

FEDERAL RESERVE BANK  
OF  
ST. LOUIS

March 23, 1942

Honorable Marriner S. Eccles, Chairman,  
Board of Governors of the  
Federal Reserve System,  
Washington, D. C.

Dear Marriner:

I am enclosing a copy of a statement which Mr. Leo J. Bub, head of the Credit-Discount Department of the Federal Reserve Bank of St. Louis, presented to a conference of officers and junior executives of the Bank on Monday, March 16. It is a comprehensive description of the functions and procedure of the Credit Division.

Yours very truly,



Chester C. Davis,  
President.

Enclosure

March 16, 1942

CREDIT DIVISION  
of the  
CREDIT-DISCOUNT DEPARTMENT

BY LEO J. BUB, HEAD OF DEPARTMENT

As most of you know, our bank for several years had a Credit Department separate from the Discount Department. Later these two departments were merged into what is now the Credit-Discount Department.

The functions of our department are in the nature of performing the operations of the bank under Sections 10a, 10b, 13, 13a, 13b, 14 and 24 of the Federal Reserve Act.

The work of the Credit side of our department may be briefly classified under the following functions or headings:

1. Statement analysis
2. Passing on eligibility and acceptability of paper and securities offered, including War Loan collateral
3. Valuation of securities and other collateral offered, including War Loan collateral
4. Reviewing reports of examination
5. Interviewing applicants, reviewing applications for industrial loans, credit investigations, and preparing summarized data to be presented to the Industrial Advisory Committee
6. Presenting offerings and applications for loans to the Discount Committee; maintaining minutes
7. Correspondence, reports and statistics

Our first function or heading, as you will recall, is

STATEMENT ANALYSIS

When paper is offered for discount or as collateral, financial statements of borrowers sometimes accompany the offerings, although in many instances statements are submitted for analysis in anticipation of their being needed in connection with the offering of paper for discount or as collateral. Banks are encouraged to submit the statements of their customers for analysis at such intervals as are convenient to the member banks. Statements submitted may be prepared by individuals, partnerships or corporations, or audit reports prepared by independent auditors or accountants.

It is our practice to return the original statements or audits to the offering banks for their files. However, so that we may be in a position to pass upon the eligibility and acceptability of paper subsequently offered, the figures representing the assets and liabilities

are transposed from the original statement or audit to our statement analysis form, which becomes a permanent record in our credit files. In this connection two analysis forms are used, namely, agricultural and commercial; the former for the analysis of statements of farmers and stockmen, the latter for the analysis of statements of retailers, wholesalers and manufacturers. Such pertinent information as sales, earnings, dividends paid, free working capital, and comments from the statement or audit which we feel are essential, are noted on our analysis. The analysis form has three columns for figures which permits a comparison of three statements. The reverse side of the analysis form provides a liability record to show all of the paper held, direct and indirect, of the name that appears on the front of the analysis card.

Our second heading is

PASSING ON THE ELIGIBILITY AND ACCEPTABILITY OF PAPER OFFERED, INCLUDING WAR LOAN COLLATERAL

The Federal Reserve Act and the regulations of the Board of Governors of the Federal Reserve System, set out certain requisites to establish eligibility under Sections 13 and 13a of commercial, industrial and agricultural paper, for discount or as collateral at the Federal Reserve Banks. The determination of eligibility in keeping with these provisions, as well as the acceptability of paper offered under these two sections as well as the other sections of the Act, is left to the discretion of the Federal Reserve Banks.

It should be borne in mind that there is a marked distinction between eligibility and acceptability. Paper may meet all the requirements of eligibility and yet be unacceptable from a credit standpoint. On the other hand paper may be acceptable from a credit standpoint, but still be ineligible under Sections 13 and 13a, for the reason that the proceeds were not used in keeping with the purposes outlined in the Act and the regulations, or the length of time the paper has to run to maturity, at the time offered, may be in excess of that permitted by the Act and the regulations.

In some instances eligibility may be determined from the nature of the instrument, as in the case of a trade acceptance or a bankers' acceptance; or eligibility may be determined from the nature of the collateral, as in the case of a note secured by chattel mortgage covering live stock; or eligibility may be determined from a financial statement of the note maker.

It may be well to mention that the collateral of itself will not destroy the eligibility of the note it secures, provided evidence is furnished in the form of a financial statement of the note maker, or other information is submitted that will establish eligibility.

Acceptability is determined from a review of the analysis of the financial statement of the note maker, endorser or endorsers, if any, or from an appraisal of the collateral. These factors are taken into consideration by the Credit Division in formulating its recommendation to the Discount Committee for final decision.

In determining the eligibility and acceptability of paper offered as collateral to War Loan deposits, the provisions of Treasury Department Circular No. 92 govern the action of the Federal Reserve Banks.

VALUING SECURITIES AND OTHER COLLATERAL OFFERED, INCLUDING WAR LOAN COLLATERAL

Since the Federal Reserve Act, and the regulations of the Board of Governors of the Federal Reserve System permit Federal Reserve Banks to make advances on various types of securities and collateral, the appraisal or valuation of the collateral may be the essential feature considered rather than that of eligibility.

In evaluating chattel mortgage paper the current market price of the live stock is the base used. Many factors are taken into consideration, for example, the grade and class are of vital importance. The breed denotes the grade and permits us to determine the proper price range into which the security falls. The class of cattle, that is, whether heifers or steers, being fed for market, or heifers or milk cows being raised for dairying, permits us to determine the general classification. Other factors taken into consideration are the age and weight, which permit us to establish the general marketability of the live stock. Some of these same general factors are also considered in valuing hogs and sheep; however, where hogs represent the principal security, we usually require that they be vaccinated against cholera. Age, weight, size and condition are the principal items considered in valuing horses and mules. The more information contained in the chattel mortgage as to the age, weight, size, breed, condition, etc., of the live stock permits a more equitable valuation to be placed on the chattels; the omission or meagerness of description naturally places the live stock in a lower classification.

In the valuation of real estate notes, an independent appraisal is the dominant feature. Consideration is also given to the type and location of the property, type and condition of the improvements, and the amount of hazard insurance. As regards Insured loans under Titles II and VI of the National Housing Act, we feel that the insurance may be relied upon to establish the value, as in the event of default, the property is foreclosed and title turned over to the Administrator, and debentures are issued. In valuing industrial, public utility, and railroad bonds, consideration is given to the rating as established by some recognized bond rating service. Current market prices are obtained. The lower of par or market is the base used.

In connection with state, county, municipal, local improvement, drainage district and school bonds, a legal opinion by a recognized bond attorney is required. The current market price is the base used. Where current market quotations are not available, we endeavor to obtain such information as will enable us to determine the financial condition and general tax status of the district of issue.

Treasury Department Circular No. 92 sets out the various classes of securities which may be accepted as collateral to War Loan deposits, and the percentage of market value at which they may be accepted, and of

course the Credit Division is guided by these provisions. Current market quotations are obtained. All securities held, whether as collateral to advances or as collateral to War Loan deposits, are revalued at least twice each month.

After the valuation base has been established, a small margin is deducted for normal fluctuations, the result being the stated or collateral value. If the stated or collateral value is in excess of, or equal to, the face amount of the note, the note of course is accepted for collateral purposes at face value. If, on the other hand, the stated or collateral value is less than the face amount of the note, and in the absence of such information as will enable us to determine the financial condition of the note maker, the note is accepted for collateral purposes at its approximate stated or collateral value.

Our fourth heading is

#### REVIEWING REPORTS OF EXAMINATION

The Federal Reserve Act provides that Federal Reserve Banks may "extend to each member bank such discounts, advancements, and accommodations as may be safely and reasonably made, with due regard for the claims and demands of other member banks, the maintenance of sound credit conditions, and the accommodation of commerce, industry and agriculture". \* \* \* The regulations provide that "each Federal Reserve Bank shall keep itself informed as to the general character and amount of the loans and investments of its member banks, with a view to ascertaining whether undue use is being made of bank credit for the speculative carrying or trading in securities, real estate, or commodities, or for any other purpose inconsistent with the maintenance of sound credit conditions; and, in determining whether to grant or refuse advances, rediscounts or other credit accommodations, the Federal Reserve Bank shall give consideration to such information".

Reports of examinations provide one of the sources of information available to Federal Reserve Banks in carrying out these provisions of the law. The Credit Division reviews reports of examinations of offering banks in order to keep the Discount Committee informed.

Our fifth heading is

#### INTERVIEWING APPLICANTS, REVIEWING APPLICATIONS FOR INDUSTRIAL LOANS, CREDIT INVESTIGATIONS AND PREPARING SUMMARIZED DATA, TO BE PRESENTED TO THE INDUSTRIAL ADVISORY COMMITTEE

Applicants calling at this office for loans of this type are interviewed by the officer in charge and a representative of the Credit Division. The interviews are conducted along the lines of obtaining general information as to the nature of the business, the amount and purpose of proposed loan, plans of the company during the term of the loan, security, if any, repayment program, and any other information that will enable us to determine whether the loan will qualify under the provisions of Section 13b. If the information developed during the interview is favorable and it appears that the loan will qualify, the applicant is requested to

complete and file with us a "Preliminary Information". The information called for on this form is the minimum credit information we feel is necessary to determine whether the loan will qualify. When necessary, field investigations are made in the form of visiting the company's plant and inspecting its physical facilities, such as buildings, machinery and equipment, also its operations. If the preliminary information and the credit data gathered during the investigation are favorable, the applicant is requested to file a formal application, which application, together with the information gathered during the credit investigation are summarized for presentation to the Industrial Advisory Committee.

The Industrial Advisory Committee is a requirement of law, which states that it shall consist of not less than three nor more than five members who are actively engaged in some industrial or commercial enterprise within the Federal Reserve district in which the Committee is established, and who are familiar with the needs and problems of industry and commerce.

The regulations provide that each Committee shall consist of five members.

The members of our Committee are selected by our Board of Directors, subject to the approval of the Board of Governors of the Federal Reserve System. The purpose of this Committee is to assist the Federal Reserve Bank in carrying out the provisions of Section 13b.

After the summarized data has been reviewed and discussed, the Industrial Advisory Committee makes its recommendation to the Discount Committee.

Our sixth heading is

PRESENTING OFFERINGS AND APPLICATIONS FOR LOANS TO THE DISCOUNT COMMITTEE:  
MAINTAINING MINUTES

All offerings and applications for loans are presented to the Discount Committee with the recommendation of the Credit Division, and each offering is accompanied by such information as will acquaint the Committee with the nature and character of the offering, the offering bank's financial condition, the offering bank's present indebtedness to us, the nature of the security, and the offering bank's past record of borrowings from us.

The summarized data assembled in connection with 13b loans previously submitted to the Industrial Advisory Committee, is also presented to the Discount Committee with the recommendation of the Industrial Advisory Committee.

Minutes of the Discount Committee and Industrial Advisory Committee meetings are prepared by the representative of the Credit Division who presents the offerings to the different committees, which minutes are retained in the Credit Division as a permanent record.

Our seventh heading is

CORRESPONDENCE, REPORTS AND STATISTICS

The Credit Division handles all correspondence in connection with offerings and applications for loans.

The Credit Division prepares various reports for the Board of Governors of the Federal Reserve System, our Board of Directors, the Executive Committee and officers of our bank.

It also maintains various records and statistics, for example - an individual liability record of each note maker, and a "Record of Borrowings" on each borrowing bank. The individual liability of each note maker is "posted" on the reverse side of our statement analysis card of the respective note makers from the collateral pledge or the discount application. This record provides information as to the date of the offering, the name of the offering bank, amount and maturity of each note; whether the note is endorsed; if endorsed, whether it is paper of the statement-maker whose liability is being posted endorsed by others, or whether it is paper of others endorsed by the statement-maker whose liability is being posted; type of borrowing, i.e., whether a discounted item, collateral to an advance or collateral to War Loan deposits; whether secured or unsecured, and if secured, the nature of the collateral. From this record we can tell at a glance the total amount of paper held on each name from each bank, and whether the total amount of paper held on each name from each bank is within the legal limits of the State laws or Section 5200 of the Revised Statutes.

The "Record of Borrowings" is prepared from the discount records semi-monthly and shows the date the bank began borrowing, the amount of its liability at each semi-monthly period, the nature of the collateral, and provision is also made to show the date of repayment. This record also provides certain information taken from the condensed report of condition of the borrowing bank submitted with the offering, for example - the liability of the borrowing bank to others for borrowed money, the amount of its loans and discounts and its deposit liability.

The Credit Division maintains credit files containing analysis of upwards of 20,000 financial statements.

March 27, 1942.

Dear Chester:

Thank you for your letter of March 23 enclosing a copy of the statement by Mr. Leo J. Bub, head of the Credit-Discount Department of your bank.

I notice that it is a compact, factual statement of the operations of the department, and I am passing it along for the information of our people here.

Sincerely yours,

(Signed) M. S. Eccles

Mr. Chester C. Davis, President,  
Federal Reserve Bank of St. Louis,  
St. Louis, Missouri.

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