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Address of J. L. Robertson, Member of
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"DUTIES AND RESPONSIBILITIES OF THE COUNTRY BANK DIRECTOR"

A few years ago, H. Allen Smith wrote a book called "Low Man on the Totem Pole". You may have wondered, as I have, exactly what he meant by that title; now I know! He must have been describing the situation I am in right now. All day we have been listening to one expert after another talk about various phases of bank operations. As each speaker and each panel discussion concluded, my fears increased that there would be nothing left for me to say. And that is exactly what has happened.

The hole I am in is partly of my own digging. I should not have agreed to speak on such a subject. First, as a native of that famous home town - Broken Bow, Nebraska - I instinctively resent whatever condescension there is in the appellation "country bank". Second, I cannot accept the implication that there is a distinction between the duties and responsibilities of "country bank" directors and any other bank directors.

The principles of sound banking and of sound credit practices are the same in every bank regardless of size or location. When a director is asked to approve a given loan, it makes little difference whether he is sitting on the Board of a \$1 million bank in Broken Bow or a \$100 million bank here in Louisville. In either case, he is going to look for the traditional three C's: Capital, Capacity, and Character. One bad loan of \$1,000 is just as serious to that bank in Broken Bow as one of \$100,000 to the larger bank.

Everyone would agree that the techniques of administration in the two banks might be quite different; nevertheless, the basic principles are identical. Thorough and regular inspections and appraisals are just as important in the case of livestock and machinery securing a farm loan as they are for the accounts receivable or inventories pledged to secure a manufacturer's loan. The importance of adherence to amortization or repayment schedules is surely no less in one bank than it is in another merely because one is classified as a city bank and the other as one of its country cousins.

I am willing to concede one difference between these two types of institutions - if anyone insists upon it. In a small bank, the director must have a more comprehensive knowledge of all the activities of his bank. The so-called "country banker" must know the answers. He is not in the position - as his city friend may be - to hire a flock of specialists to furnish him with the answers. Still, a bank is a bank, and the job of being a good bank director is not altered by any artificial label like "country bank" or "city bank".

Furthermore, this hole I am in is a little deeper than it might be if I had not been talking for a number of years about the

duties and responsibilities of bank directors, and if my well-meaning friends at the Federal Deposit Insurance Corporation had not distributed copies of these talks to many of you, for now I must assume that all of you know that bank directing is no Sunday job. I cannot even repeat my "Hints for Bank Directors" because everyone now realizes that the key to effective "directing" is adequate information.

Today, top-notch directors are insisting on being furnished with broad-scope reports from management concerning every aspect of the bank's operations - from lending and investing policies and practices to the special methods devised to deal with criticized assets. They are insisting upon the establishment of adequate internal audit controls, realizing that the old idea that small banks cannot afford such measures has been exploded, that in fact they cannot afford not to have them. They are devising methods to check up on performance, to see how Board policy decisions are working out in actual practice, to reveal elements of strength and weakness of which they should be cognizant. They are paying particular attention to personnel policies with the view not only of providing good management but of assuring a continuation of it. They are aware of the pitfalls ahead of the bank which has no management succession program.

Even more encouraging than the awareness today by bank directors of their detailed responsibilities is the widespread evidence of their realization of the importance of their jobs - jobs which cannot be delegated to others, jobs which in a sense constitute a trusteeship not only for shareholders but for the entire community. With this realization, our banking system should be in a position to make an even greater contribution to the maintenance of the high degree of economic stability and progress which our country has achieved.

The program presented here today has touched upon many aspects of the job of a bank director - responsibility for the selection and supervision of personnel, for safeguarding the bank's assets, for evaluating operating performance, and for relating general economic developments to local business conditions.

Against this background I would like to explore a slightly different path. We hear a great deal these days about three-dimensional films designed to give motion pictures new depths of perception and realism. Let me try to use a somewhat comparable vehicle to lift away the facade of present-day banking and perhaps enable us to get a fresh and clearer view of our subject.

The easiest way I know to do this is to tell about an old friend of mine. Back in the early nineteen-twenties he was a director of one of the 30,000 banks then in existence in this country. About thirty years ago he dropped off into a deep sleep, much as Rip Van Winkle had done. He woke up for a short while in the early 'thirties - just long enough to hear the bankers being roundly damned - and went right back into hibernation.

He came to the other day - and discovered that his bank was now one of less than 15,000 serving the country. There were many other changes equally astounding to him. He was not quite sure - and neither am I - which were good and which bad. But he was greatly impressed by these changes and that is the reason I want to repeat to you now what he told me.

You can imagine his surprise when he saw what a face-lifting the bank premises had had, both inside and out. "Why", he said, "this looks positively inviting. What happened to that cold, stony, atmosphere for which we were so well known?" In the lobby, he missed the wire tellers' cages. He didn't see a single Prince Albert, but he found a great many everyday folks - clerks, laborers, factory workers, farmers, and housewives - and not one of them looked sheepish, as though it were not the proper place to be seen.

He was dumbfounded - but not displeased - to find a bevy of pretty girls behind the counters. He reacted very much as one might expect to the baby pen where banking mothers could leave their children, and to the drive-in service, complete with "snorkel". He sarcastically inquired why the bank had not also constructed a grease pit at the curb so that customers could have their oil changed and checks cashed at the same time.

As he mingled with some of the employees he found that, although they were not getting rich, they were being paid more than bare subsistence wages, and that retirement, hospitalization, and bonus plans had been inaugurated. To top it off, he learned that recreational facilities had been installed to make working conditions more pleasant. This was too much, and he was just about to retire into obscurity again when the last survivor of the old-time officers recognized him and insisted he look over the rest of the bank.

When I saw him, he had finished the grand tour and was sore perplexed. He could not figure out how the bank could operate in this strange fashion; but on the other hand, he could scarcely contain himself in describing the progress made.

The bank's deposits - this was the statisticians' mythical "average bank" - were nearly ten times larger than in 1920. Not only had the volume expanded, but in relative importance demand deposits had increased at the expense of time deposits. The safety and convenience of paying by check, plus the advent of "no minimum balance" accounts, had brought these facilities broad public acceptance - thanks also to something else he had thought would never be possible, Federal Deposit Insurance.

But the changes my friend found in the bank's balance sheet were not all on the liability side. He learned some rather startling

things about its earning assets too, besides the mere fact that they also had expanded roughly ten times. First, the bank's loans were exceeded by its security holdings, which now accounted for more than half of total earning assets, as contrasted with less than one-fourth in 1920. He was told that the expanded role of investments had developed primarily during World War II, when the bank's substantial acquisition of federal government securities had been made possible by the Federal Reserve System which, through its own purchases of such securities, had provided commercial banks with the reserves essential to a large expansion of their asset structure.

Not only had total loans shrunk in importance as compared with investments, but the make-up of the portfolio had undergone great changes. Loans on securities, which were more than a third of the total in 1920, now amounted to only 5%. Farm financing had also declined - relatively speaking - although the bank had really broadened its program in this field in the past few years. "Why", he said, "it has an agricultural representative who spends all his time assisting farmers of the area to make the most efficient use of their facilities."

The bank had shown similar resourcefulness in developing new types of financing. The "personal finance" department was entirely new, having been started during the 'thirties, and then mushroomed since the end of the war. Instalment credit to individuals for the purchase of automobiles and other consumer goods, and for the repair and modernization of homes, now represented about 13% of all loans, with additional secondary credit extensions to finance companies and dealers.

He swallowed hard when he told me that his bank was financing the purchase of new automobiles on the basis of a small down payment and twenty-four months (sometimes even longer) to pay the balance, and some other lenders were even more liberal. He asked: "Isn't it possible that consumer purchasing power will be exhausted in this boom period and leave very little to fall back on in less favorable times?" Before I could answer, he added: "We used to think that it wasn't exactly wise for a man to mortgage his future income, because he might never get that income." He shook his head despairingly as he said: "I guess folks nowadays think the government guarantees them an income for life - and considerably above parity."

The volume of real-estate credit in his bank, he learned, has expanded so much that it now accounts for about one-fourth of all loans. Two developments in this field impressed him. First - and this had his hearty approval - the regular use of amortization loans, with monthly payments covering not only principal and interest, but also taxes - a technique (an officer told him) taught to the banks by a government agency called "F.H.A."; and second, the guarantee or insurance of such loans by the federal government. He was amazed to learn that nearly half of commercial bank mortgage loans are so guar-

anted at the present time, but in some measure that offset his concern about the kind of houses being built with some of that credit, and the prices those houses were selling for.

He found that business loans had also undergone considerable change in both volume and character. He was pleased to note the present tendency to wrap up all the loose ends of a credit transaction in a neat package that fits the requirements of both lender and borrower. And he was glad that this included not only full disclosure of the borrower's needs and analysis of his ability to repay, but also arrangements for adequate supervision of the loan until final payment. He chuckled when he said it wasn't altogether true that the banks had learned this technique from another government agency, called "R.F.C.". "Why", he said, "the examiners used to scold us at each examination for not sewing up our loans properly. We had to reform sooner or later."

He learned that since 1920 the service functions of his bank also had greatly expanded. There had been a marked growth in its fiduciary activities; and it was participating to an increasing extent in the fiscal operations of the federal government - selling and redeeming savings bonds, receiving subscriptions for other government securities, carrying Treasury tax and loan accounts, and accepting social security, corporation income, and withholding tax payments. Then, in the course of a hasty survey of the president's desk, his eye fell on the annual report of one bank which listed ninety-four different banking services available to its customers, and he threw up his hands.

Already bothered and yet bewitched by these changes, my friend's bewilderment was complete when he learned of the decline in the level of interest rates. Call loans, for example, on which the rate had been about 8% in 1920, now ran about 2½%; U.S. certificates of indebtedness had dropped from about 5½% to roughly 2%; and short-term business loans now yielded about one-half of their former level of something over 6%.

"How, in the circumstances", he asked, "can the bank earn a satisfactory return for its stockholders?" He was surprised that with all these changes, the bank's profits on invested capital are still about the same as in the early 'twenties - around 8%, after taxes. It took him only a moment to see that part of this ability to maintain earnings was due to relative shrinkage in the capital base (which gave him some concern), but that the major part was attributable to a larger volume of earning assets and to significant changes in bank earnings and expenses. On the income side, as he had already seen, the drop in the proportions of earnings from loans has been offset by added interest from securities, and from new sources such as service charges. On the expense side, the bank no longer had to pay interest on demand deposits, but the saving was offset by higher salaries and taxes. (On the whole, operating expenses and taxes take slightly more of his bank's gross earnings now than they did in 1920, but this has been balanced by a loss ratio lower than ever before in the history of American banking.)

As I said at the outset, my bewhiskered friend was much perplexed by the changes which had taken place while he slept, but he nearly had a stroke a moment ago when someone in the back of this room muttered: "So what?" He is not in a position to speak, but I would like to say that the point of it all is that our commercial banking system, like the whole of American civilization, changes so amazingly fast that bank officers and directors must stay on their toes if they are to keep pace with it and successfully keep it adjusted to changing conditions so that it may continue to serve the needs of a growing and dynamic economy.

Despite the speculative boom of the 'twenties, the collapse of the 'thirties, the war and its consequences in the 'forties, and now the cold war of the 'fifties, the basic characteristic of our banking system - a vast network of free and independent institutions operating under both State and Federal charters - has been preserved. Yet, in quite another sense, it is clear that banking today bears little resemblance to the banking of yesterday. Bank directors, bank officers, and I might add bank supervisors, must look at today's banking problems with the perspective of 1953 eyes, with the help, from time to time, of an occasional backward glance and an informed forward look.

As directors and bankers, you are well aware of the importance of banking and credit to your community and to the nation; well aware that you are engaged in a quasi-public business which carries with it tremendous economic responsibilities; and that profit - although necessary - is not your sole objective or measure of success. You know that a bank cannot be oblivious of developments in its community, in the nation, and in the world around it. Consequently, you must realize that it is both your duty and your responsibility to understand not only the facts of your own institution (by the use of my three-dimensional approach or whatever means you choose), but also the facts of our national economic life, so that you can help shape the affairs of your own bank in such fashion that it can make a real contribution to the preservation of our kind of economy, and our kind of life.

Let me amplify that very briefly. For roughly two years now, as a nation, we have enjoyed a remarkable degree of economic stability at record levels of output and employment. Substantial increases in productive capacity have made it possible to absorb a major defense effort without cutting back on our civilian economy. Thus far, it has not become necessary to make that difficult choice - "guns or butter". It gives me something of a start (as it may you, and certainly would my mythical friend) to realize that since the outbreak of hostilities in Korea we not only have carried on a vast program of rearmament but at the same time have built roughly three million new homes, more than twelve million new automobiles, about the same number of refrigerators, and nearly sixteen million television sets.

But bankers, particularly, should remember that a substantial portion of current expenditures of both consumers and business has been dependent on the increased use of credit. The postwar era has involved tremendous expansion of credit, and present debt levels are the highest on record. The mere existence of debts of such magnitude - \$60 billion of home mortgages, over \$23 billion of consumer credit, \$70 billion of long-term corporate debt - are factors which must be considered in gauging the stability of our financial structure, as a whole and in each of its parts. The rapid increase recently in these types of credit inevitably raises questions as to whether such volume of new borrowing can be sustained. If it cannot, the stability of the economy is threatened unless substitutes can be found for that portion of the present demand for goods and services which is based on that credit.

Credit developments such as we have experienced in recent years place a heavy burden on those who are charged with responsibilities for fiscal, debt management, and monetary policies to act in such manner as will aid in performing that most difficult tight-wire balancing feat - sustaining economic equilibrium at high levels of activity. Those same developments add greatly to the responsibilities of all bank officers and directors to exercise extraordinary prudence in extending credit.

Throughout our economy there has been a marked movement toward the restoration of freedom of enterprise. The market place, in virtually all fields, is less restricted today by governmental controls, supports, and regulation than it has been for some time. The price of this additional freedom is greater individual responsibility, for the stability or instability of our economy will reflect more than ever the composite result of thousands upon thousands of individual decisions - not only banking decisions but, even more important, man-in-the street decisions - decisions as to which the guidance of officers and directors of the banks of our smaller communities can be particularly effective.

It follows, therefore, that you must place high on the list of your duties and responsibilities those which obligate you (1) to intelligently gauge and meet the credit needs of the people - through banking policies built upon encouragement of initiative and enterprise and balanced by restraint upon speculative excesses - and (2) and perhaps even more fundamental, to provide both by precept and example a high degree of judgment, courage, and enlightened leadership in ever-widening areas of community and national life.