

MONTHLY BULLETIN

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

Vol. 14

SPRINGFIELD, ILL., JANUARY 1, 1939

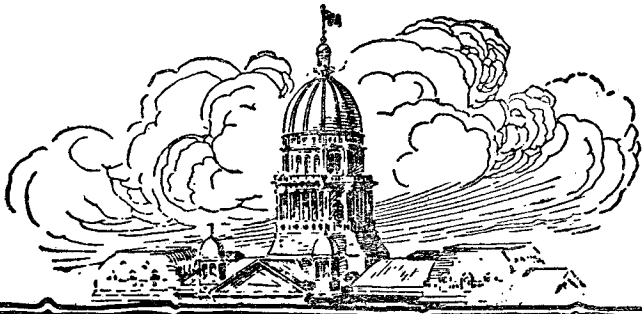
No. 10

EXAMINATION REPORT—QUESTIONNAIRE INDIVIDUAL AND SAVINGS LEDGERS—Continued

6. State whether any profits or general ledger accounts are irregularly carried in the individual ledger, in special accounts, or charged off the books.

In our July Bulletin dealing with the General Ledger we stated the principle that all general ledger accounts but that for the sake of convenience and efficiency in handling, large groups of accounts that are exactly alike may be segregated into subsidiary ledgers and each of these groups represented in the General Ledger by a control account. But all of the accounts in each group must be exactly alike. To mingle savings accounts with checking accounts or to set profit or income accounts in with checking accounts impairs the accuracy of the bank's statement.

Up until quite recently it was not all uncommon to find numerous income accounts carried in the checking depositors' ledgers and their amounts included in the checking accounts control. For instance, a bank would own several pieces of "Other Real Estate" all rented to tenants. As rents were collected, a separate checking account would be opened for each property, the rent receipts deposited in these accounts and expenses paid by officer's check against the balances. The officer



handling these matters might or might not transfer the net balances in these income accounts into the bank's Undivided Profits at the end of fiscal periods. During all of the time that these rent accounts were carried among the checking accounts they were not under the observation of the Board of Directors as they should be. And further, income accumulations of this character could easily aggregate several thousand dollars. Now when this is carried among checking accounts it appears on the statement included with liabilities to creditors whereas it is in reality income belonging to stockholders. The same is true when box rents, special fees, commissions or profits are carried among deposits. All of such accounts belong in the General Ledger under appropriate titles. The purpose therefore of item No. 6 is to bring into the report such irregularities of this nature as the Examiner discovers and when they appear in the report they should not be lightly passed over.

7. How often and in what manner are depositors' balances verified?

The verification of depositors' balances referred to in the foregoing question is that obtained from the depositor himself by reporting to him the amount of his balance as shown by the bank's books and having him report back as to its correctness. Ordinarily, banks obtain this verification by delivering to depositors statements of their accounts, together with their cancelled checks. This provides good verification if delivery of the statement to the depositor is surrounded by proper precaution. After the depositor's statement has been prepared, it should be turned over, for delivery, to an employee who is neither a teller or bookkeeper who should compare the statement and its balance with the depositor's ledger account. More than once in our experience embezzlements have been covered by posting into a depositor's statement one or more of his deposits that never got into his ledger account.

Let us examine briefly such an embezzlement and a simple way of covering it. A teller embezzles \$100.00. His cash will be short that amount in balancing out his day's work. He checks through his day's deposits and finds that John Jones made a deposit of \$100.00. He recalls that he is very friendly with Jones who transacts all of his business with the bank through this teller's window. So he takes Jones' \$100.00 deposit out of his day's work. Not having to account for that \$100.00 deposit, his shortage has been temporarily covered. In a month or two Jones asks the teller for his statement. The teller goes to the file and gets the statement and cancelled checks himself. He prepares a new statement sheet to replace the one he is about to hand out. He goes to a posting machine to transfer the balance to the new sheet and while there, he posts a \$100.00 deposit and raises the balance on the statement he is about to deliver. And so the teller hands Jones a correct statement of his account but one that does not agree with Jones' account in the bank's ledgers. Now the teller can keep this \$100.00 shortage covered in this same manner just as long as he has the opportunity of handling Jones' statement just before delivery. But as soon as some other employee handles it, the embezzlement will be discovered providing, of course, there is no collusion between those two particular employees.

The foregoing outline of an embezzler's procedure is in its simplest form. There is no end of variations and refinements that a clever individual may employ to cover his peculations. All he needs is a chance to handle the statement and access to a posting machine between the time the statement is removed from the ledger and its delivery to the depositor. If he works alone and with a limited number of accounts, his stealing may be limited to

a few thousand dollars and within surety bond coverage; but if he has a confederate he can not only absorb a good sized surety bond but the bank's capital structure as well.

Large banks with their own auditing departments functioning independently of the operating staff prevent "statement fixing" by checking and delivering statement through the auditing department. Smaller banks take the same precaution by having a clerk, who is neither a teller or bookkeeper, check and deliver all depositors' statements.

While these measures cover considerable ground toward verification of depositors' balances, they fall decidedly short of doing a complete job; for they only cover the accounts of individuals who call for their statements periodically and they do not verify the balances of individuals who rarely or never call for statements.

Supervising authorities and auditors have long been aware of the weakness of any examination or audit that does not verify the balances of the bank's customers, both depositing and borrowing. Prevailing routines of Auditors and Examiners are almost certain to discover cash shortages, manipulations in accounts with correspondent banks, certificates of deposit, cashier's checks or asset item shortages. We carefully audit the capital and operating accounts but stop right at the borderline of the embezzler's most inviting field, the checking and savings accounts.

We pause here to explain that complete verification can only be obtained through circularization. This must be done entirely independently of the operating staff. The depositors' ledgers are first balanced against the General Ledger control. Then the amount of each depositor's balance is inserted in a circular and mailed to each depositor with which is enclosed return postage addressed to the person or agency making the audit. The circular shows the depositor the amount of his balance as shown on the bank's ledgers and requests him to either certify the correctness of the balance or report back any discrepancy.

It will readily be seen that this is a big job and while not necessarily an expensive one, it requires at least several weeks time to properly complete. Supervising authorities have heretofore avoided this field of audit for two very good reasons. In the first place, examination as required by statute does not necessarily mean a complete audit and neither time nor organization permits such. Secondly, circularization through departmental channels could have a very disturbing effect on the bank's clientele. For, strangely enough, persons who are habitually careless in handling their accounts may become quite excited when they receive an official request to do a thing that they should do periodically as a matter of routine and it only takes one or two excited individuals to cause a bank a lot of trouble.

We have, however, found out quite recently that there is a way of circularizing depositors' accounts without any harmful effects upon the bank. On two occasions within the past three years two Boards of Directors completely circularized their deposit accounts. In both banks the returns were but slightly short of one hundred per cent and in one bank the result more than justified the slight expense and trouble. Both banks reported that not only was there no disturbance among the depositors but considerable favorable comment came from their customers.

The experiences and results gained by these two banks encourages us to suggest that directors themselves might very ably cover this important field of bank auditing by a complete circularization of depositors' accounts annually or, better yet, circularize depositors one year and borrowers the

next. It does seem quite futile to carefully audit and safeguard every phase of the bank's operation except the widest and most important. Something like building a bank fortified with concrete, steel and protective devices in front, top, bottom and both sides leaving the rear end wide open. The theory would be that the five formidable sides would protect the exposed sixth.

IN LIQUIDATION

McLean.....McLean.....McLean State Bank & Trust Co.....Dec. 22, 1933 ✓
 Heyworth.....McLean.....Heyworth State Bank.....Dec. 31, 1933 ✓

DISSOLVED

Sailor Springs..Clay.....Sailor Springs Banking Co. (In liquidation June 30, 1936). Nov. 3, 1933 ✓
 Wapella.....DeWitt.....Farmers & Merchants Bank of Wapella (In liquidation November 3, 1933).....Nov. 15, 1933 ✓
 Clayton.....Adams.....Bartlett and Wallace State Bank (In liquidation March 6, 1931).....Nov. 17, 1933 ✓
 Weldon.....DeWitt.....State Bank of Weldon (In receivership January 9, 1932. Dissolved by order of the Circuit Court of DeWitt County).....Nov. 30, 1933 ✓
 Fithian.....Vermilion.....Farmers State Bank of Fithian, Illinois (In liquidation December 20, 1937).....Dec. 1, 1933 ✓
 Matherville.....Mercer.....Matherville State Bank (In receivership October 22, 1931. Dissolved by order of the Circuit Court of Mercer County) Dec. 5, 1933 ✓
 Preemption.....Mercer.....Farmers State Bank of Preemption (In receivership December 24, 1931. Dissolved by order of the Circuit Court of Mercer County).....Dec. 5, 1933 ✓
 Preemption.....Mercer.....Preemption State Bank (In receivership September 8, 1932. Dissolved by order of the Circuit Court of Mercer County).....Dec. 5, 1933 ✓
 Ashton.....Lee.....The Farmers State Bank of Ashton (In receivership January 5, 1932. Dissolved by order of the Circuit Court of Lee County).....Dec. 8, 1933 ✓
 Cropsey.....McLean.....Cropsey State Bank (In liquidation February 22, 1926. Dissolved by order of the Circuit Court of McLean County).....Dec. 10, 1933 ✓
 Lee.....Lee.....Lee State Bank (In receivership September 26, 1931. Dissolved by order of the Circuit Court of Lee County).....Dec. 10, 1933 ✓
 Dowell.....Jackson.....Union State Bank of Dowell (In receivership January 22, 1932. Dissolved by order of the Circuit Court of Jackson County).....Dec. 16, 1933 ✓
 Woodbine.....Jo Daviess.....Woodbine State Bank (In receivership December 17, 1932. Dissolved by order of the Circuit Court of Jo Daviess County).....Dec. 20, 1933 ✓
 Wheeler.....Jasper.....State Bank of Commerce of Wheeler (In receivership December 7, 1932. Dissolved by order of the Circuit Court of Jasper County).....Dec. 23, 1933 ✓
 Buda.....Bureau.....Citizens State Bank of Buda (In receivership October 5, 1927. Dissolved by order of the Circuit Court of Bureau County).....Dec. 27, 1933 ✓
 Saybrook.....McLean.....Saybrook Bank (In receivership December 8, 1931. Dissolved by order of the Circuit Court of McLean County) Dec. 29, 1933 ✓
 Camp Point.....Adams.....The Camp Point Bank (In receivership July 2, 1932. Dissolved by order of the Circuit Court of Adams County) Dec. 30, 1933 ✓

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	30	1	31
State Banks in Cook County.....	28	---	28
State Banks in Illinois outside Cook County.....	490	---	490
Total.....	548	1	549

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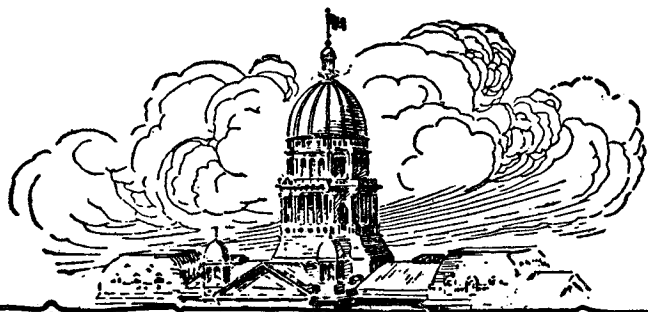
No. 11

EXAMINATION REPORT—QUESTIONNAIRE INDIVIDUAL AND SAVINGS LEDGERS—Continued

8. Give totals of dormant ledgers. How are withdrawals safeguarded?

When an account containing a balance remains unused by its owner over a considerable period of time or is used at rare intervals, it is commonly regarded as a dormant account. Included in this group is a steadily growing number of accounts that have been entirely abandoned by their owners who either through death or removal from the community will never claim the balance. There are a number of banks carrying accounts that have been dormant for thirty or forty years almost all of which contain trifling balances. Under prevailing Illinois law they must remain upon the banks' books as their owners will never claim them and the banks cannot legally expropriate them.

Such accounts carried among the active checking and savings accounts would be a constant annoyance to bookkeepers and considerably interfere with efficient handling of the active accounts. It has therefore become a long established practice in bank accounting to segregate the so-called dormant accounts away from the active. The dormant sheets are transferred into a separate ledger represented in the active ledger by a single control account; which contains the total of all the balances carried in the dormant ledger. When a check or deposit comes through the work that will affect any of the dormant accounts two postings are necessary, one upon the affected account and one upon the control account. These dormant accounts must be periodically balanced against their active ledger control just as the active accounts must be proved against the General Ledger control.



The second section of the subject question in which we inquire as to the method of safeguarding withdrawals from the dormant accounts is based upon a very real danger surrounding the existence of such accounts.

We know from numerous experiences that the dormant balances provide a very easy field for the operations of a dishonest clerk who can cover withdrawals of cash very easily with forged checks against a number of the inactive accounts. Due to the fact that these accounts are but rarely audited by their owners a large aggregate of fictitious charges could go undetected indefinitely.

The most common safeguard employed against such speculations is to place the dormant ledgers under the charge of an officer who inspects every withdrawal made against this group of accounts.

9. Number of Savings accounts? Number of Checking accounts?

The answers to this question are for statistical purposes only.

GENERAL ACCOUNTING

1. Are paid and canceled drafts filed satisfactorily?

All paid and canceled drafts are important documents. Many of them tell a complete story of business transactions involving large amounts of money. They should be filed in numerical order in durable containers and kept permanently.

2. Does Bank retain all canceled certified checks or take proper receipts for any delivered?

As previously pointed out (Bulletin of August 1, 1938), after a bank has certified a depositor's check, it becomes an instrument of debt which the bank is obligated to pay and when paid the bank is entitled to retain the canceled instrument. If the original maker desires it, he should furnish the bank with a fully descriptive receipt.

3. Are books so kept that the Examiner can readily make a thorough and complete examination?

Bank directors should carefully note the answer to this important question; for if an experienced Bank Examiner has difficulty in examining a set of bank books, what chance would the Board of Directors, their examining committee or anyone else have of doing so?

4. Are surrendered certificates of deposit, cashier's checks, certified checks, etc., properly canceled and filed in numerical order for auditing?

At each examination this Department makes a very careful audit of each of the accounts controlling evidences of debt issued by the bank which entails an inspection of each instrument paid and canceled since the previous examination. If they are kept properly segregated and in numerical order, the audit can be quickly made.

5. Is all business for each calendar day included in the proper account for that day?

A bank is duty bound to all persons doing business with it to make a record of their transactions ON THE DAY THEY OCCUR. To carry over any portion of the day's work to the following falsifies the record.

6. Are erasures made of entries in books by the use of acid or otherwise? If so, did you give proper instructions?

Once an entry is made upon a bank's books, it must not be removed even if in error. If a correction is necessary, the erroneous entry should be ruled out in such a manner as to allow it to be read and the correction set in as close to the original entry as possible. Examiners are required to instruct all bank personnels as above.

7. Were certificates of deposit, cashier's checks, certified checks, etc., audited and checked against list taken at previous examination?

8. Were Individual, Savings and dormant ledgers balanced?

9. State whether a numerical list of outstanding certificates of deposit was made and left under seal for next examination.

These three questions require the Examiner to state whether or not he has made the audits mentioned. Nos. 7 and 9 refer to the audit described under question No. 4.

10. What notice is required for the withdrawal of savings deposits?

The Examiner obtains the information requested in this question from the bank's by-laws for the records of this Department.

11. Are any certificates of deposit or bank drafts signed in blank?

If so, did you instruct officers to discontinue?

For many years this dangerous practice was quite prevalent. In order to save time and bother for himself and the exchange clerk, an officer would sign his name to one or more draft and certificate of deposit pads. Each of these pads contain one hundred blank drafts or certificates of deposit. Once these blanks were signed by an authorized officer, all the exchange clerk had to do was insert the name of a payee and an amount. Obviously, any one else getting his hands on these pads could do the same thing. It has always seemed somewhat inconsistent that a bank officer who would sign drafts and certificates of deposit in blank would bother to lock up his cash at night. No bank officer should ever sign an instrument until it has been fully drawn and he knows what he is signing.

12. Is satisfactory bond record properly maintained?

It seems strange to relate now; but for many years this Department had considerable difficulty with a number of banks to get them to install any kind of a bond record. All these banks had to show for their bond investments was a total in the General Ledger and even now, there are too many banks careless in recording their bond transactions. There are many reasons for the maintenance of a thoroughly descriptive bond record. Bonds can be lost, stolen or accidentally destroyed under which circumstances a complete description of each bond is highly important. It seems to us that a careful banker would want to preserve a record of his experiences with his bond investments showing his purchase and sale prices as well as rating range during his ownership for study and guidance both in individual selections and in the formulation of investment policies. The time and effort required to maintain a good bond record are negligible and the results well worth while.

SEE YOUR LAWYER

In the course of the year this Department receives from banks quite a number of requests, by telephone and mail, for advice concerning legal questions. Various legal forms are submitted for our approval, questions as to procedure in the collection of assets or disputes between banks and their customers are referred to us for decision. During the months of December and January, particularly, we received requests for advice in connection with proceedings at stockholders' and directors' meetings. Occasionally complicated questions surrounding the election of directors are submitted to us by telephone while the stockholders' meeting is in progress.

Many of these inquirers seem to be under the impression that our determination of such questions is final and legally binding which is not a fact. This Department is simply an executive branch of the State government with no judicial powers whatever. We like to assist our State banks whenever we can and occasionally where legal questions of very minor importance arise, we help out with suggestions but, for the most part, we have to fall back on the hackneyed phrase used in the caption, "See your lawyer".

While it is true that we encounter and see worked out a wide variety of legal problems, we know from experience that no two of these are exactly alike and that all legal questions of any consequence need the analysis and management that can only be provided by legal training and experience. Legal forms and methods are extremely important in dealing with banks' resources and liabilities and the same is true in connection with corporate actions by stockholders and directors so when bank managements find themselves confronted with legal questions, they should be submitted to a good attorney for thorough analysis and advice. Occasionally we are able to be of some assistance to an attorney handling a State bank matter and we are always glad to do so.

CAPITAL STOCK DECREASED

Greenville.....Bond.....State Bank of Hoiles & Sons from \$100,000 to \$50,000.....Jan. 5, 1939 ✓

CHANGE OF PAR VALUE OF CAPITAL STOCK

Greenville.....Bond.....State Bank of Hoiles & Sons from \$83.33½ to \$41.66½.....Jan. 5, 1939 ✓

TITLE GUARANTEE CERTIFICATE ISSUED

Geneva.....Kane.....Kane County Title Company—Deposit \$25,000.....Jan. 19, 1939 ✓

DURATION EXTENDED

Beardstown.....Cass.....First State Bank of Beardstown, Illinois. Charter extended 50 years from February 25, 1939.....Jan. 19, 1939 ✓

Mound City.....Pulaski.....First State Bank of Mound City, Illinois. Charter extended 50 years from September 18, 1939.....Jan. 23, 1939 ✓

CONVERSION

Greenville.....Bond.....State Bank of Hoiles & Sons (Converted into First National Bank in Greenville).....Jan. 23, 1939 ✓

CAPITAL STOCK INCREASED

New Athens.....St. Clair.....State Bank of New Athens from \$50,000 to \$60,000.....Jan. 24, 1939 ✓

DISSOLVED

Niota.....Hancock.....Niota State Bank (In liquidation September 10, 1934).....Jan. 5, 1939 ✓

East Lynn.....Vermilion.....State Bank of East Lynn (In liquidation April 1, 1931. Dissolved by order of the Circuit Court of Vermilion County).....Jan. 6, 1939 ✓

McLean.....McLean.....McLean State Bank & Trust Co. (In liquidation December 22, 1938).....Jan. 13, 1939 ✓

Golconda.....Pope.....Pope County State Bank (In receivership January 6, 1931. Dissolved by order of the Circuit Court of Pope County).....Jan. 16, 1939 ✓

Pierson.....Piatt.....State Bank of Pierson (In liquidation October 15, 1930. Dissolved by order of the Circuit Court of Piatt County).....Jan. 16, 1939 ✓

Creston.....Ogle.....Farmers Bank of Creston (In receivership December 8, 1931. Dissolved by order of the Circuit Court of Ogle County).....Jan. 17, 1939 ✓

Saunemin.....Livingston.....Farmers State Bank of Saunemin (In liquidation September 27, 1930).....Jan. 19, 1939 ✓

Chicago.....Cook.....Diversey Trust and Savings Bank (In receivership July 22, 1931. Dissolved by order of the Superior Court of Cook County).....Jan. 26, 1939 ✓

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	30	1	31
State Banks in Cook County.....	28	---	28
State Banks in Illinois outside Cook County.....	489	---	489
Total.....	547	1	548

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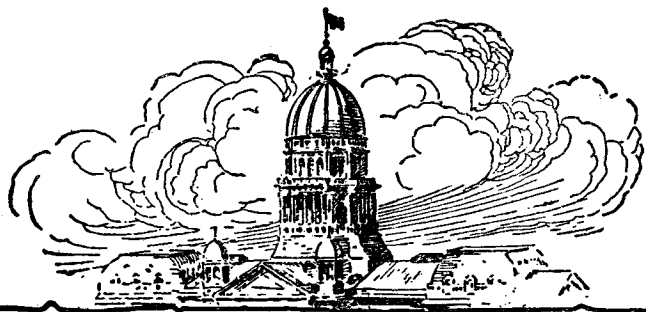
SPRINGFIELD, ILL., MARCH 1, 1939

No. 12

EXAMINATION REPORT—QUESTIONNAIRE SAFE DEPOSIT DEPARTMENT

1. Is the system of records adequate to protect the institution and its customers?

When a bank rents a safe deposit vault to a customer, it enters into fundamentally the same kind of a transaction, with certain restrictions, as a landlord does in renting or leasing a house or an apartment to a tenant. A legal contract or lease is made between the bank and vault renter which should clearly state the rights, duties and obligations of each. At the time the vault is rented and the contract executed by the lessee or renter, he should be given to understand that he only is entitled to entry to the vault. If he desires to grant access to another person, then a power of attorney should be immediately drawn for the desired alternate, which should be acknowledged by a Notary Public and also signed by the attorney designated. Should two or more persons wish to rent a vault in joint tenancy with right of survivorship, the lease should be so drawn as to show joint tenancy with right of survivorship. For the sake of emphasis, we repeat that at the time of renting the vault, the renter or renters should be given clearly to understand that only persons designated, in writing, to have the right of access will be allowed entry. Then the employee in charge of safe deposit vaults should



be strictly instructed upon this rule and he should have available the original contracts to check signatures at times of entry.

The bank should also be protected by a tenant's entry and exit register; which should show date and time of entry and exit signed by the renter. This register gives the employee an opportunity to check signatures; and no exception should be made for the renter who is well known or calls frequently. There are a large number of circumstances that can arise to make each registration very important to the bank.

A place should be made available to which vault tenants may take the stored property for examination in privacy and they should be encouraged to use these places. The examination of boxes in the bank lobby, or open quarters, should be prevented. As soon as the renter has left the booth or place of examination, the employee should immediately inspect it for mislaid items.

When a vault is rented, all of the keys to that vault should be delivered to the renter and under no circumstances should a key be retained by the bank or any of its employees. And the contract should show the number of keys delivered.

Possession of the bank's guard or master-key should never leave the employee in charge or an authorized substitute. It is very important that the bank's representative be present at the opening and closing of each vault.

There is an important provision that we occasionally find omitted from safe deposit leases which specifies the times at which the renter may have access to his vault. Access should be restricted to such hours as the bank may designate as its banking hours and the bank should be relieved from accessibility on all national, state and city holidays and at such other times as it might be deemed necessary or prudent to remain closed to the public.

In handling safe deposit business, officers should never permit relaxation of the rules. It should be constantly borne in mind that the property stored in safety deposit vaults constitutes the most valuable possessions of the renters and there is no better advertising, in our opinion, than the demonstration of constant and unbending vigilance over the property entrusted to the bank's custody.

2. Has any box-renter left his keys with an officer or employee?

When a bank or any of its operating personnel accepts custody of a key to a rented box, they lay themselves wide open to any charge that the renter may make against them. There are individuals who with a great show of confidence will confer one of their keys upon an officer or employee and the first time they fail to find something in the box that they think should be there will not hesitate an instant to put the bank and the accommodating officer or employee right on the well known spot. And that spot will be very uncomfortable and hard to move away from. This Department has seen considerable of this sort of thing; which has given rise to one of our strictest regulations. No bank or any of its officers or employees is permitted to have custody of any of the keys to its rented vaults.

3. Did you request the return of such keys to their owners?

When the Examiner finds keys to rented vaults in the custody of a bank or any of its staff, he is required to leave instructions for their immediate delivery to the proper tenants; which instructions are followed up by the divisional headquarters until complete delivery has been accomplished.

CUSTOMER'S SAFE-KEEPING

1. Is proper record kept for securities left for safe-keeping? Were securities checked against such record?

While the above question refers specifically to securities, safe-keeping arrangements usually cover a much wider field. Customers frequently come into a bank with sealed or unsealed envelopes containing securities, instruments of title, insurance papers, jewelry or other valuable property, or they may bring in lock boxes and request the bank to put them in the vault with the bank's property. Here again there is a great display of confidence and they do not even ask for or want a receipt. If they bring in securities, they will come in later asking the bank to collect the interest, clip coupons or collect dividends and credit the customer's account.

In the case of miscellaneous property other than securities, the bank should resort to a little salesmanship and rent a vault. But in the event securities are brought in and, particularly, when the owner requests the bank to collect and credit interest and dividends, then the question arises as to whether or not the bank has a legal right to enter into such an arrangement; for the latter is, strictly speaking, a trust operation. In our opinion, any bank not qualified under the Illinois Trust Act to accept and execute trusts entering into an undertaking involving the safe-keeping and collection of income or principal of securities is violating the law.

In addition to the legal aspects of safe-keeping arrangements, there is the very considerable risk to consider. This is much greater than the handling of safe-deposit vault business in which case the property, at all times, remains in the possession of the owner; while in safe-keeping, possession of the property passes to the bank in trust.

If a bank is qualified and desires to handle safe-keeping for customers, it should arrange a system of records and procedure that will fully protect the bank and its customers. To begin with, every piece of property taken in safe-keeping should be fully described in a suitable record. At the same time, a fully descriptive receipt from a numerical book should be given to the customer and a copy retained by the bank. Where the bank agrees to perform certain duties in connection with the securities, such duties should be set down in writing, signed by the customer and delivered to the bank. When securities taken for safe-keeping belong to a corporation, an appropriate resolution from the corporation should be obtained. In smaller banks, safe-keeping operations should be under the supervision of an officer who should keep under close observation all safe-keeping transactions; while in larger institutions the volume usually requires the organization of a separate department.

It is true that all of the foregoing entails much care and many duties but when safe-keeping is properly handled, it is a real service to customers for which the bank is entitled to adequate compensation. If a bank is not prepared to handle safe-keeping substantially as above outlined, they should reject it altogether as too risky.

CONVERSION

Highland.....Madison.....State and Trust Bank (Converted into The Highland National Bank).....Feb. 28, 1939 ✓

DISSOLVED

✓ Heyworth.....McLean.....Heyworth State Bank (In liquidation December 31, 1938) Jan. 5, 1939
 ✓ Nauvoo.....Hancock.....First Trust & Savings Bank of Nauvoo (In receivership September 23, 1930. Dissolved by order of the Circuit Court of Hancock County).....Feb. 1, 1939
 ✓ Belle Prairie.....Hamilton.....Farmers State Bank of Belle Prairie.....Feb. 2, 1939
 Edinburg.....Christian.....Citizens State Bank (In liquidation January 2, 1930. Dissolved by order of the Circuit Court of Christian County) Feb. 2, 1939
 ✓ Bowen.....Hancock.....Farmers Bank of Bowen (In liquidation August 26, 1930. Dissolved by order of the Circuit Court of Hancock County).....Feb. 10, 1939
 ✓ Fairbury.....Livingston.....Fairbury Bank (In liquidation February 12, 1931).....Feb. 20, 1939

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	30	1	31
State Banks in Cook County.....	28	---	28
State Banks in Illinois outside Cook County.....	487	---	487
Total.....	545	1	546

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Vol. 15

SPRINGFIELD, ILL., APRIL 1, 1939

No. 1

EXAMINATION REPORT—QUESTIONNAIRE CORPORATE RECORDS

1. DATE PERMIT TO ORGANIZE RECORDED. DATE CHARTER RECORDED.

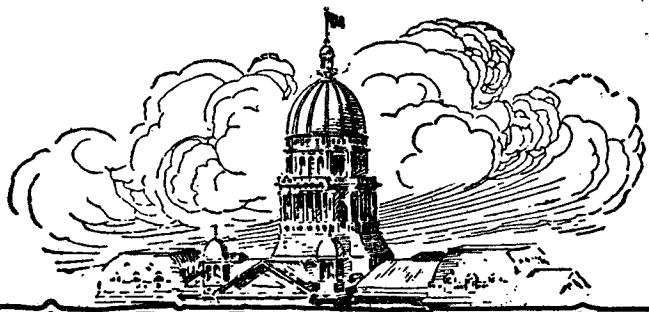
Both of the foregoing are organization documents of authority issued by this Department. It is very important that both be on file with the Recorder of Deeds in the County in which the bank is located; therefore recording is required by this Department.

2. ARE ALL CHANGES IN ORGANIZATION, MADE UNDER SECTION 12, PROPERLY RECORDED?

The reference in this question is to Section 12 of the Illinois Banking Act under which all changes in bank charters and organization are provided for.

Under Section 12 a bank may:—change its name—change its place of business—increase its capital—decrease its capital—change the par value of its stock—extend the duration of its charter—increase or decrease the number of its directors—consolidate with another bank.

In order to accomplish any of these steps, the following three actions are required: (1) ratification by votes representing at least two-thirds of the whole amount of the bank's capital stock, (2) the written approval of the Auditor of Public Accounts, (3) the filing for record with the Recorder of Deeds in the



County in which the bank is located of (a) certificate showing required stockholders' ratification and (b) the Certificate of Approval issued by the Auditor of Public Accounts. And until all of these steps have been properly taken and duly recorded, none of the above enumerated changes can be considered as legally accomplished.

As soon as any of said changes have been made, the bank is required by the same statute to publish notice of said change at least once each week for three successive weeks in their local or nearest newspaper.

These changes may be made at a regular meeting of the stockholders without previously mailed or published notice.

If they are to be made at a special meeting of the stockholders, such meeting must originate with the Board of Directors in the form of a majority resolution calling a special meeting of the stockholders for the specific purpose of making the desired change.

Notice of the time, place and purpose of the special stockholders' meeting must be mailed to each stockholder at least thirty days prior to the meeting and said notice must also be published at least once each week for three successive weeks in the local or nearest newspaper.

It should be understood that while special notice to stockholders and publication thereof is not required when the subject changes are to be submitted at a regular stockholders' meeting, if any of the changes are voted, legal publication for three successive weeks must follow.

In order to answer Question No. 2, the Examiner is required to check the bank's corporate minutes to ascertain the legality of all Section 12 proceedings. This is determined through an examination of the stockholders' minutes and executed counterparts of the documents filed with the Recorder of Deeds.

3. ANNUAL MEETING OF STOCKHOLDERS.
NUMBER OF SHARES REPRESENTED.

IN PERSON
BY PROXY

This question places in our record the date of occurrence and stock representation at the last annual stockholders' meeting. At this point, we should like to make a few observations inspired by our experience.

The vital importance of the stockholders' meeting should be realized by the officers and directors and adequate provision made to conduct it properly. The officer in charge should have a good working knowledge of parliamentary forms and follow them carefully.

One step of great importance is the appointment of a committee to examine and pass upon the qualifications of all persons voting stock. The examination of proxies, qualifications of proxy holders and qualifications of stockholders present should be made a matter of record before any voting takes place. Stockholders should be fully instructed concerning cumulative voting and the committee in charge of the voting particularly should know how to tabulate and audit cumulated votes.

The Secretary should be a person familiar with corporation procedures so that motions and resolutions will be recorded in proper form.

A most important order of business is the election of directors. No annual meeting should be completely adjourned without electing the full legal number required by the by-laws. If this is found to be impossible, the legal number should be reduced to the number of directors available. The principal reason for our insistence on the election of complete membership is that the legal number of directors, as fixed in the by-laws, also fixes

the quorum requirements. For instance, if the by-laws fix the legal number of directors at nine, five must be present in order to transact bank business and if only five directors are elected and qualify, one absence is sufficient to prevent a meeting.

The real danger, however, when full membership is not elected is in losing sight of the legal quorum requirement and conducting meetings with less than a legal quorum present. Obviously, no action taken at such meetings is legal.

4. DIRECTOR'S OATH OF FEALTY EXECUTED AND FILED
REGULARLY?

Section 4 of the Illinois Banking Act provides as follows:

"....and each director shall take and subscribe to an oath such as the Auditor shall prescribe of fealty to the bank or association of which he is director and that he will, so far as the duty devolves on him, diligently and honestly administer the affairs of such bank or association and will not knowingly violate or willingly permit to be violated any of the provisions of this Act; and that he is the owner in good faith and in his own right of the number of shares of stock required by this Act; and that the same is not hypothecated or in any way pledged as security for any loan or debt. Such oath subscribed by the director making it and certified by a proper officer authorized to administer oaths shall be immediately transmitted to the Auditor and shall be filed and preserved by him in his office."

It will be seen from the foregoing that a director elect is required to do two qualifying acts before he may enter upon his official duties. One is to subscribe to the Oath of Fealty and the other is to file his qualifying shares of stock, unendorsed and unassigned, with the Cashier. The Examiner is required to check these qualifications at each examination.

5. MONTHLY DIRECTORS' MEETINGS. DATE APPOINTED FOR
REGULAR MEETING?

Section 4 of the Banking Act provides:

"The directors of any bank or association organized under the provisions of this Act, shall hold regular meetings at least once each month."

Failure to hold at least one meeting during any given month is, therefore, a violation of the law and to be carefully avoided. If, on the regular meeting date, a quorum is not available, those present should adjourn to a certain near date within the month and then arrange for the attendance of a quorum. The second section of the above question is for the information of our files.

6. HOW MANY BOARD MEETINGS SINCE LAST
EXAMINATION? VACANCY ON BOARD?

REGULAR
SPECIAL

The answer to this question furnishes a partial indication of the activities and interest of the Board membership in the affairs of the bank. The single fact that a Board holds but one meeting a month is not in itself an indication of lack of activity or interest. But where an Examiner encounters such a combination of circumstances as one Board meeting a month, no committee activities, brief and perfunctory minutes, month after month, he is pretty

safe in assuming that the Board of Directors are doing little more than "rubber stamping" the acts and policies of the active officers and are not giving the affairs of the bank a great deal of time and attention.

On the other hand, when the minutes show numerous special Board meetings or Executive Committee or Loan Committee meetings and a broad range of influence on the bank's affairs exercised either by the Board or its Committees, he knows that the directors recognize and are discharging their legal responsibility.

CONVERSION

Elmhurst.....Du Page.....Elmhurst State Bank into Elmhurst National Bank.....Feb. 28, 1939

TRUST CERTIFICATES CANCELLED

Greenville.....Bond.....State Bank of Hoiles & Sons.....Mar. 7, 1939
 Elmhurst.....Du Page.....Elmhurst State Bank.....Mar. 18, 1939

TRUST CERTIFICATES ISSUED

Greenville.....Bond.....First National Bank in Greenville.....	Deposit	Mar. 7, 1939
	\$ 50,000.	
Elmhurst.....Du Page.....Elmhurst National Bank.....	125,000.	Mar. 18, 1939

CAPITAL STOCK INCREASED

Fairbury.....Livingston.....Farmers State Bank of Fairbury from \$40,000 to \$50,000.....Mar. 31, 1939

IN LIQUIDATION

Payson.....Adams.....State Street Bank of Payson.....Mar. 15, 1939
 Collison.....Vermilion.....Peoples State Bank of Collison.....Mar. 18, 1939

DISSOLVED

Coatsburg.....Adams.....Coatsburg State Bank.....Feb. 23, 1939
 Fithian.....Vermilion.....First State Bank of Fithian (In liquidation November 13, 1922. Dissolved by order of the Circuit Court of Vermillion County).....Mar. 11, 1939
 Broughton.....Hamilton.....First State Bank of Broughton (In receivership December 24, 1930. Dissolved by order of the Circuit Court of Hamilton County).....Mar. 13, 1939
 Chicago.....Cook.....Foreman-State Trust and Savings Bank (In receivership January 18, 1933. Dissolved by order of the Circuit Court of Cook County).....Mar. 13, 1939
 Seward.....Winnebago.....Seward State Bank (In receivership July 22, 1931. Dissolved by order of the Circuit Court of Winnebago County).....Mar. 17, 1939
 Macedonia.....Hamilton.....Macedonia State Bank (In receivership January 22, 1931. Dissolved by order of the Circuit Court of Hamilton County).....Mar. 20, 1939
 Toulon.....Stark.....Charles P. Dewey & Sons, Bankers.....Mar. 29, 1939

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	30	1	31
State Banks in Cook County.....	28	---	28
State Banks in Illinois outside Cook County.....	482	---	482
Total.....	540	1	541

MONTHLY BULLETIN

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

Vol. 15

SPRINGFIELD, ILL., MAY 1, 1939

No. 2

EXAMINATION REPORT—QUESTIONNAIRE CORPORATE RECORDS

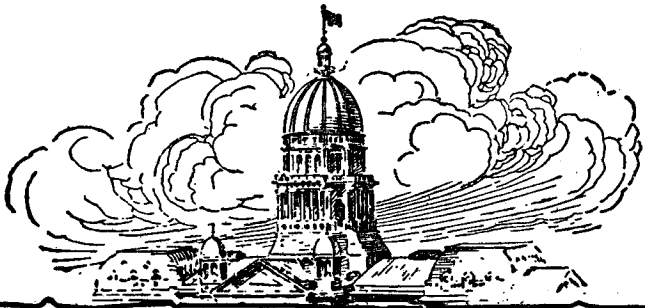
7. IS FEE PAID EACH ATTENDING DIRECTOR?
AMOUNT?

The answer to this question is merely for the information of our record.

8. ARE DIRECTORS AND OFFICERS FAMILIAR WITH THE PROVISIONS OF SECTION 10, AND COGNIZANT OF THEIR LIABILITY?

This opens up a question that is of very grave concern to every director and officer in an Illinois State Bank. The part of Section 10 covered by Question 8 reads as follows:—

"Section 10. (Chap. 16½, Sec. 10) LIMITATIONS ON LOANS—LOANS TO OFFICERS, ETC., OF BANK.] The total liabilities to any association, of any person, or of any corporation or partnership for money borrowed, including in the liabilities of a partnership the liabilities of the several members thereof, shall at no time exceed fifteen per cent of the amount of the capital stock of such association actually paid in and unimpaired, and fifteen per cent of its unimpaired surplus fund: *Provided, however,* that the total liabilities of any such person, corporation or partnership shall at no time exceed thirty per cent of the amount of capital actually paid in:



And, provided, further, that undivided profits shall not be construed as a part of the surplus. But (1) the discount of bills of exchange drawn in good faith against actually existing values; (2) the discount of commercial or business paper actually owned by the person negotiating the same; (3) the purchase of or loaning money in exchange for evidences of indebtedness which shall be secured by mortgage or trust deed upon productive real estate, the value of which as ascertained by the oath of two disinterested appraisers, is double the amount of the principal debt secured, and which mortgage or trust deed is ascertained by a guaranty policy of a title guaranty company approved by the Auditor of Public Accounts, or by a registrar's certificate of title in any county having adopted the provisions of the Land Titles Act, or by the opinion of a reputable attorney at law to be a first lien upon the real estate therein described; shall not be considered as money borrowed within the meaning of this section.

And provided, also, that the total liabilities of any one person, partnership, or corporation for money borrowed, or otherwise, shall not exceed twenty-five per cent (25%) of the deposits of any such bank or association, and also that such total liabilities shall, at no time, exceed one half the amount of the capital stock and unimpaired surplus of such bank or association.

Every such loan made in violation of the provisions hereof shall be due and payable according to its terms and the remedy for the recovery of any money loaned in violation of the provisions hereof or for the enforcement of any agreement collateral or otherwise made in connection with any such loan shall not be held to be impaired, affected or prohibited by reason of such violation, but such remedy shall exist notwithstanding the same. But every director, or officer, of any such association, who shall violate, or participate in, or assent to such violation, or who shall permit any of the officers, agents or servants of the association to violate the provisions hereof, shall be held liable in his personal and individual capacity for all damages which the association, its shareholders or any other person shall have sustained in consequence of such violation."

A proper understanding of this law must necessarily begin with a careful consideration of its main purpose; which is this, to limit the amount that a bank may loan to any single borrower. In using the word "borrower" in this article, we intend it to embrace the words "person—corporation or partnership" used in the law. If said legal loaning limit is exceeded, the law is violated and the directors and officers responsible become personally liable for any loss sustained. That is the penalty and it might be well to consider that penalty in a little more detail.

The penalty for violation is contained in the last sixty-nine words of that part of the law above quoted and is so phrased as to make the liability joint and several; which means in effect that the entire burden falls on each individual in the responsible group and if one or more cannot meet their share, the entire penalty must be borne by those who can. For example:

A violation of Section 10 results in a loss to the bank of \$5,000.00 and suit is brought against the directors and officers responsible. Now let us assume that the Court fixes responsibility on five individuals and enters judgment against each for \$5,000.00. Let us assume further that the actual violation occurred several years prior to the determination of loss and

entry of judgment and in the meantime, two of the responsible persons have died and another has become bankrupt. That leaves two individuals to pay the \$5,000.00 loss. That is what the joint and several liability means.

The next step is to understand the calculation of the legal loaning limit, in any given bank.

The phrase applicable to the Capital account is, ". . . fifteen per cent of the amount of the capital stock . . . actually paid in and unimpaired, . . ." The last five words cover situations so unusual that in a general study of this law they may be temporarily ignored.

The Surplus account is brought into the calculation with the words, ". . . and fifteen per cent of its unimpaired surplus fund: . . ." The Surplus account becomes impaired when determined losses exceed Undivided Profits and Reserves and require a part of the Surplus account to either offset the losses or charge them off. However, under the prevailing practice of charging off all losses as soon as determined, the presence of balances in the Undivided Profits and Reserve accounts is pretty good evidence of an unimpaired Surplus. So, while an impaired Surplus account is a more imminent possibility than an impaired Capital account, it is sufficiently remote to be disregarded in this analysis.

Therefore, the legal loaning limit up to this point is fifteen per cent of Capital and Surplus and so remains until Surplus exceeds Capital when the following provision enters into the calculation: "Provided, however, that the total liabilities of any such person, corporation or partnership shall at no time exceed thirty per cent of the amount of capital actually paid in: . ." That means that a bank with a Capital of \$100,000.00 and a Surplus of \$100,000.00 would have a loaning limit of \$30,000.00, but if the Surplus was increased to \$125,000.00, the loaning limit would remain at \$30,000.00 until the capital stock would be increased.

We pause here to urge Illinois State bank directors to carefully review the foregoing and apply the above limitations to their own bank and keep them constantly in mind when passing upon bank investments. When loans, particularly large ones, are under consideration, they should be checked against the legal loaning limit. And where an applicant is interested in several ventures which may also borrow from the bank, all obligations on which he may be liable should be brought together and checked against the legal loaning limit. For example:

A bank's legal loaning limit is \$10,000.00. John Jones applies jointly with his son, who is operating one of his farms, for a loan of \$500.00. Jones is a wealthy land owner and the Board passes the loan without question. However, Jones is a co-maker with another son on a note for \$5,000.00 and co-maker with others on another enterprise for \$5,000.00. Under such circumstances, that innocent little \$500.00 loan sends John Jones' total liabilities beyond the legal loaning limit, violating the law and imposes a personal liability upon the officers and directors responsible for the entire amount.

Here is another one:

The same bank buys and pays \$10,000.00 for the bonds of a certain corporation. Later on the same corporation offers a new issue and the bank buys \$5,000.00 increasing the investment to \$15,000.00, again violating the law and making the directors and officers responsible personally liable for the entire investment.

We cite these two examples to show how easily and accidentally violations of Section 10 can occur. But the law makes no allowances for accidents and the responsible officers and directors are dragged into a serious liability without knowing it, and more than once have we seen

bank directors pay heavily on liabilities of this nature that they never knew existed.

There are exceptions to this law which we shall discuss farther on; but they are of secondary importance to a thorough understanding of the general limitations discussed up to this point. Such an understanding should lead bank directors, individually and as a group, to adopt a policy and so check their loan applications and investments that violations of Section 10 simply will not occur.

Before going on with this discussion, we should like to have each Illinois State bank director and officer answer to himself this question:

Is there any sensible reason why I should jeopardize my personal fortune and the welfare of my family by becoming a party to a violation of Section 10 in which I have no interest whatever and from which I can derive no benefit? (This discussion will continue in our June Bulletin.)

CONVERSION

Columbia.....Monroe.....Monroe County Savings Bank & Trust Co. into Monroe National Bank of Columbia..... April 8, 1939
Fairbury.....Livingston.....Fairbury State Bank into First National Bank in Fairbury..... April 14, 1939

IN LIQUIDATION

Brussels.....Calhoun.....Bank of Brussels through Bank of Calhoun County, Hardin..... April 13, 1939

TRUST CERTIFICATE CANCELLED

Highland.....Madison.....State and Trust Bank..... April 24, 1939

TRUST CERTIFICATE ISSUED

Highland.....Madison.....The Highland National Bank..... Deposit \$50,000. April 24, 1939

DISSOLVED

Oconee.....Shelby.....State Bank of Oconee (In liquidation October 2, 1926)..... Feb. 10, 1939
Burnt Prairie.....White.....Burnt Prairie State Bank (In liquidation May 27, 1933)..... Mar. 16, 1939
Esmond.....DeKalb.....Esmond State Bank (In receivership December 8, 1931. Dissolved by order of the Circuit Court of DeKalb County)..... April 3, 1939
Payson.....Adams.....State Street Bank of Payson (In liquidation March 15, 1939)..... April 6, 1939
Springfield.....Sangamon.....First Trust and Savings Bank of Springfield, Illinois (In liquidation February 15, 1919. Dissolved by order of the Circuit Court of Sangamon County)..... April 7, 1939
Streator.....LaSalle.....Peoples Trust & Savings Bank of Streator (In receivership March 31, 1930. Dissolved by order of the Circuit Court of LaSalle County)..... April 10, 1939
Manlius.....Bureau.....First State Bank of Manlius (In receivership April 22, 1931. Dissolved by order of the Circuit Court of Bureau County)..... April 17, 1939
Harmon.....Lee.....Harmon State Bank (In liquidation January 17, 1933)..... April 18, 1939

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	30	1	31
State Banks in Cook County.....	28	---	28
State Banks in Illinois outside Cook County.....	479	---	479
Total.....	537	1	538

MONTHLY BULLETIN

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

Vol. 15

SPRINGFIELD, ILL., JUNE 1, 1939

No. 3

EXAMINATION REPORT—QUESTIONNAIRE CORPORATE RECORDS EXCESS LOANS—(Continued)

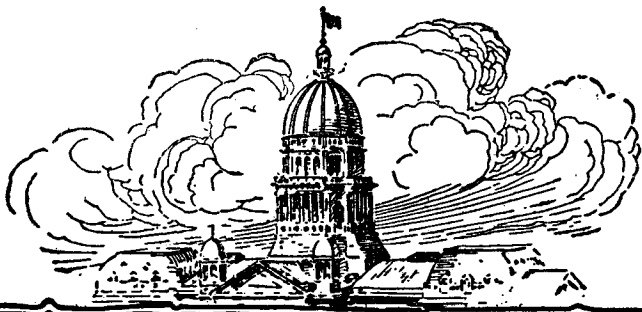
In our May Bulletin we discussed what might be called the basic or ordinary loaning limit of an Illinois State Bank; that is fifteen per cent of Capital and Surplus and not to exceed thirty per cent of Capital.

The law then exempts three types of liabilities from the basic limit and permits said exemptions to run to a higher or what might be termed an absolute limit of fifty per cent of Capital and Surplus or twenty-five per cent of deposits whichever is the lesser.

(See May Bulletin for a legal description of the three exemptions.)

The first two of these exemptions cover such highly commercial and quickly maturing liabilities as discounted sight drafts covering bills of lading, warehouse receipts or other title containing instruments, and commercial or business paper. Incidentally commercial or business paper mean exactly the same thing, being defined by Webster as "short term negotiable instruments arising out of commercial transactions."

The third exemption is real estate loans with lien, title and value certified as required in Section 10.



These three types of investment are exempt from computation as money borrowed until they, of themselves, or combined with other non-exempt liabilities of the same borrower, exceed the lesser amount of fifty per cent of Capital and Surplus or twenty-five per cent of deposits.

For example:

The State Bank of Banktown has Capital of \$100,000.00 and Surplus of \$50,000.00 which establish an ordinary loaning limit of \$22,500.00.

On a given date the Blank Manufacturing Co. owed said bank \$45,000.00. Of this amount, \$20,000.00 was made up of plain and collateral notes and \$25,000.00 was in the form of a real estate mortgage certified as to lien, title and value as required under exemption three of Section 10. This same company had also discounted, on the same date, with the subject bank, sundry customers' notes totaling \$29,000.00 and sight drafts with bills of lading attached amounting to \$1,000.00.

Applying the limits imposed by Section 10 upon the State Bank of Banktown, we would reach the following result:

LIBALITIES OF BLANK MANUFACTURING CO.

Collateral and unsecured notes \$20,000.00—Ordinary limit	\$22,500.00.
Qualified real estate loan.....	25,000.00—Exemption No. 3.
Customers' notes discounted..	29,000.00—Exemption No. 2.
Sight drafts discounted.....	1,000.00—Exemption No. 1.

Total Liabilities	\$75,000.00—Absolute limit \$75,000.00.
	(50% of Capital and Surplus)

It will be seen from the above tabulation that in no instance has Section 10 been violated. The first group of non-exempt liabilities (\$20,000.00) is within the bank's ordinary loaning limit (\$22,500.00); while the next three groups (\$55,000.00) are all exempt from computation against the ordinary loaning limit. But it should also be observed that any further increase in the liabilities of the Blank Manufacturing Co. to subject bank will exceed the absolute limit (\$75,000.00) and impose the penalty of Section 10 upon the officers and directors involved.

When a bank is offered paper which is supposed to qualify as exempt, its qualification should be very carefully examined and established.

For instance, there appears to be many who feel that any discounted trade paper would come under exemption 2. That opinion, in our judgment, may rightly be questioned. We are very doubtful that discounted installment notes running over a period of one year to eighteen months would qualify as commercial or business paper for the Webster definition, heretofore quoted, might be used by the Courts as the test.

Real estate loans taken in under exemption 3 are occasionally encountered without evidence of qualification. By that we mean that neither the required appraisal by two disinterested appraisers showing a property value of at least twice the amount of the loan or the required certification as to the lien and title are in evidence. It seems to us that bank directors who are properly impressed with the penalty imposed by

Section 10 for violation thereof would want to be assured as to the qualifications of paper offered to the bank as exempt under Section 10 from the basic loaning limit. In the case of exemption 2, they would want to be assured that the discounts were really commercial or business paper in the strict sense of the word and could be handled as such at maturity. By that we mean either collected from the maker or endorser. In exemption 3, they would want to be shown the required appraisal and certificate as to lien and title and assure themselves that all of these showings would stand up in Court.

It seems to us that the Legislature, in providing these exemptions, did not intend to permit the stretching of the basic limit for ordinary loan transactions but to provide a means for the accommodation of both bank and client to handle a limited amount of highly commercial transactions and real estate loans of unquestioned merit. To attempt to circumvent any of the provisions of this Section, either through book entries or legal interpretations, is highly dangerous for funds can always be traced and if the liabilities of a borrower exceed the limits prescribed in Section 10, no amount of misleading book entries can change that fact. In reading this Section and in considering its several provisions, it is very well to bear in mind the intention of the Legislature in enacting Section 10. Several years ago, in delivering an opinion involving this Section, the Attorney General of Illinois based much of his reasoning upon the obvious intention of the Illinois Legislature in framing Section 10 and we are going to take the liberty here of quoting several of his observations:

"The purpose and intent of the legislature in enacting Section 10 was to protect stockholders and depositors. . . ."

"Section 10 was evidently designed to compel diversification of loans so as to spread the liabilities of debtors of the bank and minimize its losses by reason of the non-payment of any such liabilities. If the loans to an individual, partnership or corporation by the bank amounted to a relatively considerable portion of the bank's assets, the losses occurring on account of the failure to meet the payment of such obligation might become dangerously large. . . ."

"The legislature sought to afford all protection possible to banks by prohibiting loaning of money or the acquisition of liabilities in such a large amount to a single individual, corporation or partnership as would have the effect of jeopardizing the interests of the depositors of the bank."

In determining and setting up violations of Section 10 in our examination reports, the Examiners naturally follow a strict interpretation of the law; and not infrequently bank managements disagree with their conclusions and we are asked to change our attitude toward certain circumstances. Actual determination as to violations and directors' liability can only be reached in the Courts based upon the records of the bank and such other competent evidence as may be adduced in Court. But if the Examiners' findings are taken as a warning, as they should be, and the violations or possible violations eliminated, as they should be, a very wholesome purpose will have been served, particularly as far as the directors are concerned.

TRUST CERTIFICATE CANCELLED

✓ East St. Louis..St. Clair.....Southern Illinois Trust Company.....May 8, 1939
 ✓ Chicago.....Cook.....State Bank of Chicago.....May 10, 1939
 ✓ Pittsfield.....Pike.....First National Bank of Pittsfield.....May 15, 1939

CAPITAL STOCK INCREASED

✓ Pontiac.....Livingston.....Illinois State Savings Bank from \$50,000 to \$100,000.....May 13, 1939

DISSOLVED

✓ Milledgeville...Carroll.....Shunway State Bank (In receivership February 18, 1932. Dissolved by order of the Circuit Court of Carroll County).....Apr. 21, 1939
 ✓ Leonore.....LaSalle.....State Bank of Leonore (In liquidation April 27, 1938).....May 1, 1939 ✓
 ✓ Colchester.....McDonough.....Peoples State Bank (In receivership July 19, 1932. Dissolved by order of the Circuit Court of McDonough County).....May 3, 1939
 ✓ Sciota.....McDonough.....State Bank of Sciota (In receivership December 26, 1930. Dissolved by order of the Circuit Court of McDonough County).....May 3, 1939
 Collison.....Vermilion.....Peoples State Bank of Collison (In liquidation March 18, 1939).....May 4, 1939 ←
 ✓ Chicago.....Cook.....Empire Trust & Savings Bank (In receivership July 16, 1932. Dissolved by order of the Superior Court of Cook County).....May 8, 1939
 ✓ Chicago.....Cook.....State Bank of Chicago.....May 10, 1939 ←
 ✓ Peru.....LaSalle.....Peru State Bank (In liquidation November 10, 1931).....May 10, 1939
 ✓ Taylor Springs..Montgomery...State Bank of Taylor Springs (In liquidation May 2, 1931)May 17, 1939

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	29	1	30
State Banks in Cook County.....	28	---	28
State Banks in Illinois outside Cook County.....	479	---	479
Total.....	536	1	537

MONTHLY BULLETIN

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

Vol. 15

SPRINGFIELD, ILL., JULY 1, 1939

No. 4

EXAMINATION REPORT—QUESTIONNAIRE CORPORATE RECORDS

EXCESS LOANS—(Continued)

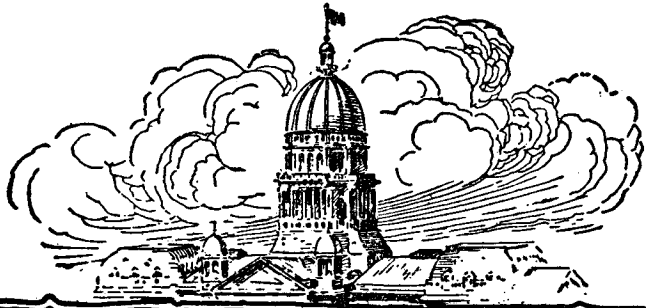
This Department has seen many tragic results of Excess Loans but none more so than the following; the recounting of which seems timely and highly illustrative at this point.

The bank was located in a fairly large city; the business interests of which were rather well diversified and there were several competing banks. It was almost entirely an agricultural bank and five of its seven directors were active farmers. The other directors were the President who ran the bank and a prominent dealer in real estate.

The rich farm lands of the surrounding country responded readily to the "land boom" of the early twenties and for several years the bank was the center of feverish activity arising from the financing of speculation in acreage.

Loans and deposits, accompanied by earnings, profits and commissions, surged upward. There were dividends and extra dividends. Borrowers' statements fairly bloomed with the radiance of \$250 and \$300 an acre land.

As farms were bought and sold and prices advanced with each deal, there would be additional financing for improvements, for machinery, bigger and better herds, automobiles



and many other needs newly discovered as the avenue of credit widened out. These loans were mainly unsecured.

The President arose with his opportunities to a commanding position as a financial leader in that part of the State. His opinions and advice were much sought after and highly valued. He was said to have become wealthy—very wealthy—in fact, so wealthy as to be exempt from the necessity of supporting his borrowings with a financial statement.

Quite humanly, the five directors reveled in all of this reflected glory and were not at all impressed when this Department pointed out five excess loans totaling nearly One Hundred and Fifty Thousand Dollars among their assets. These had originated mainly as temporary and unsecured borrowings to be paid when "certain pending deals" were completed.

These "deals" were never completed for the land boom waned, prices leveled off and began to sag.

Each examination found the five excess loans looking worse and the later acquisition of second mortgages and chattel mortgages as collateral only served to emphasize the change in these debts from promises to pay to forlorn hopes of collecting.

Throughout this period our five farmer directors maintained a puzzling attitude. They took no part in the land speculation that flourished all around them and their own personal affairs remained in impeccable order. On the other hand, they smiled approvingly on the reckless and plunging policies pursued by their President.

As the excess loans began to appear in our examination reports, we pointed them out to the directors as violations of the law and advised them of the personal liability of each director in the event of loss. These citations were all acknowledged by the Board and became matters of record.

There were conferences with the Board at the bank and in our Springfield office. The directors were apathetic. They could see nothing to be alarmed about. Sure they knew the law and their liability. The law was full of senseless restrictions like that; but there was nothing to worry about. They knew these borrowers and they knew the land. They had a good bank and were making money. That was the important thing to consider. One of these conferences came to a dramatic climax when the President, pounding the table, thundered defiantly that any time these loans became a burden to the bank, he would personally take them out and be glad to get them. When the examiner suggested putting that in writing, indignation was loud and unanimous.

The situation reached a stalemate. It was somebody's move and somebody did move—a wholly unexpected somebody—the depositors.

The run started very slowly, almost imperceptibly, through the mail. A week of this, gaining momentum, culminated in a stormy Saturday with pressing demands from a crowded lobby. They managed to get through the day but when the doors closed, everyone knew that they would not reopen. A frantic call to Springfield sent an examiner hurrying to take charge.

Community leaders were called in while examiners rushed an inventory. The competing banks agreed to protect the depositors if

the bank in trouble could furnish a sufficient amount of acceptable assets to cover the deposits. The Board of Directors agreed to submit their assets to their competitors for appraisal and the severest of all examinations got under way.

By Sunday noon the appraisal was finished. Figures were recapitulated and the Board of Directors assembled to learn the result. The appraisal showed that acceptable assets lacked just \$150,000.00 of sufficiency to cover deposits.

This announcement raised a storm of bitter protest. The competing bankers were wrong. Those assets were sound and collectible. A few items might be slow but their capital structure was far in excess of any but wantonly destructive objections. A deposit deficit of \$150,000.00 was ridiculous, the competing bankers were charged with vindictiveness and a desire to destroy those who had successfully competed against them.

These charges broke up the conference but an influential and cool-headed banker with a flair for diplomacy, from a neighboring city, was present and guided the two groups back into conference. Concessions were made and the deficit scaled down to \$100,000.00. More bickering and recriminations. Someone pointed to the five excess loans among the rejected assets, suggesting that if the bank went into receivership the directors' liability would be enforced. Why could not the directors buy \$100,000.00 of these excess loans now and save the depositors?

The directors' attorney met that one head on. With magnificent bluff, he shouted that he knew the law and had examined the record and was fully prepared to defeat that liability when, as and if it came to an issue.

Stalemate again. The situation looked hopeless and the tired conferees began to look for their hats. The persistent diplomat beckoned the directors' attorney into a private office. Later the directors were called in and, lastly, the examiner.

There was no bluffing in that conference. The diplomat, in a few simple calculations, showed a hole in their deposits \$100,000.00 big; while their attorney frankly advised them that they were indefensible against the Section 10 liability.

Badly shaken, the five farmer directors turned to their leader, the President. In a husky voice, he stammered his regrets that this crisis had caught him utterly unprepared. His means were considerable, of course, but founded entirely on equities which, in the present emergency, left him completely helpless to do that which he had always intended to do should these—ah—large loans prove burdensome. At this point the attorney broke in, "What your President is trying to tell you, gentlemen, with many words adds up to this: He is broke and can't do a thing and I know that he is telling you the truth. That leaves six of you with seven hours to meet your depositors".

There was no surprise when the real estate dealer with less language but quite as definitely sang his swan song and the five farmers faced their problem alone.

Thoroughly disillusioned now and appalled by the magnitude of the responsibility so unexpectedly thrust upon them, all five quite humanly broke under the strain. Two collapsed completely and one nearly passed away. But they were thoroughbreds as well as honorable

men and rallied quickly to face realities. They asked for a few minutes alone and emerged with the declaration that they would stand by their depositors and fill that \$100,000.00 gap with their own notes secured by sound mortgages on everything they owned.

A greater tragedy, however, in this episode came as a sort of an anticlimax. Day was breaking several hours later when a heavy-eyed examiner, returning from an orgy of black coffee, passed through the outer waiting room of the conference offices. In the dim half-light, he saw five women seated side by side along the wall, four apparently of middle age and one well along in years. Four of them were weeping, two hysterically. The older woman sat dry-eyed, staring off toward the window, folding and creasing a handkerchief on her knee.

As the examiner passed into the inner office, he encountered the attorney for the five directors and asked him who the ladies were. Bitterly resentful of the plight of his clients and his own helplessness to aid them, he replied with eloquent sarcasm, "Those ladies, my friend, are the wives of the five biggest damn fools in the world. They are here to sign five mortgages to fill that \$100,000.00 hole that we discovered during our recent deliberations. They, if you please, are the innocent victims of this tragedy who will pledge the fruits of their years of labor to pay for this crazy party that they were never even invited to attend. They are out there crying now and they will probably cry all the rest of their lives over tonight's business; but they are dutiful wives and as soon as the mortgages are drawn, they will sign them and then go home and start all over again; and that old lady out there, my friend, is seventy years old".

CONVERSION

Macomb.....McDonough.....Citizens State Bank of Macomb into Citizens National Bank of Macomb..... May 31, 1939
 Mattoon.....Coles.....Central Illinois Trust & Savings Bank into Central National Bank of Mattoon..... June 28, 1939

DISSOLVED

Cornell.....Livingston.....Farmers State Savings Bank (In Receivership April 1, 1930. Dissolved by order of the Circuit Court of Livingston County)..... June 7, 1939 ✓
 Tampico.....Whiteside.....Tampico State Bank (In Receivership April 13, 1932. Dissolved by order of the Circuit Court of Whiteside County)..... June 22, 1939 ✓
 Fulton.....Whiteside.....Whiteside County State Bank (In Receivership February 28, 1930. Dissolved by order of the Circuit Court of Whiteside County)..... June 22, 1939 ✓
 Woodhull.....Henry.....Woodhull State Bank (In Receivership May 1, 1930. Dissolved by order of the Circuit Court of Henry County)..... June 26, 1939 ✓
 Murrayville.....Morgan.....Murrayville State Bank (In Receivership March 17, 1933. Dissolved by order of the Circuit Court of Morgan County)..... June 28, 1939 ✓

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	29	1	30
State Banks in Cook County.....	28	---	28
State Banks in Illinois outside Cook County.....	477	---	477
Total.....	534	1	535

MONTHLY BULLETIN

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

Vol. 15

SPRINGFIELD, ILL., AUGUST 1, 1939

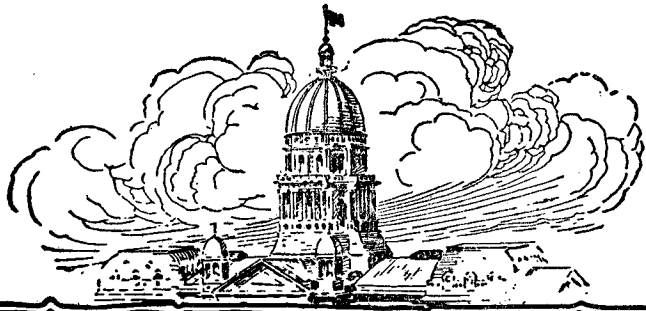
No. 5

EXAMINATION REPORT—QUESTIONNAIRE

CORPORATE RECORDS—(Continued)

9. ARE THE REQUIREMENTS OF SECTION 10 COMPLIED WITH IN THE MATTER OF APPLICATION AND APPROVAL OF EACH LOAN AND RENEWAL THEREOF?
10. IN WHAT MANNER DO THEY AUTHORIZE OR APPROVE LOANS OR DISCOUNTS?
11. DO RECORDS SHOW ANY DISAPPROVAL OF LOANS?
12. STATE WHETHER DIRECTORS HAVE AN ACTIVE DISCOUNT COMMITTEE. ARE THE MEETINGS AND ACTIONS PROPERLY RECORDED?
13. GIVE NAMES OF MEMBERS OF DISCOUNT COMMITTEE.
14. HOW OFTEN DOES COMMITTEE MEET?
15. DOES DISCOUNT COMMITTEE REVIEW LOANS IN ADVANCE OF MATURITY?

All of the foregoing questions appear in substantially the same form in a previous questionnaire (Loans and Discounts Bulletins September and October, 1937) and have been previously discussed. They recur at this point merely to remind the Examiner to check his earlier findings which he obtained from the bank officers with the bank's corporate minutes.



16. STATE WHETHER THEY HAVE AN ACTIVE EXAMINING COMMITTEE. IS COMPLETE AND SATISFACTORY REPORT ON FILE?

17. GIVE DATE OF LAST COMMITTEE EXAMINATION. DO MINUTES RECORD REPORT? ARE ACTIVE OFFICERS ONLY ON THE COMMITTEE?

Every bank should be examined at least once a year by its own Board of Directors. In many banks this job is done very thoroughly. Others make a partial examination. Some banks want to do it but don't know how to go about it; while a few never give it a thought.

In the first group are the larger institutions who have their own auditing departments working independently of the operating staff and reporting directly to the Board through the Executive Committee. As a matter of fact, such banks are under constant internal examination. Other banks in this group have an annual audit by Certified Public Accountants. Such audits are ordered by the Board and the reports are made directly to them.

A number of Boards appoint an Examining Committee which, on an unannounced date, enters the bank just like a crew of examiners and make a full balance sheet examination; others make a partial or "spot check" examination.

In such an undertaking as in any other, the results are commensurate with the skill and effort applied. However, the fact that a bank cannot afford internal or external audits annually and the Board does not feel competent to make a full balance sheet examination should not discourage all effort along that line. Some good is bound to come from any attempt made in this direction by the Board; for in the handling of assets and the examination of accounts they acquire a familiarity with their assets and operations that cannot be so thoroughly gained in any other manner.

In our opening article in this series dealing with the examination report, we characterized bank supervision from within as the most effective. The same might be said with reference to bank examination. Give to a directors' examining committee the same degree of technical skill and specialized experience as a bank examiner and they would come as close to a perfect examination of their own bank as it would be possible to achieve.

18. ARE PURCHASES AND SALES OF BONDS AUTHORIZED BY DIRECTORS BEFORE PURCHASE AND IN WHAT MANNER?

In an earlier article, we discussed the difference between the directors' authorization of a loan before making and their approval afterward. This difference becomes more important in handling the bond account; for ordinarily a purchase or sale of bonds will involve an amount far in excess of the average loan transaction. Unless a bond account is subject to very active trading, there should be an opportunity for the Board, or an appropriate committee, to review and authorize all changes in the bond account with the exception of an occasional emergency sale.

19. HOW OFTEN ARE DEMAND LOANS SUBMITTED TO DIRECTORS?

Reference is made to an earlier discussion of demand loans in our Bulletin of February, 1937. A list of all demand loans should be submitted to each monthly directors' meeting. This list should show the date of the loan and date of last interest payment.

20. DO THE DIRECTORS OR EXAMINING COMMITTEE APPROVE EXPENSE ACCOUNT PERIODICALLY, AND IF SO, HOW FREQUENTLY?

21. DO THE MINUTES RECORD SUCH ACTION?

This important account is certainly not a difficult one to examine and if expenditures are properly recorded, there should be no trouble in furnishing the Board with a classified report of expenses at each monthly meeting and the minutes should record the directors' examination and comment.

22. ARE REPORTS TO THE CHAIRMAN ON FILE OF LOANS TO EXECUTIVE OFFICERS BY OTHER BANKS? IF SO, LIST.

A Board of Directors or at least its Executive Committee, is entitled to know and should know the financial position of the bank's executive officers. The availability of such officers is measured not only by their skill, training, efficiency and experience but by the soundness and independence of their judgment. The ordinary, reasonable and current obligations of the executive officers of banks are of no concern to either the Board of Directors or this Department; but when such involvements exceed reasonable bounds and begin to embarrass and worry the individual, the Board would do well to start watching the effect of the situation upon his efficiency and judgment. This question is well founded in experience.

23. ARE THE BY-LAWS ADEQUATE? ARE THE PROVISIONS REGULARLY OBERVED BY THE OFFICERS AND DIRECTORS?

The by-laws of a bank should guide, control and regulate every phase of the bank's operation. They are legally binding upon directors, officers and employees in all provisions not superseded by statutory law. It is surprising to note, sometimes, what little concern directors and officers will show when flagrant violations of their bank's by-laws are pointed out to them. For instance; the by-laws may provide for the appointment of a committee to perform certain duties and the Board neglects and fails to appoint the committee. As a result of that failure and the non-performance of the designated duties, the bank might suffer a loss. It is quite possible that in such a situation the Board members might be held personally accountable. Or; the by-laws might provide for certain details of procedure in connection with the calling and holding of stockholders' meetings or in balloting on directors. The disregarding of even minor provisions of this character can result in serious legal consequences.

One has only to observe a judge on the bench or a good corporation lawyer deliberating a bank problem to realize the importance of the by-laws. Both will invariably consult first, the statutory law and secondly, the by-laws of the bank under consideration.

This Department has, in pamphlet form, a model set of by-laws which we shall be very glad to send to any Illinois State bank officer or director requesting one.

CONVERSION

Chicago.....Cook.....Mercantile Trust and Savings Bank of Chicago into Mercantile National Bank of Chicago..... July 1, 1939 ✓
 Fairbury.....Livingston.....Farmers State Bank of Fairbury into Farmers National Bank of Fairbury..... July 1, 1939 ✓

TRUST CERTIFICATE CANCELLED

Chicago.....Cook.....Mercantile Trust and Savings Bank of Chicago..... July 1, 1939 ✓

TRUST CERTIFICATE ISSUED

Chicago.....Cook.....Mercantile National Bank of Chicago..... Deposit \$500,000. July 1, 1939 ✓

DISSOLVED

✓ Lawrenceville..Lawrence.....Citizens Banking Company of Lawrenceville (In liquidation September 19, 1931. Dissolved by order of the Circuit Court of Lawrence County)..... July 1, 1939 ✓
 ✓ Wing.....Livingston.....The Farmers State Bank of Wing (In liquidation May 20, 1933)..... July 11, 1939 ✓
 ✓ Aledo.....Mercer.....Mercer County State Bank (In liquidation December 7, 1925. Dissolved by order of the Circuit Court of Mercer County)..... July 18, 1939 ✓
 ✓ Media.....Henderson.....Media State Bank (In receivership January 16, 1932. Dissolved by order of the Circuit Court of Henderson County)..... July 18, 1939 ✓
 ✓ Stronghurst.....Henderson.....State Bank of Stronghurst (In receivership December 12, 1932. Dissolved by order of the Circuit Court of Henderson County)..... July 18, 1939 ✓
 ✓ Versailles.....Brown.....Versailles State Bank (In liquidation September 22, 1936)..... July 25, 1939 ✓

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	28	1	29
State Banks in Cook County.....	28	---	28
State Banks in Illinois outside Cook County.....	476	---	476
Total.....	532	1	533

MONTHLY BULLETIN

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

Vol. 15

SPRINGFIELD, ILL., SEPTEMBER 1, 1939

No. 6

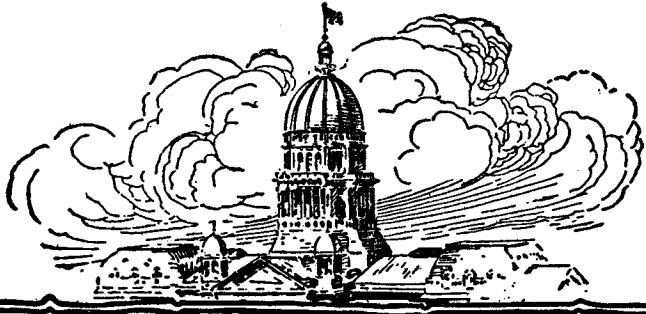
EXAMINATION REPORT—QUESTIONNAIRE CORPORATE RECORDS—(Continued)

24. WAS COPY OF REPORT OF LAST EXAMINATION BY STATE EXAMINER CONSIDERED BY DIRECTORS AND NOTED ON MINUTES?
25. ARE IMPORTANT LETTERS FROM THIS DEPARTMENT AND REPLIES THERETO NOTED IN THE MINUTES?

The minutes of a corporation should contain a record of all proceedings, events and transactions that in any way affect its existence. The examination of a State bank by this Department is essentially a test of the bank's qualifications to continue in the use of the powers granted to it through its charter by the State of Illinois.

Our examination is therefore an event of importance to the bank and its occurrence should be recorded in the bank's minutes. Likewise, when the report containing the results of the examination is received from this Department, the event should be noted upon the minutes.

The letter that usually accompanies the report is an official communication from the Auditor of Public Accounts to the officers and directors and as such, should certainly be entered upon the corporate minutes.



This letter may include analytical observations, suggestions and formal requests for correction and adjustment, all resulting from the examination. Formal requests particularly are apt to have a bearing upon the legal status of the bank and the complying corrections and adjustments should be shown upon the bank's corporate record.

In court a corporation can only speak through its records. Bank managements therefore should see to it that their corporate minutes clearly and accurately record not only their own proceedings but such external events as affect or govern their actions.

We have one further and general observation concerning bank minutes which we inject here in the absence of a specific question and that is as to completeness and accuracy.

After all, the Secretary of the Board is essentially a reporter. If he is a good one, he will carefully and promptly take note of each movement of the meeting and from his notes, write a clear and accurate account of everything that took place. A less careful Secretary writing minutes largely from memory and impressions is very apt to produce a sketchy and inaccurate report.

For this reason, corporate minutes are not considered fully authentic until some competent person, usually the presiding officer, who was present at the meeting, attests over his signature as to their correctness.

Minutes should be written and attested as soon as possible after the meeting.

26. WAS FACE OF LAST REPORT OF CONDITION CORRECT? IF NOT, LIST ERRORS AND GIVE DATE OF REPORT.
27. WERE ANY OF THE SCHEDULES OF REPORT INCORRECT?
28. IF SO, DID YOU REQUIRE BANK TO SEND TO THIS DEPARTMENT A LETTER, UNDER OATH, TO SERVE AS CORRECTION THEREOF?

The filing with this Department and publication of the quarterly reports of condition is one of the vital requirements imposed upon Illinois State banks by our Banking Act. A bank failing or refusing to file and publish a quarterly report of condition, when called for by the Auditor of Public Accounts, would forfeit all of its charter rights and powers and could not continue in business if it persisted in such failure or refusal. The law also requires that it be verified by the oath of the President or Cashier. No one other than these two officers, who are presumed to be in the best position to know the condition of the bank, are permitted to file this report.

It is the implied duty of the Auditor of Public Accounts to examine this report, as well as its published counterpart, and if he finds either to contain error it becomes his duty to take appropriate action. Should he find the report false and deceptive of the true condition of the bank, he is obliged to see that a correct report is filed and published and if such false and deceptive publication is an act of perjury as defined under Section 4, he is bound to see that appropriate action is taken against the offender. Should he find call reports containing unintentional minor errors (as they almost invariably are) it seems quite reasonable that the bank be given an opportunity to correct such inaccuracies through refiling and republication. But in any event, the Auditor of Public Accounts cannot accept and file a call report and published counterpart that contains a detectable error; for such a document would not comply with the intent of the law.

Not only are the call and published reports carefully checked immediately upon their receipt in our Springfield office but at each examination the examiner checks each report with the records of the bank. Should he find error of sufficient consequence to result in a deceptive publication of condi-

tion, it would be his duty to report the matter for correction by refiling and publication. Errors in schedules supporting condition figures on the face of the report are usually corrected by affidavit.

All of the foregoing is to stress the importance of the filed and published report of condition and the necessity for meticulous accuracy in compiling it. A little extra care in its preparation can save a great deal of annoyance and possibly expense where republication becomes necessary. At this point, we would urge that publication never be permitted until a printer's proof has been carefully checked.

TRANSCRIPTS

Very frequently in reading our examination report, transcripts of certain accounts will be found. The form employed for this purpose is a sheet containing only debit and credit figure columns on the right hand side. This form enables the examiner to show in detail or summary all of the transactions in certain important accounts between examinations.

The examiner will transcribe an account into his report when it contains important transactions or shows certain trends that do or may affect the condition of the bank.

The transcript of an asset account such as Real Estate Loans, Other Real Estate or Other Real Estate Investments will show in the debit or left hand column the bank's total investment in the account on the date of the previous examination and in the same column, will show the additions to the account up to the present examination. In the right hand column will be shown the withdrawals from the account during the same period and the last entry will be the balance in the account on date of examination.

The transcript of a liability account such as any Reserve account, Bills Payable, Accounts Payable, etc., will show in the credit or right hand column the total liability on the date of previous examination and all additional liabilities incurred through that account up to the present examination. In the debit or left hand column will appear the liabilities paid and the balance due on date of present examination.

For example, let us say that a bank is working out a heavy involvement in troublesome real estate loans; which has resulted in such accounts as Other Real Estate and Other Real Estate Investments or Real Estate Sold on Contract. Under such circumstances, three or four transcripts are likely to appear in the examination report. The first is almost sure to be a summarized transcript of the Real Estate Loan account wherein will be shown the balance in the account at previous examination, a summary of new loans made, participations in existing split loans purchased, loans purchased from customers and other additional debits or investments in that account; while on the other side or credit column, will be a summary of loans wholly paid, partial or prepayments received, transfers to the Other Real Estate account through acquisition of title or to Real Estate Investments account through receipt of reorganization paper and the closing balance on date of examination. This gives a concise and valuable picture of what is going on in the Real Estate Loan account.

The next will be the Other Real Estate account showing acquisitions, costs, improvements, sales for cash, sales on contract, etc., to show briefly, but clearly, how the bank is getting along with its real estate holdings.

Then will come transcripts of Other Real Estate Investments or Real Estate Sold on Contract to show what is being accomplished toward finally getting rid of these matters.

The transcripts should be carefully studied and thoroughly understood for when they appear, they are almost sure to tell a very interesting story.

CONVERSION

/ Kewanee.....Henry.....Peoples State Savings Bank of Kewanee into Peoples National Bank of Kewanee.....July 1, 1939

IN LIQUIDATION

/ Rardin.....Coles.....Rardin State Bank through The Charleston National Bank, Charleston, Illinois.....Aug. 30, 1939

DISSOLVED

Chicago.....Cook.....Safety State Bank.....July 18, 1939
/ Rinard.....Wayne.....Rinard Banking Company.....July 27, 1939
✓ Casey.....Clark.....Eagle State Bank (In receivership January 2, 1932. Dissolved by order of the Circuit Court of Clark County).....Aug. 8, 1939

RECAPITULATION

State Banks in Chicago.....	28
State Banks in Cook County outside Chicago.....	28
State Banks in Illinois outside Cook County.....	473
Total.....	529

*Foreign Exchange License # 21
issued to F. W. Heinichen expired 9/7/39.
New etf. issued 11/30/39 - # 24*

MONTHLY BULLETIN

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

Vol. 15

SPRINGFIELD, ILL., OCTOBER 1, 1939

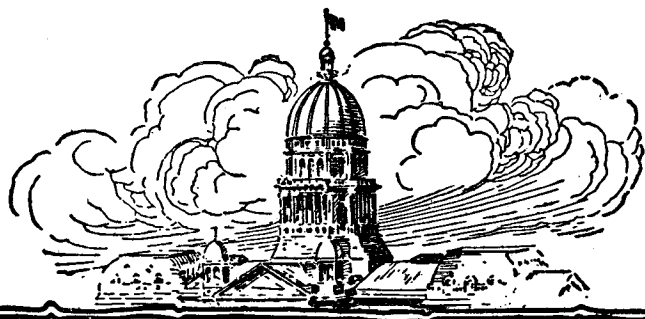
No. 7

LOOKING BACK

The September issue of this Bulletin contained the concluding article of a series reviewing the bank examination report form now used by this Department. It is a coincidence that the first article of the series appeared in the September issue of 1936; so we have devoted exactly three years of our bulletin space almost exclusively to this subject. Whatever the success of our efforts to thoroughly familiarize our State bank managements with every phase and feature of their examination report, it can never be said that we didn't try.

Joking aside, the results have been very gratifying to this Department. Evidence has been constantly drifting in throughout the series that it has "gone over"; that it has been widely read and understood by the people it was directed to and written for—the officers and directors of the State banks in Illinois. But of infinitely more importance than an appreciative reception of our efforts along this line is the steadily accumulating evidence that the examination report itself is being more thoroughly read and understood; and that, of course, was the real objective.

During the period of this series we have had frequent requests for certain issues; apparently to replace lost copies and complete a file. There have also been many requests for complete files for binding. A number of persons have inquired if we have the series complete in pamphlet form; and that gives



us an idea. From all of this inquiry, it is apparent that many of our State bank officers and directors want the entire series in bound form for reference purposes; so we are going to supply it in that form. Just give us a little time to edit this series into book form and we shall supply every State bank officer and director with a copy.

Getting back again to the real objective of the examination report series of bulletins, to use a modern catch phrase, we are trying to "sell our examination report" to bank managements as a medium through which they can gain a more comprehensive knowledge of the condition of their banks. Bank directors particularly, who have only a few hours, at most, in a week or a month to devote to the affairs of their banks cannot hope to attain the same familiarity with all of the details of the bank's operation and condition as the managing officers. But they must, of necessity, have a good general knowledge of both the bank's condition and operating results if they are going to make any respectable attempt at all to fulfill their sworn duty; and they should make it their business to have a particular and intimate knowledge of the weak spots in their condition.

We know of no place where that knowledge can be gained more quickly or in more orderly and concise form than an examination report; for the examiner in his routine of examining, appraising, analyzing and studying of assets and operation is sifting out the very things that the directors want most to know—the weak spots. If there are weak spots in the condition of a bank, the board of directors should be eager to know what and where they are and when they are pointed out in the report and stressed in the letter of comment, they should be studied carefully, noted, remembered and followed up.

We know from experience that, very frequently, after seeing such things, directors have passed them over or made light of or defended them for fear that serious inquiry into them might offend one or more of the managing officers. Such an attitude is not only weak and futile but can very often be dangerous. It should be remembered that weak spots are not necessarily matters of criticism of the managing officers. They may have developed from causes or circumstances entirely beyond the officers' control. Or the board itself might be to blame. Such matters do not have to be approached critically. The constructive approach in getting at trouble spots is one of honest inquiry. When an asset, group of assets or any other phase of the bank's condition begins to look troublesome, all of the facts pertaining to the subject should be assembled. They should be studied carefully by all of the directors and a plan or program formulated for the elimination of the bad spot. In the course of such inquiries, causes, reasons and faults will come to the surface to be dealt with in a suitable manner. But in nearly all cases, this can be done without rancor or bad feeling. The first objective is to learn the truth and the second is to eliminate the trouble and while these two purposes are being accomplished, criticism will usually take care of itself.

We have said this before but it will bear repetition here that directors, in reading our reports, should never allow themselves to jump to the conclusion that the examiner is wrong; that being a stranger, he cannot know the situation as well as the local management. No matter what he says or how mistaken he may appear to be, the safe thing to do is to carefully examine the facts that he examined and all of the additional information that may be available before taking a position. The safest thing to do is to prove him wrong; but it is dangerous to assume that he is.

We have, in the past known bank managements who gave no more thought and attention to their examination reports than was absolutely necessary to meet our corrective requirements. This number has happily decreased to the vanishing point. On the other hand, we always can take great satisfaction in contemplating a pleasant contrast. It is furnished by one of the largest banks in the country, an institution systematized to perfection and operated by as highly a trained organization as can be found anywhere. Its auditing department is constantly combing through the details of operation, going far deeper than any staff of examiners could ever hope to reach. And yet, when the examiners enter this bank for periodical examinations, the President himself makes it a matter of personal concern to see that the work of the examiners is facilitated in every way possible. Through his attitude and instructions, the operating personnel know that any book, record or file called for by the examiner is to be made available to him immediately.

When the examiner's report reaches the bank it is not only carefully studied in all of its details but important parts are photostated for the use of department heads; and that report remains as a live document and unfinished business until every exception or item criticized by the examiner has been corrected or satisfactorily clarified.

As we look back over the years, even the last half dozen, it is gratifying to realize how closely the examination report has brought this Department and the banks under its examination together into a mutual understanding of how our contacts may be applied constructively and beneficially for both.

SPOOKS

Every once in a while bankers allow themselves to become frightened, either by themselves or others, with the spectre of regimentation. Such gruesome catch phrases as supervisory dictation of policies and standardization of operation and similar bogeymen usually accompany such predictions. One would naturally expect these fearsome "hants" to associate on pretty friendly terms with bank supervisors and examiners.

At a recent convention of the National Association of State Bank Supervisors, forty-five States were represented. At the formal sessions, through technical papers, speeches and round-table discussions, the supervisors placed themselves under pretty constant and critical examination. In between sessions, delegates gathered in pairs or small groups in the Convention quarters or in the hotel lobby and, amid clouds of tobacco smoke, talked shop enthusiastically, exactly as delegates have done ever since conventions were invented.

An eavesdropper on this shop talk would have gathered that the bankers of the United States have their situation very well in hand and are doing a firstclass job of the banking business; that the genius of the banking phase of American business is alert in meeting and solving problems, discovering wider ranges of community service and new ways of garnering profits.

He would have learned that the bank supervisors' and examiners' most absorbing interest was in their own problems, in improving their own technique and in advancing to a higher degree of exactness the science of bank examination. An eavesdropper could not possibly have escaped the conclusion that the bankers will continue to run the banks and the supervisors will continue to examine, each doing the best he can in his own proper sphere.

PERMIT ISSUED

	Capital.	Surplus.	Reserve.
Salem.....Marion.....Salem Bank & Trust Company.....	\$100,000.00	\$20,000.00	\$5,000.00

Sept. 14, 1939

CLOSED

✓ O'Fallon.....St. Clair.....First State Bank of O'Fallon.....Sept. 19, 1939

DISSOLVED

✓ Warren.....Jo Daviess.....State Bank of Warren (In receivership August 25, 1930. Dissolved by order of the Circuit Court of Jo Daviess County).....Aug. 21, 1939 ✓
 ✓ Glen Ellyn.....Du Page.....Glen Ellyn State Bank (In receivership August 16, 1932. Dissolved by order of the Circuit Court of Du Page County).....Aug. 25, 1939 ✓
 ✓ Cicero.....Cook.....Mid-West State Bank (In receivership July 22, 1931. Dissolved by order of the Circuit Court of Cook County).....Sept. 6, 1939 ✓
 ✓ Sullivan.....Moultrie.....Merchants and Farmers State Bank (In receivership January 16, 1932. Dissolved by order of the Circuit Court of Moultrie County).....Sept. 7, 1939 ✓
 ✓ Chicago.....Cook.....Hegewisch State Bank (In receivership October 28, 1931. Dissolved by order of the Circuit Court of Cook County).....Sept. 8, 1939 ✓
 ✓ Chana.....Ogle.....Chana Banking Company (In receivership April 13, 1932. Dissolved by order of the Circuit Court of Ogle County).....Sept. 9, 1939 ✓
 ✓ Nilwood.....Macoupin.....The Nilwood State Bank (In receivership July 26, 1933. Dissolved by order of the Circuit Court of Macoupin County).....Sept. 15, 1939 ✓
 ✓ Irwin.....Kankakee.....Irwin State Bank (In liquidation May 5, 1924. Dissolved by order of the Circuit Court of Iroquois County).....Sept. 20, 1939 ✓
 ✓ Clifton.....Iroquois.....Farmers State Bank of Clifton (In receivership August 15, 1933. Dissolved by order of the Circuit Court of Iroquois County).....Sept. 21, 1939 ✓
 ✓ Stockton.....Jo Daviess.....State Bank of Stockton (In receivership September 25, 1928. Dissolved by order of the Circuit Court of Jo Daviess County).....Sept. 22, 1939 ✓

RECAPITULATION

State Banks in Chicago.....	28
State Banks in Cook County outside Chicago.....	28
State Banks in Illinois outside Cook County.....	472
Total.....	528

MONTHLY BULLETIN

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

Vol. 15

SPRINGFIELD, ILL., NOVEMBER 1, 1939

No. 8

STATISTICS

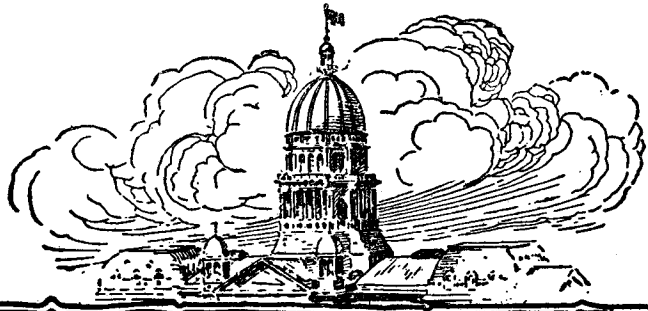
In going back through our Bulletin files over a period of several years, we find that we have not been very generous to the devotees of statistics.

The difficulties of putting out statistical data was well illustrated by a famous statistician who compared his contemporaries with gourmets and their salads pointing out that a group of epicures using the same ingredients would invariably produce a wide variety of appetizing results.

We are not going to attempt to serve conclusions but on the next page will be found a heaping dish of ingredients for the statisticians to mix up to suit their own individual tastes. In our tabulation, we have set down the composite figures taken from the Call Reports filed by all State banks in Illinois covering a period of one year, beginning September 28, 1938, and ending October 2, 1939. The arrangement of figures seems to us to be simple and self-explanatory.

One change that should be explained is a decrease in Capital of \$4,576,000.00 during the period. During this time, twenty-six banks with a total Capital of \$4,596,000.00 and Surplus of \$947,100.00 discontinued filing Call Reports. Fifteen of these, with an aggregate Capital of \$3,146,000.00 and Surplus of \$82,100.00, went into voluntary liquidation; one of which, capitalized at \$2,500,000.00, had disposed of its deposits about seven years ago. Ten banks with a Capital of \$1,425,000.00 and Surplus of \$860,000.00 converted into National Banking Associations, while one, with a Capital of \$25,000.00 and a Surplus of \$5,000.00, was closed and placed in the hands of a Receiver.

One particular point of satisfaction to this Department is in noting the steady and substantial decrease reflected in fixed assets which, during the period, were reduced \$727,243.94.



**REVIEW OF CALL REPORTS
COVERING ALL ILLINOIS STATE BANKS**

NUMBER OF BANKS.....	553	Increase or Decrease	548	Increase or Decrease	540	Increase or Decrease	534	Increase or Decrease	527
DATE OF CALL.....	Sept. 28, 1938		Dec. 31, 1938		Mar. 29, 1939		June 30, 1939		Oct. 2, 1939
RESOURCES:									
Cash and Due from Banks.....	\$408,932,429.83	\$+20,753,868.67	\$429,686,298.50	\$-30,674,202.06	\$399,012,096.44	\$+20,726,857.43	\$428,738,953.87	\$+74,848,024.35	\$503,586,978.22
Outside Checks and Other Cash Items.....	11,188,361.89	+3,080,337.71	14,274,699.60	-3,291,594.24	10,983,105.36	+3,315,169.70	14,298,275.06	-5,205,653.19	9,092,621.87
U. S. Governments—Direct and Guaranteed.....	299,623,149.69	+5,107,941.51	304,731,091.20	-15,837,473.97	288,793,617.23	+11,479,826.08	300,273,443.91	-8,750,648.98	291,522,799.93
Other Bonds, Stocks and Securities.....	249,272,731.50	+5,301,538.36	254,574,269.86	+4,979,556.67	259,553,826.53	+10,659,910.17	276,213,436.70	-19,897,432.59	256,316,004.11
Loans and Discounts.....	258,610,529.92	+5,919,101.31	264,529,631.23	+12,271,732.22	276,801,363.45	+4,587,986.74	281,389,350.19	-2,457,745.33	278,931,604.86
Overdrafts.....	114,547.71	-61,759.46	52,788.25	-37,919.55	90,708.11	-31,729.20	58,978.91	+33,215.90	92,194.87
Banking House.....	12,260,501.99	-116,249.45	12,144,252.54	-222,926.40	11,921,326.14	-61,772.40	11,859,553.74	-41,864.04	11,817,689.70
Furniture and Fixtures.....	1,980,701.91	-202,416.73	1,778,285.18	-54,038.01	1,724,247.17	-23,866.94	1,700,380.23	-4,109.97	1,696,270.26
TOTAL—Banking House, Furniture and Fixtures.....	\$14,241,203.90	\$-318,666.18	\$13,922,537.72	\$-276,964.41	\$13,645,573.31	\$-85,639.34	\$13,559,933.97	\$-45,974.01	\$13,513,959.96
Other Real Estate.....	\$8,383,579.40	\$-886,928.44	\$7,496,650.96	\$-397,563.76	\$7,099,087.20	\$-758,962.37	\$6,340,124.83	\$-437,461.76	\$5,902,663.07
Customers' Liability—Letters of Credit.....	739,561.84	-189,063.09	550,498.75	+163,804.06	714,302.81	+82,647.60	796,950.41	+45,206.91	842,157.32
Customers' Liability—Acceptances.....	67,961.28	+50,131.28	118,092.56	-15,777.10	102,315.46	+14,497.29	116,812.75	-14,005.84	102,806.91
Other Resources.....	8,048,704.58	-267,880.84	7,780,823.74	-147,553.27	7,633,270.47	+923,590.95	8,556,861.42	-2,248,098.47	6,308,762.95
GRAND TOTAL RESOURCES.....	\$1,259,222,761.54	\$+38,494,620.83	\$1,297,717,382.37	\$-33,288,116.00	\$1,264,429,266.37	\$+65,913,855.65	\$1,330,343,122.02	\$+35,869,432.05	\$1,366,212,554.07
LIABILITIES:									
Deposits									
Demand Deposits.....	\$652,033,602.79	\$+24,450,904.25	\$676,484,507.04	\$-57,757,414.13	\$618,727,092.91	\$+72,522,023.79	\$691,249,110.70	\$+26,064,687.37	\$717,313,804.07
Time Deposits.....	379,440,203.58	+13,088,624.14	392,528,827.72	+1,769,798.38	394,296,626.10	+6,758,150.30	401,054,776.40	-4,541,105.05	396,513,671.35
Due to Banks.....	98,818,554.46	+2,231,582.57	101,050,137.03	+20,807,691.41	121,857,828.44	-13,602,620.63	108,255,207.91	+17,587,762.41	125,842,970.32
Deposits Secured by Pledge.....	\$ 34,021,599.66	\$ +4,901,378.73	\$ 38,922,978.30	\$ +8,788,091.19	\$ 47,711,069.58	\$ -8,753,213.01	\$ 38,957,856.57	\$ +2,300,283.55	\$ 41,258,140.12
Deposits not Secured by Pledge.....	1,096,270,761.17	+34,867,732.23	1,131,138,495.2	-4,015.53	1,087,170,477.87	+74,430,766.57	1,161,801,244.44	+36,811,061.18	1,198,412,305.62
TOTAL DEPOSITS.....	\$1,130,292,360.83	\$+39,769,110.96	\$1,170,061,471.79	\$-35,179,924.34	\$1,134,881,547.45	\$+65,677,553.66	\$1,200,559,101.01	\$+39,111,344.73	\$1,239,670,445.74
Other Liabilities									
Bills Payable.....	\$ 1,642,902.36	\$ -674,379.29	\$ 968,523.07	\$ -52,752.60	\$ 915,770.47	\$ -22,406.16	\$ 893,364.31	\$ -24,327.24	\$ 869,037.07
Re-Discounts.....	63,989.37	+321,702.03	385,691.40	-364,815.06	20,876.34	+256,545.35	277,421.69	-135,898.67	141,523.02
Dividends Unpaid.....	741,186.84	-197,088.09	544,098.75	+173,579.06	717,677.81	+80,577.10	798,254.91	+35,366.04	833,629.95
Letters of Credit.....	160,538.25	+33,688.63	194,226.88	-35,957.90	158,268.98	+43,725.78	201,994.76	-37,786.80	164,207.96
Bank Acceptances.....	4,059,554.90	-266,611.34	3,792,943.56	+675,349.36	4,468,292.92	+362,206.58	4,830,499.50	-2,054,404.19	2,776,093.31
Other Liabilities.....									
TOTAL OTHER LIABILITIES.....	\$ 1,642,902.36	\$ -674,379.29	\$ 968,523.07	\$ -52,752.60	\$ 915,770.47	\$ -22,406.16	\$ 893,364.31	\$ -24,327.24	\$ 869,037.07
Capital Structure									
Capital Stock.....	51,121,550.00	-2,630,000.00	48,491,550.00	-550,000.00	47,941,550.00	-465,000.00	47,476,550.00	-931,000.00	46,545,550.00
Income Debentures.....	4,422,050.00	-23,100.00	4,398,950.00	-326,050.00	4,068,900.00	-9,386.84	4,059,513.60	-165,115.59	3,894,398.13
Surplus.....	27,854,794.33	+1,050,354.32	28,905,148.65	+5,322.59	28,913,471.24	-7,914.60	28,905,556.64	-635,059.57	28,270,497.07
Undivided Profits (Net).....	18,819,000.19	+299,777.77	19,118,777.96	+1,253,552.51	20,372,330.47	-328,226.50	20,044,103.97	+1,403,256.62	21,447,360.59
Reserve Accounts.....	20,043,854.47	+816,145.84	20,860,000.31	+1,110,580.38	21,970,580.69	+326,180.88	22,296,761.57	-696,943.34	21,599,818.23
TOTAL CAPITAL STRUCTURE.....	\$122,262,248.99	\$-491,822.07	\$121,770,426.92	\$+1,496,405.48	\$123,266,832.40	\$-484,346.56	\$122,782,485.84	\$-1,024,861.82	\$121,757,624.02
GRAND TOTAL LIABILITIES.....	\$1,259,222,761.54	\$+38,494,620.83	\$1,297,717,382.37	\$-33,288,116.00	\$1,264,429,266.37	\$+65,913,855.65	\$1,330,343,122.02	\$+35,869,432.05	\$1,366,212,554.07
ANALYSIS—LOANS AND DISCOUNTS									
Commercial Paper.....	\$ 22,818,290.63	\$-2,318,839.09	\$ 20,501,451.54	\$ +2,886,165.40	\$ 23,387,616.94	\$-2,174,499.19	\$ 21,163,117.75	\$+2,470,043.82	\$ 23,633,761.57
Collateral Loans.....	56,249,856.49	+2,341,540.36	58,591,396.85	-509,526.96	58,081,869.89	+1,297,787.32	59,349,654.21	-1,991,498.16	57,358,166.05
Other Loans.....	131,344,246.34	+4,339,002.84	135,683,249.18	+10,133,716.62	145,816,965.80	+2,433,332.63	148,290,298.43	-6,602,223.74	141,688,074.69
Farm Loans.....	14,109,390.77	+1,083,270.01	15,192,660.78	-1,247,604.88	13,945,055.90	-223,942.57	13,621,113.33	+228,355.29	13,849,468.62
Other Real Estate Loans.....	34,088,745.69	+472,127.19	34,560,872.88	+7,985.04	35,719,857.92	+3,255,308.55	38,975,166.47	+3,436,947.46	42,412,113.93
TOTAL LOANS AND DISCOUNTS.....	\$258,610,529.92	\$+5,919,101.31	\$264,529,631.23	\$+12,271,732.22	\$276,801,363.45	\$+4,587,986.74	\$281,389,350.19	\$-2,457,745.33	\$278,931,604.86

IN LIQUIDATION

✓ Chicago.....Cook.....West Thirty-First State Bank.....Aug. 30, 1939

RECEIVER APPOINTED

✓ O'Fallon.....St. Clair.....First State Bank of O'Fallon—Charles H. Albers.....Oct. 7, 1939

CAPITAL STOCK DECREASED

✓ Cerro Gordo.....Piatt.....State Bank of Cerro Gordo from \$60,000 to \$50,000.....Oct. 30, 1939

CHANGE OF PAR VALUE OF CAPITAL STOCK

✓ Cerro Gordo.....Piatt.....State Bank of Cerro Gordo from \$100 to \$83.33½.....Oct. 30, 1939

DISSOLVED

✓ Scottville.....Macoupin.....First State Bank of Scottville (In liquidation August 4, 1930. Dissolved by order of the Circuit Court of Macoupin County).....July 20, 1939⁹
 ✓ Edgewood.....Effingham.....State Bank of Edgewood (In liquidation November 28, 1932).....Sept. 7, 1939
 ✓ Mansfield.....Piatt.....The State Bank of Mansfield (In liquidation December 30, 1927).....Oct. 4, 1939
 ✓ Woodland.....Iroquois.....The Woodland State Bank (In receivership February 24, 1932. Dissolved by order of the Circuit Court of Iroquois County).....Oct. 7, 1939
 ✓ Hutsonville.....Crawford.....Newlin State Bank (In receivership January 23, 1932. Dissolved by order of the Circuit Court of Crawford County).....Oct. 17, 1939
 ✓ Apple River.....Jo Daviess.....Bank of Apple River (In receivership March 8, 1932. Dissolved by order of the Circuit Court of Jo Daviess County).....Oct. 24, 1939
 ✓ Apple River.....Jo Daviess.....First State Bank of Apple River (In receivership October 10, 1931. Dissolved by order of the Circuit Court of Jo Daviess County).....Oct. 24, 1939
 ✓ Pulaski.....Pulaski.....Citizens State Bank of Pulaski (In receivership February 17, 1934. Dissolved by order of the Circuit Court of Pulaski County).....Oct. 24, 1939

RECAPITULATION

State Banks in Chicago.....	27
State Banks in Cook County outside Chicago.....	28
State Banks in Illinois outside Cook County.....	472
Total.....	527

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MONTHLY BULLETIN

Issued by
EDWARD J. BARRETT
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BANKING DEPARTMENT
State of Illinois

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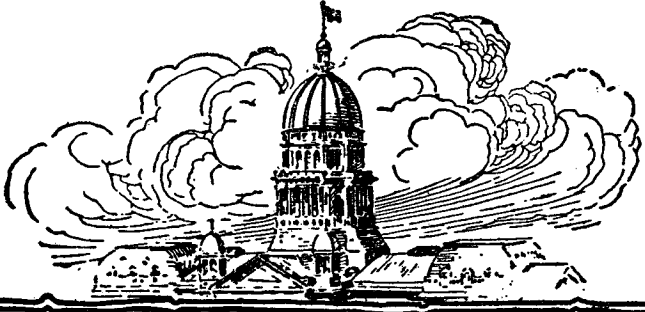
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TRAPS

During the course of a year this Department has an opportunity to observe at close range a large amount of money lending. Our examiners in their routine of bank examinations review an immense amount of loans from which much valuable data is gathered for later study and analysis in this office. In addition to this, we are in a position to scrutinize all losses in detail as well as the circumstances leading up to them. As a result of this analytical and review work, we are able to recognize certain traps and pitfalls that bankers are apt to stumble into when they relax the rigid scrutiny that should precede the making of bank loans.

Strangely enough, our studies along this line in recent years reveal more mistakes in the making of secured loans than in unsecured loans. During the past four or five years, losses on unsecured paper have been reduced to a very low figure. This, in our opinion, is the result of an increased vigilance in examining applications for unsecured loans and the negotiation of such loans on terms that reduce the hazards of loss to a minimum. In other words, the risks of unsecured paper are being borne constantly in mind and carefully guarded against.

It is in dealing with the so-called secured paper that bankers allow themselves to be occasionally trapped and



particularly in that type of loan which we shall call, for the want of a better name, "the value loan". In taking on this type of loan the loaning officer occasionally allows himself to become so thoroughly sold on the value of the collateral that he is willing to disregard all of the other elementary requirements of a good loan, such as financial worth of maker, moral risk and paying ability. We have, at times, encountered large loans of this type where these important factors were, in some instances, unknown and in others unfavorably known and yet, we have been assured that such loans could stand indefinitely as a thoroughly sound and secure investment. Frequently they are. This type of loan cannot be categorically condemned. The point that we desire to make is that the mere appearance of adequate collateral security should not cause the officers or directors to relax, even to the slightest degree, from the full inquiry into all phases of the loan that they exercise in respect of all other loans.

For instance, a borrower approaches a loan officer with a request for a loan of \$5,000.00 and offers, as security, his own note secured by a mortgage on a parcel of real estate. The banker is familiar with the property in a casual way and quickly calculates it is worth at least \$15,000.00. The borrower is willing to pay six or seven per cent interest which makes the loan a very tempting proposition. It matters not that the borrower may be of questionable worth, moral character or paying ability for the loan is secured at least three for one and the return is generous. That loan simply cannot be allowed to get away and after a brief title examination, the loan is made with the knowledge that the Board of Directors or the Loan Committee will never turn down one like that. The history of the loan then becomes a monotonous series of extensions with prompt payments of interest and may run along for three, four or five years. During that time the borrower is collecting the income from the property and at each maturity, the banker receives his interest, mentally recalls that three for one security and renews the note. The showdown comes when the Board of Directors or the bank examiner begin to insist upon a demonstration of the collectibility of the note. Payment is demanded and the borrower demurs, pleading the disadvantage of a forced sale. After a couple of more renewals, the bank decides to move in and the disgruntled borrower refuses to co-operate, forcing the bank to take legal steps to obtain title to the collateral. Then follows foreclosure, the redemption period, and finally the bank acquires title.

During the period when the assurance of three for one security obliterated all other questions, it was never deemed necessary to make a tax search and to carefully examine the condition of the property; but immediately upon the acquisition of title, the theoretical three to one

vanishes into the realm of theory and accumulated taxes and depreciation come into being as stern realities that have to be dealt with. So by the time the property is in condition for sale, the bank is very apt to have an additional investment of two or three thousand dollars. After that, recovery may be hampered by such further hazards as neighborhood deterioration and unfavorable business conditions. These impediments may result in the bank having to carry the property for several years longer, at the end of which time they might receive an offer of \$5,000.00; and so the loan that started out with such gilt-edged prospects becomes a series of headaches to a point where the bank is willing to get out at almost any figure. By this time the management has had enough and have decided to take the quickest way out of a bad deal by selling and charging off a loss of \$2,000.00 or \$3,000.00.

This is a loan made entirely on the basis of value or we might better say assumed value. The banker was misled here into committing three serious errors. In the first place, he did not make a tax search because he felt sure that whatever accrual of taxes might be involved would be more than absorbed by value. In the second place, he did not bother with an appraisal or a close inspection of the property because on the basis of his actual knowledge of the property, he set a minimum value of \$15,000.00 which still left him plenty of margin for shrinkage. In the third place, he made no inquiry as to the borrower's plans or prospects for the disposal of this property nor any arrangement for the reduction of the debt. Under the circumstances, a banker could feel pretty sure that the entire transaction was based upon a speculation and that the bank was expected to carry the risk of this speculation on indefinitely until the borrower's desired profit had been realized.

In reviewing the figures and circumstances outlined in the foregoing hypothesis, they may seem extreme and exaggerated but they have actually happened and with many variations. On the other hand, it may be said that a large majority of loans of this type have worked out satisfactorily. The main danger, as we see it, is that this type of loan has a natural appeal by reason of the apparent security and high interest yield which has a tendency to overcome the instinct of caution that ordinarily guides a bank officer in the negotiation of unsecured credit and straight real estate loans.

We might add that while in the foregoing we have used real estate for an example, "value loans" can arise from any form of collateral, such as chattel mortgages on barnyard equipment, farm property, unlisted securities restricted by narrow marketability, beneficial interests in trusts, etc. and it is surprising to note that every now and then even the best of money lenders will, in a weak moment, get caught in one of the numerous varieties of traps surrounding the "value loan".

IN LIQUIDATION

✓ Chicago.....Cook.....Hamilton State Bank..... Nov. 8, 1939

DISSOLVED

✓ Chicago.....Cook.....South Central State Bank (In liquidation September 11, 1935)..... Oct. 11, 1939
 / Aurora.....Kane.....Aurora Trust and Savings Bank (In receivership November 15, 1933. Dissolved by order of the Circuit Court of Kane County)..... Oct. 30, 1939
 / Bridgeport.....Lawrence.....Farmers State Bank of Bridgeport (In receivership September 11, 1933. Dissolved by order of the Circuit Court of Lawrence County)..... Nov. 6, 1939
 / Forrester.....Ogle.....Commercial State Bank of Forrester (In receivership November 21, 1932. Dissolved by order of the Circuit Court of Ogle County)..... Nov. 24, 1939
 / Kings.....Ogle.....Farmers Bank of Kings (In receivership February 14, 1933. Dissolved by order of the Circuit Court of Ogle County)..... Nov. 24, 1939
 / Steger.....Cook.....First State Bank of Steger (In receivership February 2, 1932. Dissolved by order of the Superior Court of Cook County)..... Nov. 27, 1939

RECAPITULATION

State Banks in Chicago.....	26
State Banks in Cook County outside Chicago.....	28
State Banks in Illinois outside Cook County.....	472
Total.....	526