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Backstage at a Bank Funeral: Feds Swoop In on an Unsuspecting Town 1

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By Damian Paletta

In a time of credit crisis, small to medium bank branches are failing, forcing the Federal Deposit Insurance Corporation (FDIC) to go in and clean up the mess. Coming in stealthily to avoid public panic and sudden withdrawal of all a bank's funds, which would result in a sinking of the bank and possibly others in the area, the FDIC makes a quick job of taking over the bank. However, while hotel reservations under fictitious company names may be an effective way to cover up the FDIC's affairs in a town of 3,200, one wonders what will happen when larger banks in more populated areas have to be reckoned with. How will the FDIC's tricks fair on a larger scale as credit problems become more of a cycle?

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STAPLES, Minn. -- At 7 p.m. on Friday, May 30, Mayor Chris Etzler walked through the back door of First Integrity Bank. The lobby should have been closed for the weekend, but dozens of strangers in dark suits were bustling about with laptops and file boxes. Someone had just delivered 32 pizzas.

On Friday morning, the officials and local contractors hired to help with security held a meeting to plot out their strategy for the afternoon bank failure.

Dan Walker, a top official with the Federal Deposit Insurance Corp., a Washington, D.C., bank regulator, had summoned Mr. Etzler to explain what was going on: The FDIC had just taken over First Integrity.

"All the deposits are safe," Mr. Walker tried to reassure the mayor. "Nobody is going to have any problems."

It isn't easy for 75 federal officials and contractors to slip into a small town undetected and liquidate an 89-year-old bank without anyone knowing. But that's what just happened in this old railroad town, population 3,200. It's a scene that's likely to repeat itself across the country as banks struggle through a painful credit cycle, overwhelmed by troubled mortgages and soured construction loans.

First Integrity, which had two branches and \$55 million in assets, was the fourth FDIC-insured bank to fail this year. That's one more than during the entire three-year stretch leading up to 2008. Some analysts predict that as many as 150 banks, mostly small and medium-size, could fail over the next three years.

In its role as receiver for failed banks, the FDIC acts as a SWAT team, playing equal parts secret agent, medical examiner, salesman and grief counselor. The first 48 hours are typically the most frantic, as the agency must turn a failed bank inside out and oversee its sale -- or its

orderly burial.

Secrecy is paramount to prevent a panic among the locals and a run on the bank. That could sink a bank and lead to runs on neighboring institutions. Banks only retain a percentage of their deposits in cash, and use the rest for things like loans, which means they don't have enough money on hand if everyone demands their deposits back at once. Created during the Great Depression to prevent such scares, the FDIC insures deposits at more than 8,000 banks, covering up to \$100,000 per depositor in most cases.

To keep a low profile, FDIC officials often use personal credit cards while in town. Many will tell curious strangers they work in insurance. In the case of First Integrity, Mr. Walker rented a conference room in a town 30 minutes away for a meeting of "Robinson & Associates," and a sign near his hotel's front door welcomed the fictitious company.

The FDIC allowed a Wall Street Journal reporter to go along with its team in Staples this past weekend, offering a rare window into a little-known government task force.

Spectators in Lawn Chairs

Despite the military-style planning that goes into taking over a bank, things can go wrong. Once, a local motel guessed the feds were coming and put up a welcome banner on the marquee. Another time, FDIC officials hired a hypnotist to get a confused bank employee to remember the vault code. Sometimes, locals pull up lawn chairs and watch from across the street.

Mr. Walker, 61 years old, has been a part of 10 bank closings, but First Integrity was his first time in charge. Before becoming a regulator, he spent four years in the Army and 12 in the Texas National Guard.

In late April, Mr. Walker flew to Minneapolis to plot a strategy in case the bank failed. The FDIC knew First Integrity was in trouble because its capital reserves had evaporated, and the delinquent loans on its books more than doubled in 12 months. Many of the bad loans were tied to Florida real estate. The FDIC is still sorting through the bank's records and wouldn't elaborate. David Duhn, the former president of First Integrity, didn't return calls for comment.

On that first trip, Mr. Walker visited the bank's headquarters in Staples. He then drove seven miles east to First Integrity's other branch in the tiny town of Motley, to get a feel for its layout and size. He strolled in and asked to exchange a couple of dollar bills for commemorative state quarters. The teller obliged. He took a look around. And then he left.

As First Integrity's health worsened, the bank was unable to find a buyer. Regulators picked a date to swoop in. Ken Jarzombek is an FDIC official in charge of all the groundwork for a takeover team, from

acquiring printers to ordering pizzas. He called the Todd County sheriff's office and notified them that a "government agency" could be coming to town and would pay deputies overtime to assist it. Mr. Jarzombek has worked on about 60 bank failures and says law-enforcement officials often try to push him for specifics. "I try to beat around the bush," he says.

A Painful Chapter

On Wednesday, Mr. Walker and other top FDIC officials flew in. They set up a base in a hotel in Baxter, not far from Staples. They recorded the estimated drive time to Staples and scouted for a place to park 50 rental cars.

A onetime railroad and lumber town in central Minnesota, Staples is now a shadow of its vibrant days. The old opera house closed decades ago, and the town is working to refurbish its main landmark, a train depot across the street from the bank. Todd County is one of Minnesota's poorest areas, and some residents say First Integrity's failure will be another tough chapter in their history.

On Thursday, a local newspaper, the Staples World, printed an article about the troubled bank and raised the possibility it could be liquidated. Mr. Walker was alarmed; this could cause a panic. An FDIC official stationed inside the bank monitored the lobby. Only when it was clear customers weren't swarming the place did regulators relax.

Friday morning, minutes after First Integrity opened for the last time, Mr. Walker sat in his hotel's conference room and watched the other FDIC officials file in. He waited for someone to close the door before he spoke. "Is anybody in here not supposed to be at a meeting of Robinson & Associates?" he asked. No one said a word.

There was little room for error. A Watford City, N.D., bank, First International Bank & Trust, had tentatively agreed to acquire roughly 75% of First Integrity's assets, worth about \$36 million, and all of its deposits, for a premium of \$2 million. The FDIC would retain the loans and assets First International didn't want, and try to collect as much of the loans outstanding as possible. First International planned to open the lobby Saturday morning to assuage the community.

Late in the afternoon on Friday, Mr. Walker and a few others began the 30-minute drive to Staples. They walked into the bank and began the formal proceedings. Officials from the Office of the Comptroller of the Currency, a division of the Treasury Department, revoked First Integrity's charter and appointed the FDIC as receiver.

Rumors Spread

Mr. Walker went into the lobby and introduced himself to the shaken staff. "We understand what you are going through," he recalls telling them. No one asked questions, and Mr. Walker offered one warning: "It's

going to be crowded," he said.

The rest of the FDIC officials then swarmed in. Armed sheriff's deputies moved to the doors to stand guard. FDIC officials put tape on some interior doors to prevent them from automatically locking.

By the time the mayor arrived, the agency had already restored access to the automated-teller machine for depositors and changed the bank's Web site. The vaults were secure.

A crowd of people stood on the sidewalk across the street at a bar called Gary's Place -- a rumor was spreading about a bank robbery. Once they learned deposits were safe, most went back inside.

"We're going to be out of here as fast as we can," Mr. Walker told the mayor, Mr. Etzler, who had rushed over from his daughter's high-school graduation. "It will just be a brief blip in history -- that's it."

Mr. Etzler looked relieved. "Just the uncertainty and the questions that have been floating around, to get some finalization to it," he said.

Some FDIC officials stayed at the bank until 1 a.m. Saturday morning, and many returned seven hours later. By Sunday, almost all of the bank's files were in boxes and the vaults were being cataloged.

Local residents said the FDIC officials seemed to come out of nowhere. "I didn't know they were coming, but we knew when they were here," said Becky Hasselberg, 58, who has lived in Staples her whole life. "People in suits and ties walked into the coffee shop. They weren't too casual."

Monday morning the bank reopened. A temporary sign out front read "First International Bank & Trust -- Member FDIC."

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Corrections & Amplifications

The Federal Deposit Insurance Corp. was created in 1933, during the Great Depression. The initial version of this article incorrectly said the FDIC was created after the Great Depression.