



FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

OFFICE OF THE CHAIRMAN

STATEMENT

AN UPDATE ON THE FAILURE OF THE PENN SQUARE BANK
OKLAHOMA CITY, OKLAHOMA

PRESENTED TO

COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS
UNITED STATES SENATE

BY

WILLIAM M. ISAAC
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

9:30 A.M.
FRIDAY, DECEMBER 10, 1982

ROOM 5302 DIRKSEN SENATE OFFICE BUILDING
WASHINGTON, D.C.

Mr. Chairman:

The events surrounding the Penn Square failure have been widely publicized and are well known to the Committee; I will not dwell on them in my prepared remarks. I would like to focus on the lessons to be learned from Penn Square and update the Committee on FDIC's post-closing activities.

Our feeling is that the failure does not teach us much new. Rather, it confirms a lesson of the past, namely that laws, regulations, and supervision are not always effective in preventing or curing problems where a bank -- and its Board of Directors -- are dominated by a strong personality who is set on a course of mismanagement. We feel strongly that uninsured depositors and other investors need to pay more attention to how their banks are run and must be provided better information upon which to base their judgments. To the extent that Penn Square has heightened awareness of this, it has been beneficial.

Well before Penn Square, we were in the process of revising and expanding the call reports we obtain from banks. We believe Penn Square underscores the desirability of collecting more and better information and of making more information available to the public. Quarterly reports on nonperforming loans, for example, will be required commencing January 1, and this information will be made public commencing with the reports of June 30, 1983. While some bankers have expressed concern about making this information public, I should point out that similar information has been reported for years to the SEC by publicly-held institutions without resulting in any undue harm. If institutions with higher than normal

ratios of nonperforming loans have more difficulty attracting funds, we believe that is a healthy and appropriate result of disclosure. Given timely and factual information about banks, we hope and believe the investing public will reward the better-managed institutions with lower-cost funds.

In addition to seeking additional information about banks and requiring its public disclosure, we are proceeding with the deposit insurance study mandated by Title VII of the Garn-St Germain Act. In an environment where funds may be transferred almost instantaneously by electronic transmissions anywhere in the world, where money managers must operate profitably on narrowing spreads, and where deposits are more likely to be viewed as investments than ever before, it is appropriate to reexamine the basic tenets of our insurance programs and regulatory structure. We are particularly concerned that as federally-mandated restrictions on competition are diminished there be some effective substitution of market discipline. Our study is directed toward finding answers about how to maintain the integrity of our financial system in this challenging new competitive environment. We look forward to appearing before you next year to discuss these matters.

When the FDIC was appointed receiver for the Penn Square Bank on July 5, we found ourselves faced with one of the most difficult situations we have ever encountered. I cannot speak too highly of the performance of the scores of FDIC employees who have been working 16 and 17-hour days, seven days a week since that holiday weekend. The early days were chaotic, and some of the banks participating in the Penn Square loans

were understandably concerned about their inability to get all of the information they wanted. Our first priority had to be to make funds available to insured depositors and issue receiver's certificates to the uninsured general creditors. During August and September, we detailed 41 extra people to the receivership to expedite the handling of loans, and we now believe we are on top of these administrative problems.

The creation of the deposit insurance national bank proved to be an effective way of avoiding panic, minimizing inconvenience to depositors, and limiting disruption in the community. Last week we obtained court approval to sell the former banking house and remaining deposits to an investor group that is seeking a national bank charter. We expect the charter to be granted soon, and when that is done we will transfer the remaining insured deposits to the new bank and terminate this aspect of our operations.

Attached to my statement is a report on the status of the deposit insurance national bank and the receivership. As noted there, we acquired assets of Penn Square Bank amounting to \$511.3 million. As of October 31, 1982, we had collected \$221.4 million in principal and interest on loans (including \$101.6 million on loans sold by Penn Square to the other banks). Expenses charged to the receivership as of October 31 totaled approximately \$3.0 million, or 1.36 percent of collections. As we work off the better assets and concentrate on the tougher problems, this ratio of expenses to collections can be expected to rise significantly. As noted in the attachment, interest income of the receivership through October 31, 1982, totaled \$12.8 million.

Excess funds collected are invested in Treasury obligations and earn market rates of interest pending distribution to holders of receiver's certificates. It is our hope an initial distribution can be made to holders of the receiver's certificates in an amount of 10 to 15 percent of their face value during the first quarter of 1983.

An important part of our work in the receivership is the ongoing investigation of possible criminal violations which may have contributed to the bank's failure. Since our last report to the Committee detailing activities through September 30, 1982, we have referred 13 additional cases to the Attorney General, for a total of 43 referrals of possible criminal activity. Active and successful prosecution of these cases by the Attorney General would do more to deter future bank problems than anything I can think of.

I would be pleased to answer any questions. Thank you.

Attachment