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Address of J. L. Robertson, Member of

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"A SCOTCH POINT OF VIEW"

You will notice I have switched titles. When I adopted the former one - the one on your program - I had no idea what I wanted to speak about. My only thought was: "Is it broad enough to enable me to talk about whatever comes to mind?" Now I realize - only too well - how easily bad mistakes are made. And, as one who has recently discovered anew how many things I ought to know but do not, and, accordingly, how presumptuous it would be for me to try to point out things you bankers ought to know, I recall - somewhat sadly - the fate of the lady who smilingly went for a ride on the back of a tiger, only to return inside, with the smile on the face of the tiger.

Being slightly Scotch in temperament as well as heredity, I should like to devote a few minutes to showing that a bank examination <u>can</u> be a bargain. Whether it <u>is</u>, is up to you.

How many of you have voiced the sentiment, or heard it from one of your associates nearest the door: "Here come those . . . bank examiners again!"? And how many of you have exclaimed with relief when they left: "I'm glad that's over with!"? That attitude is by no means universal, I am glad to say, and it is diminishing rapidly. In a very few cases it may still be justified.

Let me admit at the start that there are some examiners who are rubber-stamp-minded; some who have a "Jehovah" complex or "know it all" attitude; some who are hypercritical; and some who are hipped on ratios and rules of thumb and use them as though they were commandments handed down at Mount Sinai. There are also a few bankers who, for different reasons perhaps, fall in that same general category. With due humility, I imagine there are not a half dozen persons in the United States who personally know more of <u>both</u> examiners and bankers than I. Consequently, let me testify that the proportion of bankers in that category is about equal to the proportion of examiners.

Starting from that premise, I should have little difficulty in convincing you that examiners are not bogies with which to frighten children into good behavior, persons whose arrival at your bank should be dreaded or feared. Rather, they should be welcomed. Remember, your objectives and the objectives of bank supervisors are the same. This was well stated by President Francis Cocke of the American Bankers Association, when he said to the State Bank Supervisors: "Our common objective is safe, sound, serviceable banking - strong banks and a strong banking system, dedicated to an enlarged and adequate banking service." I might add that a part of that common objective is profitable banks.

Every healthy banking institution should yield a fair compensation to those who provide the capital funds and the talent, skill and judgment for its operation.

Several years ago, Dr. Marcus Nadler appropriately recommended "New Glasses for Bank Examiners". I should like to suggest new glasses for some bankers, for use when they look at their examiners and bank supervisors. Having recently left one organization in which bank supervision was the sole function for another in which it occupies an important but not dominant position, I am motivated solely by the desire to harness the common interests of banks and supervisors in a fashion which will enable you bankers to get your money's worth out of examinations. The vehicle I advocate is frequent meetings between examiners and your directors. If you think I'm reaching for the stars, remember Robert Browning's words:

> "Ah, but a man's reach should exceed his grasp,
> Or what's a heaven for?"

In dealing with this subject, it seems essential first to delineate the bank examination and then the qualities of examiners themselves. As you bankers know, but your directors may not, bank examinations, in the broad sense, are made to ascertain, assess, and improve (where possible) the financial condition, management policies, and general affairs of banks. The examination, which embraces every activity found in the bank, has three immediate and primary purposes: (1) to determine whether the bank's assets are intact, are worth their book value, and afford ample liquidity for the volume and type of deposits, (2) to detect violations of law or regulations, and (3) to discover whether the bank is being operated in accordance with sound banking principles. All aspects of a bank examination, ranging from counting the cash to gauging the wisdom of current management policies, are geared to the accomplishment of these ends.

In speaking of the examiners, I hope everyone will pardon me for using the national bank examining force as my bench mark. I use it only because I know that organization best. However, I trust the essentials of my description fit all other examining agencies as accurately.

I suppose everyone knows that no man blossoms into an examiner overnight. Every person who aspires to be an examiner must enter the service as an assistant examiner. Those men are not political appointees. They are selected for appointment on the basis of integrity, intelligence, education, experience, and personality attributes, the prime consideration being possession of background and traits which indicate a firm foundation on which to build a successful career in bank examination work.

The individual is developed, through explanation, education, actual performance, and his own initiative. In the course of that development, which takes years, he will have learned to judge credits, to determine the legality of bank operations, to appraise the ability and capacity of bank management, to judge capital adequacy and its relation to bank earnings and dividend disbursements, to evaluate trust activities, to analyze the securities portfolio with respect to diversification, quality, and maturity spacing, and to form the numerous other judgments that are necessary in reviewing a bank's operations.

In short, the effective examiner is a highly trained man - one who in any other field would be labeled an "expert". He is capable of pushing through the fog of detail and coming up with a fair appraisal of any bank's operations. Top level examiners are men who have demonstrated their ability to utilize their technical knowledge, skill, and experience as a background on which to base impartial and unemotional opinions, decisions, and judgments. They have convinced their superiors of the depth and broadness of their judgment, of their resourcefulness in meeting and successfully handling difficult situations, of their ability to apply sound banking principles and logic, and of their capacity to cope successfully with opposing viewpoints and controversial issues without subordinating sound decisions to either expediency or results desired by others.

In the organization which, for the moment, I am using as an example, the examiners function under the guidance of field chiefs, who have risen from the ranks on the basis of merit. The District Chief, like the examiner, is in a position to compare banks - but on a district-wide basis; to see the systems that work best and most smoothly; and to pick out the weak spots and the areas most likely to give rise to trouble.

But even this is not all. The whole staff of examiners - from the District Chiefs on down - are directed by a small corps of career men in Washington. The direction exercised by this head office is intelligently active and alert. By that I mean that they keenly observe the activities of banks in all sections of the country, comparing one with another. They meet periodically with the field force in all parts of the nation to discuss ways of approaching specific problems, improving techniques, and strengthening individual banks and hence the entire banking system.

This central force is not dependent solely on the intellects of its individuals. Like all other bank supervisory agencies, state and national, it draws upon years of accumulated experience in determining the wise course to follow; years which have witnessed banks of every description, good and bad, solvent and insolvent, those whose failures were caused from without, and those which failed from internal causes.

Let me ask, where else - in what other field - can you find equivalent forces of completely impartial experts, in as good a position to render real service to members of the industry?

I realize that I may be accused of gilding the lily. It would seem that if the men who make up these career forces - state and national - are as good as I paint them, few would long remain in public service. Well, I am sorry to say the turnover is high; the New Jersey Bankers Association is well sprinkled with alumni; even so, there always remains a nucleus of high calibre career men - men who derive great satisfaction from the nature and quality of their work. It would also seem that if examiners are as good as I describe them, more bank officers and directors would be endeavoring to meet with them at the end of an examination for the purpose of picking up any bits of wisdom they might drop. I know many bank directors who do just that. My purpose is to urge more of them to do it - for their own sake.

Just a few years back, a certain bank was headed for trouble. The ailment was a combination of incapable management and a slow but sure accumulation of weak loans - a combination which acts like creeping paralysis. The examiner insisted on a meeting with the Board of Directors for a frank discussion of the bank's affairs. Suffice it to say, the meeting was effective; existing losses were taken while the capital funds were still adequate for the purpose, and new management was engaged. The bank is now in excellent condition. Less than six months ago, one of those directors dropped in to see me. He wanted to know why a meeting between the examiner and the directors at the close of each examination should not be a standard requirement. He felt certain that the losses in his bank would have been greatly diminished if his Board had met with the examiner long prior to the "must" meeting; and he felt the examiner would also have been in a better position to determine the condition of the bank. He complained that even now the members of his Board never see the examiner. His Scotch burr became a bit more accentuated when he said: "We pay for these examinations and we think we are entitled to our money's worth."

There is considerable merit to his point of view. When your bank pays the examination fee, something is being bought. The directors are buying the services of exceptionally trained men. They are obliged - of course - to take cognizance of the finished product, the report of examination. But doesn't it seem just a bit - let us say - wasteful for directors to buy that service without ever exchanging a word with the examiner, whose findings should be very significant and important to them? And if the report contains criticisms, wouldn't it be better, from the point of view of you bank officers, for the directors to discuss those items directly with the examiner and learn at first hand the basis of his criticisms? In my opinion, whether the examination fee is $50 or $50,000, your bank has simply incurred an expense, and has not received full value, unless the directors, or at least a representative group of them, have met with the examiner and discussed with him the broad aspects of the institution's operations.

A short time ago a friend of mine, a bank President, wrote me about a conversation he had with one of his directors, a rugged individualist who was convinced that banks had very little independence left and that the government was always telling them what to do and how to do it. The director criticized the President for always bringing to Board meetings some bank examiner's report, quoting it as if it were scripture, and deciding loans pretty much on the basis of whether the examiner would approve of them or not. All of us have heard the story many times - certainly I have. But this banker answered him in a way which made me wish I had said it myself, and so I want to quote to you from his letter:

> "When he had concluded, I said I'd like just a minute to correct a few impressions. I asked him if his firm, which is large and important, hired auditors to make periodic studies and reports; he said they did. I asked him if he had ever retained outside management engineers to come in and study certain of their operations and report; he said they did. I asked him if it wasn't true that in building a certain new plant recently they hired a firm of mining experts to make a study and report on the available potential ore supply, and an engineering firm to consult with them on the layout of the plant; and another consultant to sit in with them on the question of fuel supply and to advise them how to handle that; he said they did. I then told him that I regarded the examining function as bringing to our bank the same advantages that these consultants had brought to his firm. He objected that those were advisers whom they had selected and paid; I replied that we had also paid for ours. I told him that the particular experts in the United States, career men, qualified by experience and training to bring those same advantages to the banks were the bank examiners.
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> "I think he saw it a little differently and began to realize that we look upon the examiners not as a regulatory institution

of government but rather as experienced, informed experts from whom we can obtain a great deal of valuable information and suggestion. I finally said to him: 'As a matter of fact, if the bank examiners were not available to perform this function, we banks would have to set up another organization for that same purpose which would probably cost more and accomplish less.'"

I think that banker is getting his money's worth from examinations. He certainly does not feel compelled to agree with everything an examiner says. He shouldn't be expected to. No one contends examiners are supermen. But he, and many other bankers in this country (albeit too few) have come to understand the benefits to be derived from having both management and directors sit down with the examiner and go over his entire list of comments - not with the idea of getting him to change classifications, but rather with the idea of testing the validity of the examiner's comments, grasping their true significance, and charting a suitable course of action.

It is possible that the examiner may have some definite impressions of the mechanics of the institution. Subconsciously, at least, he will have compared the smoothness of operation and the adequacy of the administrative management of your bank with that of other banks he has examined. And although examiners never discuss the affairs of one bank with representatives of another, they frequently can give you suggestions that will result in improvements in administrative and mechanical methods. Sometimes the management and directorate of a bank are too close to the picture to see some of the defects which are apparent to an experienced examiner in a position to take an over-all, outside, and unbiased view of the institution.

Bank officers and directors who have stood aloof from the examiner and regarded him as a necessary evil may be surprised (and even benefited) if they prevail on him - of course, I am now speaking of both state and federal examiners - to sit down with them at the end of an examination and tell them whether he observes or senses any deterioration in the quality of the assets, any evidence of slipshod or careless handling, any let-down in standards and practices. In what we call "problem" banks, he will, in the natural course of events, do that automatically, but in the average bank he will not, without your invitation, because he has been trained scrupulously to avoid stepping over that shadowy line of demarcation between management and supervision. Bank supervisory authorities are no more anxious to invade the province of management than you are to have them do so.

Perhaps your institution is superlative in every way, and beyond improvement. If so, you are exceedingly fortunate - and it is unique. If not, if it is merely a good bank, why not experiment with the idea I am trying to present? Why not urge your directors, or at least some of them, to meet with the examiner and discuss the bank's affairs? It may result in the discovery that your lending, collection, or investment policies can be improved or strengthened, your review procedures modernized, your internal controls made more effective, your operational systems made to function more smoothly and even with less manpower. Examiners are not systems experts, but they often become endowed with a "bird-dog instinct" which enables them to distinguish between systems that are archaic or poor and those that are good and effective. Likewise, examiners are not personnel experts, but sometimes they can detect latent strength and good material for development among your subofficial personnel that may have escaped your attention.

To my way of thinking, all of this is a part of what banks are paying for when they pay the examination fee. The benefits to be derived from such a procedure may prove to be preventive rather than curative; if so, so much the better for you and your bank. The potential benefits are so great that the procedure should form a part of alert directing. And to be very realistic, in addition it would provide directors an opportunity to "size up" the examiner and hence determine the significance to be attached to any criticisms set forth in a report of examination.

If such voluntary meetings between management, directorates, and examiners would be productive, why do they take place so seldom? Is it the fault of the supervisory agencies or that of directors and management? Candidly, it may be the fault of both. Too often, as I well know, the bank examiner, in the press of time, cannot always conveniently find the hour to hold such discussions in good banks. And often - too often - the active management objects to these discussions because of a groundless fear that the examiner will frighten the Board; objects with the erroneous notion that the management - not the Board - is the boss; objects on the ground that the officers may be put on the spot.

I remember one case where, after a meeting with the directors, the President informed the examiner that the directors had been hypnotized by him and that it would take six months to get the Board "back on the track". Before that six months had expired, the bank had charged off over $100,000 in loans and had a new President. But that was a "must" meeting. I am not talking about those situations.

In some cases, meetings are not held because the directors are "just too busy" to come to the bank during an examination. As I have said before, bank directing is no Sunday job. Sometimes a little inconvenience can pay off in large dividends. Even in sound banks, there are defalcations - sometimes so large that the "soundness" disappears. Yet, too frequently those "too busy" directors ask: "Where were the bank examiners? Why didn't they uncover this shortage before it reached such proportions?" If those same directors had taken the time to attend one - just one - meeting with the bank examiner, they could have learned that bank examiners are not auditors; that the examination is not an audit. They could have learned the weaknesses of their own internal audit system. They could have learned, too, that theirs is the responsibility to make certain that a vigilant internal audit is maintained in their institution.

In summing up my case, I want to urge, with all available force, that bank officers and directors seek, and that supervisory authorities give, full value for the examination fee. One essential to "full value" is a meeting of the type I have been discussing.

In order to realize "top-dollar" benefit from such meetings, a bank's directors must be active participants. Rather than passively accepting the examiner's views and conclusions, they should respond with probing questions which will explore the basis of his thinking and judgment. Not only will this give them maximum value, from a Scotch point of view, but in turn the examiners - compelled to justify their judgments on grounds of logic and experience - will become more alert and aware of any weaknesses in their thinking that need correction. And this, in its turn, will result in a better and more valuable supervision. In these days of vicious cycles, we should welcome an opportunity to take part in a beneficial cycle - one which produces mutual betterment rather than mutual injury.

This is merely another way of saying that it is incumbent on all concerned - bank officers, directors, and supervisors - through the maintenance of strong individual banks, to make for ourselves the soundest banking system possible, capable of meeting whatever the future may hold in store for us.

Our banks and our banking system are just what we make of them, irrespective of what they used to be or what they may be when some one else is running them. We alone are responsible for the present. To borrow from Judge Learned Hand:

"... the Present is our Indubitable Own; we can shape it, for we can shape ourselves; we can shape it as near to the Heart's Desire as we have constancy and courage."

If only we will take full advantage of every opportunity to improve our individual banks - day by day - we will build a system of which we can be proud, and there will never be occasion to wince when we look back upon our past.