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## Organized Protection against Organized Predatory Crime--National Bank Offenses, VII

John Edgar Hoover

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information concerning illicit traffic, narcotic factories in operation, and laws and regulations of each signatory.

This Convention strikes at the sources of supply of the illicit traffic, and this powerful, world-wide curb on the illicit narcotic traffic became effective by the ratifications of more than twenty-five nations, on March 31, 1933.

The Federal Government has been and is doing its full share toward ridding the country of this menace; and in common justice the States should assume the responsibility which is properly theirs, but which the majority of them, in the past, have been shirking.

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## VII NATIONAL BANK OFFENSES

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JOHN EDGAR HOOVER<sup>1</sup>

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### 1.

Embezzlements and other misuse of the funds of a national bank are made violations of the Federal laws, and since the creation of the Federal Reserve System, member banks, in addition to the national banks, are afforded this Federal protection. In view of the Federal or national character of national banks, practically all irregularities occurring in those particular banks are investigated by the Division of Investigation and prosecuted in the Federal Courts. Such virtually exclusive jurisdiction does not exist with reference to member banks of the Federal Reserve System, and most of the offenses occurring in Federal Reserve member banks are prosecuted in the State Courts, although an increasing number of such violations are being investigated and prosecuted by the United States Government.

The extent of irregularities in banks, generally speaking, can therefore be gauged only, so far as the Federal Government is concerned, by the extent of said irregularities in the national banking system. During the fiscal year 1933, 312 convictions were recorded in cases investigated by the Division of Investigation, and sentences in the aggregate were recorded as follows:

Actual Sentences	454 years
Probationary Sentences	277 years
Suspended Sentences	124 years

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In addition, fines to the extent of \$76,207.56 were imposed. With the exception of the fiscal year 1931, this is the greatest number of convictions, imposed during the past eight years. Beginning with 1924, when the records of the Division of Investigation first were arranged to reflect accurately the work accomplished by the Division there has been a consistently regular increase in convictions and sentences throughout the eight years, with the exception of the year 1931, when the convictions reached the unusual total of 351, and sentences the following large totals:

Actual Sentences	421 years
Probationary Sentences	318 years
Suspended Sentences	193 years

Possibly the considerable figures for the year 1931 were due to the stress of those times when bank failures throughout the entire country reached such a high total (although it should not be inferred from this that irregularities on the part of the officers and employees of banks constitute the dominant cause of the failure of banks).

The Division of Investigation has among its investigative personnel Special Agents who are qualified as experts in accounting. One of the major functions of this particular group of special agents is the investigation, through the books of account, of offenses occurring in national banks and member banks of the Federal Reserve System. The line of demarcation between the duties of the National Bank Examiners and the Special Agents of the Division of Investigation is, perhaps, not clearly defined in the public mind. It should be stated, therefore, that the functions of these groups of employees are entirely separate and distinct. The National Bank Examiners are attached to the office of the Comptroller of the Currency in the Treasury Department of the United States Government. It is their duty to examine periodically all national banks for the purpose of reporting to the Comptroller the condition of those banks, the management, the systems employed, and the adherence to the rules laid down by the Comptroller, in order that the Comptroller may exercise the supervision with which he has been charged by statute. In the course of the regular and special examinations made by the National Bank Examiners, they frequently discover shortages. The facts concerning the shortages, in so far as they have been ascertained by the Examiners, are reported by them to the Comptroller and to the appropriate United States Attorney. The Special Agents of the Division of Investigation are

then called upon to conduct an investigation of the shortages for the purpose of collecting the necessary evidence, both documentary and oral, to support prosecution in the Federal Courts. The Division of Investigation is not required to await the report from the office of the Comptroller; in fact, in many instances, the Special Agents of said Division proceed with their investigation upon reports from other authoritative sources, prior to the time that an Examiner from the Comptroller's office conducts an examination, but the majority of cases are received after an examination by a National Bank Examiner.

It should be borne in mind that the Special Agents of the Division of Investigation do not confine their investigations of these cases solely to the items of shortage reported by the Examiners. As a matter of fact, the investigation of the Special Agents not infrequently reveals many shortages which were not disclosed by the Examiners, due to the fact that extraordinary measures have been taken by either the bank or the employees involved in the irregularities to arrange the accounts of the bank prior to the examination, so that it would be difficult, if not seemingly impossible, for the Examiners to discover said irregularities in the absence of an exhaustive investigation.

## 2.

The unlawful use of funds of a bank is not an offense which lends itself to the operations of organized syndicates or gangs. It is nearly always the offense of an individual or individuals in a particular bank and only rarely extends beyond that particular bank. Also, while practically all other crimes are generally committed by persons with criminal instincts, who have been reared, perhaps, in an environment of crime, this offense, on the contrary, is committed in nearly all instances by persons who have had previous good reputations and are generally known as persons of excellent character. In fact, it is almost impossible for an individual to become an employee of a bank unless he has enjoyed the best of reputations prior thereto, and it is believed safe to state that the great majority of these offenses are committed by employees who have given many years of faithful service to the bank which they finally betray. The records are replete with cases where the embezzler or defaulter has served his bank and his community throughout the best part of a lifetime, has achieved an enviable reputation as a friend of the community and a bank officer of unimpeachable integrity and honesty,

but who, through circumstances bringing unusual pressure to bear upon his moral fiber, has succumbed to temptation and betrayed both the bank and the community. On the other hand, there are many cases on record where no particular circumstances have arisen to tempt the officer of the bank but where greed has apparently obsessed him and caused him to manipulate the funds of the bank, while enjoying the respect and confidence of his brother officers and the depositors of the bank.

Indeed, it is difficult to ascribe any particular vice or circumstance as the controlling or most prevalent cause of this type of failure of trust. A few years ago, a United States District Judge in one of the judicial districts in the Eastern section of the country, requested the Division of Investigation to advise him, if possible, by an examination of the cases arising in his district, the most prevalent cause of bank defaulting. An analysis was made of the cases which had been investigated in that particular jurisdiction over a period of five years. Stock speculation appeared as the most frequent cause of this offense. Extravagance in living was the cause of the offense in nearly as many instances. Gambling seemed the contributing cause in almost an equal number of cases. Unusual household or family expenses where the salary of the employee was a small one, apparently was the inducement leading to the defalcation in a number of instances. Drinking and fast living were not far behind these other causes as the impelling motive for dishonesty.

This analysis merely confirmed the existing theory that no one particular vice constitutes a prevailing dominant cause of bank defaulting, and that, after all, in the absence of a strict system of checks and balances, the bank is dependent upon the strength of the moral fiber in the make-up of its employees. A rigid system of checks and balances seems to be the strongest defense against this type of crime. It is notable that large defalcations rarely occur in the larger banks due, no doubt, to the thorough system of checks maintained by those institutions where no one employee is permitted absolute control over any department of the bank, when, on the contrary, in the smaller banks or the so-called "one man banks," the bank dominated and under the virtual control of one man, large defalcations frequently are disclosed, this probably is due to the fact that this dominant character maintains absolute control over the accounts of the bank and is in a position to manipulate the accounts at will without fear of detection other than through the examinations made by the Bank Examiners; even then he is in a posi-

tion to arrange the accounts of the institution so that it becomes extremely difficult for an Examiner to detect any irregularity.

### 3.

It has been previously stated that this type of crime is not one susceptible to promotion by organized gangs. In possible qualification of that statement, it should be stated that not infrequently conspiracies are discovered among officers and employees of banks where a number of said officers or employees have agreed to cover up each other's defalcations and in this manner loot the bank. Even in this situation, however, it should be stated that conspiracies of this character are rarely preconceived or deliberate, but they arise through reason of a possible limited use of the funds of the bank for speculation by one or more employees, then the discovery of that fact by other employees, and the joining of those employees with the first offenders in continued speculation. The viciousness of such an agreement is perhaps best illustrated by the failure of a large institution in Michigan several years ago, where practically the entire assets of the bank were wiped out by the speculative activities of twelve officials of that institution (which, incidentally, was a member bank of the Federal Reserve System). The losses in that case approximated three and one-half million dollars.

A more recent case of this type was that occurring in a national bank at Reading, Pennsylvania, which resulted only in September, 1932, in the imposition of substantial sentences for embezzlement against six of the employees of the bank who had used its funds to speculate in the stock market. In practically all of these cases where two or more officers or employees of the bank are discovered to have used the funds of the bank unlawfully, the controlling motive has been speculation in the stock market. Ordinarily the original peculations have resulted in profits and the funds of the bank which have been used are returned. Almost invariably, however, continued peculations of this sort lead to losses, and once the losses become substantial, the employee or employees in desperation take more and more of the bank's money, hoping always to make sufficient profits to restore the bank's funds.

There is another rare exception to the rule that violations of the banking laws are committed by individuals rather than gangs. This exception occurs where through one reason or another, an employee of a bank falls under the power, spell or domination of a criminal syndicate and either willingly or unwillingly acts as a tool

whereby the syndicate is permitted to loot the bank. A most apt illustration of this type of offense is one occurring quite recently, which, in fact, has not to date been prosecuted. A group of forgers and confidence men made a contact with an employee in a national bank and through that employee obtained a cancelled check of a corporation which maintained a large balance at this bank. The expert forgers traced the signature appearing on this cancelled check, obtained similar checks, together with a check protector stamp, inserting the amount of the check by this stamp, and began operations by two of the group opening accounts in other banks in the same city and shortly thereafter depositing these forged checks which were later cleared and accepted by the bank on which they were drawn, when the cash was withdrawn from the other banks by the two individuals who had opened the accounts therein. This scheme was successful for more than a month during which time nearly \$150,000 was obtained by the gang. The method of operation was not disclosed until the Division of Investigation in its inquiries developed the connection of the employee in the bank. All parties are now under indictment awaiting trial, the outsiders being charged as aiders and abettors to the bank employee in committing a violation of the National Bank Act.

An instance of unwilling cooperation on the part of a bank employee with a criminal gang is best illustrated by a case in the Northwestern section of the country. The bank employee, because of small favors shown by an apparently prosperous depositor, first permitted an inconsequential overdraft to occur in that depositor's account. Having permitted such small overdraft on one occasion (and this, of course, being known to the scheming depositor), larger overdrafts were passed. Upon protesting, the employee was led to believe that through the granting of a further overdraft and the placing of that money upon a "sure thing" horse race, they would not only cover the overdraft, but make a handsome profit which might be split between them. While it is difficult to conceive of any one having faith in such a plan, at least more than once or twice, the fact of the matter is that this sort of representation by the depositor led the employee into permitting overdrafts amounting to a half million dollars over a period of months. Yet, at no time did the employee obtain any benefit from these misapplications. In this connection, it can be stated that the records present many cases where the offending employee has failed to benefit through the misapplications or embezzlements of the bank's funds. This nearly always occurs where

the officer or employee desperately strives to make the bank whole by taking greater and greater sums in a frenzied effort to assist the speculator friend to recoup his losses.

Before passing from the several types of offenses of this character, it should be stated that a frequent cause of the misapplication of the funds of a bank is found to be the development of outside interests by a bank officer or employee. In other words, a bank employee, usually an officer, enters upon the promotion or development of a business entirely foreign to that of banking. Usually he is entirely honest and has no intention whatever of using the funds of the bank; but as hard times come upon the business concern with which he is affiliated, he contrives to permit loans by his bank to his affiliates in the business industry without proper security or collateral, or when he knows or should know that the business concern is not solvent. The granting of such loans, sometimes even with the consent of the loan committee of the bank, constitutes a jeopardizing of the assets of the bank, which is considered a misapplication of the funds of that bank.

#### 4.

The several offenses peculiar to the national banking system are not generally known. In fact, it has come to the attention of the Division of Investigation that some law enforcement officials are not fully familiar with the jurisdiction of the Federal government, and particularly with the functions of the Division of Investigation in its conduct of investigations of violations of the national banking laws. It seems to be a popular misconception that robbery of a national bank by bandits or highwaymen constitutes a violation of the National Bank Act. This is not a fact. The National Bank Act reaches only to officers, agents and employees of the bank; unless such a person is in collusion with outsiders, or has connived at a robbery there is no Federal jurisdiction. The chief criminal offenses named in the National Bank Act, and subsequently in the Federal Reserve Act, are misapplication, embezzlement, and abstraction of the funds of the bank, and false entries made either in the books or accounts of the bank or in reports to the Comptroller of the Currency.

Abstraction is the most limited of the three terms referring to the funds of the bank occurs where an officer, agent or employee of the bank abstracts or steals money or funds which are not in his custody. This type of offense can best be illustrated by the mes-



senger or janitor of the bank who, having momentary access to a cage or vault, steals a sum of money therefrom. Such an employee has no custody over the funds and, therefore, does not commit embezzlement by his act.

The crime of embezzlement is generally known. It occurs where the officer or employee having custody of certain funds, steals therefrom.

The offense of misapplication occurs where the officer, agent or employee permits a misapplication of the funds of the bank. This is best illustrated by the act of an officer approving or granting a loan to a concern which he knows to be insolvent and which he knows will seriously jeopardize the assets of the bank. This offense likewise occurs when a bookkeeper, for instance, permits a loss to the bank by making a fraudulent entry with reference to a forged check received or by destroying the forged check when it reaches him, thus eliminating that check from the records of the bank. Efforts to cover up such irregularities on the part of the bank employees by making false entries in the books usually constitute the offense of making a false entry. It is interesting to note that this latter offense, that of making false entries, sometimes permits prosecution for an offense which otherwise would be barred by the statute of limitations, which, as is generally known, prevents prosecution for a crime when more than three years have passed without the government obtaining an indictment. A typical case of this character is that which occurred in an Eastern state a short time ago when it was discovered that the cashier of a bank had embezzled approximately one hundred thousand dollars more than twelve years before the discovery of that shortage. He had been successful in covering up the shortage from year to year by making false entries upon the books of the bank. When the shortage was discovered, although not a penny had been taken by this officer for twelve years, it was possible to prosecute him under the false entry offense, because, of course, false entries had been made up to the time of the discovery, and in the prosecution of the false entry offense, the facts of the embezzlement were necessarily developed.

Federal Statutes other than those relating primarily to the National Bank and Federal Reserve Systems not infrequently provide legal weapons to combat this type of crime. In a very extensive banking fraud of several years past which involved the failure of more than 150 small banks throughout the Southern states, all of these banks being controlled by a parent organization known as the Bankers Trust

Company, it was found extremely difficult to adequately deal with the principals concerned under State Statutes, through reason of the fact that their activities extended beyond State lines. The Division of Investigation thereupon was called into the matter and after conducting an extended investigation collected ample evidence to support prosecution in the Federal Courts for using the mails in furtherance of scheme to defraud. This prosecution was eminently successful and the principals were sentenced to long terms of imprisonment.

The Mail Fraud Statute is also used in dealing with check kiting schemes. The usual check-kite with which the Division of Investigation is called upon to deal arises through the practice of certain individuals of drawing checks on a bank in one town and depositing said checks in their account in a bank in another town, and drawing a third check on still another bank, which in turn is deposited in the bank upon which the first check is drawn. The time required for the transmittal of these checks from one bank to another and through the clearing houses is carefully gauged, so that some check is always what is known as "in float", that is, in process of reaching the bank upon which it is drawn. Where kites reach any appreciable sum of money, they are, of course, usually noted by one or more of the banks and detected in sufficient time to prevent any great loss. The greatest danger of this situation is where a bank employee is cooperating. In that case, the bank stands to lose a considerable sum of money. A kite, of course, can be prosecuted under the Mail Fraud Statute, even though no employee of a National or member bank is involved therein. The Mail Fraud Statute, however, has proved an efficacious weapon to the Federal Government likewise in cases where bank employees have been involved in kites.

In closing, it should be stated that the ferreting out of the facts with reference to irregularities in banks is a difficult and tedious work. It requires the services of a Special Agent familiar with the books of account of a bank, thoroughly skilled in the science of accounting, and trained as an expert investigator. His activities are not confined to the books of the bank, and his work is not that of an auditor. He is compelled to break down and see beyond the work of men who are skilled in the recording of bank transactions. He must be able to recognize the very slight signs which point to questionable transactions, and to match his wits oftentimes against those of the offenders, still employed in a dominant capacity in the bank.