Expert Worries Bankers Won't Learn From Past

By Danny M. Boyd
Staff Writer

Tom Loy is troubled by the adage that those who forget the mistakes of history are doomed to relive them.

He is especially concerned when ignorance of history involves Penn Square Bank.

"I think it's absolutely mind-boggling that 15 years after Penn Square's failure, very few bankers around this country and an alarming number of bankers in Oklahoma are not familiar at all with what happened," Loy said.

A former banker and now director of the community banking program at Oklahoma City University, Loy recently found that most younger bankers in one bank's management course knew little about the collapse of Penn Square and its ramifications. To forget, he said, is to miss critical lessons in banking history.

The lessons and impact of Penn Square's collapse are still subject to disagreement 15 years after it failed. But Loy and others assert that the bank failure changed the face of banking in Oklahoma and throughout the country and influenced the state and U.S. economies.

On July 5, 1982, regulators closed Penn Square Bank, considered by many a study in excess and failed regulatory oversight during the heady days of the Southwest oil boom.

Once a sleepy shopping center bank in Oklahoma City, Penn Square embarked on energy lending with a vengeance in the late 1970s.

The bank entered into energy lending partnerships with some of the country's premier banks, including Chase Manhattan, Continental Illinois, Seattle First National Bank and Michigan National Bank.

Altogether, Penn Square's partners bankrolled billions in energy loans through the Oklahoma City bank and often relied on Penn Square officers to decide the credit-worthiness of borrowers.

Though some borrowers were good for the money, many others weren't. Penn Square's story is replete with extravagance, failure to hedge its risks, lending on overinflated oil values and poor due diligence, according to the book "Belly Up," by Phillip L. Zweig.

Zweig broke the story on the bank's troubles as a reporter for American Banker.

Bank officers made questionable loans on insufficient or no collateral, occasionally pledging the same collateral to different loans held by larger banks, according to Zweig's account.

The bank was accused of shifting millions in bad loans to good customers or the larger banks.

Loan record-keeping was shoddy and incomplete, and the bank covered bad loans with new loans, effectively delaying the day of reckoning, according to accounts.

"Every possible violation of lending, they did it," said Zweig, now an editor and writer at BusinessWeek magazine.

When Penn Square Bank failed, other banks, credit unions and thrifts lost millions kept in CDs at the bank, which offered the highest rates to attract depositors to fund its freewheeling lending practices.

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Penn Square Bank's Collapse

The following is a chronology of key events leading up to the failure of Oklahoma City's Penn Square Bank 15 years ago:

- **March 13, 1981:** Arthur Young & Co. gives Penn Square Bank a "qualified," or unsatisfactory, report on the bank's statement of financial condition.
- **March 19, 1982:** Peat Marwick Mitchell & Co. gives the bank an "unqualified," or satisfactory, report on its financial condition.
- **April 26, 1982:** An unfavorable article by Phillip Zweig on Penn Square's energy-lending practices appears in American Banker, a banking industry newspaper.
- **June 30, 1982:** Oklahoma City oil man and bank director Robert Hefner III directs his business to withdraw more than $20 million from Penn Square Bank. Meanwhile, Hefner and bank Chairman Bill Jennings travel to Chicago to try to raise $30 million in new capital for the bank, at the direction of regulators. Their efforts fail.
- **July 5, 1982:** Penn Square Bank is closed by regulators.
- **July 6, 1982:** Depositors withdraw $60 million from the failed bank.

Bank

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Regulatory oversight was lax. Bank examiners failed to cite Penn Square for unsound practices until the bank become notorious.

Three Penn Square officers admitted guilt or were convicted of crimes related to the bank failure.

Questions arose about the stability of the U.S. banking system after revelations of Penn Square's relationships with the big banks and news reports of Oklahoma City depositors waiting in line to get their money, an image largely unseen since the Depression.

"This relatively small bank in Oklahoma had infected some very large institutions elsewhere and left them in grossly weakened positions," said Paul Volcker, chairman of the Federal Reserve board of governors at the time.

Chicago-based Continental had bought more than $1 billion in energy loans from Penn Square and was forced to write off most of them when Penn Square failed. The bank eventually was rescued and managed by the Federal Deposit Insurance Corp. after the energy bust and fallout from Penn Square consumed its worth.

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>
> Paul Volcker

Penn Square's failure rocked other banks, as well. For example, troubled Seattle First, then known as Seafirst, lost $90 million in 1982 and more than $100 million in the first quarter of 1983. Bank of America acquired it in the largest interstate banking acquisition of its time, allowing Seafirst to avoid becoming what would have been the largest failed bank in U.S. history.

The fallout from Penn Square contributed to changes that directly affected the country's economy, Zweig said. Interest rates were in double digits in summer 1982. Volcker had told Congress the Fed planned to continue a tight monetary policy, which contributed to high interest rates with the goal of curbing inflation.

But things changed. When the big banks began divulging their Penn Square-related losses, money managers scurried to divert funds from CDs into relatively risk-free government securities, Zweig said.

Despite Volcker's earlier statements, the Fed soon quit resisting lower interest rates. The developments led to lower interest rates that summer, fueling the beginning of an economic resurgence in the country after a deep recession.

In short order, one of the longest bull markets in U.S. history began, Zweig said.

Volcker called the Penn Square failure "a great event," but said other factors such as a looming banking crisis in Mexico also contributed to the Fed's decision to ease up on its monetary policy.

"Penn Square was important because it symbolized ... and it manifested the excesses in banking and speculation that was brought on in considerable part by the inflationary episode we went through," Volcker said.

The event brought home the importance of effective bank supervision and management, he said.

Former Penn Square Chairman William P. Jennings said talk of Penn Square's larger influence and Zweig's account of its practices are exaggerated.

He also said Zweig's book was unfair.

"I had a difficult time understanding how they could relate the failure of one bank to the impact that many folks thought it had," he said. "I believe it was other factors. We've been over that, and I'm not going to change anybody's mind."

Penn Square had the misfortune of being the first major bank failure of more than 100 in Oklahoma during the 1980s, when the energy boom finally went bust, said Jennings, who was not among bank officers accused of wrongdoing.

Hundreds of other banks failed throughout the Oil Patch states, he said.

"It was the failure of the oil industry that brought about the chaos," Jennings said. Banks have recovered and are prospering, he noted.

Jennings has said previously that Penn Square's aim was to contribute to Oklahoma's economic prosperity.

But Loy, who said Zweig's account is well-researched and accurate, said Penn Square had much to do with changing the face of banking.

"It's arguable that just the appearance of Oklahoma banking today would be radically different, had it not been for Penn Square."

Large banks like Oklahoma City's First National Bank and Fidelity Bank might not have failed if Penn Square had not, Loy said.

The markets of banks small and large were adversely affected by failed businesses that were overlent to by Penn Square and its large bank partners, Loy said.

The fallout deflated real estate values that, along with lower oil and gas prices, eventually claimed the big venerable banks as well as several banks controlled by the late Morrison Tucker, a prominent Oklahoma banker who employed Loy as chief financial officer.

Without the failure of Penn Square and its effect on the larger Oklahoma banks, Loy said, Bank of Oklahoma might not have reached its current formidable place in banking. Fidelity merged with Bank of Oklahoma after Penn Square failed.

Without the failure, new bankers like Bank of Oklahoma's George Kaiser might not have entered the field, Loy said.

There was also the mistaken impression that Penn Square's practices were normal, he said.

The event and its consequences created a schism between Oklahoma's banks and borrowers, who questioned each others trustworthiness, he said, although he added that the breach is healing.

Banks throughout the country reexamined their lending practices after Penn Square, Zweig said.

"I think it's critically important," Loy said of learning about Penn Square Bank. "There's the old adage that those who fail to learn from history are doomed to repeat it, or variations thereof, and I'm a firm believer."