STATEMENT ON

CRIMINAL MISCONDUCT AND INSIDER ABUSE

PRESENTED TO

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

BY

WILLIAM M. ISAAC, CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

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Room 2247, Rayburn House Office Building

Mr. Chairman, members of the Subcommittee, we welcome this opportunity to present the FDIC's views on the subject of criminal misconduct and insider abuse.* As the insurer of the nation's banks we are vitally interested in any activity which leads to bank failures, and the correlation between insider abuse and failures is well documented. We join with you in seeking additional solutions to this problem.

Today I will outline some of the steps we are taking to combat criminal misconduct and insider abuse and discuss our recommendations for legislative help in addressing them. First, though, I will enunciate what we perceive the problem to be.

Criminal misconduct in its broadest sense is not the problem. There are literally thousands of incidents of criminal misconduct annually. Yet, in the vast majority of instances, the risk is effectively controlled and dealt with by the banks involved through the use of proper audits, insurance, and the initiation of quick and decisive action against those individuals responsible. The problem lies in that small segment of banks where abusive practices are engaged in by the bank's most senior officers, dominant directors, or principal shareholders who are in a position to control bank operating practices and, in most instances, dominate the policymaking functions of the bank's board. I believe this view of the problem, or one very similar to it, is shared by the Subcommittee, but the point is worth emphasizing because it reveals some unique characteristics of the problem and suggests where our efforts should be directed.

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* Our response to the Subcommittee's detailed request of April 4, 1984, has been submitted for the record under separate cover.

First, we are focusing our onsite examination resources on banks with 3, 4 and 5 ratings and on larger banks. Lower rated banks are more likely to exhibit the conditions conducive to insider abuse and, although insider abuse occurs infrequently in larger banks, it can be particularly devastating to them. We are also substantially upgrading our offsite monitoring capabilities which will be of assistance to us in identifying institutions where the potential for insider abuse may be present.

Second, we are augmenting our already extensive training programs. In practically all of our schools and in our on-the-job training programs, we teach specific techniques for uncovering insider abuse as well as the danger signals which may indicate its existence. Many of the training modules in these schools are being strengthened and a new course is being developed which is directed at the preparation of blanket bond claims and director and officer liability claims. The skills taught in this course will be directly transferrable to the detection of insider abuse in operating banks.

Third, we are taking initiatives in the areas of public disclosure and risk sharing with uninsured creditors which will limit funding opportunities for poorly managed banks. Publicly available information in quarterly Call Reports has already been substantially expanded, and we are working on making additional information available, including the existence of enforcement actions against specific banks. We have recently tested a modified pay-off approach to handling bank failures which exposes uninsured creditors to loss while at the same time providing them with immediate access to funds equal to what we estimate will ultimately be collected in the receivership. You are also familiar with our recent rulemaking to limit deposit insurance on

brokered funds. We are convinced that actions such as these will substantially inhibit the ability of individuals to fund abusive schemes and, where abusive practices exist, will surface them more quickly. The ready availability of funding facilitates the concealment of criminal or abusive conduct and balloons our losses.

Once insider abuse is detected -- and it always is eventually -- we assess its impact on the institution and take necessary actions with respect to both the bank and the individuals involved. Information has been supplied to the Subcommittee showing extensive utilization of our civil enforcement powers. Excluding actions taken with respect to consumer compliance laws, we entered into 454 memorandums of understanding in 1983, compared to 237 in 1980. Formal enforcement actions increased even more dramatically from 49 actions in 1980 to 258 actions in 1983. Use of our most forceful powers, insurance removal and emergency cease and desist actions, grew from 11 cases in 1980 to 62 cases in 1983. Actions against individuals also increased significantly although this cannot be defined numerically. These include not only civil money penalties and removal actions, but also specific clauses in all types of orders which are directed at individuals and their functions within the institution, as well as removals and resignations obtained through informal means.

When a bank fails, our efforts are directed toward seeing that any violations of criminal laws or other abusive practices, as well as negligence, are uncovered and appropriate actions taken against the individuals involved. In addition to referring criminal violations, we aggressively pursue claims against bonding companies and civil actions against individual officers and

directors, accounting firms and others who it appears have been negligent in performing their functions. This is not only necessary as a part of our receivership activities, it also provides strong encouragement for others in the banking industry to perform their duties in an honest and diligent manner.

We are working very hard to eliminate that small element of insider abuse and unprofessionalism that exists in the banking industry, but we are in need of legislative assistance to enhance our ability to do so. Last November we requested legislation (H.R. 4451) to strengthen and refine certain provisions of the Federal Deposit Insurance Act. A new version of this bill will soon be submitted which will contain additional provisions, most of which are directly applicable to the subject matter of these hearings. This bill will include provisions enabling us to pursue our marketplace discipline objectives and to enhance our civil enforcement powers by improving their timeliness as well as their flexibility in dealing with individual officers and directors. It will strengthen our ability to examine and control transactions with bank affiliates and will give the FDIC the authority to take the full range of enforcement powers with respect to all insured banks.

Our proposed legislation would also allow the FDIC to make distinctions among different types of depositors and to determine which should be eligible for federal deposit insurance. In our opinion, there is no legitimate reason for insuring deposits placed in banks by other depository institutions or by government agencies such as the the Bureau of Indian Affairs. Credit unions, savings and loans, banks and government agencies clearly ought to be able to make informed judgments about the condition of the financial institutions in which they place funds, instead of merely seeking the highest yields as they

too often do today. If these types of depositors were forced to make such judgments, banks would have a powerful incentive to curb excessive risk-taking. This reform is essential if we are to ensure the continued strength and effectiveness of the federal deposit insurance system.

Finally, our proposed legislation would enable us to move to a risk-based assessment system for deposit insurance and would authorize the FDIC to charge troubled banks for the increased cost of supervision they require. Though our proposals in these areas are modest, they represent long overdue steps toward a more equitable deposit insurance system -- one that rewards the vast majority of banks that are prudently operated and penalizes the few that abuse the franchise they have been given.

I thank you for the opportunity to appear and present our views on this important subject. I am not so naive as to believe that the problem of insider abuse will ever be completely eliminated, but I firmly believe that, with the Congress' assistance in adopting necessary legislation, we can make significant strides in controlling it.