NEWS RELEASE

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THE GENERAL CHARACTER CF MANAGEMENT

Address of

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FEDERAL DEPOSIT INSURANCE CORPORATION
Washington, D. C.

at the

ANNUAL CONVENTION
of the

ILLINOIS BANKERS ASSOCIATION

at the

Hotel Sheraton Jefferson

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The General Character of Management

It is evident to all of us that the management of a bank is the basic element in a bank's success. The Congress recognized the importance of management when it included the general character of management among the six statutory factors the Federal Deposit Insurance Corporation must consider when passing upon applications.

It is not overstating the case to say that the management ingredient is the central issue in most cases that come before the FDIC Board of Directors. The other factors that must be considered, such as financial history, condition, adequacy of capital structure, and earnings prospects, are for the most part reflections of the quality and ability of management. There are, of course, exceptions to this statement. But the management factor remains crucial.

Just what do I mean by management? I am not talking about such subjects as the art, the science, or even "the philosophy" of management. These challenging topics are best left to others. The management concept I am talking about is much more fundamental. I am talking about the <u>force</u> that gives direction to the affairs of the bank, whatever shape the force may take. In short, I am talking about the direction and the control of the bank.

The fundamental obligation of the management of each bank rests with its board of directors. The duties and liabilities of directors include those imposed by Federal and State statutes, by the charter and by-laws of the bank, and by the common law responsibilities arising from the fiduciary relationships of the directors to the bank's stockholders, depositors, and other creditors. The measure of this stewardship is stern indeed. A director must direct; the very term "director" implies action.

This is not to say that the directors must actively participate in the operation of the bank. Most directors have neither the know-how nor the time to participate in the bank's day-to-day operations. However, the directors are responsible for the proper conduct of the bank's affairs. Accordingly, the primary responsibilities of the bank's board of directors are to formulate broad investment and operational policies and to select and appoint competent officers to execute these policies.

Responsibility for the daily operations of a bank rests with its managing and operating officers. Successful implementation of policies formulated by the bank's board of directors depends upon competent officers. The executive officer of a bank, whatever his title may be, is the key figure. The success of a bank may well depend upon the executive officer's talents, personality, and general capability.

Control is, of course, an important factor in management. In some instances supervisory authorities have found it necessary to look beyond the bank's official family when giving consideration to the general character of management. It has not been unknown to have the control of a bank exercised by one or more individuals who were neither directors nor officers of the bank.

Control can range all the way from the beneficent to the nefarious. There have been some outstanding examples of the latter type of control in the past year or so. I am referring to those rare but significant situations where the unscrupulous have seized control of banks and immediately proceeded to loot and pirate. The looting is accomplished by various methods, including swift expansion of the loan portfolio through extensions of credit to the new owners and their related interests and through other self-serving practices.

It is not without reason then that the sale and transfer of control of a bank has become of increasingly urgent concern to supervisory agencies. In recent months the Federal Deposit Insurance Corporation has been giving the matter intensive study and now has under active consideration means to deal with this very serious problem.

An evaluation of management by supervisory authority is much the same as an analysis of credit by a bank loan officer. Many of the same skills are used by field investigators working on a new bank or branch. The major focus in both cases is upon management.

The directorate, the active officers, major stock holdings, and the ultimate control of the bank must all be accorded considered attention. Special circumstances or conditions must be recognized and given due weight. When certain conditions not readily apparent are ascertained, supervisors must look at the situation realistically and apart from any legal or theoretical considerations of the management structure.

An appraisal of management as a group would not be complete without a word about the one-man bank or the dominated bank. This is a matter quite apart from those situations where the control of a bank is acquired with the intention of quickly denuding the bank of its assets. The domination may arise from stock control or even from sheer force of personality. Often this domination is not harmful to the bank. It is wholly understandable that a bank, like any other enterprise, needs a strong figure at its helm.

In extreme cases, however, these banks present management problems of several types. By definition, the one-man bank or the dominated bank lacks the benefits of group judgment and of group direction and control. The problem of management succession inevitably arises under these circumstances. This problem might appear to have received overemphasis from supervisors over the years. Yet a large portion of applications to merge and consolidate are predicated precisely on this matter. Some of the banks that plead a succession problem cannot by any measure be classified as small banks.

Everyone would agree that integrity is a prime requisite of a director or an officer of a bank. Service on a bank directorate is everywhere regarded as a high honor and a public trust. Few men are given this opportunity to serve their communities. The record of bank management in this respect is, by and large, an enviable one. It is important that this record not be soiled by the acts of the relatively few who have infiltrated the banking community with motives that are anything but altruistic. It is incumbent upon bankers to police the system. The attitude of a supervisory authority should be one of positive encouragement toward higher standards of management, not an attempt to assume the historic role of management.

Integrity, like other matters, can take subtle forms. It is a fact that most bank failures in recent years have been occasioned by embezzlements or other dishonest acts and not by external causes such as crop failures or other economic disturbances. Generally, these defalcations are absorbed by fidelity insurance. But does the banker's duty end when recommended fidelity coverage has been provided? Or is it his responsibility to take all reasonable measures to protect employees from undue temptation? Should not every bank have effective internal controls and a sound audit program consistent with the size and type of operation? If one considers, for a moment, the impact of an arrest and a conviction on a man and his family, the answer becomes evident.

There has been a dramatic and alarming increase of late in external crimes, such as burglary and robbery, against banks. The physical security arrangements and protective devices of some banks fall far short of the recommendations of the appropriate authorities and of various bankers' associations and groups. Here again it is readily apparent that some banks look solely to their insurance protection. These banks are failing to fulfill their traditional role of good corporate citizen. Apart from the matter of losses, which for the most part are borne by the insurance carrier, are not all of us under a duty to thwart and prevent crimes in our communities?

In addition to a high standard of integrity, it is essential that the management of a bank possess a high order of competence. The assessment of management's competence - which is one of the distinguishing features between a bank examination and a bank audit - is made on the basis of all available data. Where appropriate, an attempt is made to look forward as well as back.

In the case of a newly organized bank applying for deposit insurance, the general backgrounds of its directors and the experience of its chosen executive officer constitute the best indicators of management's competence. Generally a bank's board of directors should reflect a cross section of the community and represent broad diversified interests. It should be comprised of individuals who have enjoyed a measure of success in their business and professional careers. Business acumen, financial position, age, health and a demonstrated willingness to serve the bank and the community are all relevant considerations. Directors of a new bank must be supporters of the bank and, if the bank is to prosper, they must not permit their initial enthusiasm to wane.

An able, energetic, and personable executive officer is vital to the success of a new bank. The old saw that anyone can run a bank is not true today and, in all likelihood, never was. The complex and diversified areas of investments, credits, operations, and public relations demand the services of a knowledgeable and an adaptable person. A mistake in any of these areas could prove extremely costly.

In the case of operating banks, it can generally be said that the proof of management's competence is in its performance. Naturally the performance, or the results of management's efforts, must be viewed in light of all the surrounding circumstances. Not all banks operate under identical conditions. The difference in the economic environments of various areas may be substantial. The management of a bank located in an economically depressed area may be performing in a first-rate manner, even brilliantly, but the results may not be reflected in balance sheet figures or operating statements. Growth areas can present matters that are, at once, both problems and opportunities for management. Thus each situation must be assessed in its own surroundings.

Specifically, in evaluating the competence of the management of an operating bank, it is necessary to consider a number of matters in addition to the personal qualifications and abilities of the directors and officers. The soundness of investment and operating policies and practices, the composition and quality of assets, the adequacy of capital and the profit-making ability of the bank are all important. Each of these matters is a major subject in itself, but each is intimately related to the competence of management.

When applications are pending before the Federal Deposit Insurance Corporation, the final analysis and the essential issue is whether or not the management is able to operate the bank in a safe and sound manner.

Banks are operating today in an intensely competitive environment. Money and capital market conditions are nothing less than dynamic. There is every reason to believe that these conditions will persist. Under such circumstances the quality of management cannot be overstressed. If a bank is to achieve its basic goals - safeguarding depositors' funds, meeting legitimate credit needs, making a profit and paying reasonable dividends to shareholders - it will require highly competent management.

During the coming years it will be of paramount importance for banks to continue to render effective and imaginative service to their communities and to allocate their resources efficiently and impartially, in a manner consistent with sound investor judgment and basic credit principles. Investment policy will have to be characterized by flexibility and assets will have to be managed actively.

Remember, above all, this one fact: No supervisory agency wants to, or can, manage a bank. It can, and must, insist that bank managers adhere to proper standards - but profitable, effective management is the ultimate responsibility of the banker.