## ADDRESS GIVEN BY M. S. ECCLES ON "BANK MANAGEMENT"

## AT UTAH BANKERS ASSOCIATION CONVENTION HELD AT LOGAN, UTAH

## JUNE 22nd, 1929

The subject assigned to me, "Bank Management", covers a lot of territory and a great deal can be said and is being said on this all-important subject. Able management is more responsible for the success of any business, in my opinion, than all the other factors put together. It is the most important element in business today and the thing in greatest demand, and banking more than any other business is almost entirely dependent upon the capabilities of those charged with its management. It is evident when we look at the record of bank failures during the past ten years that there is ample room for improvement in bank management, there having been more than 5,000 failures in this country and that is without taking into account the assessments paid on bank stocks and weaker banks being absorbed by stronger banks to prevent failure, to say nothing of the banks which have not paid dividends for years.

### BANK FAILURES

An honest and intelligent study of the cause of bank failures in the past eight years brings the firm conviction that the principal reasons have been mismanagement, incompetence or pure ignorance of sound banking principles. You have all noted the trend to decrease the number of banks rather than increase them -- this should mean fewer banks and better bankers. Overbanking, without question, has been the cause of a great many bank failures in the past. Good management would never have established many of the banks which were established. Good management would have detected that there was inadequate business for another bank and that it was inevitable that the first economic depression would precipitate failure. Most states as well as our national government at the present time are following a much more rigid policy in issuing new charters than was the case prior to the epedemic of bank failures. The necessity, as well as the experience and financial responsibility of the organizers must be shown before new charters are granted. Our public banking officials should be encouraged in this policy. There are still too many banks in this country. Further consolidation would improve banking conditions both for the public and for the bank, and should be encouraged.

There was a time in this country when almost any person of average intelligence could aspire to become a banker without any previous training or experience. The old-fashioned banker was simply a custodian and a lender of money. He relied almost entirely upon his own personal knowledge of his customers, guess-work in place of credit analysis, and very often he was guided by no more than a business hunch. The time has passed when banking can be successfully conducted by the untrained, inexperienced men, and it takes more than common sense and a business hunch to successfully run a bank.

### CHANGED CONDITIONS

Changed conditions have forced many changes in the methods of managing banks. The rapid growth in the banking business in this country in the past ten years, with the developing of the trust and investment business, is requiring trained and experienced bankers who will employ scientific methods. Since the close of the war, increasing demands have been made upon banks for financial services growing out of our rapidly expanding industrial and commercial development. Banking, to be successful and profitable, must operate in all departments upon scientific principles based upon expert study.

Competent management in banking is more important than in any other line of business because of the public nature of the banking business and the great number of people who are directly and indirectly affected by its operation. Every bank failure is a local disaster and an economic setback to the community. On that account public policy requires that banks be strong and safe, and public interest demands that steps be taken to bring the improperly managed banks in line with modern banking methods.

I will attempt to discuss briefly some of the more important phases of bank management as I see them and as they apply more particularly to the business in this intermountain country with which I am the most familiar.

## LOAN POLICIES AND ADMINISTRATION

We all recognize loan policies and administration as of first importance and as largely responsible for the success or failure of the bank.

All unsecured loans of $500 or more should be supported by a current signed financial statement of the borrower, showing a satisfactory liquid condition. These statements should be kept from year to year and copied on an analysis card where comparisons can be made of changes in the borrower's financial condition. Statements should be carefully gone over and analyzed by those competent to determine whether or not they reflect proper values, and whether or not the borrower is making proper progress or going behind.

In the case of large commercial loans detailed certified statements should be required, and where possible credit rating should also be secured from responsible credit agencies, and where business is done with more than one bank the line should be checked with other banks.

In the case of chattel mortgages on livestock, in addition to the current financial statement an inspection report should be made by a competent inspector twice a year and filed with the bank. It is also advisable where unsecured loans are made based upon livestock to have periodical inspection made as well as an eligible statement.

In the case of real estate loans, it is advisable that they be taken upon an installment basis where possible, monthly or yearly, depending upon the type and nature of the loan. Real Estate loans should be confined to improved business property, modern residence property and irrigated farm property, and limited to 50% of an appraised value. A detailed appraisal should be filed with each mortgage loan, together with abstract brought to date of loan, showing satisfactory title, and sufficient fire insurance covering improvements assigned to the bank. The amount invested in real estate mortgages should depend upon the amount of the bank's time funds, and in smaller towns and country districts it is advisable to make only farm mortgages and then only to a very limited extent on the best improved land.

Crop and chattel mortgages on goods or equipment are the least desirable type of loans and should only be made where the borrower has a good record, and then only upon the most conservative basis of value.

Where an applicant for credit has nothing but his character to back up his ability to pay, loans should not be made. Small unsecured loans are usually an expense and an annoyance, and cause the average bank no end of trouble. Where it is necessary and advisable to make this type of loan, satisfactory endorser or endorsers should be required, and it is usually advisable to discount the note and require that it be paid back in installments.

Most of the banks in this territory have altogether too many notes in proportion to the amount of their total loans. This is due to making too many small loans to people who do no business with the bank or whose business does not warrant credit, and allowing borrowers to get their credit requirements in small amounts instead of in one or two amounts, thus saving interest to the borrower and resulting in his carrying no compensating balance.

Any loans not coming under the above classifications should be secured by adequate and marketable securities properly endorsed and pledged under a collateral note form. Market values and security should be checked periodically, and additional security required when necessary.

In the case of all loans, safety should never be sacrificed for interest rates. The average balance of the borrower should be considered in connection with all credit lines and a proper balance required based upon the amount of the credit line and the cost of the service in handling the account of the borrower. This makes it advisable to keep an average balance card for every account, and in the case of interest bearing accounts, bank accounts or commercial accounts depositing many items on outside points a deferment schedule should be kept so as to determine the net balance upon which to figure interest or base credit. It is also advisable in the case of very active accounts to keep track of the number of items being handled to determine whether or not the account is profitable. The matter of interest rates charged should be based upon market demand for money, net balance carried, and the liquidity of the loan. A daily report should be made of all loans made and all loans paid and once a month a report of all past due loans should be provided.

There should be a periodic liquidation of all commercial loans, and a seasonal reduction or liquidation of all livestock and agricultural loans. There should be aswide a diversification of loans as possible. A knowledge should be had of the seasonal fluctuation in deposits, and during that period of the year when the bank has excess funds those funds should be invested in call loans or commercial paper or short-term bonds so that funds are available to take care of the decreasing deposits and to meet the increasing demands for loans.

## RESERVES ANALYZED

It is generally recognized that a bank's capital and surplus should be maintained at not less than 10% of its total liabilities. This is considered necessary for the proper protection of the depositors. Of that amount not more than 50% should be invested in bank building, furniture and fixtures, and other real estate.

With reference to reserves, the primary reserve in cash and due from banks should approximate from 15% to 25% of the total resources, depending upon the size and activity of the bank's business. All banks should carry secondary reserves, quickly convertible into cash, which should run from 15% to 30%, depending upon the period of the year and type of business. The remaining 55% to 70% available funds, after primary reserves, secondary reserves and investment in building, furniture and fixtures, are available for investment and for customers or other local loans.

With reference to the secondary reserve referred to, it should be invested in government, municipal and high grade marketable bonds, and in addition call loans and commercial paper during peak deposit periods. The securities can be either liquidated or used to borrow upon in case conditions develop where it becomes necessary for a bank to use them to take care of seasonal requirements or to meet some unexpected contingency.

## NEW BUSINESS

The officers of the bank should be provided with a report of the daily activity of accounts, showing new accounts opened and accounts closed, as well as any unusual withdrawal or activity. In the case of all new business a card should be made on each prospect with any and all available information recorded thereon and the matter consistently followed up until it is closed one way or the other. Employees should all be encouraged to develop business for the bank and should be given recognition of their activity in this connection.

Statistical reports should be kept of both commercial and savings accounts, showing periodical increase or decrease, and average balance per account. A banker should have sufficient knowledge of the deposits in the bank to know their value. This can only be done by maintaining an average balance card on each checking account, as well as a deferment record and activity of account in the case of the larger and more active accounts.

## CONTROLLABLE FACTORS

Referring to controllable factors of income and expense:

Based upon its capital, surplus and deposits a bank can estimate very closely what its normal gross income should be. By a close analysis and supervision the expense can be brought into control so that there should be a net normal profit (before chargeouts and recoveries) of from 20% to 30% of the normal gross income. This would depend upon the size of the bank and its type of business and would indicate that if it were not for losses taken on loans the banking business in general would yield a very satisfactory profit. A profit and loss report should be gotten out at least quarterly, showing a proper classification of all income and expense items as compared with the same period in the previous year. Reserves should be set up for each quarterly period covering taxes accrued as well as interest on savings and time certificates of deposit, also for depreciation covering bank building, furniture and fixtures, and a reserve for doubtful items. Until this is done no balance should be considered available for dividends or to go into the surplus account of the bank.

## NON-CONTROLLABLE FACTORS

Net profits of banks in many cases are affected by noncontrollable factors, which are those that can be remedied only by group action of all banks in each community. I refer to the adoption of what we term as clearing house rules, charges and regulations, which should provide for uniform terms and interest rates on all time deposits; also those demand deposits such as public funds, country bank accounts and possibly certain other large accounts upon which it is customary to pay interest; also service charges on checking accounts of sufficient amount to compensate the bank for the services in handling the account; return items; all escrow and safe keeping papers; exchange charge; rent schedule and uniform contract on safe deposit boxes; contributions and many other items of more or less importance which enter into any sound businesslike operation of a bank. These factors can only be brought under control by cooperation of all banks in the community. Each bank should be made to realize by a proper analysis the affect of these factors on the net profits of each institution.

## PERSONNEL IMPORTANCE

Too much importance can not be given to the value of a satisfied loyal personnel throughout a banking organization. This can best be brought about by properly defining the duties of each member of the organization, try to recognize their respective abilities, place them where they are best suited and compensate them accordingly. Try to retain in the organization as many Class A employees as possible for even though you are required to pay them more it will prove to be profitable. An employees' organization is suggested in larger banks where the officers and employees can meet together at a dinner periodically and discuss banking or other problems of interest. Officers should always take a friendly interest in all employees and encourage initiative and invite their suggestions.

It is suggested that group insurance and some plan of savings or pension plan be provided for employees. This is an obligation which any organization owes to those who are devoting the best part of their lives to its upbuilding. It will help to build up loyalty and maintain a satisfactory morale.

In the case of the managing bank officers, there is no substitute for hard work and plenty of it. They must study finance, not only from a local but from a national and international aspect. They must watch and be acquainted with market conditions, not only securities but commodities. They must also acquaint themselves with the rapid changes which are taking place in industrial development and distribution. They should read banking journals and financial literature. They must have initiative, enthusiasm and be efficient if they expect to successfully lead an organization. The organization will reflect the ability of its executives.

Very much more could be said on so important a subject as "Bank Management" but in the time allotted to me I have only been able to briefly discuss in a general way some of the more important phases from which I trust you may get some idea or inspiration which will be helpful to you.

I thank you for your very courteous attention.