

MONTHLY BULLETIN

Issued by
EDWARD J. BARRETT
AUDITOR of PUBLIC ACCOUNTS
BANKING DEPARTMENT
State of Illinois

Vol. 12

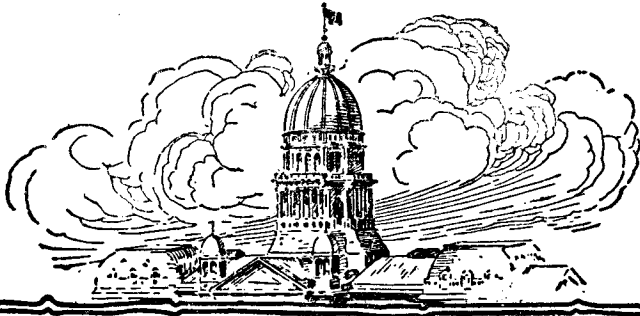
SPRINGFIELD, ILL., JANUARY 1, 1937

No. 10

OFFICERS, EMPLOYEES AND DIRECTORS

The fourth exhibit in our new examination report form needs little explanation. This exhibit is divided into two sections. The first section deals with officers and employees and contains a listing of all officers and major employees showing shareholdings, salary, amount of surety bond and direct and indirect loans to each. In the second section we list the Board of Directors and show the record of attendance, shareholdings, address, loans—direct and indirect—estimated worth, and occupation of each. At the bottom of this section we recapitulate the total borrowings, and indirect liabilities of all officers and directors, to which we add the loans of firms, corporations, or other enterprises in which directors, officers and employees are interested and show a total of loans to relatives of the bank's management.

When this particular form is reviewed it will be noted in the recapitulation at the bottom of the page a deduction



is made for duplications. The reason for this is that occasionally two or more officers and/or directors will appear on the same note or several notes, in which event we would show the full amount of the obligation under each name. For instance, if two officers, and a director who is not an officer, all co-sign on the same \$1,000.00 note, this note would be shown in its full face amount in the direct liabilities of each of the three individuals. This would result in a duplication of \$2,000.00 and that amount would be deducted in the recapitulation to arrive at a net total. We would also make the same deduction in dealing with indirect liabilities—that is, where several members of the bank's management would appear on the back of the same note as endorsers or guarantors. These duplications can be readily located by referring to the management loans which are listed in detail in the first group of loans appearing in the loan exhibit that follows next in the report.

The exhibit under discussion requires little technical explanation. Its chief value to this department is to provide a survey of the management operating the bank under examination before the detailed analysis of the report is undertaken. To a director or officer studying the report, the most valuable feature of this exhibit is a concise picture of the borrowing operations not only of the management, but its affiliated business interests and other connections.

Prior to 1933 this department had considerable experience and trouble with unsatisfactory management loans and from that experience, much has been learned. This type of loan well made and properly handled can certainly qualify among the bank's best investments, but experience has demonstrated that this type of loan poorly made and improperly handled, can deteriorate to the other extreme to be classified among the worst of bank assets.

The reason for this is that when a management loan begins to "turn sour", the bank is faced with the embarrassing alternative of either proceeding publicly against a member of its own management to enforce its legal remedies or standing helplessly by and doing nothing more than hope for the best and this same hesitancy prevails with respect to outside business interests of the management and not infrequently extends to family connections.

Another difficulty apparently lies in attempting to deal with management loan applications in the same manner as the general run of loan applications are handled; for the very presence of the applicant during the discussion of his application, almost invariably prevents the searching and frank examination that each loan application should receive. We know this to be true because in times past, we have frequently heard bank directors admit that they had assented to unsound extensions of credit to fellow Board members and knew at the time of their assent that the loans were unsound, rather than face the embarrassment of opposing a business associate or a close personal friend.

Ethically, of course, this is a startling admission but it is a very human element that must be recognized as prevailing very widely and herein lies the chief source of danger in management loans. It is idle to say that no individual holding a position of trust in a bank management would not take advantage of the reluctance of fellow Board members to frankly vote their convictions on applications for unwarranted loans. It has been done in the past and can be done again. We have more than once encountered bank Directors who boldly stated that their principle reason for serving on the Board of Directors was the easy means to bank credit provided.

There are various ways by which the evils inherent in management loans have been eliminated. In a large number of banks, Directors avoid embarrassment by requiring a fellow Board member to withdraw from the meeting while his application is under consideration. Other Boards have voluntarily agreed to make no loans to directors, officers or employees and still others will loan to the management only on the basis of readily marketable collateral. There are also bank Boards who agree upon standards to which management loans must conform and permit no extensions or renewals.

Any of the foregoing policies can be effectively used providing they are rigidly enforced. The important thing is for bank managements who have not adopted a settled policy with respect to management loans, to do so and to make the policy adopted a part of their By-laws. The effect of such a step will, by the operation of the By-laws, eliminate from bank managements, any individual who may be inclined to abuse his position and impose upon his fellow Board members.

The foregoing observations are based upon the actual experiences of this department and our records, particularly those of our closed banks, contain many enlightening illustrations of the grave injury that can be inflicted upon a bank through ill considered and unwarranted loans to its management and we would particularly urge bank directorates to take every precaution against allowing the members of their operating personnel to become financially involved the results of which can be very far reaching and damaging to the bank.

It is gratifying to note that since the National Moratorium of 1933, a very large number of bank directorates have taken steps along one line or another to guard against the dangers of loans to directors, officers and employees and it is to be hoped that the vigilance that now so widely prevails, will be continued unremittently.

In our opening article in this series dealing with our new examination report, we characterized internal supervision as the most effective in bank management and in dealing with management loans, it is our judgment that the strict supervision of a conscientious Board of Directors will operate as effectively and probably more fairly than any Statutory regulation that can be devised.

IN LIQUIDATION

Virginia.....Cass.....Peoples Bank of Virginia through Petefish, Skiles & Co. Dec. 30, 1936

CHANGE OF LOCATION

Chicago.....Cook.....Uptown State Bank, from 1050 Wilson Avenue, Chicago, Illinois, to 4753 Broadway, Chicago, Illinois.....Dec. 30, 1936

CONVERSION

Stillman Valley...Ogle.....Stillman Valley Bank into The Stillman Valley National Bank.....Dec. 31, 1936

DISSOLVED

DeWitt.....DeWitt.....State Bank of DeWitt (Receiver appointed Nov. 16, 1931, dissolved by order of Circuit Court of DeWitt County) June 17, 1936
 Tallula.....Menard.....Farmer's and Merchants State Bank of Tallula, Illinois (Receiver appointed April 22, 1930, dissolved by order of Circuit Court of Menard County).....Dec. 14, 1936
 Milmine.....Piatt.....Milmine State Bank (In Liquidation Feb. 2, 1932).....Dec. 19, 1936
 North Henderson, Mercer.....Farmer's Bank of North Henderson (In Receivership Sept. 25, 1931—Dissolved by order of Circuit Court of Mercer County).....Dec. 22, 1936

not published in '36 because

RECAPITULATION

	Reopened by Permit.	Closed under holiday.	Total.
State Banks in Chicago.....	35	1	36
State Banks in Cook County outside Chicago.....	31	---	31
State Banks in Illinois outside Cook County.....	517	---	517
Total.....	583	1	584

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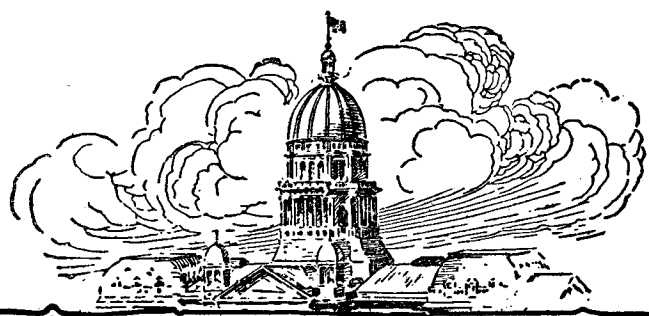
SPRINGFIELD, ILL., FEBRUARY 1, 1937

No. 11

LOANS AND DISCOUNTS

In reviewing our new examination report form, we have up to this point, dealt entirely with summaries and results. The first form (Statement) summarized all of the bank's accounts with its Resources and Liabilities. On the second page we show in summarized form, the results of the bank's operation during the period under examination. The third page summarizes the bank's liquidity and the Examiner's appraisal of Resources; while the fourth page furnishes a summary of the management.

From here on, we take up the detail section of the report wherein the Examiner sets up such data as he has used to arrive at the conclusions shown on page three in this appraisal of assets. It is important to state here and for each Director to remember, that every entry made by the Examiner on the appraisal form, will be found analyzed in detail in the corresponding detailed section of the report. For instance, if the



Examiner shows on the appraisal form, \$50,000.00 in loans classified as "Slow," there will be found in the "Loans and Discounts" section of the report, all of the individual items making up said total with the Examiner's analysis of each loan and the reason for his classification. If the appraisal form shows \$10,000.00 in loans classified as "Doubtful," an analysis of each doubtful loan and the reason for doubtful classification will also be found in the "Loans and Discounts" section, and the same will be true of "Estimated Losses".

We begin the exhibit of "Loans and Discounts" with a recapitulation classifying all loans as to type and showing in this same form, their condition as to maturity. On the left hand side of this form, we list in vertical order the following types of loans: "Loans on Collateral Security", "Unsecured Loans", "Purchased Paper (secured)", "Purchased Paper (unsecured)", "Call Loans", "Brokers' Loans", and "Real Estate Loans". Then following the form to the right, we show the total of each type of loans due on "Demand", "Not Due", "Over-Due", and total. Inasmuch as most banks classify their loans as to type on their daily statements, Directors have this information currently available. There are, however, two important points brought out in this form that need more than casual notice.

The first in order of appearance is the amount of loans due on demand. While this type of loan has a very brisk sounding title and appears to be highly liquid in print, it usually works out just the opposite in practice. A very high percentage of so-called "Demand Loans" eventually find their way into the "Slow" classification. Our experience with this type of loan has often led us to wonder who is supposed to make the demand, the borrower or the lender. Very frequently this type of loan runs on indefinitely and often requires an "Over-due" classification; for under our regulations, a demand note running beyond six months from date without payment of interest, becomes "Over-due". We feel well justified in stating that in a large majority of instances, that unless a demand loan is secured by collateral, that will liquidate the debt on demand, that a demand collection cannot be accomplished. It is, therefore, our conclusion that unless a loan can in fact be collected on demand, it should bear a definite maturity date. Directors in reviewing this form, should not be misled by the loans shown as due on demand.

The second detail to be carefully noted on this form is "Over-due" total. A large amount of over-due paper usually means that either loans are being poorly handled or that bad loans are beginning to accumulate. Either reason is very important to the Board of Directors and should be promptly corrected. It is true that occasionally notes will go into default due to the death of the maker and will have to remain in that condition during the term of probate but this status should not be permitted to continue longer than is legally necessary.

In the detail exhibit of loans that follows, the Examiner lists first as a group, all of the loans to Officers, Directors, Employees and their affiliated interests; which is the detail supporting the summary of management loans shown on page 4.

Following this group, the Examiner will list in detail, an analysis of Excess Loans if any are encountered and this section holds a personal

interest for each individual Board member inasmuch as the Law holds him personally and individually liable for any loss on such loan or loans. A great deal of a legal and technical nature might be written concerning Excess Loans, but in our opinion, the following should be a sufficient word of caution:

Section 10 of the Illinois Banking Law fixes a limit that may be loaned to any individual, firm or corporation and the loaning limit of a bank under examination will be shown at the beginning of the Loans and Discounts exhibit. When a loan or any investment (with the exception of United States Government Bonds or State of Illinois Bonds) exceeds this limit, the Law has been violated and the Directors' personal liability incurred as above noted.

There are, it is true, exceptions provided by Law whereby certain types of loans can qualify for exclusion from the provisions of Section 10, but there is rarely any sound reason for taking advantage of these exceptions to loan in excess of the legal limit. The loaning limit fixed by the Illinois Banking Act has been operative for many years and we have seen a large number of banks serve their communities very successfully and profitably without a single violation of Section 10. Bank Directors will serve their personal interests very well if they will see to it that all loans are strictly confined within the legal loaning limit.

In arranging the form of the Examiner's exhibit of loans, we have attempted to design an analysis that will bring out all of the essential information upon which the quality of any loan may be judged. The total amount of a maker's obligations are shown in the column on the left hand side of the form. In the next space to the right, the signers on the face of the note are listed and the endorsers, if any, are shown. If collateral is pledged to secure the loan, a general description and appraisal of same will be shown. A brief review of borrowers' financial statements as well as available information concerning other signers, will be set down. There will also be a brief outline of the history of the loan showing date of entry upon the bank's books and its fluctuation since that time. If the Examiner feels that the loan is subject to criticism, his critical comments will be briefly outlined. If all or any portion of the credit line is in default, the amount of the defaulted notes will be shown in the next column to the right indicated as the Over-due column. If the Examiner feels that the loan or any portion thereof will be difficult to collect, he will enter the amount so classified in the Slow column next to the right of the Over-due column. If collectibility of the line or any portion thereof is doubtful in the Examiner's opinion, a Doubtful classification will be shown in the column so headed next to the right of the Slow column. Estimated Losses in loans will be shown in a column entitled "Estimated Losses" at the extreme right hand side of the form. Totals will be shown at the end of the "Over-due", "Slow", "Doubtful" and "Estimated Losses" columns, and the totals shown under the "Slow", "Doubtful" and "Estimated Losses" columns will agree with the entries on the Examiner's appraisal form on page 3.

We shall continue our discussion of this very important exhibit of "Loans and Discounts" in our March issue.

CHANGE OF PAR VALUE OF CAPITAL STOCK

Homewood...Cook.....Cook County Trust and Savings Bank of Homewood. From \$50 to \$25.....Jan. 14, 1937

DURATION EXTENDED

Steelville.....Randolph.....State Bank of Steelville. Charter extended 25 years from Feb. 20, 1937.....Jan. 7, 1937
 Seaton.....Mercer.....State Bank of Seaton. Charter extended 10 years from Aug. 20, 1937.....Jan. 26, 1937

DISSOLVED

Chicago.....Cook.....State Bank of West Pullman.....Jan. 6, 1937
 Farmersville.....Montgomery.....Farmersville State Bank (Receiver appointed Sept. 8, 1930. Dissolved by order of Circuit Court of Montgomery County).....Jan. 16, 1937
 Harvel.....Montgomery.....Harvel State Bank (Receiver appointed Dec. 22, 1930. Dissolved by order of Circuit Court of Montgomery County).....Jan. 16, 1937
 Chicago.....Cook.....Burnside Trust and Savings Bank (In liquidation Aug. 11, 1932).....Jan. 22, 1937
 Belvidere.....Boone.....The Peoples Bank of Belvidere (In liquidation May 22, 1933).....Jan. 23, 1937

RECAPITULATION

	Reopened by Permit.	Closed under holiday.	Total.
State Banks in Chicago.....	34	1	35
State Banks in Cook County outside Chicago.....	31	---	31
State Banks in Illinois outside Cook County.....	517	---	517
Total.....	582	1	583

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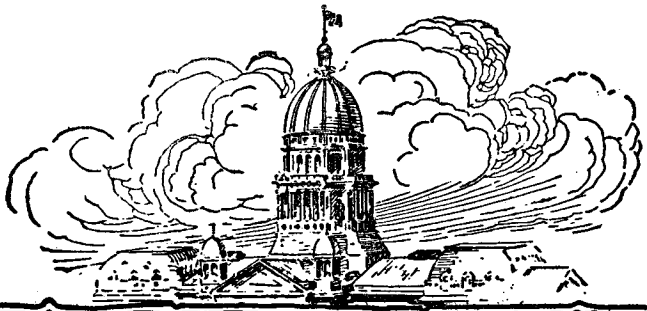
SPRINGFIELD, ILL., MARCH 1, 1937

No. 12

LOANS AND DISCOUNTS (Continued)

We believe that it would be helpful at this point in our discussion of Loans and Discounts as they are reviewed in our new examination report form, to explain the Examiner's viewpoint as he exhibits and classifies loans in his report.

The Officers and Directors in a bank under examination see much more in connection with their local loans than the Examiner. In the case of practically every loan, at least one and generally more, and sometimes all of the Directors and Officers are personally acquainted with the borrower. In smaller communities they have probably known him as a neighbor for many years. They know his personal characteristics such as ability and integrity and frequently know the condition of his affairs as well as the borrower himself. The Examiner, on the other hand, has never seen the borrower; all he sees is the record of the borrower's dealings with the bank. If the borrower's financial statement of condition and operating statement is available, the Examiner can see the present condition of the borrower's business. These financial statements indicate to the Examiner, what the borrower can do about paying his debts and the record of the past tells him what the borrower has actually done.



In the course of an examination the Examiner will review the records of a large number of merchants, manufacturers, farmers, etc., and will see that they are continuously in and out of debt building up inventory, buying raw material, planting crops, stocking feed lots, etc., getting into debt to do so, and getting out of debt as the seasons send their products to market.

Ordinarily the Examiner can see in their operating statements and balance sheets, steady progress in building up their enterprises. These are sound commercial loans and as rapidly as the Examiner is able to identify them as such, he passes them by.

SLOW LOANS

Occasionally he will encounter a loan that has been on the books without change from one to four years, renewed at the same amount every ninety days or six months. He checks over the borrower's statement and finds substantial holdings of non-liquid assets. On the borrower's statement he may find heavy inventories and Accounts Receivable that vary little from year to year. Such a loan classifies itself as Slow and the Examiner so indicates, but the banker frequently protests that the loan is not Slow and can be collected at any time, that the borrower has ample assets to liquidate all of his debts and the loan is so sound that the banker does not want to collect it.

Examiner inquires as to when the loan is likely to be paid and the banker hasn't the slightest idea and so the record shows the Examiner that the borrower has not for sometime demonstrated any ability to pay his debt to the bank. Borrower's statement discloses little in the form of liquid assets with which to pay or reduce the debt and the banker states that there is no understanding as to when the loan is to be paid. He hastens to assure the Examiner that if a demand were made upon the borrower, that he would have no difficulty whatever in obtaining a loan elsewhere. This changes the prospect from the debtor's ability to pay to his ability to borrow somewhere else. We cite these typical details to show by contrast how loans classify themselves.

The Examiner has long since learned by experience that the successful business man although frequently in debt, is constantly working his way out of debt.

There are many varieties of Slow Loans but they all have essentially the same background; a borrower well possessed of assets whose operations do not include a specific program of debt retirement. Examiners very frequently learn upon inquiry that the majority of loans of this type were slow when they were made due to the fact that debt retirement was not discussed with the borrower.

In our December Bulletin we characterized Slow Loans as debts that would require a considerable period of time and possibly involve some difficulty to collect. Directors in reviewing this classification should be concerned as to the amount of this type of paper for to a large extent, it will be found decidedly frozen and weakens the bank from a commercial standpoint.

DOUBTFUL LOANS

When an Examiner encounters a substantial line of credit that has been carried without reduction for a considerable period of time and

where he finds from the bank's record that the borrower is in default of interest payments and occasionally meets interest payments in small installments, he knows before he even examines the debtor's financial statement that not only is this loan Slow, but that the borrower is finding it difficult to meet even his interest requirements. He then examines the debtor's statement and finds a heavy burden of debt.

The balance between borrower's Resources and Liabilities may indicate a substantial Net Worth but usually situations of this kind will show upon checking over a number of previous statements that the borrower's debt position is steadily increasing. This indicates to the Examiner that business profits are not sufficient to meet operating expenses and interest charges and that the borrower is in failing circumstances. He knows from experience that if the creditors force liquidation upon this borrower, that the distress value of the assets will very quickly wipe out the Net Worth indicated and it is no longer a question as to the collection of the debt, but a question as to how much can be salvaged out of such an asset.

If the loan is supported by collateral, the Examiner will attempt to appraise the collateral and give the loan a Slow, sound value equal to the appraised value of the collateral and classify the balance as doubtful. If there is no collateral support for the loan, the Examiner has no alternative but to classify the item as Doubtful as a whole although conceding the probability of some recovery.

While there can be little argument as to the classification of a Slow loan, there is occasionally a sharp difference of opinion between the banker and the Examiner over Doubtful classifications. The banker points to the large margin of debtor's assets over Liabilities as represented by Net Worth and feels secure in that margin. He is familiar with the quality of the assets representing that margin and feels that he is amply protected.

The record shows the Examiner that the borrower is failing in his business and he knows from experience that creditors' liquidations ordinarily mean a heavy asset depreciation and a doubtful liquidation for creditors, and he so indicates in his classification. Such a classification is, of course, arbitrary on his part and occasionally the outcome is favorable and the Examiner's classification in that particular instance, is proved wrong, but in the majority of cases, the Examiner's view will be found surprisingly accurate in the final analysis.

Regardless of the fact that a Director or Officer reviewing our report may disagree with the Examiner's Doubtful classification, they can both find common ground in the agreement that the paper of a borrower so involved, is an unsound and undesirable bank asset.

ESTIMATED LOSSES

As a rule, there is little difference of opinion involved in this classification. Where losses are reasonably determinable, bank managements are quick to recognize and eliminate them. However, we sometimes find bankers hesitant to remove items that are practically worthless of themselves when there is a possibility of recovery from outside sources. For instance, Examiners occasionally encounter notes of borrowers who admittedly cannot pay but through some future contingency such as an expectancy of an inheritance, may later become possessed

of assets sufficient to meet their obligations. Ordinarily Examiners will refuse to recognize such prospects and rightly so, for obviously under circumstances of this kind, the asset itself has no present value and is worthless until the expectancy materializes. Again when the liquidation of an asset becomes involved in a complicated law suit which is likely to be long drawn out, circumstances may incline the Examiner toward an arbitrary loss classification.

One of the major purposes of a bank examination is to detect and eliminate unsound bank assets which are the principal threat against the bank's Capital account and one of the greatest values that bank managements can derive from our examination report, is to review and carefully study unsound assets which are represented in the "Doubtful and Estimated Losses" classifications. It is also important that the Slow classification of loans be carefully studied for it is from this classification that loans move into the Doubtful and Loss groups.

PERMIT ISSUED

	Capital.	Surplus.	Reserve.	Date.
Herrin.....Williamson.....The Bank of Herrin, 3 North Park Avenue.....	\$50,000	\$5,000	\$2,500	Feb. 27, 1937

CONVERSION

Homewood.....Cook.....Cook County Trust and Savings Bank of Homewood into The Cook County National Bank of Homewood.....	Jan. 28, 1937
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NAME CHANGED

Eureka.....Woodford.....The Farmers State Bank of Eureka, Illinois to State Bank of Eureka.....	Feb. 17, 1937
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DISSOLVED

Pearl.....Pike.....Peoples State Bank of Pearl (In liquidation December 26, 1931).....	Feb. 8, 1937
Pittsburg.....Williamson.....First State Bank of Pittsburg (In receivership May 15, 1930. Dissolved by order of Circuit Court of Williamson County).....	Feb. 11, 1937
St. Charles.....Kane.....Stewart State Bank (In liquidation July 20, 1931).....	Feb. 26, 1937

RECAPITULATION

	Reopened by Permit.	Closed under holiday.	Total.
State Banks in Chicago.....	34	1	35
State Banks in Cook County outside Chicago.....	30	---	30
State Banks in Illinois outside Cook County.....	517	---	517
Total.....	581	1	582

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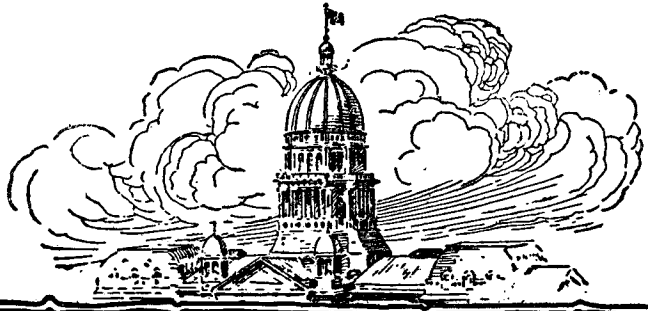
SPRINGFIELD, ILL., APRIL 1, 1937

No. 1

REAL ESTATE LOANS

In our new examination report form, we have so designed our Real Estate Loan Exhibit that in setting each loan into the form, it is automatically analyzed so that a Director reading this exhibit, will find all the essential features of the loan brought out. This form discloses the liquidating ability of the borrower by showing the date of origin and original amount of the loan, followed by the present unpaid balance. The form also shows the amount of reduction between examinations.

A study of this part of the record will give a fairly accurate idea of the position the bank is going to be in with respect to this loan and maturity. The form then goes on to analyze the security showing the lot size if city real estate, or acreage if farm property. The age of improvements is also shown; then follows the appraised valuation, the date of the appraisal and the name of the appraiser. If there is a lien of record prior to the bank's mortgage, this is also shown as well as accrued and unpaid taxes. The bank's protection against Fire and Windstorm in the form of insurance is further indicated; annual rental is also shown. These are all important features of the loan and if in reviewing



this exhibit, any of these features are not shown, it means that the information was not available to our Examiner and the Directors should see to it that the missing information is promptly acquired.

In our contact with banks both through the medium of correspondence and personal conference, we have on numerous occasions, had reason to question whether bank Directors gave a great deal of thought or consideration to their Real Estate Loan Account. In such contacts, it has seemed to us that the fact that certain assets were secured by mortgages upon real estate, was deemed to be sufficient to remove such items from all question as to value. In other instances if the report indicated that there was sufficient value in the real estate to cover the loan, there would be little concern as to the time of collectibility or the method of collection.

Generally speaking, there is no asset in any bank that can be filed away as a sound investment and forgotten; all investments need periodical review and analysis. Real Estate Loans regardless of their apparent security, need just as careful supervision as any other assets in the bank. Often-times an amply secured Real Estate Loan poorly made and handled, can cause a bank a great deal of unnecessary trouble.

While the security underlying a Real Estate Loan is a very important factor, its collectibility as a debt is of almost equal importance; for to make an amply secured Real Estate Loan to a borrower who cannot pay, is simply inviting trouble. It therefore seems to us that when considering an application for a Real Estate Loan, the first factor to be definitely established is its collectibility from the borrower and the borrower's ability to pay the debt and retain his property should be unquestionably established as far as it is possible to do so; for in nearly every instance where a bank is forced to liquidate a Real Estate Loan through foreclosure, some injury is done which is frequently reflected upon the bank although not measurable in terms of dollars.

No one likes to see a man lose his property even by legal process and bank Directors should guard against such an extremity as carefully as they would against actual loss.

Real Estate Loans are invariably in substantial amounts and the maturity fixed in bank loans of this type is usually five years. If no provisions are made for loan retirement, it is generally a foregone conclusion that at the end of five years, the borrower cannot pay the full amount of the loan and faces one of three alternatives, either extension, borrowing elsewhere or foreclosure. If a loan elsewhere cannot be arranged, then the bank must either extend or foreclose. If the loan has not been substantially reduced, the property may have greatly depreciated during the term of the loan which would then leave the bank facing two very undesirable alternatives—extension or foreclosure.

The factor of collectibility is so important in the making of a Real Estate Loan that practically all concerns who specialize in this type of business insist upon amortization or periodical reduction. As regards the individual loan, amortization simultaneously accomplishes two very important results—it reduces bank's risk and increases the borrower's equity in the property so that at the end of a five year period, the bank's

risk has been reduced to an almost negligible factor and borrower's equity increased to a point where he is not only anxious but able to protect same.

Consideration should also be given by bank managements to the effect that amortization will have upon the Real Estate Loan Account as a whole. A Real Estate Loan Account containing \$100,000.00 in straight five year Real Estate Loans is a highly frozen account regardless of the soundness of the investments. But this same account amortized \$10,000.00 every year takes on an entirely different complexion for an account constantly in the process of liquidation is growing steadily stronger not only as to collectibility, but in security as well.

Further let it be assumed that this account contains twenty loans and that \$100,000.00 is the maximum of Real Estate Loans that the bank can make. If all of these loans are straight five year loans, additional investments of this type would mean over-extension in Real Estate Loans and additional "freezing up". On the other hand, if \$10,000.00 is collected from the account every year, additional loans can be taken on without affecting the bank's position. We cannot escape the conclusion that Real Estate Loan amortization will result in a more liquid Real Estate Loan Account, a better secured Real Estate Loan Account and at the same time enable the bank to extend a wider Real Estate Loan service to its community.

Directors in reviewing this exhibit should be on the alert to detect "split loans". By that we mean where the bank holds only a portion of the loan while the balance is held by private investors. In the light of past experience, we would like to see participation in split loans abandoned by all of our State banks for the notes sold out to private investors are very frequently a source of annoyance and trouble to the bank. Usually when a bank is forced to foreclose a split loan, it must not only advance the costs and expenses and do the work, but bear the criticism as well. Participation in split loans also means, as a general rule, that the bank has originally made the loan and sold a portion to private investors. This is a practice that we should like to see our State banks discontinue and carefully avoid in the future for here again experience has conclusively demonstrated to our satisfaction, that no bank can be sufficiently compensated or benefited by sale of notes or securities to customers to justify the risk not only of monetary loss but of prestige and good will as well.

We have, in previous articles, pointed out the necessity for opinions of title drawn by competent authority who examine records and pass upon titles. In spite of all that has been said concerning this important step in the making of a Real Estate Loan, we find a few executives who continue to make Real Estate Loans without a title search and in this connection, we are struck by a rather amusing comparison. A Bank and a Building & Loan Association will be operating in the same town and both making Real Estate Loans. The Building & Loan Association will very carefully check titles and have all of these steps carefully examined by competent legal authority. The banker does not consider it necessary to do this and we wonder why.

CAPITAL STOCK INCREASED

Woodstock.....McHenry.....The State Bank of Woodstock, from \$50,000 to \$100,000..... Mar. 4, 1937

TITLE GUARANTEE CERTIFICATE ISSUED

Wheaton.....DuPage.....DuPage Title Company—Deposit \$25,000..... Mar. 5, 1937 ✓

RECEIVER APPOINTED

Downers Grove.....DuPage.....State Bank & Trust Company of Downers Grove—Charles H. Albers..... Mar. 17, 1937 ✓

CLOSED

Rio.....Knox.....Rio State Bank..... Mar. 26, 1937 ✓

DISSOLVED

Broadlands.....Champaign.....First State Bank of Broadlands (In receivership November 22, 1930. Dissolved by order of the Circuit Court of Champaign County)..... Mar. 12, 1937 ✓

Fisher.....Champaign.....Fisher State Bank (In receivership July 21, 1930. Dissolved by order of the Circuit Court of Champaign County)..... Mar. 12, 1937 ✓

Rock Island.....Rock Island.....First Trust and Savings Bank of Rock Island (In liquidation January 12, 1928. Dissolved by order of the Circuit Court of Rock Island County)..... Mar. 25, 1937 ✓

Hume.....Edgar.....The Hughes State Bank (In liquidation January 16, 1932) Mar. 31, 1937 ✓

TRUST CERTIFICATES CANCELLED

Evanston.....Cook.....City National Bank and Trust Company of Evanston..... Mar. 29, 1937 ✓
Charleston.....Coles.....The National Trust Bank of Charleston..... Mar. 30, 1937 ✓

RECAPITULATION

	Reopened by Permit.	Closed under holiday.	Total.
State Banks in Chicago.....	34	1	35
State Banks in Cook County outside Chicago.....	30	---	30
State Banks in Illinois outside Cook County.....	516	---	516
Total.....	580	1	581

MONTHLY BULLETIN

Issued by
EDWARD J. BARRETT
AUDITOR of PUBLIC ACCOUNTS
BANKING DEPARTMENT
State of Illinois

Vol. 13

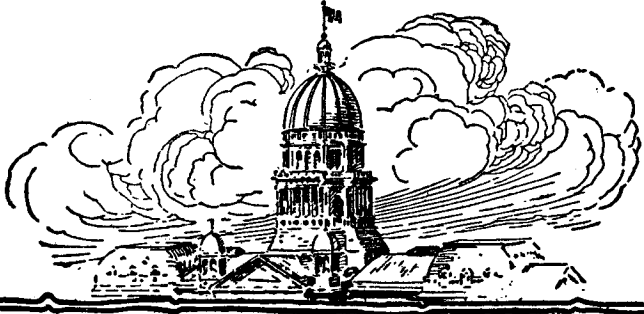
SPRINGFIELD, ILL., MAY 1, 1937

No. 2

THE BOND ACCOUNT

In designing our new examination report form, we have not changed either the form or treatment of the Bond Account. In the exhibit proper, we note the name of the issuing corporation; in the next columns a brief description of the indenture, the rate of interest, date of maturity, par value, book value, market value, and current market quotation.

The part of this exhibit containing the greatest interest for bank Directors is in the first sheet of the exhibit in which we outline, in condensed form, an analysis of the Bond Account. This analysis is designed to bring out two essential points; the first is the position of the account marketwise and the second is the quality of the bonds contained therein. By the position of the account marketwise, we mean the relationship that the book value of all bonds bears to the market value of said bonds on the date of our examination. This position can be learned by comparing the two money columns, the first being headed "Book Value" and the second "Market Value". The total "Book Value" represents the amount at which all of the bonds are carried upon the books of the bank, while the "Market Value" represents approxi-



mately what all of the bonds would sell for on the date of examination in the open market. If the "Market Value" exceeds the "Book Value", the excess is called "Appreciation". If the "Book Value" exceeds the "Market Value", the amount of the shrinkage is called "Depreciation". In preparing this analysis for the report, we show "Appreciation" in red figures and "Depreciation" in black figures.

While market position is an important point for consideration, this Department is more concerned about the quality of the bonds which is also brought out in this same analysis.

In summarizing our conclusions as to quality, we employ two sections; in the first we show by groups, the kinds of bonds and other securities carried in this account divided as follows: United States Government Securities, Municipal Obligations, Railroad Bonds, Public Utility Bonds, Industrial Bonds, and Stocks (if any). We thus show how the investment in bonds is spread out among the various kinds of business enterprises, Municipal and Governmental Corporations.

In the second section, we regroup all of the bonds according to ratings. Before explaining this section further, a word concerning bond ratings may be helpful.

For a number of years, certain concerns have specialized in assembling information concerning all bonds of any consequence traded in the United States. These concerns employ large staffs of experts in Accounting, Statistics, Law, and Finance, to assemble and study the histories, figures, and other statistical data of most of the corporations issuing bonds to be sold to the public; and on the basis of all of this information, they grade the bonds according to quality.

Broadly speaking, bonds will fall within four main grades—High, Medium, Speculative, and Doubtful Investments. These grades are again broken up into several sub-groups to denote variations in quality within any given grade of bonds. Each of these concerns employ symbols to indicate the various ratings; and these symbols indicate the investment standing of any particular bond under the standards used by the rating concern. The ratings in general, indicate the opinion of the rating concern as to the ability of any given corporation to pay that particular issue of bonds both as to principal and interest.

With the foregoing general explanation in mind, we shall now proceed with the second section of the analysis of the Bond Account as to quality. In order to condense this analysis as much as possible, we use three groups instead of four, showing first the totals of the highest grade investments which we consider eligible for bank investment; secondly, what we call the sub-standard group in which are bonds not considered eligible for bank investment; and thirdly, we show the total of bonds in default (also ineligible for bank investment). To these we add non-rated municipal obligations. If corporate stocks have been acquired by the bank in the process of collecting debts, they are also shown in a separate group.

In the matter of Municipal Obligations, we might add that the rating concerns apparently have not as yet covered this field of investment as thoroughly as the industrial field and there are a large number of excellent municipal bonds that are not rated, so in order to deal fairly with this group of bonds, we list them separately in our analysis subject to the individual study of the Directors reviewing the report.

As stated above, only the highest grade bonds are considered as eligible for bank investment for it is only in this group that can be found with the highest degree of certainty, the qualities that bank managements should require of their bond investments which are; first, the certainty of payment, and secondly, the certainty of market. A bank's supreme test is, always has been, and always will be, its ability to meet the demand of its creditors; and this ability is measured first by its cash means, secondly by the amount, quality and marketability of its Bond Account, and thirdly, by the quality and liquidity of its local investments. It is, therefore, of great importance to bank managements when considering bond purchases, to bear well in mind what the bonds they are about to purchase may mean to their institution.

Occasionally it will be found that rating concerns disagree on the rating to which a particular issue of bonds is entitled. This will not affect our analysis if both ratings are within the highest group. However, if the rating of one service placed a particular bond within the group that we consider eligible for bank investment and another service of equal standing would place the same bond in the sub-standard group, such a disagreement would affect our analysis to the extent of placing such a bond in the non-eligible group. When such a situation is brought to our attention and we find that the bond was purchased in good faith on an eligible rating by recognized statistical service, we would give such a bond an eligible rating.

It is important to point out here, that while ratings are a valuable guide in bond purchases, ratings frequently change upward or downward.

These changes should be carefully watched and as soon as any given bond is rerated to a lower grade, bank managements should be on the alert to ascertain the reason; for that is a danger signal that must not be overlooked.

In building up a Bond Account, maturities are a very important factor in making selections for it is well to have bonds maturing at various intervals throughout the year for replenishment of cash reserve or such advantageous reinvestment as may be available.

We have, in this Department, encountered a number of bank Officers and Directors who seem to feel a responsibility to have their annual Operating Reports show substantial bond profits. While good profit showings are quite gratifying to this Department, we are always concerned to learn how bond profits are produced; for an anxiety on the part of bank managements to annually produce large bond profits, almost invariably develops a tendency to use the Bond Account as a trading account. While this may occasionally be done to a moderate extent within the highest rated group, there is a further temptation to buy sub-standard bonds for appreciation in quality, market price, or both; and this is a speculative tendency that should be discouraged. We hold it to be axiomatic in the banking business, that quality should never be sacrificed for profit.

It is, therefore important for Directors in studying the Bond exhibit section of the report, to note the amount of sub-standard and defaulted bonds and corporate stocks carried in the Bond Account; and it is our considered recommendation that all such securities be disposed of as soon as it can advantageously be done and this important part of the bank's assets restricted to only the highest grade investments.

In stressing the importance of the Bond Account, we are mindful of the fact that we are confronting many bank directors with a perplexing problem; for there are doubtless a number interested in bank operation who while sound business men, have never had occasion or opportunity to devote a great deal of time to the study of bond investments and it is largely for such individuals that this article is written.

In our June Bulletin, we shall continue the discussion of this important account from the point of view of Bank Directors and Officers who need a little help along these lines.

PERMIT ISSUED

			Capital.	Surplus.	Reserve.	Date.
McLeansboro.....	Hamilton.....	First State Bank of McLeansboro, Illinois...	\$50,000	\$5,000	\$2,500	Apr. 20, 1937

CHARTER ISSUED

			Capital.	Surplus.	Reserve.	Date.
Herrin.....	Williamson.....	The Bank of Herrin, 3 North Park Avenue... Fred G. Harrison, Pres. H. A. Whittenberg, Cash.	\$50,000	\$5,000	\$2,500	Apr. 6, 1937

RECEIVER APPOINTED

Rio.....	X	Knox.....	Rio State Bank—Charles H. Albers.....	Apr. 20, 1937
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DISSOLVED

Royalton.....	✓	Franklin.....	Royalton State Bank (In receivership October 19, 1927. Dissolved by order of the Circuit Court of Franklin County).....	Mar. 27, 1937
Warrensburg.....	✓	Macon.....	State Bank of Warrensburg (In receivership April 13, 1931. Dissolved by order of the Circuit Court of Macon County).....	Apr. 6, 1937
Bridgeport.....	✓	Lawrence.....	The Bridgeport Bank and Trust Company (In receivership December 22, 1921. Dissolved by order of the Circuit Court of Lawrence County).....	Apr. 7, 1937
Gilman.....	✓	Iroquois.....	Gilman State and Savings Bank (In receivership July 22, 1930. Dissolved by order of the Circuit Court of Iroquois County).....	Apr. 10, 1937
Bloomington.....	✓	DuPage.....	Farmers and Merchants State Bank of Bloomington (In liquidation July 1, 1931).....	Apr. 17, 1937
Chicago.....	✓	Cook.....	Division State Bank (In receivership June 30, 1932. Dissolved by order of the Circuit Court of Cook County).....	Apr. 19, 1937

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	34	1	35
State Banks in Cook County outside Chicago.....	30	—	30
State Banks in Illinois outside Cook County.....	517	—	517
Total.....	581	1	582

MONTHLY BULLETIN

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EDWARD J. BARRETT
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BANKING DEPARTMENT
State of Illinois

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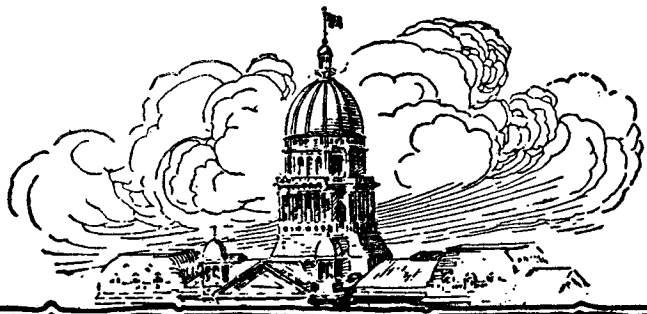
SPRINGFIELD, ILL., JUNE 1, 1937

No. 3

THE BOND ACCOUNT—(Continued)

Large metropolitan banks organize complete departments of investment experts for the management of their Bond Accounts. Others of lesser volume may have one or more officers well versed in investments whose sole duties are in the management of the Bond Account. It is to the smaller institution with one executive officer and a few clerks that this problem assumes vital proportions. The executive officers in smaller banks are burdened with many matters of routine detail including the handling of local investments which leave them with little time to devote to investment study and analysis.

It seems obvious to us, that banks in such a position have no other alternative than to seek outside help in their investment problems. Granting this to be true, the reliability of the source of this assistance becomes the next important question. As stated in our May Bulletin on this subject, there are several nationally known concerns whose sole business is the assembling of information for the guidance of investors. These concerns neither buy nor sell securities and will furnish only as much service as a client asks and pays for; if a bank desires information and statistical ratings only, it will be furnished; if recommendations are



sought, they will be supplied; if complete supervision of the Bond Account by one of these concerns is desired, such service is available. The bank pays for the amount of service, along these lines, that it receives.

We have considered the fact that the foregoing sounds like advertising matter, but we are greatly impressed with the seriousness of this problem to the small bank and we can think of no other source where reliable and DISINTERESTED information can be obtained. We do not claim infallibility for any of these concerns and we have never heard of their claiming it; so it is not improbable that in dealing with a field so vast and complex as business and investments, that errors in judgment will occasionally occur. But we do say that there are several nationally known bond analytical services who on their records, have won the confidence of business in general and whose findings we accept as reliable.

While on this subject, we have a word of caution for bank managements in connection with all investments made outside of their own immediate trade territory. This not only applies to bonds, but all varieties of commercial paper. No investment should be made outside of the bank's own trade territory until the soundness of the investment has been established to the satisfaction of the Board of Directors, by authentic, reliable and DISINTERESTED information. To be shown a financial statement and business prospectus, should not be sufficient. To an investor, a financial statement should mean nothing more than a display of figures until a competent DISINTERESTED authority has analyzed those figures and investigated the resources that they represent.

To be told about collateral trust security and warehouse receipt collateral means nothing until some competent and DISINTERESTED authority has examined and appraised the collateral or the investor knows the quality and condition of the products covered by warehouse receipts and the warehousing arrangements under which said products are held. In brief, bank managements must recognize the risks involved in seeking outside investments and should develop investment procedure wherein they will select their investments on the basis of reliable information.

We have in the past, talked to bank Directors and Officers who after taking heavy losses on poorly selected bonds, have declared that they were through with outside investments and that future investments would be confined strictly to their own locality; and we have, in a very few instances, actually encountered bank managements who followed such a policy. In the last mentioned extreme cases that we have in mind, they had no bond losses to write off to be sure, but the Receivers after several years of forced liquidation and compromise, are now writing off the losses on local investments.

We believe that a small bank serving a rural community would do well to make a survey of the legitimate and sound credit needs of its own trade territory. In other words, let them determine by such a survey, the number of individuals in their community entitled to commercial bank credit and the amount of credit that they can safely manage; then let them determine their normal cash needs and maintain a comfortable cash reserve to meet such needs. These two figures plus their Banking House and Furniture & Fixtures Accounts, will determine the amount of resources that can safely be employed locally. If the balance of the bank's resources are invested in a well selected investment account, it should be as sound as is humanly possible to make it. Such an institution carefully watched and supervised internally, should meet all of the requirements of a sound commercial bank, namely, a maximum degree of safety and a reasonable return from operations.

It is undeniable that during the period of forced liquidation of 1931, 1932, and early in 1933, that a number of banks took heavy bond losses; but a frank inquiry into such experiences, will frequently reveal that a large part of such losses came from bonds that should not have been purchased. Despite such heavy losses which are, of course, regrettable, many of these banks are in operation today and we know and they know, that in spite of the losses, their Bond Accounts saved them. It is probably inescapable that in a period when business is in the process of forced liquidation, that even the best of assets will show losses but such a result should not drive bank managements to an extreme policy of avoiding marketable investments for the reason that they are not thoroughly informed in that field. A substantial and well selected Bond Account might well be termed a vital organ in any commercial bank; and bank Officers and Directors who assume the responsibility of managing such an institution, must make it their business to familiarize themselves with what it is, and what is required to maintain its functions in a healthy condition.

We have in discussing this subject with bank Directors, encountered a number whom we knew to be men of business experience and sound judgment, who feeling themselves unfamiliar with bond investments, took little interest in their Bond Account; yielding perhaps, to the judgment of an Officer or Director more experienced in these matters. To such an individual we would state that after the necessary information and financial data has been assembled, common sense and sound judgment play the same part as they do in any other business transaction. When investment transactions are being considered at Board meetings, if these individuals will ask such questions and acquire such information as their ordinary business curiosity will evoke, they will, in a surprisingly short time, gain considerable familiarity with the subject of investments. This will not only prove very interesting to such a Director, but will increase his helpfulness in the management of the bank.

CHANGE OF LOCATION

Herrin.....	Williamson.....	The Bank of Herrin, from 3 North Park Avenue, Herrin, Illinois to 200 North Park Avenue, Herrin, Illinois.....	May 1, 1937
Marengo.....	McHenry.....	Marengo State Bank, from 113 South State Street, Marengo, Illinois to 126 South State Street, Marengo, Illinois.....	May 29, 1937

DISSOLVED

Berwick.....	Warren.....	Farmers State Bank of Berwick (In receivership February 18, 1931. Dissolved by order of the Circuit Court of Warren County).....	May 3, 1937
Thompsonville.....	Franklin.....	Thompsonville State Bank (In receivership November 13, 1929. Dissolved by order of the Circuit Court of Franklin County).....	May 7, 1937
Joliet.....	Will.....	Stern State Bank (In liquidation March 24, 1928).....	May 25, 1937
Martinton.....	Iroquois.....	The Martinton State Bank (In liquidation April 15, 1933).....	May 28, 1937

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	34	1	35
State Banks in Cook County outside Chicago.....	30	---	30
State Banks in Illinois outside Cook County.....	517	---	517
Total.....	581	1	582

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SPRINGFIELD, ILL., JULY 1, 1937

No. 4

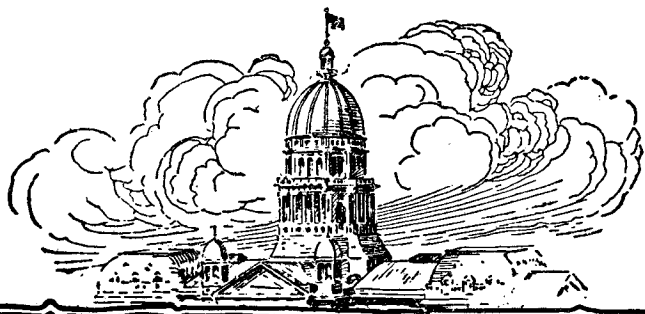
OTHER ASSETS EXHIBIT

In our new examination report form, this exhibit will be found immediately following the Bond Account. This form has been designed to exhibit all assets not otherwise provided for in the report. This section might well be termed the exhibit of "odd and ends" and when such an exhibit is found in an examination report, it usually merits special study.

Into this exhibit the Examiner will segregate overdrafts subject to criticism, irregular cash items, claims and judgments, or any other personal property acquired by the bank in the conduct of its business. The form itself is a simple one, the amount involved or book value being shown in the left hand column, a description of each individual item and Examiner's comment being contained in the next column to the right and then three columns to indicate the Examiner's classification of Slow, Doubtful or Estimated Loss.

Almost invariably items segregated into this exhibit are Slow at best and are usually of a character that will quickly develop into Doubtful or Loss items unless energetically looked after.

A close study of this exhibit is important to the Directors for the reason that the items contained therein



are very frequently the results of operating mistakes and carelessness such as doubtful or uncollectible overdrafts that should never have been permitted to occur, and doubtful or uncollectible Cash Items that indicate indulgence or lack of alertness on the part of Officers or Clerks.

A Board of Directors in studying this exhibit would do well to make inquiry concerning the reason for every item appearing therein. It is also equally important that after reviewing this exhibit, that definite instructions be issued to the Officers to collect such items immediately.

There will be exceptions, of course, in the case of judgments involved in litigation and claims against estates in Probate, but even in the case of such exceptions, liquidation should be pursued as rapidly as legal remedies will permit. To show indulgence toward Claims and Judgments on the theory that they are sound and collectible, develops a tendency toward the accumulation of highly undesirable bank assets.

Recent years have brought a highly commendable change in the matter of overdrafts. At one time, this pernicious practice seemed almost impossible to control; today, this accommodation seems well on the way toward elimination.

There are a number of banks and the number seems to be increasing, where overdrafts are never permitted. We have talked to several bankers who have permanently discontinued the allowance of overdrafts and have not had an overdraft on their books for several years, and they report that this improvement in bank operation was accomplished with surprisingly little difficulty or embarrassment. If bank Directors really desire to end this practice, they have only to pass a resolution to that effect and hold the Officers and Employees and their bondsmen personally responsible for overdrafts permitted.

There has also been a splendid improvement in the matter of Cash Items and today, irregular Cash Items are not frequently encountered in our cash count. It is a matter of regulation in this Department, that only such items as can be cleared within twenty-four hours are admissible to the Cash Account. This regulation restricts Cash Items almost entirely to small accumulations of bond coupons and postal money orders. The fact that Cash Items are usually small and supposedly of a temporary nature only is no justification for any toleration of looseness in the handling of the Cash Account. The records of this Department show a number of instances of defalcations and misappropriation that had their origin in what appeared to be small accumulations of Cash Items, and in one particular case, we have a record of a misappropriation of funds to the extent of nearly \$75,000.00 that originated in what appeared to be moderate accumulations of Cash Items.

For the sake of emphasis, we repeat that this exhibit of Other Assets invariably contains items that the bank should be anxious to liquidate as quickly as possible and it should be borne in mind that the bank has nothing to gain and much to lose by a tolerant attitude toward the items contained therein.

OTHER REAL ESTATE

This is the next form appearing in our report and one that will contain items of a highly undesirable nature from a commercial banking standpoint. This form offers a very complete analysis of each parcel of Other Real Estate owned by the bank. In the first column we provide for the name of the item which is usually carried under the name of

the mortgagor from whom title was acquired. In this same column we give a general description of the property, the date of acquisition, date of recording, insurance coverage, and indication of how it was acquired, etc. In the ensuing columns to the right, we show consecutively, Book Value, Prior Liens, Estimated Value, and Income, the amount classified as Doubtful and the amount classified as Estimated Loss.

To a Director examining this form, it is of first importance to note how long the bank has held title as shown by the date of the deed for under Section 9 of the Banking Act, the bank is permitted to carry Real Estate acquired other than Banking House, not to exceed five years from the date of acquiring title. At the end of said five-year period, that particular item must be removed from the Statement of the bank.

When a bank in the process of collecting its debts is forced to take title to Other Real Estate, the Directors and Officers should set about immediately to dispose of the real estate so acquired. Naturally they will be anxious to realize the full amount of their investment plus acquisition costs and as soon as they are able to accomplish this, they should not hesitate to dispose of the property. Sometimes it is even advantageous to sell at a nominal loss rather than manage the property over a period of changing markets and at the risk of still further loss. And we occasionally encounter a disposition to hold real estate for further profits after offers have been made that will show full realization of investment. From our observation, worthwhile profits in bank real estate dealings are rare exceptions while as a rule, banks are very fortunate to break even in the management of their Real Estate holdings.

Unquestionably bank managements share the antipathy of this Department toward placing items of Other Real Estate upon their books and this reluctance to take titles where such action is inevitable, sometimes leads to evasions that are not only matters of questionable practice, but actually dangerous.

We have known banks to carry Real Estate Loans long in default knowing that there was no other alternative than acquisition of title, hoping that through some adjustment, the showing of Other Real Estate upon their Statement could be avoided. In other instances, titles have been conveyed to nominees who would execute conveyance to the bank and said conveyance held unrecorded. The use of accommodation notes signed by Directors to replace items of Other Real Estate, has also been resorted to. Such practices should be shunned as they occasionally involve one or more innocent people in serious trouble. If a bank has no other alternative than the foreclosure of a mortgage or trust deed, in order to collect a debt, they should proceed openly to acquire the title for the bank as a corporation and so record it, and until the property is finally disposed of, it should be dealt with entirely by the corporation as such.

From time to time, the question arises as to the correct accounting procedure to follow when a parcel of Other Real Estate is sold under contract. It is sometimes contended that when a parcel of Other Real Estate is sold by a bank under contract, that the property has been disposed of and the contract should be placed in the Real Estate Loan account. This Department cannot agree with that reasoning. We view the situation from the standpoint of title and as long as a bank continues

to hold title to Other Real Estate, it should be so reported. A Real Estate Contract is merely an agreement to sell and pass title when the terms of the contract have been entirely fulfilled. The real evidence of the asset is the instrument of title held by the bank and not the contract governing its disposal.

CONVERSION

Chicago.....Cook.....Merchandise Bank and Trust Company into the Merchandise National Bank of Chicago.....May 6, 1937

IN LIQUIDATION

London Mills...Fulton.....The State Bank of London Mills.....June 23, 1937

TRUST CERTIFICATE ISSUED

Bloomington...McLean.....The National Bank of Bloomington.....^{Deposit.} \$50,000 June 23, 1937

DISSOLVED

Smithfield.....Fulton.....Smithfield State Bank (In receivership April 23, 1931. Dissolved by order of the Circuit Court of Fulton County)...May 19, 1937

Maroa.....Macon.....Crocker & Co., Bankers (In liquidation January 11, 1932)...June 5, 1937

Alexander.....Morgan.....Alexander State Bank (In receivership December 5, 1932. Dissolved by order of the Circuit Court of Morgan County)...June 10, 1937

Chicago.....Cook.....Belmont-Sheffield Trust & Savings Bank (In receivership August 7, 1933. Dissolved by order of the Circuit Court of Cook County)...June 25, 1937

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	33	1	34
State Banks in Cook County outside Chicago.....	30	---	30
State Banks in Illinois outside Cook County.....	516	---	516
Total.....	579	1	580



(32330)

MONTHLY BULLETIN

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EDWARD J. BARRETT
AUDITOR of PUBLIC ACCOUNTS
BANKING DEPARTMENT
State of Illinois

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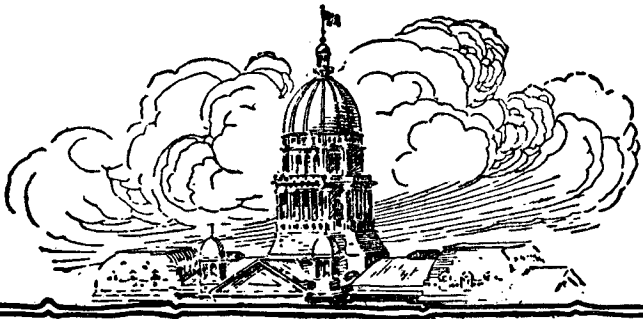
SPRINGFIELD, ILL., AUGUST 1, 1937

No. 5

BANK BALANCES RE-DISCOUNTS AND BORROWED MONEY ASSETS PLEDGED

The next page in our new examination report form deals with the three captioned subjects. In the form provided for Bank Balances, we show in the left hand column balances due from correspondent banks. In the upper half of this column we list balances due from correspondents on Demand and in the lower portion we list Time Deposits with correspondent banks showing the name of each correspondent and the amount of net balance on the date of examination. In the right hand column we list the balances due to correspondent banks showing, as above outlined, separately the Demand and Time balances.

The several totals contained in this form are carried over to page 3 of the report as a part of the bank's primary cash reserve in working out the Analysis of Liquidity (see Bulletin, November 1, 1936.) This form also carries the detail of the entry on the first page of the report form under the entries Due from Banks "Demand" and Due from Banks "Time". When a Director reading this report sees these totals used on page 1 and 3, he can find a list of the banks



in which these balances are carried on the form that we are now describing.

The form dealing with Re-Discounts and Borrowed Money is so simple as to need no explanation; however, there are principles involved here that merit serious consideration on the part of bank managements. Borrowing by banks ceased, as far as active Illinois State Banks are concerned, about four years ago so that Bills Payable are and have been for some time an absent factor in the condition of the banks under our supervision. It, therefore, strikes us that this might be a good time to discuss this subject.

It is important to note that the Banking Act contains no authority for bank borrowing and the pledging of assets to secure such loans. Several court decisions have held that the legality of bank borrowing has been well established by custom and is a corporate power incidental and necessary to bank operation. And it is probably true that many emergencies have been overcome through temporary borrowing.

If banks could borrow money on an unsecured basis the effect of such an action would be little different than the receiving of a deposit. However, when banks borrow they are ordinarily required to pledge to the lender their best assets to secure the loan, with a liberal marginal value over and above the amount received as protection for the lender against depreciation and loss in liquidation. The first effect then is the creation of a preference in behalf of the lender as against all of the rest of the creditors of the bank. We know of bankers who will not enter into any transaction that is apt to prefer one or more creditors as against all of the rest, and it is a laudable matter of pride to these individuals that in their particular banks all creditors stand in an equal position.

We recognize the fact that circumstances occasionally arise where moderate temporary borrowing serves a very useful purpose. The point that we should like to stress here is that when bank directors are asked to authorize their bank to borrow money, they inquire very thoroughly into the reason for such action. If, for example, the bank is faced with an unusual and unforeseen demand for funds that will jeopardize its primary cash position, and needs a short time to liquidate in an orderly manner certain assets, and the active management has a definite program worked out that will insure complete retirement of the obligation within a short period of time, such a borrowing would ordinarily be warranted.

On the other hand if cash reserves are weak and secondary reserve inadequate, and the bank heavily committed to loans of the slow type, such a combination of circumstances should be recognized as a danger signal. In our opinion such a bank might well be termed a sick institution, where the borrowing of money would be only a temporary remedy at best and would serve only to aggravate a condition that should be diagnosed and cured.

Ten years ago when bank borrowing, bills payable, and re-discounts were more or less commonly encountered and were, in most instances, clear indications of over-extended credit, we generally heard the explanation that they were the result of seasonal demand for credit. At the same time we could see in the soundly operated banks that the same seasonal demands were being met by adjusting operations internally and not by bringing in money from the outside.

There are a number of banks under the supervision of this Department that have been in operation for many years and have never borrowed funds for any purpose; all of which proves that it can be done.

Anecdotes of the Road

Bank examination and supervision is a very serious business; but withal, its tedium is not infrequently relieved with flashes of very human wit and comedy. This Department is not without its traditional stories arising from the experiences of our Examiners who have for years been traveling the length and breadth of our big State, meeting with all kinds of people under a wide variety of circumstances. All of these stories are original and we shall digress, from time to time from our technical discussions, to pass them on to whom we hope will be appreciative readers.

This one took place about ten years ago and involves an Examiner and the Cashier of a country bank in the middle part of the State. The Examiner was particularly well groomed and well poised and was undoubtedly sized up by the Cashier as a "city boy." In this he was quite mistaken as the Examiner had been born and raised on a farm; had operated a farm and knew his barnyard very well indeed.

They were discussing a fairly large loan that had been dormant for several years. The loan was secured by a chattel mortgage about two years old. The Cashier assured the Examiner that he had recently inspected the pledged chattels and that they were all accounted for and in good condition.

Casting his eye over the list the Examiner inquired—"Has he still got the ninety spring pigs listed here?"

The Cashier assured him that they were still in the possession of the mortgagor.

"Still pouring corn into them, is he?" pressed the Examiner, and the Cashier nodded his assent.

"Gosh" replied the Examiner, lapsing easily in the vernacular of the barnyard, "I'll bet them hawgs is right stout critters by now; I expect they'll need a stock car apiece to bring 'em to market in for they must be as big as elephants."

And was the Cashier's face red!

CONVERSION

Harrisburg.....Saline.....First Trust & Savings Bank of Harrisburg into The Harrisburg National Bank.....June 30, 1937 ✓

PERMIT ISSUED

	Capital.	Surplus.	Reserve.	Date.
Benton.....Franklin.....Bank of Benton.....	\$50,000	\$5,000	\$5,000	July 6, 1937

CHARTER ISSUED

	Capital.	Surplus.	Reserve.	Date.
Benton.....Franklin.....Bank of Benton.....	\$50,000	\$5,000	\$5,000	July 24, 1937 ✓
208 Public Square. Dr. G. C. Buntin, Pres. G. C. Payne, Cash.				

DISSOLVED

Browns.....Edwards.....	Browns State Bank (In receivership October 27, 1931. Dissolved by order of the Circuit Court of Edwards County)	June 28, 1937 ✓
Georgetown.....Vermilion.....	First State Bank of Georgetown, Illinois (In liquidation October 29, 1923. Dissolved by order of the Circuit Court of Vermilion County)	July 3, 1937 ✓
Armington.....Tazewell.....	Farmers State Bank of Armington (In receivership June 30, 1931. Dissolved by order of the Circuit Court of Tazewell County)	July 8, 1937 ✓
Belle Rive.....Jefferson.....	Belle Rive State Bank (In receivership May 27, 1930. Dissolved by order of the Circuit Court of Jefferson County)	July 14, 1937 ✓
LaPlace.....Piatt.....	The State Bank of LaPlace (In receivership August 8, 1928. Dissolved by order of the Circuit Court of Piatt County)	July 15, 1937 ✓
Williamsfield.....Knox.....	First State Bank Company (In receivership May 13, 1930. Dissolved by order of the Circuit Court of Knox County)	July 20, 1937 ✓
LaPrairie.....Adams.....	Peoples State Bank of LaPrairie (In liquidation August 30, 1922. Dissolved by order of the Circuit Court of Adams County)	July 24, 1937 ✓
Buncombe.....Johnson.....	First State Bank of Buncombe (In liquidation December 21, 1929. Dissolved by order of the Circuit Court of Johnson County)	July 27, 1937 ✓

RECEIVER APPOINTED

Chicago.....Cook.....	Old Dearborn State Bank—Harry R. Spellbrink (James S. Rodie, Receiver—resigned)	July 31, 1937 ✓
Chicago.....Cook.....	Union Bank of Chicago—Harry R. Spellbrink (James S. Rodie, Receiver—resigned)	July 31, 1937 ✓

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State banks in Chicago.....	33	1	34
State Banks in Cook County outside Chicago.....	30	--	30
State Bank in Illinois outside Cook County.....	516	--	516
Total.....	579	1	580

MONTHLY BULLETIN

Issued by
EDWARD J. BARRETT
AUDITOR of PUBLIC ACCOUNTS
BANKING DEPARTMENT
State of Illinois

Vol. 13

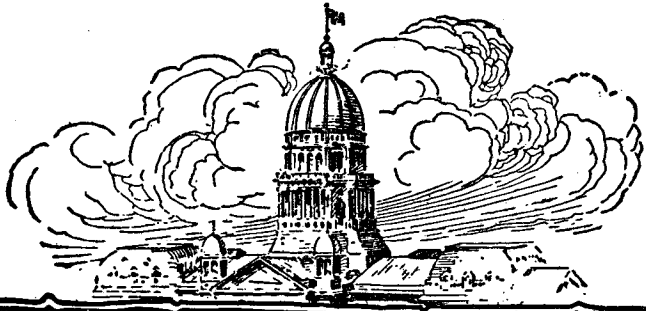
SPRINGFIELD, ILL., SEPTEMBER 1, 1937

No. 6

QUESTIONNAIRE

Our new examination report form is divided into two parts. We have up to this point in these bulletins, discussed and explained the first section which deals entirely with Assets, Liabilities, and operating results and in the first section the physical examination of the bank is complete. We shall now enter upon an explanation and discussion of the second section which is made up of a series of questionnaires; systematically arranged and so designed as to bring out the factors, causes and circumstances that furnish the general background for the conditions disclosed in the first section of the report.

The primary purpose of these questionnaires is to furnish the Examiner with a routine; the following of which is designed to lead him into all phases and features of the bank's condition and method of operation. We have found from experience that the disclosures brought out in these questionnaires run closely parallel to the examination results shown in the first section of the report. In other words, if an unsatisfactory condition is brought out in the first section, a review of the questionnaires cannot fail to disclose the reason.



While, as stated above, this series of questionnaires were primarily designed for Examiner's use, the information brought out therein is frequently so important that it was decided to embody it in the report furnished to the Directors. We, therefore, not only recommend, but urge that the Directors give careful consideration to this part of the report in order that no important disclosure brought out by our Examiners may be overlooked.

In this and ensuing articles, we shall review the various questions used in this section of the report in order to bring out as clearly as possible, their purposes and effects upon the general condition of the bank.

LOANS AND DISCOUNTS

1. To what general lines of industry or classes of borrowers are loans chiefly made?

This question is largely for the information of this Department to show briefly the type of community served by the bank.

2. Are they well diversified as to classes and distributed as to amounts?

The purpose of this question is to bring out any large concentrations of credit representing an industry, concern, or group. For instance, a community may contain a large industrial enterprise which may or may not be indebted to the bank. However, an analysis of the bank's loans, may disclose that a number of small businesses and individuals in debt to the bank may be entirely, or very largely, dependent upon such an enterprise. In such an event, collectibility of a very considerable number and amount of the bank's loans would be affected by the circumstances of their major industry. In agricultural communities, loan commitments will run almost entirely to farmers, but here there is a possibility for some diversification among grain farmers, dairy farmers, and stock feeders that should be borne in mind.

Bank Officers and Directors, as a rule, in carrying out their routine duties, deal with loans largely on an individual basis and in doing so, may without realizing it, become heavily involved in a group of borrowers dependent upon one main source for income; and should this source become involved in difficulty, a large portion of the bank's loans may become affected. In surveying loans, the Examiner tries to discover these trends and his disclosures will be brought out at this point.

3. General character of collateral?

An Examiner's first test of collateral is as to its marketability. This test will result in three distinct classifications—Ready—Restricted—Slow. Collateral of ready marketability consists entirely of listed securities the value of which can be very accurately determined from day to day by market quotations. In the restricted marketability class will be found certain non-listed securities as well as live stock on feed or any other property where the bank would be forced to seek or wait for a market. In the slow marketability class, will be found shares of stock or bonds of small and obscure corporations, real estate equities, interests in trusts, and barnyard chattels.

As we have previously stated several times, collateral security should be obtained wherever possible. However, it is very important that the Directors of a bank study the degree of marketability and the Examiner's answer to this particular question will express the result of his findings.

4. Is collateral register properly kept?

Our concern over the keeping of a collateral register arises from the bank's responsibility for collateral pledged. The bank is accountable for this property and should keep a careful and accurate record covering its possession and disposition.

When personal property is received from a debtor pledged as collateral for a loan, a record should be made showing the date of its entry and sufficient description to identify the property. When the property is later returned to the debtor upon payment of the loan, said debtor should be required to sign a receipt, preferably in the register itself, showing that his property has been returned to him.

5. Is liability ledger in use properly kept? How often balanced?

This Department has always considered a liability ledger as one of the most useful records in the bank. Such a ledger records the loan transactions with each borrower in a separate account, and furnishes a history that tells the Board of Directors one of the most important stories that can be told about an individual borrowing from the bank, and that is, how he pays his loans.

When a loan application is considered, there are two important questions that should be answered first: Has he borrowed from us before?—and How did he handle his obligations? These two important questions will be very satisfactorily answered by the liability ledger. This record being a very important one, should be absolutely accurate and a test of its accuracy should be frequently made by balancing at least once each month. Many banks make this test twice a month.

6. How often are loans and discounts proven?

In this question we refer to the proof of the notes themselves which is determined by adding up the unpaid balances on all notes due the bank and comparing the grand total with the figures shown under the heading of Loans and Discounts on the bank's Statement.

Inasmuch as there are numerous daily transactions affecting Loans and Discounts, it is essential that the accuracy of recording said transactions be frequently tested and this should be done at least twice each month. Next to the bank's cash, its notes are more frequently handled than any other of its assets. They are frequently removed from the note portfolio and can occasionally become confused with other papers and mislaid or lost. A single note may represent hundreds or thousands of dollars of the bank's resources, and if an item has been mislaid or lost, it is important to determine the fact as quickly as possible and this can usually only be detected by an actual run of the notes themselves.

7. Describe method of directors' supervision, authorization or approval of all loans and discounts.

At first glance, the words authorization or approval are quite similar, however, as used in this particular sentence, they represent a vast difference to bank Directors. When we find that Directors are supervising loaning activities by *authorizing* loans *before* they are made, we know that they are fully impressed with their responsibilities and conscientiously discharging them by actually directing the making of local investments. When on the other hand we learn that Directors *approve* loans and therefore consider them only *after* they are made, we know that they have delegated one of their most important duties to one or more officers.

In the case of numerous banks where Directors meet but once a month, it becomes necessary to handle loan authorization through a Dis-

count Committee the members of which Committee are so situated that they can consider loan applications as frequently as necessary.

We strongly advocate the use of loan applications which are so designed as to bring out all of the information pertaining to a borrower's financial condition that the Directors would require in passing upon the loan. Through the use of carefully checked loan applications, the element of guess work is largely eliminated and when bank Directors are given the opportunity of considering all of the essential facts pertaining to a borrower's financial condition before the loan is made, a long step has been made toward the elimination of losses and liquidation difficulties. When Directors are compelled to consider loans only after they have been made, it is difficult to conceive of anything else to do but approve; for by that time the borrower already has the bank's money.

TRUST CERTIFICATE CANCELLED

Oak Park.....Cook.....Avenue Trust Company.....Aug. 5, 1937 ✓

DISSOLVED

Waynesville...DeWitt.....Waynesville State Bank (In receivership December 31, 1930. Dissolved by order of the Circuit Court of DeWitt County).....July 16, 1937 ✓
 Monticello...Piatt.....The Dighton-Dilatash Loan Co. (In receivership October 28, 1933. Dissolved by order of the Circuit Court of Piatt County).....Aug. 4, 1937 ✓
 Green Valley...Tazewell.....Green Valley Bank (In receivership July 23, 1930. Dissolved by order of the Circuit Court of Tazewell County).....Aug. 5, 1937 ✓
 Mill Shoals...White.....Mill Shoals State Bank (In receivership August 11, 1932. Dissolved by order of the Circuit Court of White County).....Aug. 6, 1937 ✓
 Anna...Union.....Anna State and Trust Bank (In liquidation September 15, 1930).....Aug. 7, 1937 ✓
 Oak Park...Cook.....Avenue Trust Company.....Aug. 14, 1937 ✓
 Greenview...Menard.....First State Bank, Greenview (In liquidation January 6, 1930).....Aug. 19, 1937 ✓
 LaHogue...Iroquois.....LaHogue State Bank (In receivership April 29, 1932. Dissolved by order of the Circuit Court of Iroquois County).....Aug. 26, 1937 ✓

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	33	1	34
State Banks in Cook County outside Chicago.....	29	--	29
State Banks in Illinois outside Cook County.....	516	--	516
Total.....	578	1	579

MONTHLY BULLETIN

Issued by
EDWARD J. BARRETT
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State of Illinois

Vol. 13

SPRINGFIELD, ILL., OCTOBER 1, 1937

No. 7

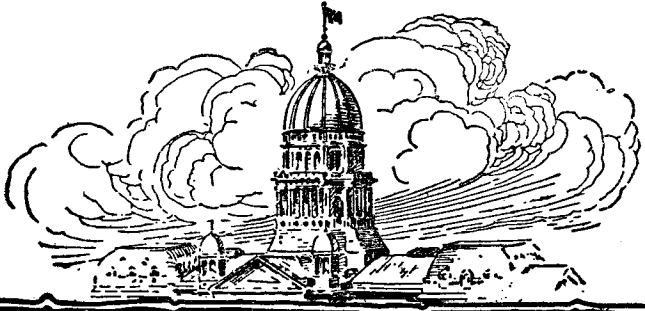
QUESTIONNAIRE LOANS AND DISCOUNTS

(Continued)

8. Are loans to corporations and partnerships supported by proper documents of authority?

A bank in loaning money to or handling the funds of a corporation must bear constantly in mind the fact that they are not doing business with a natural person. A corporation can only speak through its corporate records and act through its Board of Directors, and then only within the limits of its Charter powers. A corporation can borrow money but only upon the authority of the Board of Directors as expressed in an appropriate resolution passed at a legally called meeting.

A bank should make no loans to a corporation until the corporation has been authorized by its Board of Directors to borrow money from the bank and a certified copy of the resolution under the seal of the corporation has been furnished to the bank. Such a resolution should name the officer or officers authorized to sign the note and specify the terms and conditions of the loan, and it should also be carefully studied and understood by the loaning Officers in order that the authority conveyed by the corporation shall not be exceeded. We



might add in passing that this caution is equally necessary in handling deposits and checks of corporations. The depositing and withdrawal of corporate funds should be regulated by resolutions of authority and all transactions of this character held strictly within the limits of the authority conveyed in said resolutions.

The foregoing not only applies to private corporations, but municipal corporations as well.

When doing business with a corporation through an officer, agent or other representative, the first question that should occur to the banker is how much authority the individual has to deal for the corporation; and the answer to this question can be found only in the records of the corporation. The danger in ignoring these steps arises from the fact that if as a result of an unauthorized transaction of an officer of a corporation, through the bank the corporation loses money or suffers other damage, the bank is quite likely to be held liable for said loss or damage. Moreover if a bank attempted to sue a corporation on a debt, the corporation's note or evidence of debt would be of questionable value until supported by evidence that the debt had been authorized by the corporation.

9. Are there any Bank Certificates of Deposit carried in loans and discounts?

This is largely a matter of accounting as a Bank Certificate should be accounted for under the heading of—"Due From Banks" either on a Time or Demand basis.

10. Is discount committee active?—Does it keep records?

A discount committee might well be regarded as the right arm of the Board of Directors; in that said committee in its functions does most of the work of the Board and performs one of its most important duties—that of supervising loaning activities. Formerly discount committees were found only in the larger banking institutions where the numerical size of Boards of Directors, together with the activity and volume of loaning business, made it impossible for the Board as a whole to supervise loaning activities. However, of recent years, we have found an increasing number of small banks striving for closer control of loaning operations by the Board of Directors appointing discount committees from their membership to meet at least weekly and frequently several times a week to consider loan applications.

Inasmuch as this committee by the authority of the Board of Directors exercises certain important delegated powers an adequate record of their activities should be preserved and reviewed by the Board of Directors at monthly meetings and said record should be incorporated in the monthly minutes of the Board of Directors.

11. Are the requirements of Section 10 (Illinois Banking Act) strictly complied with in the making of loans to Officers, Directors and Employees, and are any of such loans subject to criticism?

We quote herewith, the Statutory reference in the foregoing question:

"It shall not be lawful for any bank to loan to its President or to any of its Vice-Presidents or its salaried Officers or Employees, or to corporations or firms controlled by them, or in the management of which any of them are actively engaged, until an application for such loan shall have been first approved both as to security and amount by the Board of Directors".

In reading the above quotation the question will naturally arise as to its application to non-salaried Directors. While this question has never arisen for judicial interpretation, we have an Attorney General's opinion that non-salaried Directors of Illinois State Banks are subject to the provisions of Section 10 of the Banking Act. We find violations of this requirement all too frequently—usually an oversight resulting from haste or carelessness. Attempts are made to correct such oversights by securing approvals sometimes months after the loan has been made. We seriously question that such attempts actually correct violations of the Law which specifically provides that management loans shall not be lawful "—until an application for such loan shall have been FIRST approved both as to security and amount by the Board of Directors".

Where our Examiners in answering this question cite certain specific management loans as matters of criticism, said criticisms should be read in open Board meetings. At this point we would recommend the rereading of the article in our Bulletin of January 1, 1937.

12. Does this Bank place paper with other banks?—If so, to what extent?

When an Examiner finds that a bank under examination sells without recourse or on a repurchase agreement, or discounts paper with other banks, he is required to investigate very thoroughly the reason for said transactions. The reasons have been usually plausible enough, but the results almost invariably are over-extension on the part of the selling bank. This is particularly true of smaller institutions whose limited facilities permit the accurate handling of a limited amount of loans. If such a bank develops a loaning volume beyond its own investment capacity and has a substantial surplus of investments to sell to other banks, its credit requirements and loaning policies in general might very reasonably be questioned. Where the Examiner finds that paper sold under a with recourse or repurchase agreement creates an over-extended condition in the bank under examination, such condition is an unfavorable development and must be reported. Where sales have been made on a without recourse basis, the purchase of same may effect very noticeably the condition of another bank also under his examination.

13. Does this Bank take loans and discounts to accommodate other banks?—If so, to what extent?

Where an Examiner finds that the bank under examination takes personal loans and discounts to accommodate other banks, he must thoroughly investigate the reason or necessity for accommodating another banking corporation in this manner. He can reasonably assume that when a bank is forced to place its paper with a neighboring institution, that it has developed its loaning business beyond its investment capacity.

ANECDOTES OF THE ROAD

The hero of this story is a very capable but colorful Bank Examiner who had a vocabulary to match. In the course of an examination he discovered a defalcation on the part of one of the Officers that quickly developed into substantial figures. He was reporting the matter by telephone to the Supervising Examiner at his divisional headquarters. His verbal report was carefully worded in code and the Su-

pervising Examiner on the receiving end could sense the suppressed excitement of the colorful personality reporting. As the Supervising Examiner studied the decoded outline of the conversation before him he muttered to himself, "He's short is he?", and like a flash the un-sought reply came back over the wire, "Yes Sir, he's as short as a bull fighter's pants".

CONVERSION

Chicago.....Cook.....I-C Bank and Trust Company into The I-C National Bank
of Chicago.....June 30, 1937 ✓

CLOSED

Roanoke.....Woodford.....Roanoke State Bank.....Sept. 8, 1937 ✓

PERMIT ISSUED

Marion.....Williamson.....The Bank of Marion.....Capital. Surplus. Reserve.
\$50,000 \$5,000 \$2,500 Sept. 15, 1937

CAPITAL STOCK INCREASED

Chicago.....Cook.....Amalgamated Trust & Savings Bank, from \$200,000 to
\$400,000.....Sept. 28, 1937 ✓

DISSOLVED

London Mills...Fulton.....The State Bank of London Mills (In liquidation June 23,
1937).....Aug. 19, 1937 ✓

McClure.....Alexander.....State Bank of McClure (In liquidation December 31, 1926.
Dissolved by order of the Circuit Court of Alexander
County).....Sept. 9, 1937 ✓

Deer Creek.....Tazewell.....Deer Creek Bank (In receivership February 17, 1934. Dis-
solved by order of the Circuit Court of Tazewell
County).....Sept. 13, 1937 ✓

Joliet.....Will.....Commercial Trust & Savings Bank of Joliet (In liquidation
June 29, 1929).....Sept. 16, 1937 ✓

Elburn.....Kane.....Elburn State Bank (In liquidation September 6, 1930).....Sept. 22, 1937 ✓

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	32	1	33
State Banks in Cook County outside Chicago.....	29	--	29
State Banks in Illinois outside Cook County.....	515	--	515
Total.....	576	1	577

MONTHLY BULLETIN

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State of Illinois

Vol. 13

SPRINGFIELD, ILL., NOVEMBER 1, 1937

No. 8

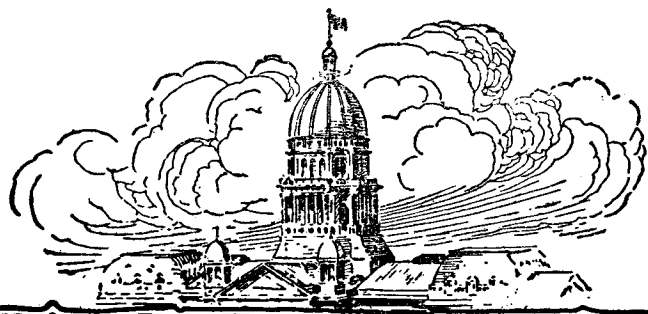
QUESTIONNAIRE LOANS AND DISCOUNTS

(Continued)

14. If Bank makes Real Estate Loans, who appraises property?

15. Are written appraisals on file?

The purpose of question No. 14 is not so much to learn the identity of the appraiser as to learn from the Examiner's reply the real foundations for real estate values shown in his report. If all of the real estate appraisals reported by an Examiner in connection with a given examination are from one or several professional appraisers or if the appraisals are the valuations agreed upon by a committee of directors and in complete written form, we feel safe in assuming that the work of appraising real estate security is being conscientiously and accurately done. If, on the other hand, we learn from the answers to these two questions that the valuations submitted to the Examiner were in the form of verbal opinions supplied by one or more officers or directors, we can rightly question the reliability of valuations given and the thoroughness of real estate loan supervision.



During the past five years this Department has had a very broad opportunity of checking appraisals against actual sales and, from these comparisons, we have been able to form some very definite conclusions. It is undeniable, of course, that prevailing economic conditions at the time of sale and forced sales will throw the most careful appraisals out of line but, all too frequently, we find that a large shrinkage from appraised valuation to selling price is the result of property defects not considered in the original appraisal. This can only result from either superficial inspections or appraisals made without inspection both of which must necessarily rest, to a large degree, at least, upon guesswork.

The purpose then of questions No. 14 and No. 15 is to learn whether or not bank managements are carefully inspecting and appraising the properties upon which they are loaning money or relying upon cursory inspections and verbal conclusions. When reviewing real estate loan applications, the Board of Directors should have before it a complete physical description of the property, as well as a complete survey of all of the factors making up or affecting its value, and this should be in writing.

16. Amount of Real Estate Loans sold and still outstanding?
17. Total sales last calendar year? Repurchases same period?
18. Amount of other loans sold and still outstanding?
19. Has any of this paper been repurchased since last examination?

The answer to these four questions can have a very important bearing upon the actual condition or a potential condition of the bank; for not a few banks have, in times past, drifted into serious condition almost entirely as a result of heavy sales of real estate loans. In many of such situations, dissatisfaction appeared first among real estate loan purchasers who could assert no legal claim, spreading wider among the depositors who could assert an immediate legal claim. A considerable number of bank failures began to take form when bank managements, disturbed by dissatisfaction among real estate loan purchasers, began to make heavy repurchases to quiet the discontent or make loans secured by real estate paper formerly sold which generally amounts to the same result as repurchase. In this manner, such banks would, within a short period of time, become highly frozen that might otherwise have remained in a sufficiently liquid condition to have met the demands of their depositors and continued in operation. We have seen bank managements, in selling real estate loans, take every known precaution against legal or moral liability and later yield to the pressure of investors to the serious detriment of the bank's position.

20. Is adequate credit information available?
Are statements of recent date and complete as to detail?

This Bulletin has, for a number of years, repeatedly stressed the need and value of borrowers' financial statements and the improvement in bank credit files has been very marked. In fact, it is rather exceptional now to examine a bank that does not have a good credit file. While the task of building up complete credit files in our State banks has progressed a long way, instances occur occasionally that raise some question in our minds as to how carefully this work is being done and how

thoroughly credit files are being used in the extension of credit. During the past few years, we have encountered several instances where statements of borrowers' condition were compiled by bankers and borrowers for the sole benefit of the bank examiners. We have been told more than once by a borrower that a certain statement was made up for our benefit only and that they were frankly told that the only reason that they were being requested to make a statement to the bank was to satisfy the curiosity of the bank examiners. Ordinarily, bank officers yielding to an inclination to do this sort of thing are actuated by nothing more than two very human impulses. In the first place, they are still embarrassed in asking a borrower for information that any lender is entitled to and they apologetically ask the borrower for a statement of his condition to satisfy the bank examiner; secondly, they like to make their loans look good by showing up the borrower's condition as favorably as possible. The bank officer doing or permitting this sort of thing should realize that he is the only party to the transaction who will be injured thereby. The first injury takes place immediately when the borrower learns that the banker would do anything to mislead an Examiner and his confidence in that particular bank and banker drops perceptibly.

We had a very illuminating case of that kind brought to our attention this year. A certain debtor to a bank in receivership, in requesting a compromise of his indebtedness, filed a sworn statement of his condition with the Receiver which showed a net deficit of assets against liabilities of several hundred dollars. That statement was made in May of this year. We knew that this debtor had obligations in a going institution and we referred to our report containing his statement which was made to the bank in January of this year and showed a net worth of Twenty Thousand Dollars. The statement to the Receiver was carefully checked and found to be correct. The statement to the bank not only greatly over-stated certain asset valuations but omitted a substantial mortgage debt that could not have escaped the banker's attention had he made any investigation at all in connection with his statement. In the first place, no banker should compile a statement for a borrower to sign. Every statement made by a borrower for the purpose of obtaining credit should be in his own handwriting or prepared by him. When the statement is submitted, the banker should tactfully discuss and familiarize himself with the various assets and liabilities and thereby gain an even closer familiarity with the borrower's condition and affairs. In addition to this, bankers, through their broad community contacts, frequently learn of circumstances and conditions affecting individual borrowers that cannot be shown upon statements. Memoranda should be made of such information and embodied in the credit files for the information of the Board of Directors, not infrequently memoranda of this kind are of more value than a borrower's statement.

There is one very noticeable deficiency that we find rather generally in examining credit files and that is the lack of borrowers' operating statements. We cannot consider a credit analysis as complete without an examination of the results of the borrower's operations. It is true

that there may be numerous small enterprises or individual ventures that would be unable to readily furnish operating figures but such information should be available and a little tactful inquiry would undoubtedly obtain it without great difficulty. It seems to us that a careful banker would be as much interested in learning from an operating statement where a borrower is going as he would be to learn from his balance sheet what he is taking with him.

We have a number of very excellent banks who use a borrower's financial statement only as a starting point for an investigation that usually results in an accumulation of credit data of much greater value to the Board of Directors than any financial statement could possibly provide.

CONVERSION

Highland Park...Lake.....Highland Park State Bank into The First National Bank of Highland Park.....Oct. 1, 1937

RECEIVER APPOINTED

Roanoke.....Woodford.....Roanoke State Bank—Charles H. Albers.....Oct. 6, 1937

IN LIQUIDATION

Mundelein.....Lake.....State Bank of Mundelein through First National Bank of Mundelein.....Oct. 18, 1937

DISSOLVED

Taylor Ridge.....Rock Island.....State Bank of Taylor Ridge.....Sept. 25, 1937

Benton.....Franklin.....Mercantile Bank and Trust Company (In receivership December 15, 1927. Dissolved by order of the Circuit Court of Franklin County).....Oct. 1, 1937

Downers Grove...DuPage.....State Bank & Trust Company of Downers Grove (In receivership March 17, 1937. Dissolved by order of the Circuit Court of DuPage County).....Oct. 8, 1937

Braceville.....Grundy.....Peoples State Bank of Braceville (In liquidation October 2, 1929. Dissolved by order of the Circuit Court of Grundy County).....Oct. 9, 1937

Virden.....Macoupin.....State Bank of Virden (In liquidation May 31, 1930. Dissolved by order of the Circuit Court of Macoupin County).....Oct. 11, 1937

Deland.....Piatt.....State Bank of Deland (In liquidation May 3, 1924. Dissolved by order of the Circuit Court of Piatt County).....Oct. 15, 1937

Hecker.....Monroe.....State Bank of Hecker (In receivership January 12, 1931. Dissolved by order of the Circuit Court of Monroe County).....Oct. 18, 1937

Sesser.....Franklin.....Sesser State Bank (In receivership May 31, 1929. Dissolved by order of the Circuit Court of Franklin County).....Oct. 18, 1937

Capron.....Boone.....Capron Bank.....Oct. 27, 1937

Yenice - Madison - Yenice State Bank Liquidation 10-7-37

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	32	1	33
State Banks in Cook County.....	29	--	29
State Banks in Illinois outside Cook County.....	511	--	511
Total.....	572	1	573

(41744)

See memo in liquidation folder

MONTHLY BULLETIN

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State of Illinois

Vol. 13

SPRINGFIELD, ILL., DECEMBER 1, 1937

No. 9

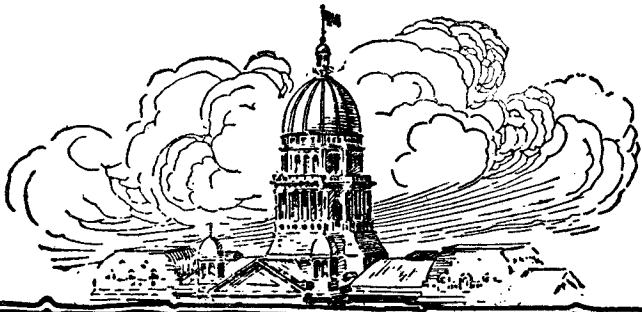
QUESTIONNAIRE

The next section appearing in our Examination Report Questionnaire covers four important subjects which the directors should scrutinize with particular care.

OVERDRAFTS

It will be noted that in the first question we ask for the number of accounts overdrawn. If it shows that more than half a dozen accounts are overdrawn, we can be reasonably sure that the majority are deliberate and not accidental overdrafts. If the amount shown in answer to the next question exceeds \$100.00, the foregoing conclusion is confirmed.

The next question calls for the amount of overdrafts reported in the bank's last Call Report, which is the quarterly report of condition filed with the Auditor of Public Accounts and published. The reason we call for this comparison is that we have learned, by experience, that bank managements who tolerate more or less liberally the practice of overdrafts anticipate their Call Report dates and arrange to have overdrafts cut down to a minimum figure at that time. It is surprising how consistently we find this to be true.



In the next question we ask, "Are overdrafts carried on general ledger?"

The simplest but incorrect way of dealing with overdrafts in compiling a balance sheet or statement of condition is to deduct the total of overdrafts from the total of deposits and in times past that was not an uncommon practice. The theory that supports this method is rather quaint in that it implies that when an individual overdraws his account the amount of the overdraft is borrowed from other depositors' balances. What actually happens is that an arbitrary or fictitious balance is to be created in that individual's account and the check charged against said balance. This balance must be provided from the assets of the bank and therefore is created by a charge to the assets entitled "Overdrafts paid." Consequently, in order to show on a bank's balance sheet or statement the true condition created by an overdraft, there must be an asset account of same carried upon the General Ledger. If this is not done, the bank's statement is incorrect and if sworn to and/or published in that condition, the Banking Act has been violated.

We next ask for a list of depositors' accounts that are habitually overdrawn. Persons who do this are simply imposing upon the bank and it is difficult to conceive of a desire on the part of any Board of Directors to continue a customer relationship under such an arrangement.

In the next question we ask, "Are Officers, Directors, Employees or their connections offenders in this respect?"

Bank directors as a governing body would do well to take a very firm stand against the indulgence in the overdraft practice on the part of any of the management. If it is tolerated at all, it can quickly extend to unreasonable and even dangerous limits.

We inquire in our next question, "Do Officers and Directors watch overdrafts?"

If toleration of overdrafts is not carefully watched by officers and directors and rigidly curtailed, it will almost invariably lead to abuses. From experience we have learned that there is hardly a bank in operation that does not have a certain number of customers who, through carelessness in matters of business dealing, will knowingly or unknowingly, impose upon a bank frequently by overdrawing their accounts and while through accidental miscalculation on the part of a customer an overdraft will occasionally occur, genuine accidents of this kind are very rare and can be reduced to negligible results if the bank will take a firm attitude toward its elimination. If a Board of Directors of any given bank really desires to stop overdrafts, they can very easily do so by taking a determined attitude and properly penalizing infractions.

When reviewing our examination report form, overdrafts particularly criticized by the Examiner will be found in the form provided for "Other Assets."

CASH ITEMS

From an accounting standpoint, cash items are regarded in the same light as actual cash. In fact they are so quickly convertible into cash that it is not necessary to classify them into other asset accounts. Government bond coupons, postal money orders, orders on municipal Treasurers, etc., that will be cleared during the next business day can qualify as cash items, but beyond these, or items of similar liquidity, cash items become irregular. Therefore, the Examiner will first make

two classifications of cash items encountered i. e., regular and irregular. The regular items are considered as cash and subject to no further comment. The irregular items are criticized as a group, listed and appraised. Irregular cash items are very frequently another and more pernicious form of overdraft. In this connection, we have in mind debit tickets representing withdrawals of cash by officers or employees or occasionally a small loan to an individual, cash advances used for the protection of or collection of assets, miscellaneous expense items, etc. It is essential that executive officers and directors watch this practice very closely and penalize abuses severely.

In an institution large enough to employ more than one Cash Teller, each individual Teller should be required to turn over daily all cash items to an executive officer whose duty would be to clear the items.

ANECDOTES OF THE ROAD

A Bank Examiner quickly adapts himself to a constantly changing work bench and is usually quite tolerant under all sorts of working conditions. However, with equal facility he falls into a routine designed to accomplish his assignment effectively and thoroughly. He is invariably meticulous about this routine and will be found a bit hard to get along with when his proceedings are unreasonably interrupted.

About ten years ago there was a bank in our State operating in close affiliation with a large and very active real estate company. The cages occupied one side of the lobby and the officers, who were also the executives in the real estate company, occupied the other, together with all of their files and records.

This particular Examiner had made several previous examinations at this bank and on each occasion encountered substantial shortages in balancing the notes. Invariably these shortages would be promptly covered by an officer who would produce an armful of notes and real estate mortgages with many apologies and assurance that they had been brought over to the real estate loan company for certain checking only the day before. This development naturally nullified the first run of the notes and not only necessitated sorting and re-running, but verification back into the records of the bank. In addition to this, book records and important documents needed in the examination would be missing from the bank files to turn up later among the effects of the real estate loan company. This Examiner, who was very conscientious and thorough in his work had borne patiently with these interruptions for several examinations and would probably have suffered in silence through this one were it not for the fact that at the close of the examination the President of the bank led with his chin.

As the Examiner was winding up the examination and preparing to leave the bank, the President, who was a very expansive individual, approached the Examiner, with a friendly slap on the back, and inquired, "Well, Mr. Examiner, what do you think of our little bank?" In a very characteristic gesture, the Examiner pushed his heavy horn-rimmed glasses up on his forehead, hooked his thumbs into the arm holes of his vest, sat back and crisply delivered the following opinion:

"Mr. Gold, I have made several examinations here and each time have been reminded of an old gentleman who lived in our town when I was a boy. He had a long white beard that dropped to his waist and

every Saturday morning he rode in from his little home at the edge of town on a white pony. The old gentleman was bent with years and as he rode along, his long white beard descended into the pony's white mane, so that you had to have pretty good eye-sight and get up rather close to see where the beard left off and the pony's mane began, and one of the most difficult jobs in making this examination is to determine where your bank leaves off and your real estate company begins."

Naturally President Gold exploded with righteous indignation. "Studied insolence" he called it in his written complaint later on. Perhaps it was but it is not without a certain poetical appeal. And who would expect that from a Bank Examiner?

TRUST CERTIFICATE ISSUED

Highland Park...Lake.....The First National Bank of Highland Park.....^{Deposit.}
\$125,000 Nov. 9, 1937

TRUST CERTIFICATE CANCELLED

Highland Park...Lake.....Highland Park State Bank.....Nov. 9, 1937

DURATION EXTENDED

Towanda.....McLean.....Towanda State Bank. Charter extended 30 years from
December 10, 1937.....Nov. 13, 1937

IN LIQUIDATION

Cobden.....Union.....First State Bank of Cobden through The First National
Bank of Cobden.....Nov. 24, 1937
Junction.....Gallatin.....First State Bank of Junction.....Nov. 29, 1937

DISSOLVED

Nason.....Jefferson.....First State Bank of Nason (In liquidation May 1, 1926)...June 10, 1937
Seneca.....LaSalle.....Farmers' Trust and Savings Bank of Seneca (In liquida-
tion January 7, 1929).....Sept. 29, 1937
Clayton.....Adams.....Clayton Exchange Bank (In liquidation May 21, 1927.
Dissolved by order of the Circuit Court of Adams
County).....Oct. 21, 1937
Shumway.....Effingham.....Citizens State Bank of Shumway.....Oct. 21, 1937
DuBois.....Washington.....DuBois State Bank.....Nov. 4, 1937
Plainview.....Macoupin.....Plainview State Bank (In liquidation February 15, 1926)...Nov. 4, 1937
Tower Hill.....Shelby.....Tower Hill State Bank (In liquidation June 4, 1925).....Nov. 5, 1937
Neponset.....Bureau.....Farmers State Bank of Neponset (In liquidation January
26, 1925).....Nov. 11, 1937
West Frankfort...Franklin.....First State Savings Bank of West Frankfort (In receiver-
ship November 22, 1930. Dissolved by order of the
Circuit Court of Franklin County).....Nov. 13, 1937
Avon.....Fulton.....The Avon State Bank (In receivership October 16, 1931.
Dissolved by order of the Circuit Court of Fulton
County).....Nov. 15, 1937
Penfield.....Champaign...Bank of Penfield (In liquidation April 2, 1931. Dis-
solved by order of the Circuit Court of Champaign
County).....Nov. 16, 1937
Murdock.....Douglas.....Murdock State Bank (In receivership December 9, 1932.
Dissolved by order of the Circuit Court of Douglas
County).....Nov. 24, 1937

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	32	1	33
State Banks in Cook County.....	29	--	29
State Banks in Illinois outside Cook County.....	507	--	507
Total.....	568	1	569