INFORMATION SUPPLEMENTAL TO

THE TESTIMONY OF

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Appendix (Transcript of FDIC Board Meeting)

RECENT REGULATORY HISTORY OF UNITED AMERICAN BANK
IN KNOXVILLE, KNOXVILLE, TENNESSEE

The following is a discussion of significant events occurring between the time of the last change of control ownership of United American Bank in Knoxville (UAB) and the date of the bank's closing.

I. Trends During the Butcher Era

Jake F. Butcher acquired approximately 51% of the shares of UAB, then known as Hamilton National Bank of Knoxville (no legal relationship to Hamilton Bancshares, Inc., Chattanooga), during the period from December 19, 1974, to February 20, 1975. At year-end 1975, the bank's name was changed to United American Bank, N.A., and on November 1, 1976, the bank converted to a state-chartered institution.

The bank that Mr. Butcher acquired from Frederick Ingram, James Stradler, and others, was not in satisfactory condition. The bank for a number of years had been experiencing problems in asset quality, manifested by an above-average level of adverse loan classifications and loan losses, and in earnings which were depressed somewhat by interest costs on deposits, where growth had been almost exclusively confined to interest-bearing time deposits.

The following are earnings-related figures for calendar 1974-1981 (000 omitted):

	1974	1975	1976	1977
Loan loss provision	3,414	1,919	1,075	1,655
Net income	101	2,507	2,414	2,802
Dividends	450	875	1,125	1,220
Sale of debt	6,000			
Sale of capital				
Net change	6,137	1,677	1,480	1,582
Return on Assets	.03%	.58%	.21%	.33%

	1978	1979	1980	1981
Loan loss provision	2,856	1,800	2,330	2,372
Net income	1,104	1,810	3,047	3,522
Dividends	990	990	1,026	1,080
Sale of debt				
Sale of capital		1,500	2,025	
Net change	114	2,333	4,046	2,442
Return on Assets	.20%	.33%	.51%	.50%

The 1981 return on assets of .50% was about one-half the relevant peer group average. Clearly, during the period covered by the above schedule, the bank was a poor earner. Its reliance on costly large denomination liabilities ($100,000 and over) was a material factor, as were loan losses. Less a factor, but nonetheless relevant, were executive salaries, other remuneration, and credit life premiums. Following are figures for 1977 through 1982 (000 omitted) for J. F. and C. H. Butcher:

	1977	1978	1979	1980	1981	1982
J. F. Butcher						
Salary, bonus and fees	198	86	197	178	176	175
Expenses	28	27	12	6	8	15
Credit Life	241	26	73	--	--	--
C. H. Butcher, Jr.						
Salary, bonus and fees	--	54	66	25	--	--
Expenses	--	4	10	9	1	--
Credit life	--	36	--	--	--	--

The May 12, 1975, OCC examination found the bank continuing to manifest problems in about the same proportion as that of the earlier November 18, 1974, examination. Adverse loan classifications as a percentage of equity and reserves were basically unchanged at 83%. This level of adverse classifications would usually be considered high, but not particularly critical.

The April 26, 1976, OCC examination showed the condition of the bank improved, with a reduction in adverse classifications to 50% of equity and reserves, an improvement in credit files, and slightly improved earnings. The letter transmitting the report of examination to the bank's board criticized both executive remuneration and dividends and the bank's credit life practices. Our files do not contain any enlightenment concerning the outcome of the criticism.

On November 1, 1976, in conjunction with a simultaneous examination and/or visitation program of 13 Butcher-related banks in two states under the supervision of six separate federal regulatory offices, FDIC examiners visited UAB to gather general information concerning the bank, especially

as related to insider activities. On January 11, 1977, the Memphis Regional Director wrote to the UAB board and advised it of the FDIC's policy concerning credit life commissions. He requested that the distribution of credit life commissions be considered and acted on by the board, that the bank be reimbursed for its costs related to credit life, and that the arrangements be disclosed to the stockholders. On January 25, 1977, the board approved the distribution and Mr. Butcher agreed to reimburse the bank for expenses. The stockholders approved the credit life arrangements on April 19, 1977. This practice was followed thereafter to the best of our knowledge.

The April 18, 1977, FDIC and State of Tennessee examination reflected a continuation of the improving trend, with adverse asset classifications decreasing further to 30% of equity and reserves. Criticism included comments related to delinquent loans, a more or less chronic problem then and thereafter owing to inconsistent and generally inferior loan servicing. Also mentioned were "official family" borrowings which were equal to 72.6% of capital and reserves. Adjusted equity and reserves stood at 5.5% of adjusted assets, somewhat below peer levels.

On November 18, 1977, the Memphis Regional Director invited J. F. and C. H. Butcher to the Regional Office to discuss the condition of UAB and other controlled banks. Two primary areas of discussion were liquidity and capital. Credit life commissions, adverse asset classifications, official family debt, and excessive out-of-area lending were also discussed. The Butchers gave assurances that appropriate attention would be addressed to these issues.

The May 8, 1978, FDIC and State of Tennessee examination showed a slight increase in adverse classifications to 39% of equity and reserves. Adjusted equity and reserves was mostly unchanged at 5.2% of adjusted assets.

Criticism included comments concerning the high level of loan delinquencies; the "reasonably adequate" but declining equity and reserves relation to total assets which were, at that time, expanding moderately; an increasing level of directors, officers, and related-interest debt, then equal to 142.9% of equity and reserves; and the bank's decision to extend its securities maturity distribution with new purchases since the previous examination.

The examiner met with the board of directors and reviewed the findings of the examination. The examiner noted at the time that the bank had changed to fairly aggressive lending practices, but had seemingly done so without having employed the staff necessary to service a loan portfolio reflecting such progressive policies.

On November 15-17, 1978, a visitation of UAB was conducted, and circumstances appeared not to have changed since the May examination.
C. H. Butcher, Jr., was again invited to the Regional Office to discuss UAB and other Butcher banks. At that time, Mr. Butcher suggested he and his brother were entertaining the idea of shrinking their empire by selling off a few banks.

UAB was next examined by the FDIC and the State of Tennessee as of the close of business January 15, 1979. Adverse loan classifications were up fairly substantially to 90% of equity and reserves. The adversely classified total included debt of some individuals who, although not official family by strict definition, were family or known friends and associates of J. F. Butcher. The examiner, citing a number of loans which were "substandard when made", urged a tightening of lending policies. There was clear indication that borrowers, in many cases, were dictating terms to the disadvantage of the bank. Earnings were described as weak, reflecting all previously noted problems as well as the additional negative income spread created by long-term, depreciated securities. Only $113,600 was added to capital after a dividend payout of $990,000. A capital augmentation plan was agreed to, and $1.5 million in additional equity was sold later in 1979.

Directors' and officers' borrowings were criticized due to the size of this category of debt. The total had risen to 149.7% of equity and reserves, including about one-third of that amount which was loaned to third parties against the equities of insiders' companies. The salaries of J. F. Butcher and other officers were criticized by the examiner who found them, in his opinion, "excessive."

All the foregoing findings and related recommendations were outlined to the bank's board at a meeting following the close of the examination. On April 18, 1979, J. F. Butcher came to the Regional Office to discuss the

examination report. There was some discussion of his salary, but other, more important matters were also discussed. A commitment for the sale of capital flowed from this meeting, and Mr. Butcher received a fuller understanding concerning the extent of the FDIC's dissatisfaction with UAB's lending practices, including insider lending.

The June 9, 1980, examination found adverse classifications in a "favorable trend," dropping to 47% of equity and reserves. Delinquencies were down to 7%, which remained fairly excessive, but an improvement over the 10% figure at the 1979 examination. Loan account servicing was again criticized.

The examiner correctly observed that the bank was especially vulnerable to adverse economic conditions because of the speculative nature of some of the ventures on which the bank was lending. The examiner held a board meeting, at which time he outlined the examination's findings and set forth his recommendations. The equity and reserves ratio had increased slightly to 4.9%, owing to the 1979 capital sale. Director, officer and related-interest debt was 139.0% of equity and reserves, but again was not criticized as to quality.

On August 18, 1981, the State of Tennessee examined UAB. The examination report reflected adverse asset classifications equal to approximately 64% of equity and reserves. There were no other areas of substantive criticism except for comments relating to four state law violations.

The FDIC conducted its next examination on November 13, 1981. Virtually all the improvements shown in 1980 had been reversed. Adversely classified assets were up markedly to 84.3% of equity and reserves. Adjusted equity and reserves slipped slightly to 4.7%, despite a 1980 capital sale of $2,025,000; liquidity had fallen to the very low level of 13.6%; and the large liability dependence ratio (the extent to which large liabilities are necessary to fund the loan account) was situated at a very high 43%. Official family debt, however, had fallen to 88.8% of equity and reserves.

The examiner met with the bank's executive committee at the close of the examination. The committee agreed that the bank would have a 6% equity ratio by year-end 1982 and a liquidity plan would be formulated.

After having reviewed the report, the Regional Director invited the examiner into the Regional Office for further discussions. From those discussions flowed a decision to meet with the bank's board. The meeting occurred on May 18, 1982. The Regional Director outlined the FDIC's mounting concerns about the bank, stating that, unless significant improvements were evident by year-end, the FDIC would seek to enforce a program of rehabilitation.

II. The Last Examination

The FDIC was now alternating examinations with the State of Tennessee, and the State Banking Department was scheduled to examine UAB next. When no examination had been conducted by September, the State was asked to either join us or "stand aside" for a November 1 examination since the Regional Director felt he could wait no longer. The State could not join the FDIC, but did agree to defer its own examination date to accommodate the FDIC's schedule.

The OCC and FRB were contacted with regard to a coordinated examination program. The OCC arranged to "visit" the bank in Lexington, Kentucky, since it had recently examined the bank. The FRB arranged to conduct a loan visitation of its bank in Nashville simultaneously with the FDIC's examination schedule. Since it was now fairly clear that Butcher banks had in the past shifted assets around during examinations, the Memphis Regional Director decided it would be well to examine at least the largest Butcher banks at once. That approach would also have the advantage of allowing examiners to look simultaneously at borrowings of the same debtors in different banks, perhaps to develop a better appreciation of their real debt service requirements and the source of their loan repayment proceeds. This, in the end, proved most helpful.

Six Tennessee examinations and six Kentucky examinations commenced by November 1, 1982. Examiners from the Atlanta, Columbus and Memphis Regions who, along with support staff in the various offices, numbering approximately 150, were utilized in the effort.

There was a great deal of coordination before and during these examinations. There were three meetings involving examiners from the various banks: one before the examination, one in mid-November, and one in mid-December following loan discussions with bank management. The general purpose of these meetings was to develop common strategy for combatting loan shifting to avoid detection of problem credits, to share information, and, finally, to arrive at uniform classifications of common credits.

The examiners at UAB were able to detect a clear indication of the seriousness of the situation due to the high level of delinquent credits discovered in initial loan review. Also, widespread capitalizing of accrued interest was uncovered, signifying lax servicing, borrower distress, or both. The loan review at UAB lasted for a very extended period of approximately six weeks, due partially to poor credit and collateral files, but also due to a serious lack of management knowledge of credits. Despite many promises by senior officers to obtain supporting information, progress in improving the condition of the criticized credits was very slow and sparse. Many loans were discussed several times in an effort to gain management's attention to them, with the hope that some fruitful discussions would flow. This basically did not result and, in fact, any

defense to adverse classifications of loans was practically nonexistent. During the loan discussions, senior officers generally responded by stating they would obtain necessary documentation and get back to the examiner later.

On January 7, 1983, Regional Directors Meadows and Waldrop and Director Sexton met with J. F. and C. H. Butcher, Jr., who subsequently committed in writing to a program with respect to all banks owned or controlled by them. The program included halting certain loan purchase transactions, restricting lending to any one borrower to 2% of equity capital without prior board approval, restricting further extensions of credit to classified borrowers, and weekly reporting of certain loan activity to the appropriate Regional Office.

On January 11, 1983, a joint meeting was held at the FDIC with representatives of the FDIC, OCC, FRB, and FHLBB to advise all involved agencies of the preliminary findings of the coordinated examination efforts and the perceived solvency problems at UAB. Although there was no indication that the January 7 informal agreement had been violated, it was believed that the condition of UAB was so imperiled that the agreement should be broadened and formalized in Section 8(c) actions ("temporary" or "emergency" orders to cease and desist). The 8(c) Orders, adopted by the FDIC Board of of Directors on January 19, 1983, prohibited selling loans to other institutions without full written disclosure; required approval by the bank's board of any new loans made in excess of $250,000, with a weekly list of such transactions to be provided the FDIC; prohibited the making

of further out-of-area loans; prohibited loans to insiders absent legally binding commitments; prohibited issuing letters of credit (except for cash) and guarantees; and prohibited executing repurchase agreements on any loans sold.

On January 12, in an all-day meeting with FDIC examination staff, J. F. Butcher was made aware of each major loan classification, even though, through other meetings and contacts, he was generally aware of the seriousness of the problem well in advance of that time. One such occasion was a December 17 meeting with the Memphis Regional Director when Mr. Butcher was advised that the preliminary loan classifications were massive and that new capital in the "tens of millions" range was going to be needed.

Early in January, Mr. Butcher asked how long the examination would remain open; *i.e.*, how long did he have to improve the classified loans before the FDIC considered the examination final enough to act on. Due to the need to bring the matter to the UAB board's attention and get some corrective programs underway, the Regional Director set up a board meeting on January 25, which meant the report would have to be closed by that time. During the week of January 17th, Mr. Butcher apparently decided that his efforts on credits were a tactical error and that he could better spend his time raising new capital. For the first time, it seemed, Mr. Butcher appeared seriously concerned that UAB might be declared insolvent.

It is worth noting that, between December 24 and January 1, three large loans which had been criticized extensively during the loan discussion were sold to another financial institution. As examiners were able to determine that a repurchase agreement existed, the $13 million in loans were not removed from UAB's adverse classifications. Mr. Butcher tried unsuccessfully to get the repurchase agreement cancelled. UAB ended up having to repurchase the loans. This type of activity was encountered on several occasions by our examiners as management attempted to mitigate adverse classifications by nonsubstantive and/or evasive means.

On January 25, 1983, the Memphis Regional Director and the examiner-in-charge of the UAB examination met with the bank's board of directors. At that time, full disclosure of the bank's condition was made. The board was advised that, based upon the level and severity of the adverse asset classifications, the bank's capital needs would approximate $90 million. During the board meeting, the directorate asked no questions concerning adversely classified loans, despite the examiner's willingness to entertain questions on the large losses. The board was advised that the Regional Director would recommend that action be instituted to remove the bank's deposit insurance due to its poor condition.

On January 28, 1983, despite information received at the board meeting on January 25, UAB released financial information stating 1982 losses were only $2.3 million. In addition, the bank submitted to the FDIC year-end Reports of Condition and Income reflecting similar figures. Since the

bank had placed what the FDIC considered to be misleading and inaccurate information in the public domain, a meeting was held on February 1, 1983, in the Washington Office with representatives of the bank, at which time immediate correction of the inaccurate disclosures was demanded. As the bank's response and proposed solution did not appear to adequately address the problem in a timely fashion, the FDIC Board on February 4 adopted an order under Section 8(c) prohibiting the bank from issuing any false or misleading information to the public or filing any false Reports of Condition and Income; requiring correction of the misleading public statement issued on January 28; and requiring the filing of amended Reports of Income and Condition as of December 31, 1982.

On February 4, 1983, J. F. Butcher, et al., met with FDIC officials in Washington concerning his plan to furnish capital for UAB. The plan involved a $30 million injection of capital. Of this amount, $15 million in preferred stock seemed obtainable since the proposed purchaser appeared strong enough financially to handle the purchase. Another $5 million of preferred stock involved three individuals who might or might not have been able to perform. On these individuals, we asked to be advised of sources of funding. On the remaining $10 million, J. F. Butcher proposed a merger of another of his banks into UAB, projecting the equity increase at $10 million. We were a little skeptical of the value, and asked that it be documented more fully although such documentation was never received. We advised Mr. Butcher that while we would be pleased to have any new capital in UAB, the amount proposed was inadequate to convince us that action under Section 8(a) (withdrawal of deposit insurance) would be

any less appropriate. Our calculations showed that even accepting Mr. Butcher's represented values with respect to the capital injection, the bank would still have a substantially negative adjusted capital, with a remaining terrific overhang of adversely classified credits for which reserves would have to be supplied.

Mr. Butcher and the others were informed by the FDIC that the bank's situation was extremely critical. Federal Reserve borrowings were mounting and a serious crisis of confidence on the part of depositors and other funding sources was developing. The FDIC urged the bank's management and directorate to come up with something immediately in the way of a solution to the bank's problems. It was pointed out that the bank at that point was living day-to-day. If something dramatic were not done promptly, a depositor run could begin at any time.

On February 6, FDIC representatives from Washington and Memphis met with Atlanta Federal Reserve officials and the Commissioner of Banking in Tennessee, W. C. Adams. The purpose of the meeting was to make contingency plans. The State of Tennessee had entered the bank late in January to make a determination as to whether the bank was viable and was still involved in that effort. The president of the Atlanta FRB was concerned that the $75 million in collateral taken (with the FDIC's advice and assistance) would not be sufficient to allow Commissioner Adams to finish his examination at UAB. The meeting ended on a strategy that Commissioner Adams would finish up his work by Wednesday of the following week. If his findings revealed insolvency, he would convene the bank's board and ask

for the appropriate amount of capital and, depending upon his assessment of the board's ability and inclination to meet the demand, would either close the bank or would give the bank's board a week to raise the capital. This being the program, the FRB president said he could envision lending up to the area of $200 million to give the board, or alternatively the FDIC, time to do what had to be done. Of course, the FRB would take a blanket asset lien to protect itself while doing this.

III. The Final Weekend

The Commissioner did not finish his examination on Wednesday; in fact, he subsequently advised us that the board meeting could not be held until Monday, the 14th. Meanwhile, the FDIC's newest 8(c), relating to correction of published information, had become an important local news item. Before the week of February 7 was over, borrowings at the FRB were in the $85 million range because of a steady "run" of large creditors, signs had gone up at some places of business announcing that UAB checks were not welcome, and a retail depositor "run" was experienced at the bank's Fountain City branch. At a little after the bank's closing time on February 11, the FRB president called, expressing doubts that the situation could be held together. The FDIC agreed that might well be the case and decided that the bidders' meeting had to be moved very substantially forward. Commissioner Adams was not prepared at this time to give the FDIC a letter indicating that the bank was insolvent because his loan review was continuing through Saturday. He ultimately was able to set up a board meeting at 4:00 p.m., Sunday the 13th. At that meeting, Commissioner Adams

demanded $30 to $40 million in additional capital by the following Friday (the 18th).

Whereas the FDIC had planned to call bidders (assuming the Commissioner gave the FDIC a letter asking the FDIC to prepare for a closing) on Tuesday the 15th, hold the meeting on Wednesday the 16th, and accept bids on Friday the 18th, we had to forego that preferred "leisurely" pace and call bidders the next morning, Saturday the 12th. The meeting was set for 6:00 p.m., Sunday, in Atlanta.

The FDIC had 50 banking organizations on its bidders' list. Despite weekend communications problems, we were able to contact 46 of these, and 23 came to the bidders' meeting.

This was FDIC's first experience under the interstate provisions of the Garn-St Germain Act. It was decided that qualified in-state banking organizations with assets of $1 billion and over would be invited, along with all contiguous-state holding companies with assets of $1.5 billion and over, and in all other states, holding companies with assets of $5 billion and over. An equity ratio of 5% was required for all, as was a composite CAMEL rating of 1 or 2. The purpose of the size criteria was simply to get a decent-sized universe of bidders capable of handling the transaction. The reasons for the quality criteria are obvious.

Meanwhile on Sunday evening, UAB was moving closer to opening hour on Monday the 14th. A number of responsible observers were predicting a massive run and that the Commissioner, the FDIC, and the FRB, could easily be left

with the wreckage of a bank forced to be closed during the day. Television cameras and newspaper reporters were camped around the UAB offices speculating about the bank's condition and the possibility of a run on Monday.

The Commissioner considered a joint FDIC/Commissioner press release stating that the bank's board was planning to raise $30 to $40 million in new capital by the following Friday, which would restore the bank to solvency. The FDIC declined to join in the proposed press release on the ground that even $40 million would not be nearly adequate to cover the massive losses and leave the bank in viable condition. The Commissioner was informed that even if the funds were injected, the FDIC would find it necessary to commence a Section 8(a) action to terminate deposit insurance.

In a last-ditch effort to avoid closing the bank on Monday, the FDIC conducted individual merger negotiations throughout the night on Sunday with three in-state banks, First Tennessee, Union Planters and Third National. Each was requested to make a proposal for an open-bank merger along the lines of the transaction ultimately entered into with First Tennessee.

Union Planters and Third National made offers between midnight and 1:00 a.m. which were rejected on the basis of price (cost to the FDIC). First Tennessee worked throughout the night and around 5:00 a.m. made an offer, which was generally acceptable. Unfortunately, time had run out. It was simply not possible in the few hours remaining prior to the bank's opening hour to put together the merger.

At this point, the Commissioner and the Federal Reserve were faced with an enormously difficult decision. Should the bank, which was clearly insolvent, be permitted to open on Monday and face the probability of a massive, televised run? What effect would that have on public confidence in other banks in Tennessee and elsewhere? Would it be less disruptive to close the bank on Monday and issue a press release announcing that the FDIC would have the bank reopened at normal hours on Tuesday under new ownership and that no depositor would lose any money?

It was decided by the Commissioner and the Federal Reserve, a judgment in which the FDIC concurred, that the risks involved in permitting the bank to open on Monday were simply too great. The bank was insolvent by a large margin and no acceptable recapitalization plan was available. A run seemed certain and the potential ramifications for other banks could not be risked. The Federal Reserve called its loan, the Commissioner closed the bank and the FDIC issued a press release promising to have the bank reopened at normal hours on Tuesday.

The banks attending the bidders' meeting on Sunday had been informed that we did not know if or when the bank might close, but they should be prepared to bid on short notice. First thing Monday morning they were called and instructed to have their bids in by 5:00 p.m. that day. Eight bids were received. Because the best bid was from an out-of-state bank and two other bids were within 15% (in terms of net cost of the failure to the FDIC), a second round of bids involving the top three bidders (C&S, First Tennessee and First Union) was required by law.

First Tennessee was informed prior to receipt of its first bid that we would prefer that it bid on the same basis as the other banks rather than submitting a bid structured along the lines negotiated the previous evening. Despite this, First Tennessee submitted a nonconforming bid.

The three bidders were each given one hour to submit their second round proposals. First Tennessee was clearly instructed that it must submit a conforming bid on the second round in order to facilitate cost comparisons.

C&S, the highest bidder on the first round, raised its bid by $5 million. First Tennessee raised its bid by $10 million, but declined to submit a conforming bid.

After a lengthy discussion, the FDIC Board decided to accept the C&S bid because it had conformed to the bidding instructions and was arguably higher than the First Tennessee bid (a transcript of the Board meeting is attached). First Tennessee was informed it had lost. The FDIC then discovered that C&S and the OCC were involved in a disagreement relating to capital and the booking of goodwill. First Tennessee was called back immediately and asked to stand by in case the problem with C&S could not be resolved.

Apparently, the OCC had given C&S instructions about the capitalization of the new bank in the event its bid were successful and C&S had failed to conform to those instructions. The FDIC urged the parties to resolve the matter one way or the other without delay.

Time was becoming critically short. A deadline was set for resolution of the problem. It missed by 10 minutes or so. Another brief extension was sought by C&S and it was granted. When the second deadline went by and the impasse was still apparent, the FDIC felt it had no option but to switch to First Tennessee. The discussions between C&S and the OCC had lasted for more than an hour without any apparent progress. If we did not do something quickly, the bank would be closed a second day.

First Tennessee and the FDIC worked throughout the night Monday to draft the agreements and get the bank opened. All offices of the former UAB were opened on Tuesday morning by about one-half hour later than the normal time.

IV. How It Happened

The question of what happened to UAB has several facets. To start with, as has been suggested previously, the bank's officers were not in control of the files, much less the borrowers. More to the point, the borrowers were dictating terms to the bank. In many cases, we feel the reason for that inverted relationship is that the borrowers were close friends or associates of the person or persons making the decisions in the bank. Because of this, as well as the bank's own consciously-chosen expansive operational philosophy, marginal credits were made in the normal course of business. Adverse economic conditions deal harshly with marginal borrowers and banks, and this case was no exception.

There may be more to the fundamental story than that. As is our usual practice, we have investigators in the bank whose job it is to search for civil liability and to report any criminal irregularities uncovered. As those facts are found, we will take appropriate action.

Another question is how this problem exploded so spontaneously from an apparently much less serious situation at the last examination. Of the $377,201,000 in adversely classified loans at the November 1, 1982, examination, the FDIC analyzed the genesis of $358,519,000 (all except a sizable group of smaller credits). Here is the result:

Adversely classified at last examination	24,072,000
Less: Reductions of various types	4,183,000
Net remaining classifications	19,889,000
Loans existing at the last examination, but not classified	178,274,000
New loans since last exam	160,356,000
	358,519,000

To attempt to understand the $178,274,000 figure, we analyzed the 25 largest loans which were subject to adverse classification and found a variety of circumstances. In some cases, the loans simply worsened as economic conditions and high interest rates continued to weaken the position of marginal borrowers. In others, management promises, whether or

not meant to mislead, did not materialize as represented. In one case, a substantial loan had been participated upstream and was repurchased. Also, the simultaneous examinations helped considerably in 1982, as examiners were able to obtain a better picture of overall borrowings and the source of debt-service payments by customers shared in common by UAB and various other affiliated banks.

In some cases, adverse classifications were simply missed. The volume is difficult to determine from this vantage point but there were several loans where weaknesses could have been found had management's explanations been disregarded in favor of some deeper analytical work. The examiners at the current examination had the benefit of skepticism based on some of the insights contained in the previous report. Also worth mentioning is that the files were in abominable condition at the 1982 examination. Bank management had gotten unusually careless, and the FDIC examiners had a great deal of tenacity.

Another aspect is that of insider dealing, not in the usual definitional sense, but in a broader context which is difficult to define. We hope to ultimately find out why so many friends, family and associates borrowed so much and why they have been so reticent about payback. Strict-definition insiders (officers, directors, and their interests) owed UAB only 62% of its total equity and reserves. When loans to borrowers who are not insiders but who are considered friends, associates and family of insiders are added, the figure becomes $211,516,000, or 506% of total equity and reserves.

Further light is shed by the following categorization of 245 of the largest classified loans (duplication between the groups makes the total a meaningless figure):

		No.	AMT. (000)
1.	Loans to failed businesses remaining on the bank's books	5	5,008
2.	Loans on which documentation and management knowledge were seriously absent	35	95,980
3.	Loans for speculative real estate investment and development	62	127,748
4.	Loans to interests of the Butcher family, friends, and associates	70	211,516
5.	Loans to borrowers whose financial positions were weak, questionable or not supported	94	194,064
6.	Loans to ventures related to the World's Fair	14	11,320
7.	Loans to ventures and interests in Florida	10	24,434
8.	Loans to coal mining interests	7	14,544
9.	Loans to borrowers whose weaknesses appeared directly related to economic recession	9	19,276
10.	Loans which were assumptions and restructures of previously distressed credits, or other real estate owned by this bank	16	60,581

It is also a fact that the bank's five largest borrowers, including their various corporate interests, owed the bank $251 million on the date of examination. UAB was active in selling loan participations although it

bought few. At the 1982 examination, there was $125 million in participations sold, compared to $106 million at the 1981 examination. "Upstream" participations account for $16 million and $34 million, respectively. The latter figures perhaps reflect the manner in which the "upstream" correspondents had dried up during the last year, largely in reaction to the Penn Square episode.

V. Payoff vs. Merger

The FDIC has a choice between a payoff and an assisted merger transaction when handling a failed bank. In this case, the premium First Tennessee paid to the FDIC reduced the FDIC's cost below that of a payoff of insured depositors, making the assisted merger the least expensive action. The FDIC estimated that the ultimate loss on the collection of assets would be in the $160,000,000 range (including securities depreciation). Of that amount, uninsured creditors would have absorbed about $50 million, leaving the FDIC with a $110 million ultimate loss. The First Tennessee bid was valued at $67.5 million, meaning that the FDIC's loss was reduced to $92.5 million.

First Tennessee offered to accept $86,500,000 in total loan losses after having received all assets of the former UAB and after having assumed all its unsubordinated book liabilities. After this threshold is reached, the FDIC commences to absorb losses and will continue to absorb all further losses identified by the FDIC during the period extending two years from

the date of closing. Losses occurring beyond that date are the responsibility of First Tennessee. The $86,500,000 in losses are absorbed as follows: $42 million by UAB's equity accounts, $10 million by UAB's subordinated creditors, and $34.5 million by First Tennessee.

First Tennessee's bid is priced at $67.5 million as follows:

Loan losses to be absorbed	$34.5 million
Securities depreciation existing in securities acquired	18.0 million
Value of the contract to FDIC	15.0 million
Value of bid	$67.5 million

The value of the contract includes lower funding and collection costs and the advantage of avoiding losses occurring beyond two years. Moreover, collections on charged-off assets are to be distributed to the FDIC, and potential claims against directors, officers, accounting firms, etc., were assigned to the FDIC as part of the agreement.

VI. Competitive Analysis

In forming the competitive analysis associated with selecting bidders for the UAB transaction, it was recognized that, because of the size of UAB, any combination of institutions already in Knox County would have some adverse competitive effects. UAB had 18 offices in Knox County with total IPC deposits of $438,177,000, which was equal to 31.6% of total commercial bank deposits in Knox County and 21.1% of total commercial bank and thrift

institution deposits in Knox County. The First Tennessee National Corporation subsidiary, First Tennessee Bank, Knoxville, Tennessee, had seven offices in Knox County with total IPC deposits of $138,975,000, which was equal to 10% of commercial bank deposits and 6.7% of combined commercial bank and thrift institution deposits in Knox County. UAB had 2.6% of total statewide commercial bank deposits, and First Tennessee National Corporation, through its 14 subsidiaries, had 11.1% of total statewide IPC deposits. Before inviting First Tennessee to bid for UAB, a competitive analysis was performed. It was our judgment, that while there were other institutions whose entry into the market might have been more pro-competitive, First Tennessee's concentration in the Knoxville market -- attributable primarily to the institution it was seeking to acquire and not to the institution it already owned in the market -- was acceptable. Whatever problem was created did not rise to the level that would suggest that First Tennessee be denied the opportunity to bid on the UAB purchase and assumption. The Antitrust Division of the Justice Department was not contacted in this matter because it did not appear necessary.

VII. The Private Placement

A remaining issue to be addressed concerns the sale of capital stock in the final days of the bank's existence. UAB had proposed to sell $10 million in capital stock in a private placement to National Investors Life Insurance Company, Little Rock, Arkansas, a subsidiary of Baldwin-United Corporation, Cincinnati, Ohio. The private placement was arranged through Phoenix Investment Corporation, New Canaan, Connecticut. In December, $4

million in common was indeed sold. At the time of the bank's failure, the sale of the additional stock was pending. No offering circulars or related statements were available to the FDIC's knowledge. No formal circular was used since the transaction was in the form of a private placement relying on a "due diligence" review by the placement broker.

The FDIC has no guidelines or rules that would apply to a private placement of securities by a state nonmember bank. Private placements are exempt from the registration requirements under the securities laws and, thus, the FDIC has no authority to regulate such issues. The sale of the stock was in response to a request by the FDIC for UAB to raise more capital based upon the findings of the November 13, 1981, examination.

The circumstances surrounding this transaction are currently of special interest to the FDIC investigations unit. For example, on January 12, 1983, UAB, for itself and as agent for five other affiliated banks, purchased $13 million in Baldwin-United Senior Term Debentures due in 1996. The propriety of what appears to be a <u>quid pro quo</u> funding arrangement is certainly open to serious question.