problems are too severe to be corrected, we want the institution closed as quickly as possible to mitigate the damage.

B. The FDIC's Motives. Another charge we have heard from some quarters is that the FDIC's investigation of the UAB situation was politically motivated -- that we were "out to get" the controlling shareholder because he was a high-profile politician. Any unbiased observer who might believe that simply does not understand how the FDIC functions. The loan classifications, partly because they were so shocking, were reviewed again and again at higher and higher levels all the way up to the Director of our Division of Bank Supervision. The enforcement actions were unanimously recommended by our senior staff and were unanimously approved by our bipartisan board of directors.

In the end, however, the facts will have to speak for themselves. The losses in UAB are massive and that will be borne out over time. We sincerely wish that were not the case. Our staff is spread from one end of the continent to the other working incredible hours handling a record number of problem banks and failures; the last thing we need is superfluous work. And no one is more acutely aware than we of the hardships and personal tragedies that normally accompany a bank failure.

C. The Rapid Deterioration. Other observers look at the massive classifications in the 1982 exam compared to the 1981 exam and wonder whether the FDIC should have been able to get on top of the situation more quickly. That is a fair question to which we do not have the complete answer at this time.

Nearly half of the loans classified at the 1982 exam were new loans since the 1981 exam. Moreover, a large portion of the remaining deterioration between 1981 and 1982 can be explained by the continuing decline in the economy and high interest rates. Finally, the simultaneous exams in 1982 were enormously useful in identifying troubled borrowers by focusing on their borrowing activities at various affiliated banks. Nevertheless, we believe some loans were



underclassified in 1981 -- that weaknesses could have been found in some loans had management's explanations been disregarded in favor of some deeper analytical work.

We will, of course, learn everything we can from our experiences at UAB, but we are satisfied that our overall performance was about as good as could have been expected under the circumstances. To uncover the UAB problems we had to weave our way through one of the most complex and tangled webs we have ever encountered. The effort tied up nearly 10% of our nationwide field force for the better part of three months.

Once we uncovered the problems, we acted appropriately to protect the public interest. We gave the bank every opportunity we could to contest our findings or come up with a solution. When the bank issued what we believed to be a misleading public statement regarding its 1982 results, we moved decisively to obtain corrected disclosure.

D. The Bidding Process. The final area of controversy I want to address involves the fairness of the bidding process. Some people believe that we showed favoritism toward First Tennessee in permitting it to submit a nonconforming bid. The detailed statement we have submitted to

the subcommittee, including the transcript of our board meeting, clearly demonstrates the contrary. The First Tennessee proposal was negotiated Sunday night when we were making an intense, though futile, effort to arrange a merger with one of three in-state firms to avoid the necessity of closing the bank. After the Commissioner closed the bank, we instructed First Tennessee to submit its bid on the same basis as all the other bidders. When it failed to do so, we selected the C&S bid even though most of our staff and I believed the First Tennessee bid to be superior from the FDIC's standpoint. It was not until C&S was unable to settle its differences with the Comptroller that we turned to First Tennessee.

Others contend that the process was too hurried and some bidders may have been precluded from bidding as a result. The observation is accurate; the process was in fact more compressed than we desired it to be, and I do not doubt that some potential bidders may have been excluded due to time pressures. However, I cannot apologize for our actions. We were faced with a crisis. I and a large number of FDIC personnel spent two consecutive days and sleepless nights to resolve the situation in the most orderly way possible to minimize the disruption to UAB's customers and maintain public confidence in the banking system. Those

objectives simply had to have priority over the objective of giving potential bidders all the time they might need to submit their proposals.

Mr. Chairman, I am gratified that you have given us this opportunity to answer some of the many questions that have been raised regarding the failure of UAB. I would be remiss, however, if I did not at least mention some of the larger issues with which we believe the Congress should be concerned.

UAB was a comparatively large failure and involved a high-profile political figure. In view of these factors, the special attention it is receiving in the media is perhaps understandable. But behind all of that, it is just another bank failure, not too dissimilar in terms of its underlying causes from nearly 50 others since the beginning of last year.

It is important that we not get lost in the trees -- that we step back and take a good, hard look at the forest. We should do more than question whether the regulators committed any errors in judgment with respect to the failure of UAB. I would be the first to acknowledge our fallibility.

In our judgment, a far more important question is whether our system of bank regulation and insurance is adequate to cope with an increasingly deregulated, complex and competitive banking environment. We believe it is not.

There is too much fragmentation in the regulation of banks and thrifts. Seven different agencies shared responsibility for UAB and its affiliates. That is at least several too many.

But no regulator or regulatory system will be able to stay on top of the problems we see emerging unless we get some help from the marketplace. A fast-paced, deregulated banking system, which we believe is in the public interest and fully support, will require substantially more discipline from the marketplace than is evident today.

This spring we will submit to the Congress a number of proposals for reforming the insurance system. They may include merging the deposit insurance funds, instituting risk-related insurance premiums, providing better disclosure concerning the activities and condition of depository institutions, and moving away from the notion that all creditors at the larger banks and thrifts will always be made whole when an institution fails.

I urge you and other thoughtful members of Congress to give these proposals prompt and serious attention. They are sorely needed if we are to achieve our number one priority at the FDIC: the maintenance of a strong and stable financial system under private ownership.

Mr. Chairman, thank you again for providing this forum. I will be pleased to respond to any questions you or other members of your subcommittee may have.

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